The Ownership Reform in China: what direction and how far?

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Post-Mao China has obviously moved away from the centrally planned command economy in the past two decades of reform. However, the key issue is in what direction and how far. To determine what direction China is headed for and how far China has moved in that direction, this article examines and evaluates the nature of institutional change in the ownership structure, particularly collectives, SOEs, and land ownership, which is then followed by a closer look at the post-Mao shareholding reform, its trends and problems from the basic perspective of property rights theory.

Introduction

After two decades of post-Mao economic reform, commercial, labor, real estate, and stock markets have emerged and many other elements of a market economy have come into being in today’s China. Some questions to be addressed in this article will be as follows. Has the post-Mao economic reform transformed a centrally planned command economy into a market economy or its equivalents? What is the nature of the post-Mao economic reform? What are the trends and limits of the ownership reform in China?

To answer these questions, we must focus on the ownership system, because the ownership system, rather than the market mechanism, is fundamental to China’s economic transition. Moreover, it is in this most important domain of China’s economic reform that the dispute over the nature of China’s economic reform—capitalism or socialism—has centered in post-Mao political and ideological discourse. However, some studies in China’s economic reform tend to equate the market or marketization with capitalism or privatization, and consider the market as the defining feature of capitalism and planning as the defining feature of socialism, which can be formulated as a simplistic definition: market = capitalism; state planning = socialism.

However, this equation makes no distinction between capitalism and socialism and contradicts the modern empirical world in which capitalism embraces state...
planning while socialism utilizes the market mechanism. What distinguishes capitalism and socialism is the type of ownership which generates property rights and residual income rights by owning the means of production and exchange, defines the core of the relations of production, and determines the nature of an economic system.\footnote{Mark N. Hagopian, \textit{Regimes, Movements, and Ideologies} (New York and London: Longman, 1978), pp. 436–437. According to Hagopian, the means of production include such things as energy resources, land, raw materials, tools, machines, and factories. The means of exchange include transportation and communication facilities, wholesale and retail outlets, banking and credit institutions, etc.}

Socialism is an economic system in which the means of production and exchange are publicly owned and major economic activities are performed by governmental, societal, or public agencies, while capitalism is an economic system in which the means of production and exchange are privately owned and major economic activities are performed by private organizations.\footnote{Thomas M. Magstadt and Peter M. Schotten, \textit{Understanding Politics: Ideas, Institutions, and Issues} (New York: St. Martin’s Press, 1996), p. 367; Robert J. Jackson and Doreen Jackson, \textit{A Comparative Introduction to Political Science} (New Jersey: Prentice Hall, 1997), p. 160; Jack C. Plato and Roy Olton, \textit{The International Relations Dictionary} (Santa Barbara, CA: ABC, 1982), p. 81.}

However, as the history of modern socialist movements has suggested, socialism does not presuppose public ownership of \textit{all} the means of production and exchange, but is compatible with the existence of private ownership in some economic fields, for instance in agriculture, handicrafts, retail trade and small and middle sized industries. Socialist countries not only differ on the method of socializing the economy but also vary greatly in the degree to which their economies are socialized because of the widely different political cultures of these countries.\footnote{Leon P. Baradat, \textit{Political Ideologies: Their Origins and Impact} (New Jersey: Prentice Hall, 1979), p. 186.} Even then, however, the single most essential trait of ownership is sufficient to allow these countries to be placed in a common classification.

\textbf{Theoretical models}

In the history of economics, Adam Smith and Karl Marx presented two ideal types: the ‘free market economy’ of capitalism and the ‘planned command economy’ of communism. In a free market economy, it is private citizens or private firms who own the private property or the means of production, and therefore control their own factors of production, determine what should be produced, and have the right to the residual income from their asset. It is the ‘invisible hand’ of the market forces that establishes the exchange value while the state plays a passive role allowing private actors to operate freely in the market and prevent private actors from doing violence to each other or violating the rights of others. In a planned command economy, it is the state who owns the means of production, and therefore controls the economy, and determines what to produce and who will receive what.
products at what levels according to the state plan. It is the state who sets the official values for all exchanges of goods and services.

However, there have been many mixed types of political economy in between because states and markets have played various roles in the economy throughout the world. There have been two most important hybrid types of economy: ‘state capitalism’ and ‘market socialism’. We now have four ideal types. Although an ideal type may not be a perfect reflection of any real-world example, it attempts to simplify and generalize a diversity of modern economic systems. These models can be presented along the left–right spectrum given in Figure 1.

This spectrum locates ownership and control at some points between two extremes. In terms of ownership, it involves the distribution of property rights pertaining to the means of production. In terms of control, it refers to the role of state and market in the economy. State ownership with state control is a command economy. State ownership without state control is market socialism. Private ownership with state control is state capitalism. Private ownership without state control is a laissez-faire market economy. In the pre-reform era of the communist world, the Soviet Union and China served as the prototypes of command economy and Yugoslavia and Hungary as market socialism when these countries attempted to make decentralized market arrangements while maintaining the dominant public ownership. In the Asian NICs, Taiwan and South Korea were made good examples of state capitalism in which private owners and the market were both controlled and heavily regulated by the strong government. In the Western capitalist world, Great Britain in the nineteenth century and the United States prior to the New Deal are good models of laissez-faire market economy in which the state restricts itself to providing public goods and safeguarding private ownership and the operation of the self-regulating market.4 A two-dimensional spectrum can be used to further illustrate the key points of these four ideal types (as in Figure 2).

The model takes the horizontal axis to indicate ownership dimension with state ownership at one extreme and private ownership at the other and also uses a vertical axis to measure the role of the state and market in the economy with state and market at opposite extremes. Thus, the differences and similarities between the four ideal types can be clearly illustrated.

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Post-Mao China has obviously moved away from the centrally planned command economy in the past two decades of reform. However, the key issue is in what direction and how far. There is no general agreement among scholars about where China should be located along the left–right spectrum or on a two-dimensional spectrum. But, overall, it has become fashionable among China analysts to argue that China has moved toward the far right or the market economy, which means that ‘capitalist takeover’ has occurred in post-Mao China. This view actually assumes that the post-Mao economic change is so fundamental that it has essentially transformed the economic system into a new market economy of capitalism or its equivalent that contains virtually all the essential elements of a market economy of capitalism.5 The author of this article argues that this might be a premature conclusion and wishful thinking. An examination of China’s ownership reform might help us get a better understanding of the nature, trend, and limit of post-Mao reform and therefore determine in what direction China is heading and how far China has moved in that direction.

The transformation of ownership system in China

The transformation of ownership system in communist China can be roughly divided into two major historical periods. The period between 1949 and 1979 was characterized by the attempt by the CCP to establish a new socialist planned economy based on a complete public ownership including collective and state sectors, wiping out virtually all private enterprises and any other forms of ownership. The result of this transformation is the establishment of a Soviet-type ‘command economy’ in China, although the Chinese economy might differ from the Soviet economy by a certain degree. The period between 1979 and 2000 was characterized by the effort to transform ownership structure from a complete public ownership to the mixed ownership structure with predominant public ownership coexistent with other economic elements such as cooperative, individual, private, foreign, and joint-ventured. The post-Mao reform period can be divided into three main stages.

The first stage, from 1979 to 1987, centered on the decentralization of management or an expansion of managerial autonomy of SOEs by introducing to enterprises ‘mandatory planning reduction’, ‘profit-retention mechanisms’, ‘profit-tax reform’, and ‘production responsibility systems’ under which enterprises could operate more autonomously and efficiently. However, such reforms were implemented within the framework of traditional state socialism without making any significant changes to the existing ownership structure. Although enterprises could retain more profits, which were increased from 5% in 1979 to 45% in 1987, enterprises kept profits without bearing losses. That is to say, if enterprises run losses and fail to return revenue to the state, it is the state that bears the losses.6

The second stage, from 1987 to 1992, centered on the separation of ownership

and management by introducing a system of ‘contracted managerial responsibility’ under which powers to manage enterprises were delegated to managers and directors by contracts which clarified the responsibilities and benefits between the state and the managers. However, such a reform was not fully based on the market competition but on the bargaining between state agencies and individual managers, and thus stimulated ‘rent-seeking’ behavior. Moreover, managers attempted to maximize returns within their contact periods paying little attention to the long-term development of enterprises. If an enterprise ran losses or went bankrupt, the final responsibility still rested upon the state. The soft budget constraint of enterprises under state socialism continues to be a major problem.

The third stage, from 1992 to the present, centered on the establishment of a ‘socialist market economy with Chinese characteristics’ by transforming the ownership system into a mixed structure with the public sector dominant and various types of ownership coexistent. Such a reform has allowed and even encouraged non-public sectors to develop and expand, within the limit of state policy. At the same time, the state has attempted to corporatize or restructure the SOEs into giant conglomerates, shareholding companies or shareholding cooperatives based on the competition of the market while leasing out or selling off some small and medium-scale SOEs that run losses. The buyers are not necessarily private enterprises or foreign firms; they can be state and collective owned enterprises or joint-ventured enterprises, which is often the case in China. The reforms include various measures such as mergers, acquisitions, leasing, auction, bankruptcy, formation of shareholding companies or cooperatives, and joint ventures, which have in many ways helped SOEs turn debt into shareholders’ equity or release the state’s financial burdens of loss-making activities to society. The past years of reform have indeed transformed the Chinese ownership system into a mixed structure, with various forms of ownership coexistent in the economy. According to the State Statistics Bureau and the State Administration Bureau of Industry and Commerce, the post-Mao Chinese economy has become a mixture of eight sectors: state-owned, collective-owned, private-owned, individual-owned, cooperative or joint-ventured, shareholding, foreign-owned, and others (Hong Kong, Macao, Taiwan and other overseas Chinese invested). However, Jiang’s regime has set the direction for restructuring: its economic core must be dominated by public sectors with SOEs controlling the ‘commanding heights’ of the national economy while allowing diverse types of ownership to develop.

The questions are as follows. Has the post-Mao economic reform fundamentally transformed a centrally planned command economy into a free market economy or its equivalents? What is the nature of the post-Mao economic reform? What are the trends, problems and limits of the ownership reform in China? In what follows, we will examine and evaluate the nature of institutional change in the ownership structure, particularly collectives, SOEs, and land ownership, which will be followed by a closer look at the post-Mao shareholding reform, its trends and problems from the basic perspective of property rights theory.

Table 1. Shares of different economic sectors in GDP and industry, selected years

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<thead>
<tr>
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<th>GDP (%)</th>
<th>Industrial assets (%)</th>
<th>Labor force (%)</th>
<th>Industrial output value (%)</th>
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<tbody>
<tr>
<td>SOEs</td>
<td>56</td>
<td>29</td>
<td>74</td>
<td>67</td>
</tr>
<tr>
<td>COEs</td>
<td>42</td>
<td>39</td>
<td>24</td>
<td>8</td>
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<tr>
<td>Others</td>
<td>2</td>
<td>32</td>
<td>2</td>
<td>8</td>
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Sources: *China's Statistical Yearbook*, various years; *China Economic Information Network*, (31 January 2000).

Notes: SOEs = state-owned and state-holding enterprises; COEs = collective-owned enterprises, including collective enterprises and cooperatives; Others = share-holding, joint-ventured, foreign-owned, private-owned, and individual-owned enterprises.

The ownership structure

Our examination and evaluation will begin with some empirical data to address this question: after two decades of economic reform, which economic sector is predominant in the Chinese economy—public ownership or non-public ownership? This is one of the most important aspects of institutional change in the ownership structure since the reform. Table 1 illustrates some quantitative changes in the Chinese ownership structure.

The result of the past years of ownership reforms has suggested that among the major economic sectors, SOEs and collectives together, as the public sector, continue to comprise 60–70% of the economy in almost every key respect, despite the fact that the non-public sector has increased considerably in terms of its percentage of China’s GDP, industrial assets, labor force, and industrial output value. In the non-public sector, we also have to recognize that share-holding corporations and joint-ventured enterprises are not private-owned but mixed economies, including state and collective funds, which comprise about a third of the non-state sector. These enterprises are the fastest growing sector since shareholding reforms. Their ownership is not controlled by any individual or private organization but shared by different economic elements. The state sector has indeed shrunk in the past two decades. However, the state sector continues to dominate, control and monopolize the ‘commanding heights’ of the national economy.

The ‘commanding heights’ of the Chinese national economy

- *Infrastructure industries* (energy, raw materials, and transportation)
- *Pillar industries* (mechanical, metallurgical, electrical, chemical, building, machinery, petroleum, natural gas)
- *High tech industries* (information, telecommunication, biological technology)
- *Financial and banking systems*
- *Foreign trade and international economic cooperation*
- *New material technology*
As the *Economist* observes, ‘the state sector tends to contain industries that are the most capital-intensive and often the largest in scale, and financing them absorbs a large share of national resources, especially financial resources’. Some Chinese scholars called for more reduction of SOEs in national economy based on the argument that the nature of socialism would remain unchanged if SOEs could control these key industries and commanding heights of national economy, even if the share of SOEs would decrease to somewhere around 20%. According to Jinglian Wu, one of the most important Chinese economists, although the state sector produces about one third of overall GDP today, it is still the major user of China’s economic resources. Reform of SOEs has been far from satisfactory, and the old system maintains its influence and continues to impede the establishment of a new market economic system. Therefore, ‘we cannot say that the market has started to operate as the primary allocator of economic resources’. The resources that are actually controlled by the government include the following major types.

1. Resources obtained through various forms of revenues, including tax revenues, surtax revenues, government capital funds, special-item revenues, revenues from all kinds of administrative fees and levies at all levels of government, currency-minting revenues, extra-budgetary revenues, and non-budget revenues which are largely non-transparent and collected under concealed circumstances.

2. Accumulated stock of state-owned and state-holding assets, with the original principal value of state-owned fixed assets being 73% of the total assets of the society in 2000.

3. Natural resources controlled by the state, including land, mine deposits, forest resources, water resources, and so forth.

4. Non-state assets controlled through various administrative methods. From the perspective of ownership, these resources are owned by enterprises that are not owned by the government. However, their deployment is actually subject to the direct control of the government and therefore they become resources actually controlled by the government—through its authority to review and approve investment projects, operation licenses, stock and bond issuing, through maintaining state stock-controlling status, through the allocation of loans and credit capital by state bank, through setting up administrative barriers and state monopolies, and so forth.

One of the important measures to maintain the predominant position of SOEs was to conglomeratize or corporatize the large- and medium-scale enterprises (LMEs). The sales and profits of the 300 largest SOEs were responsible for more than 50% of the total SOEs sales and profits, although these major enterprises were only 1% of the total SOEs. ‘SOEs are still responsible for a substantial share of the economy, but the government’s control of the economy goes far beyond those

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enterprises it directly owns. State-issued economic plans set policy on all ventures, including private and foreign-owned ones. The total value of the state assets, rather than decreasing, had actually more than doubled since the late 1980s, among which the LMEs had 75% of the total state assets and contributed 60% of total profits and tax revenue. The LMEs in the Chinese SOEs are at the heart of China’s traditional state socialism and the reforms of LMEs should represent the core of China’s overall economic systemic transformation. The same logic would be that the abandonment of the ‘Four Cardinal Principles’ should represent the core of China’s overall systemic transformation. Even after the wave of corporatization of SOEs into joint-stock companies, the majority of these corporatized firms have the state as the dominant owner and, more crucially, the essential features of their governance structure (soft budget constraint, government intervention, and the employment relationship) have remained intact. As one recent field trip study suggests, SOEs continue to benefit from various government policy preferences, such as debt-for-equity swaps, outright debt write-off, and subsidized loans. The reform of SOEs and their economic status will be discussed in depth in the next section on shareholding reforms.

The ownership of land is another critical aspect of change in the ownership system since the reform. The formal ownership of land has actually changed little and remained almost exclusively under some form of public ownership, although a great change has occurred in land management systems. The reform in rural areas since 1978 has changed the management system of land from a ‘three-level ownership system’ (production team–brigade–commune) into a ‘household contract responsibility system’, which distributes arable land among village households based on family size and the availability of labor. Production decisions have become the responsibility of the household governed by contracts with the relevant rural collective economic organization. However, although the old system of communes, brigades, and production teams was abolished, these entities were reconstituted as townships or villages, the government of which was charged with the responsibility for land management and the negotiation of contracts with the households. Moreover, land remains under public ownership.

Agricultural decollectivization is not an equivalent of ‘privatization’, but only the transformation of the rural economy into ‘a new type of collective economy, characterized by combining public ownership of the land with totally individualized operations of production’. To the post-Mao leadership, contracting land use rights to individual households is defined as the ‘separation of land ownership rights and

16. Ibid., p. 90.
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land use rights’, which retains public ownership of the land as the main means of production while providing working incentives and productive freedom for peasants.20 Land ownership rights are forbidden from sale while the transfer of land use rights could be achieved through negotiations among involved parties and must be ratified by villagers committees or higher authorities. Land prices are arbitrarily determined. When land is owned by the state (one owner), it is not a commodity; what is on the market for exchange is not land ownership rights but land use rights.21 This is absolutely not tantamount to a transfer of private property rights in capitalist economies or a policy of privatization of public ownership in post-Soviet or post-communist economies.

Contracting use rights of the land to individual households has led to the problem in the use of land associated with small, fragmented land holdings. To solve this, another important reform has been introduced: the emergence of shareholding cooperative systems in various parts of the country, by which land or property under the direct control of the collective ownership is valued and divided into equal shares. Some shares are reserved for collective ownership and the rest are distributed among the village households. These shares for individual households cannot be traded but earn dividends. In this way, villagers in cooperative systems no longer cultivate small pieces of land but give their contracted land to the cooperative in return for shares upon which they earn dividends. The cooperative may cultivate the land or use it as a factory site, which must get the approval from higher government authorities, hiring labor from the households involved in the cooperative arrangement.22

However, such a practice has changed little of the ownership of land. The collective retains a dominant share in the cooperative and controls the decision-making power in the use of land, while the villagers actually do not own those shares distributed among them, nor can they trade those shares. Neither do individual households have the decision-making power in how to use the land since they have given their contracted land to the cooperative in return for shares upon which they earn dividends.

Moreover, the use of land or trade of the usage of land is tightly controlled by the township, county, or provincial governments, depending on the government guidelines for the use of land and the administrative jurisdiction of the land. There are very strict administrative procedures for approving the use of arable land for purposes other than agricultural production. In 1999, the General Office of the State Council issued a ‘Circular of Strengthening Administration of the Transfer of the Use Right of Land and Strictly Forbidding Speculation on Land’, which regulated that the collective use rights of land in rural areas were not permitted to sell, transfer, or lease for purposes other than agricultural production, houses of individual peasants in rural areas were prohibited to sell to individuals in urban areas, the use and development of land must be strictly restricted within the state general and yearly plans, and no individual and organization were allowed to sign

21. Ibid., p. 89.
22. Bell et al., China at the Threshold of a Market Economy, p. 15.
contracting use of land with rural collective economic organizations without approval of higher authorities responsible for land, etc. Obviously, land, as the most important factor of production, has been publicly owned, controlled by the state, and not considered as a commodity for free exchange in the marketplace. So-called ‘privatization’ of land is the misuse of the concept in interpreting changes in rural reforms.

According to one recent study on China’s urban land system, the economic reform measures in the urban land system are partial and gradual. The old socialist allocation system of land for public and private users still exists in parallel with the market system, and in many respects such allocation exceeds the market system in terms of land granted and the pricing system is not truly a competitive market model, because China’s urban land reform has been carried out under the ideology of ‘market socialism’.24

To conclude, it is really hard to assess what percentage of the economy is truly adjusted by the market force, since all the key aspects, key industries, major resources, land, other production factors, and ‘commanding heights’ of the national economy, which seriously affect the market formation process, are still determined by the government and state agencies. From this perspective, talk of a free market economy in post-Mao China is premature and misleading. China still manifests the dominance of public sectors in the economy, the presence of administrative controls in economic daily life and administrative allocation of materials, the limitation of market mechanisms, and the maintenance of the communist economic system. It is true that economic activities are more responsive to the market today, but they are still deeply involved in and restrained by the controlled interdependence of economic, social, cultural, administrative, and political institutions. Compared with the situation in Mao’s era or in the 1980s, the level of government intervention in economic activities has been significantly reduced. But government intervention of all forms has not been removed. The state is not withdrawing from its role in the economy, but merely redefining it. China has actually moved away from a centrally planned command economy toward some kind of party-state controlled market socialism dominated by state ownership rather than a free market economy of capitalism.

The nature of shareholding reforms

For the purpose of a sensible assessment of the nature of China’s ownership reform and the extent to which privatization has or has not been implemented, we have to clearly define and clarify some key terms. First, ‘economic liberalization’ refers to the loosening or elimination of government restrictions on economic transactions, including freeing prices, trade, delegating control rights or decision-making rights from the state to enterprise managers, and allowing the development of various types of new business firms and enterprises, such as joint-vented, individual-

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 owned, private-owned, and foreign-owned. Second, ‘marketization’ is the attempt to develop important elements of a market economy and create market institutions such as legal, financial, and social welfare systems. Finally, ‘privatization’ is a political process wherein the government, by the use of state power, administers a privatizing program and policy for the purpose of the dramatic and fundamental transformation of the existing public ownership, with the massive transfer of state-owned or collective-owned enterprises, land, and other public assets to private hands.25 The three major reform policies in communist states could be related yet distinct from each other. In what follows, we will discuss how China’s shareholding reform is distinct from privatization in European post-communist states.

The distinction between ‘state–collective–private mergers’ and ‘private takeovers or buyouts’ is crucial in understanding the nature of the economic transformation in post-Mao China. The former is not a genetic or systemic change, but a developmental change while the latter is a genetic or systemic change. However, in the past years various forms of ‘mergers’ with public sectors holding dominant shares are central realities in China’s shareholding reforms while ‘private takeovers or buyouts’ are negligible because the role of these money-losing or deficit enterprises of small SOEs and collectives is negligible in the entire Chinese economy. Selling off some losers of small SOEs and collectives will not affect the foundation of the Chinese public ownership and therefore the nature of the entire economic system.

The Chinese shareholding reform, as clearly demonstrated in leaders’ policy speeches and party-state documents, has stressed the objective of strengthening the state sector’s ability to control the national economy and the basic principle of ‘the predominant position of public ownership with diversified forms of ownership’ and ensures the majority shareholding of the state or collective corporations in the ‘state–collective–private mergers’, prohibiting private citizens from controlling the majority share.26 The party-state policy statements and related legal documents regarding the shareholding reform have actually specified which industries or enterprises are allowed to practice the shareholding system and which are not, and also regulated, in those enterprises where the shareholding system is allowed, what should be allowed for the private share and what should not be allowed for, and what percentage must be held for the public ownership.27 Article 4 of the Company Law requires the state to hold controlling stocks of pillar industries and subscribe at least 35% of total shares in shareholding companies, which enables the state to be the largest shareholder since the other shareholders are often highly dispersed in China.28 In most cases, however, the state share is greater than 50%. If corporate shares of enterprises (qiye faren gu) are also taken into account, the state actually holds controlling stakes of shareholding companies since the holders of corporate

27. Ibid., pp. 124–125.
shares are state agents and such shares are indirectly owned by the state. All these regulations and practices have been used to ensure the nature of the socialist public economy as a whole with diversified forms of ownership.

In addition to the ‘majority-share control’ of listed state enterprises, the basic components of the securities market itself, including share issuing, price offering, and public listing, are strictly controlled by the government, the A- and B-share dichotomy, and the appointment of stock-exchange leadership by the China Securities Regulatory Commission (CSRC), which has emerged as China’s sole securities regulator. The stock market was developed by the Chinese government primarily as a means by which to tap Chinese individual savings for SOEs fund-raising at a time when SOEs faced mounting debts and serious capital problems. With the evolution of economic reform, many SOEs found themselves increasingly unable to rely solely on government budgetary resources, grants or designated policy loans, especially when a tight monetary policy was adopted. It is against this background that the stock market initiative was made, and therefore, China’s capital market has been used to facilitate the state economy, rather than to privatize it.

Rather than relying on the market mechanism, China has adopted an administrative method to determine which firms will be allowed to issue and list shares. The central authorities, including the State Planning Commission, the People’s Bank, and the China Securities Regulatory Commission, set the annual stock issuance plan, which stipulates the total number of new shares to be issued. Then, subject to the overall limit, each province is allocated a sub-quota. Firms wishing to issue shares, apply to the local provincial authorities who select the candidates according to the Industrial Bureau’s recommendation and the overall balance between industrial sectors. The final decision is made at the central level to determine if the firm meets certain qualifications. Therefore, it is not ‘the market’ that decides which companies go public, but a combined decision of central and local government authorities. This is the legacy of the planned system, arising from the initial intention of the government to ensure a leading role for the state in the ownership of assets in the economy.

Currently, all public offerings and listings are controlled by the state. The great majority of the shares issued so far have been offered at a state price set months before the issue date, and therefore, the offer price does not reflect the real relation between the demand for and the supply of shares. No margin trading or short selling has been allowed in China. Stock exchange balance members’ accounts and any net payments are due on the next day. To restrain the market, regulators have also imposed a 10% limit on daily share price movements. The size and frequency of new issuing are decided by the government, and this has been regarded as a powerful tool to control and adjust the market.

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29. Ibid., p. 388.
32. Ibid., pp. 50–51.
33. Ibid., pp. 52–53, 63.
To separate the domestic market from the international market, China has adopted a dual-track system of A- and B-share categories. A share is reserved for Chinese investors while B share is reserved for foreign investors. For shares to be listed on the overseas markets such as Hong Kong, New York, London, and Singapore Stock Exchanges, the approval process is more complicated and more tightly controlled, and the selection of issuer is subject to case-by-case approval. The issuer-choosing system is the most important measure the Chinese government has adopted to control and adjust the market.34

China has recently allowed the transfer of state-owned and corporate shares of listed firms to investors from overseas. However, according to the circular issued jointly by the China Securities Regulatory Commission, the Ministry of Finance, and the State Economic and Trade Commission, the share transfer must comply with the requirements set out in the catalogue on industry guidelines for foreign investment in China and the regulations issued by the China Securities Regulatory Commission on purchase of shares of listed companies and information disclosure. Therefore, the share transfer relating to industries or type of business where foreign investment is forbidden cannot be transferred to overseas investors. In areas where the Chinese side is required to have controlling shares, it should retain a controlling position after some shares are transferred to overseas investors. Moreover, the share transaction must be approved by the State Economic and Trade Commission if it involves industrial policies and corporate restructuring. Approval from the Ministry of Finance is needed if the share deals involve the management of state-owned shares.35 This move is to ensure the predominant position of the state-owned sector with diversified forms of ownership.

Therefore, to equate the shareholding reform with privatization is a serious misunderstanding of the post-Mao regime’s economic policy and practice, because the goal and scope of restructuring ownership structure are totally confined by the post-Mao leadership and its constrained reform vision. The goal of restructuring property rights is to enhance the competitiveness of public sectors in the market and improve their productivity and efficiency while avoiding a fundamental transformation of the economic system through privatization. The scope of restructuring is limited, following the direction of the official guiding principle: ‘seizing on the big and letting go the small’ (zhuada fangxiao).

For the small SOEs, comprising about 80% of the total number of the SOEs, the form of shareholding cooperatives (gufen hezuo zhi) is the most popular in the implementation.36 The showcase of the Chinese government between 1992 and 1995 is a reform of 274 small SOEs in Zhuchen county in Shangdong Province, where 213 small SOEs were converted into shareholding cooperatives or limited liability companies, 18 were auctioned off, 35 were leased out, five were transformed by mergers and acquisitions, and the remaining three appeared in court for bankruptcy.37 Small SOEs are those non-key industries of the national economy.

34. Ibid., pp. 51, 56.
35. Xinhau, (3 November 2002).
with poor technological equipment and low productivity. Losers or deficit enterprises of small SOEs are 90% of the total losers of SOEs, and have become a heavy burden on the government budget. Therefore, the new policy of ‘seizing on the big and letting go the small’ is to resolve this situation. Selling some of the small SOEs to private owners will not affect the nature of the entire economic system, because the role of these SOE losers is negligible in China’s economy. At a national conference held in Beijing in July 1998, Jiang criticized some local governments for their misunderstanding of the central policy and simply ‘dumping’ (selling off) those small SOE losers. He emphasized that the policy of ‘seizing on the big and letting go the small’ is to restructure and develop SOEs, not to do it in opposite directions. ‘Letting go the small’ is to ‘invigorate them’ (fanghuo), not to give them away or abandon them. There are many ways to ‘let the small go’, such as reorganization, association, merger, administrative delegation, leasing, contract, shareholding cooperatives, and sell-off. Sell-off is only one of many forms of ‘letting go’, and the policy is not to sell all the small state enterprises or simply give them away. Many small SOEs can be invigorated and transformed into new firms without changing the nature of their public ownership.

For medium SOEs, comprising about 15% of the total, the formation of shareholding companies (gufen youxian gongsi) is the most preferred method by the Chinese government. The government would transfer a certain percentage of shares to workers and managers who become joint shareholders with the state or collective which holds a dominant share. Although there is a certain degree of transfer of state assets to private owners, these private shareholders have little ability to exercise their property rights and decide how to utilize the asset (control rights), only gaining cash flow rights (dividends) and alienation rights (ability to sell shares). When these shareholding companies want to hear what shareholders have to say, decisions are made on the basis of ‘one shareholder one vote’ rather than ‘one share one vote’. Most ironically, workers are forced to participate or buy the required amount of shares in the implementation of shareholding reforms. As is observed, workers are not very enthusiastic about this kind of shareholding system, especially those workers in the money-losing enterprises. Many workers believe this is a way for the government to take their money to pay off the debt of their enterprises and refuse to participate. In response some enterprises have threatened to fire those who do not buy the required amount of stocks. Some local governments made a policy requiring that 90% of the workers of a SOE must become shareholders when the shareholding system is implemented, which resulted in forced participation in the shareholding system.

The large SOEs, although only comprising 5% of the total, hold 70% of the total state assets and contribute 60% of total profits and tax revenue. For these enterprises, the dominant method is the creation of limited liability companies (youxian zeren gongsi), with listed stock, mergers and acquisitions among state shareholders. These listed companies remain wholly state owned and shares are not issued to the public. The large SOEs are therefore corporatized into ‘national enterprise groups’ (NEGs) or conglomerates. The formation of NEGs is the most important form adopted by the Chinese government to avoid a fundamental transformation of the state property through privatization. The NEGs help the state control the production output in such key industrial sectors as heavy machinery, steel and iron, energy, telecommunication, metal, automobile, airplane, space, and finance and, therefore, they help the state fulfill its macro economic policies.

The large- and medium-scale enterprises (LMEs) in the Chinese SOEs are at the heart of China’s traditional Soviet-type economy and the reforms of LMEs should represent the core of China’s overall economic systemic transformation. The goal of corporatizing SOEs is to restructure ownership relations without changing the identity of the owner, clarify the rights and responsibilities of enterprises, establish clearer property rights, separate the functions of government from enterprise operations, strengthen corporate governance, gear enterprise operation to the market, and address the problems with incentives, efficiency, and productivity that have long plagued SOEs. Even after the wave of corporatization of SOEs into joint-stock companies, the majority of these corporatized firms have the state as the dominant owner and, more crucially, the essential features of their governance structure (soft budget constraint, government intervention, and the employment relationship) have remained intact. Overall, the approach adopted by the Chinese government to reform SOEs is fundamentally different from privatization in Russia and East Europe. These reforms have been adopted by the post-Mao leadership to maintain the party-state control in the marketization and economic liberalization and reinforce the position of state ownership, rather than to move the Chinese economy toward capitalism. ‘Market socialism’ under the communist regime might be a more appropriate term to capture the distinctive feature of the post-Mao reform and its direction.

Therefore, the present various joint stock companies and shareholding cooperatives do not affect the nature of Chinese national economy, regardless of all kinds of mergers of state–collective, state–foreign, collective–foreign, collective–private, or joint-ventured cooperatives. In China’s constitution, shareholding cooperatives are officially viewed as a new form of collective economy, incorporating some forms of shareholding companies, with the combination of labor cooperation and capital cooperation. The collective share of workers must be predominant. The shareholding cooperatives are considered an effective form in the restructuring of small SOEs and collective enterprises. Diversification of ownership is experi-

44. Dic Lo, Market and Institutional Regulation in Chinese Industrialization, pp. 6, 89.
45. Ibid., p. 90.
mented with on the basis of the predominant position of public ownership, involving the transformation of operation forms of public-owned enterprises, which has neither weakened the dominant position of public ownership nor reduced the scope of its influence in socioeconomic life. For example, according to Chinese economists, in implementing the joint share system and joint stock cooperative system, the state or 'worker collectives' can control 100% of enterprise capital by holding a majority share, thus expanding the public sector’s financial capacity and its influence on the economy.47

From the start the Chinese government has been cautious in implementing the shareholding reform. It is the central government that controls the scope and pace of the shareholding reform and decides how many SOEs to be converted into joint-stock companies, which SOEs to be selected for restructuring, how to determine the ownership structure of company stock, and how to set share prices.48 Every year the central government directly decides how many new shares will go public and assigns quotas to provincial governments and industrial ministries, which in turn distribute quotas to chosen state firms within their jurisdiction. Some major preventive measures are observed in the shareholding reform. In July and August 1998, two urgent notices were issued by the central government to curb local efforts to sell off small- and mid-sized SOEs.49 Lui Jie, Vice President of China Academy for Social Sciences, Jiang Zemin’s think tank member, laid out a general framework for these measures as follows.

First, the shareholding reform must be gradually promoted, and the joint share system must be one with the state- or collective-share dominant, or in joint stock cooperatives, with the state controlling a dominant share of the company and the rest of the shares owned by individuals, other institutions, or even foreigners, to ensure the actualization of the shareholding system of socialist public ownership. Shares are prohibited from being concentrated in the hands of a small number of people.

Second, private enterprises are restricted from issuing shares in the stock market, or if necessary, private enterprises can be gradually transformed into joint stock cooperatives. This will prevent a private entrepreneur from becoming a big capitalist.

Third, laws and statutes must regulate the share limit of individual or private corporations to prevent them from having dominant shares in corporations.

Fourth, the state should levy high progressive individual income tax and a high inheritance tax to reduce the exploiting class or the dividend-eaters to the smallest number.50 This suggests the fundamental constraint on ownership reform. As Jiang Zemin pointed out, ‘We must continue to adhere to the policy with public ownership as the principal part of our economy while at the same time allowing the development of multiple economic sectors … however, the dominant position of public ownership must not be weakened or abandoned’.51

The basic indicator of a free market economy is ‘the achievement of the conditions of a competitive environment in which market prices reflect relative scarcities, and enterprises and individuals make decisions mainly in response to undistorted market signals’. The very foundation of a free market economy is private ownership or ‘impersonalization’ of property rights. According to Kornai, the state-owned enterprises in socialist countries are characterized by the ‘soft-budget constraint’; as the economic theory of property rights would put it, ‘the residual income that emerges as the difference between receipts and expenses does not pass into the pockets of natural persons, and the losses are not covered by the same natural party’. This embraces the central thesis of the property rights approach: that it is only the natural–personal owners who control and direct production and distribution of residual income, and that it is only based on this condition that modern capitalist economies have developed. The impersonalization of property rights is the very foundation of the free market economy. Therefore, China’s ownership reform should be characterized by an enhanced role of the market and competition, but not necessarily by the replacement of public ownership with ‘private ownership’ as in a capitalist system. The objective is to retain the predominance of public ownership supplemented by non-state and private ownership, while achieving an effective separation between ownership and management of enterprises.

Trends and problems

In the foreseeable future, the ownership structure will continue to be dominated by public ownership coexistent with other economic elements. The shareholding or cooperative shareholding system would become a major form for SOE reform. The shareholding system to be established would be the one in which the state and collective, rather than individual shareholders, has the dominant share and the controlling rights. This shareholding system is different from the Western shareholding system because the Chinese system adopts a ‘one shareholder one vote’ rather than ‘one share one vote’ approach. Many SOEs after being transformed into shareholding forms continue to act and function in the same way as they did and are therefore considered as examples of ‘old wine in a new bottle’. As CPPCC member Yan Yaoqing noted, the shareholding reforms have so far failed to resolve such old problems as redundant employees, bad debts, all kinds of burdens and charges on enterprises. Furthermore, ‘the shareholding co-operative system does not clearly define the responsibilities and rights of shareholders. Egalitarianism has existed in many enterprises where workers hold equal numbers of shares, thus hampering flexible management of these enterprises’.

55. Bell et al., China at the Threshold of a Market Economy, p. 11.
Although the positive side of this innovation should be acknowledged, for example, the property rights are more clearly defined, SOEs are forced to compete with non-SOEs, and the operation of enterprises has to respond to the supply and demand of the market, it has the limits both at operational and fundamental levels. For example, for a stock shareholding firm, the public must hold a dominant share and major decisions are based upon ‘one shareholder one vote’. This has not fundamentally changed the way firms are managed but the way funds are raised. Moreover, ‘one shareholder one vote’ is a socialist utopian practice in which individuals do not have the incentive to buy more shares and take more risks. To prevent evasion of debt payment, massive unemployment and social unrest, the shareholding reform requires money-losing enterprises to merge with ‘healthier’ enterprises, but many of the mergers have mainly led to changes in names rather than genuine restructuring.58

Corporatization of SOEs without privatizing them has also worsened the agency problem. SOEs are owned by the state, but control rights are divided between government bureaucrats and enterprise managers. Although bureaucrats are supposed to act as owners, they are not legally entitled to the residual income rights that private owners would have. It is this lack of real owners combined with inadequate corporate governance that distinguishes a corporatized SOE from a Western-style public corporation and makes the agency problem far more serious. Red tapes, soft budget constraints, using company funds to speculate in the property and stock markets, investing carelessly in plant expansion, dining on the enterprise, rent-seeking behavior or embezzlement and corruption are all manifestations of the agency problem.59 The existence of the agency problem reflects the very nature of shareholding reform: it is not privatization but controlled reorganization of SOEs with a rearranged pattern of public ownership—some sort of reassignment of ownership rights, assigning the majority of shares to state agencies and enterprises and the minority of shares to enterprise managers, employees and private citizens.60 In the process, the ownership structure has been diversified, with the public ownership in a dominant position.

For a cooperative shareholding firm, outsiders cannot own its stock and shares can only be exchanged internally among employees, which prohibits external funds from coming in and reduces capital mobility. Therefore, it might help to solve some problems but will not fundamentally. ‘Such a shareholding system does not provide fundamental changes in the way firms are managed. It only changes the way funds are raised … the shareholding system with a dominant public shareholder cannot solve the efficiency problem facing the SOEs.’61 This is a Chinese innovation of the ‘Socialist Market Economy’ or the Chinese-type ‘market socialism’ which is innovated and developed by the Chinese communist regime to avoid both ideological and practical difficulties of privatizing SOEs.

59. Ibid., p. 532.
61. Tian and Liang, ‘What kind of privatization?’, p. 84.
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The Chinese-type market socialism

- The goal of restructuring property rights is to enhance the role of the market and improve productivity while maintaining the party-state control in the process of marketization and reinforcing the predominant position of public ownership in quality and quantity, rather than moving the Chinese economy toward capitalism.
- State and other public-sectors have continued to dominate the economy and control all the key aspects, industries, resources, production factors, and ‘commanding heights’ of the national economy while on the other hand other economic sectors have gained considerable importance in GDP, employment, industrial output, production of commercial goods and services.
- Large and medium SOEs have been corporatized into joint stock and shareholding companies with a rearranged pattern of public ownership.
- The core of socialism remains but coexists with market relations or something similar to market relations. The decision-making of public and non-public owned enterprises has become market-oriented or market-based, but being subject to the state interference and influence due to the state control over the resources and the various constraints of party-state political context in which the economy operates. Many elements of market economy, such as factor markets, real estate market, stock market, etc., have come into being, but are weak and distorted.
- Decollectivization without privatizing land. Peasants have only use rights not ownership rights, and therefore these rights are often constrained by the power of state agencies and cooperative organizations. The state can often limit what peasants can do with the land through administrative means although use rights are transferable for benefit according to the land lease system.
- The party-state system remains intact and powerful and state intervention remains extensive. The core of the party-state system defines the nature and functioning of Chinese politics and the parameters within which the economic policy can be initiated and implemented and the entire economy can move around.

Why has China not moved toward the far left or in the direction of the capitalist market economy? The post-Mao reform has been fundamentally limited by two major factors. At the cognitive level, the goal of the post-Mao leadership is to improve and strengthen the Chinese socialist economic system rather than negation of the socialist system. Ownership continues to be seen as the core of production relations in China and its transformation must adhere to socialist principles and maintain the predominant position of public ownership in quality and quantity. As Chinese Premier Zhu maintained ‘resource allocation under a market economy is more efficient than that of a planned economy’, but ‘maintaining a just society and working towards common prosperity of its people is a socialist ideal. Public ownership of property can better maintain social justice and increase common prosperity than systems which encourage private ownership’. Therefore, Zhu claimed that ‘China can establish a market economy while public ownership continues to predominate’. 62 Li Peng, former Premier, argued that planned and

market economies each had their own strengths and weaknesses and that China needs to draw upon the strengths of both in order to build an integrated mixed economy.\textsuperscript{63} Jiang Zeming, the party chief, also claimed that China should be able to establish a market economy under a socialist system, which ‘can and should operate better than one under the capitalist system’.\textsuperscript{64}

At the practical level, public sectors under the communist regime, particularly the state sector, are responsible for many important social and political functions and therefore cannot seek profit maximization at the expense of its inherent social and political preferences and policies, such as social justice, employment, stabilization of markets, protection of national industries, and enhancement of state security. Moreover, the problem of privatization of the ownership system in any of the communist countries is more political than economic. The resolution of this fundamental problem will not only run into resistance and obstacles from the communist ideology but also into the difficulties caused by popular fear and doubt about privatization, due to the long tradition of socialist public ownership and ideological propaganda. More importantly, how to privatize such a huge estate of state ownership within the framework of the existing political system and structure is really problematic and technically unworkable. The experience of other former communist countries has shown that there is no single case of making privatization successful with the communist party remaining in power and its political system intact.

**Conclusion**

All the hard evidence, carefully examined and evaluated against our models or theoretical reference points, has pointed to the direction that post-Mao China has actually moved away from a centrally planned command economy toward some kind of party-state controlled market socialism dominated by corporatized public ownership rather than a free market economy of capitalism. The de-facto extent of ownership reforms is actually consistent with China’s official documentary objectives and corporatization of SOEs has not contributed to any significant privatization. Post-Mao economic reforms have not done away with the public ownership system, which is declared by all communist states as one core element of the fundamental principles and norms of communist ideology and a socialist economic system. Public ownership of the major means of production and exchange in the communist economic system must be sustained to maintain the regime identity, though it is not necessarily displayed to the same degree all the time. All hard evidence has suggested SOEs and other public-sector enterprises have continued to dominate the economy; large and medium SOEs have been turned into joint stock and shareholding companies with a rearranged pattern of public ownership; decollectivization has not led to privatization of land; SOEs have continued to dominate and control all the key aspects, industries, resources, production factors, and ‘commanding heights’ of the national economy, although


\textsuperscript{64}. *International Herald Tribune*, (13 October 1992).
its share in China’s overall GDP has largely shrunk; the state control system has remained effective and powerful; and state intervention has been extensive and commonplace in the post-Mao policy and performance.

The goal of the post-Mao leadership is not to transform the entire political economic system into a capitalist one but to improve and strengthen the socialist system and develop the Chinese economy as rapidly as possible within the basic framework of state socialism and its political governance structure. ‘A distinguishing feature of the Chinese reforms is the attempt by the leadership to preserve the socialist character of the economy. As such, the authorities have not pursued a strategy of mass privatization as in some of the transitional economies of Eastern Europe and the former Soviet Union.’65 The household responsibility system in agriculture serves as one example: although the use of land and its management are contracted out to individual households, land continues to be publicly owned. Some other examples are also evident: although the ownership system has become diversified, public ownership, including state- and collective-owned enterprises, continues to be dominant in the economy; although the forms for realizing public ownership have become diversified, the state sector continues to control and monopolize the key aspects or the ‘commanding heights’ of the economy and the party organizations continue to oversee the operation of enterprises; although the market plays a more important role, and the ‘dual track’ system continues to exist and all kinds of administrative interventions have not been reduced but rather strengthened, ‘randomized’ and direct at the local government level.

Post-Mao China has made a considerable change, compared with Mao’s China, in terms of the non-public sector, enterprise autonomy, and economic marketization. But how far it will go still remains to be seen. Compared with the economic transition of five Eastern European countries in terms of six key progress indicators (privatization laws, progress in privatization, output share of the private sector, price liberalization, quantitative restrictions on trade, and internal convertibility), China’s progress still lags far behind in respect of most of these indicators, even though China’s economic reform started 10 years earlier than these countries. ‘Thus, China’s transition must be judged to be less advanced than that of its Eastern European counterparts.’66

65. Bell et al., China at the Threshold of a Market Economy, p. 4.