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# Market Socialism Revisited: The Case of Chinese State-Owned Enterprises

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*This article explores the relevance of the Chinese experience of a socialist market economy (SME) to the idea and viability of market socialism (MS). It starts by reviewing the defining characteristics of MS as well as the key policy challenges in the transition from state socialism to market socialism and the debates around them. This is followed by an examination of the formulation of an SME by the Chinese Communist Party (CCP) and the actual implementation of an SME in China. Focusing on reform of the state industrial sector, especially through* gufenzhi *(shareholding) reform and stock market listing, the article then analyzes this experience in terms of the policy measures implemented and their impact on the sector and beyond. It concludes that the Chinese SME not only falls short of the aspiration of MS in terms of equality, but also suffers from a fundamental contradiction between the attempt to maintain the dominance of public ownership, which is integral to both MS and the SME, and the need to develop a full-fledged competitive market economy. The implications of these findings are discussed in the conclusion..*

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Market socialism (MS), generally defined as combining dominant public ownership with the market mechanism, has captured the imagination of generations of economists. It promises to bring the best of both socialism and capitalism, namely the economic efficiency of the market mechanism on the one hand, and the elimination of exploitation and inequality through public ownership of the means of production on the other.[1] A crucial question is, however, whether this hybrid is viable. This question lay at the heart of the famous debate between Hayek and Lange in the 1930s and 1940s. More than half a century later, Brus and Laski still regarded it as "the only question worth examining in the context of MS."[2]

A decade ago, Nove and Thatcher speculated that, "Perhaps the best hope for market socialism is China."[3] Some may argue that this hope is still very much alive, since China has been pursuing an economic system similar to market socialism under the banner of a "socialist market economy" (SME) since the early 1990s. Moreover, it has had tremendous economic success over the past decade, and is an emerging global economic power. However, despite the semantic similarity, the relevance of the Chinese experience with an SME to the MS vision remains under-explored. It is also unclear what implications the Chinese experience holds for the question of the viability of MS.

The purpose of this article is to examine tentatively the relationship of the Chinese SME to the idea of MS, and to explore the implications of

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[1]For a comprehensive review of the contemporary literature on market socialism, see Gabriel Temkin, "The New Market Socialism," *Communist and Post-Communist Studies* 29, no. 4 (December 1996): 467-78.

[2]Wlodzimierz Brus and Kazimierz Laski, *From Marx to the Market: Socialism in Search of an Economic System* (Oxford: Clarendon, 1989), 137.

[3]Alec Nove and Ian D. Thatcher, eds., *Markets and Socialism* (Aldershot and Brookfield: Edward Elgar, 1994), xvii.

the Chinese experience for the debate on the viability of MS. It is in three parts. Part one provides a critical overview of the debate on the viability of MS. It highlights the contradictions that scholars have identified in the idea of MS and discusses their possible solutions. Part two will then turn to the experience of China's experimentation with MS under the banner of an SME. This will include an examination of how the Chinese SME is defined, and how the reform program has attempted to resolve the contradictions identified in part one and the problems that have arisen. Finally, part three includes a discussion of the implications for MS of the Chinese experience.

## The Debate on Market Socialism: Is It Viable?

There are as many conceptions of market socialism as definitions of socialism. Mises argued that, "All the means of production are in the exclusive control of the organized community. This and this alone is socialism. All other definitions are misleading."[4] In Hayek's view, "the common end of all socialism in the narrower sense, of 'proletarian' socialism, is the improvement of the position of the propertyless classes of society by a redistribution of income derived from property."[5] However, in the wider sense, he considered socialism as "any case of collectivist control of productive resources, no matter in whose interest its control is used."[6] These statements point to two interconnected essential features of socialism, namely public ownership of the means of production and commitment to income equality. The logic of this formulation is that public ownership would make it possible for the state to distribute wealth according to a set of socially determined criteria.

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[4]Cited in Yingyi Qian and Chenggang Xu, "Commitment, Financial Constraints, and Innovation: Market Socialism Reconsidered," in *Market Socialism: The Current Debate*, ed. Pranab K. Bardhan and John E. Roemer (New York: Oxford University Press, 1993), 175.

[5]Friedrich A. Hayek, "The Nature and History of the Problem," in *Collectivist Economic Planning*, ed. Friedrich A. Hayek (London: Routledge, 1935), 15.

[6]Ibid., 17.

Socialism is also characterized by the scope that it affords for planning. However, while supporters have stressed the economic advantages that would arise from this,[7] critics have argued successfully that socialism's inability under central planning to derive a set of equilibrium prices for producer goods undermines its allocative efficiency.[8] In this context, Lange proposed to solve this problem by introducing an analogous Walrasian market for producer goods while retaining the price-fixing power of the state. In such a system, public enterprise managers are required to follow a set of rules in their production decisions in order to mimic the effect (i.e., marginal costs equal to price) of what is achievable through the pursuit of profit maximization by private enterprise managers in a competitive market.[9] In effect, however, Lange's proposal was an acknowledgment that socialism could not operate rationally without the aid of the market. This is why Lange is often credited with inventing the notion of market socialism. Notably, in Lange's MS, public ownership of the means of production is dominant, but not exclusive. Private ownership is allowed in agriculture and small-scale industry.

Extending Hayek's work,[10] Bardhan and Roemer have divided the development of the idea of MS into five stages (or generations).[11] In their classification, the period of economic reforms in the former socialist economies, ranging from Yugoslavia to China, represents the fourth stage. As a major contributor to the fourth generation, Kornai pointed out that it is necessary to make a distinction between MS as a system that is to replace capitalism, and MS as a system that is to replace the old-style, Stalinist, pre-reform socialism under the guidance of a series of reform measures

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[7]See, for example, Oskar Lange, "On the Economic Theory of Socialism," in *On the Economic Theory of Socialism*, ed. Benjamin E. Lippincott (New York: McGraw-Hill, 1938; reprint 1966), 55-143.

[8]Hayek, "The Nature and History of the Problem," 1-40; and Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth," in Hayek, *Collectivist Economic Planning*, 97-103.

[9]See note 7 above.

[10]Friedrich A. Hayek, "Socialist Calculation: The Competitive 'Solution'," *Economica* 7, no. 26 (May 1940): 125-49.

[11]Bardhan and Roemer, *Market Socialism*, 3-9.

and policy statements, or "the blueprint."[12] He characterized the latter by the political monopoly of the Communist Party, predominance of state ownership, and profit-maximization as the main criteria of firm success.[13] In Bardhan and Roemer's views, Kornai's thesis of soft budget constraint in socialist economies was the most important contribution of the fourth generation. In essence, this thesis argues that socialist enterprises tend to operate under soft budget constraint and that their behavior is characterized by an almost insatiable demand for inputs, both financial and physical, and very slow response to changes in relative prices. The sources of soft budget constraint are the negotiability of tax rates, soft subsidies, soft administrative prices, and soft credits.[14] Furthermore, in Bardhan and Roemer's view, the end of the fourth generation was marked by Kornai's argument that the failure of the market socialism experiments in various former socialist countries is unavoidable as long as one political party maintains a power monopoly over the state and firms.

Evidently, members of the fifth generation of MS are less shackled by traditional preoccupations. According to Bardhan and Roemer, they have not only dropped Lange's insistence on the fixing of industrial prices by planners, they have also dispensed with public ownership in the narrow sense of exclusive state control of firms.[15] In their proposals, firms are envisaged as operating independently of state control, with boards of directors representing either workers or institutional equity holders or creditors. Their main claim to socialism remains aversion to private ownership and commitment to egalitarian distribution of profits. The common belief is that there are different kinds of property rights that would induce firm managers to maximize profits—at least as effectively as they do in large capitalist corporations—but that would preclude profits from being distributed

[12]Janos Kornai, "Market Socialism Revisited," in Bardhan and Roemer, *Market Socialism*, 42.

[13]Bardhan and Roemer, *Market Socialism*, 9.

[14]This draws on Paul Bowles and Gordon White, "Contradictions in China's Financial Reforms: The Relationship between Banks and Enterprises," *Cambridge Journal of Economics* 13, no. 4 (December 1989): 483.

[15]Bardhan and Roemer, *Market Socialism*, 3-17.

extremely unequally (as in capitalist economies).[16] Accordingly, Roemer defined socialism not as a system in which there is public ownership, but as a system in which there are institutional guarantees ensuring that aggregate profits are distributed more or less equally among the population.[17]

Both the fourth and fifth generations are strongly influenced by postwar developments in economics, especially the principal-agent theory. In essence, this theory presupposes that enterprise managers are self-interested and that they must be motivated by appropriate incentives and compelled to perform through effective corporate governance and competition. From this perspective, while providing managerial incentive is necessary for motivating good performance, the most crucial factor is effective monitoring by owners. However, financial institutions, such as banks and the stock market, can substantially facilitate monitoring by creating and reinforcing competition.

To the critics, the principal-agent theory shows that MS faces an insurmountable dilemma: while rewarding managers of publicly-owned enterprises is necessary to motivate them, the commitment to egalitarian distribution makes this difficult if not impossible.[18] Indeed, the theory suggests that MS is unlikely to be able to achieve the full benefit of the market mechanism for an even more fundamental reason: in order to reduce the agency problem, monitoring by the owners is crucial, although proper corporate governance and competitive markets for products and factors of production could make monitoring more cost-effective.[19] In a market socialist economy, however, the owner is missing and is represented by government departments (or their bureaucrats) acting on behalf of society.

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[16]Ibid., 7-8.

[17]John E. Roemer, "Can There Be Socialism after Communism?" in Bardhan and Roemer, *Market Socialism*, 89-107.

[18]Louis Makowski and Joseph M. Ostroy, "General Equilibrium and Market Socialism: Clarifying the Logic of Competitive Markets," in Bardhan and Roemer, *Market Socialism*, 69-88.

[19]Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure," *Journal of Financial Economics* 3, no. 4 (October 1976): 305-60.

Because the bureaucrats are agents themselves, they are unlikely to be effective monitors. Moreover, because of the lack of opportunity to customize one's investment portfolio in a system of dominant public ownership, members of society have insufficient incentive to monitor the monitors.[20] Finally, it has also been argued since Hayek that without private ownership, there is no motive for entrepreneurship.[21] Therefore, publicly-owned enterprises would not be able to outperform private enterprises.

Theoretically, possible solutions for agency problems of this kind are either to transfer state ownership to private individuals (i.e., privatization) or to decentralize control to workers and managers. In both cases, the purpose is to give those who operate the enterprises stronger incentives. In the latter case, Brus and Laski recommended a high degree of separation between the state and state enterprises, indeed "the renunciation by the state of all interest and involvement in enterprises' activities, except the return on and growth of assets."[22] How much control should be devolved to enterprise employees is obviously a critical issue here. Brus and Laski also pointed out that this separation must be based on the separation of the state's role as an owner from that of its being the authority, the regulatory body, and custodian of the non-enterprise sector, because otherwise the state may abuse its power in favor of state enterprises. This is a point that Kornai, too, emphasized.[23] Indeed, the difficulty of achieving this separation is part of his explanation why the blueprint of market socialism is destined to fail.

The principal-agent theory highlights the importance of competition as a monitoring device.[24] Indeed, there is a consensus among mainstream economists that competition and regulation may be more important than

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[20]Louis Putterman, "Incentive Problems Favoring Noncentralized Investment Fund Ownership," in Bardhan and Roemer, *Market Socialism*, 156-68.

[21]Temkin, "The New Market Socialism," 474.

[22]Brus and Laski, *From Marx to the Market*, 136.

[23]Kornai, "Market Socialism Revisited," 49.

[24]Jensen and Meckling, "Theory of the Firm"; and Oliver D. Hart, "The Market Mechanism as an Incentive Scheme," *Bell Journal of Economics* 14, no. 1 (Autumn 1983): 366-82.

ownership in determining enterprise performance.[25] However, in the transition from traditional socialism to MS, there is a question whether a dominant state sector can be fitted into a genuine market framework, as competition is largely absent to start with. In this regard, Newbery pointed out that competition could be introduced into a Soviet-type economy in three ways, listed here in order of difficulty: (1) by opening the economy to international competition; (2) by encouraging entry into the industry by domestic competitors; or (3) by breaking up the existing enterprises.[26]

While the first emphasizes openness to foreign trade and investment, the second requires the creation of a level playing field for all enterprises regardless of ownership. In relation to the last, Brus and Laski emphasized another separation: "state enterprises ... have to become separated not only from the state in its wider role but also from each other."[27] Indeed, they suggested that, unless the state's share in the enterprise sector becomes sufficiently small, the components of the state's domain must under MS be given greater autonomy than the divisions of a private corporation. This was deemed necessary because,

> Even under conditions of oligopolistic competition a large corporation still acts in a market environment and cannot destroy the principal rules of the games, whereas—under conditions of dominance of state-owned enterprises—a concerted action by the criterion of profitability of the totality of state assets would actually destroy the market and let in the command system by the back door.[28]

On the other hand, proponents of MS also find support in the principal-agent theory. They argue that both state-owned enterprises (SOEs) and private corporations suffer from the agency problem, as both are characterized by the separation of control and ownership. Therefore, the reasoning goes, by reforming corporate governance (including hardening

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[25] John Vickers and George Yarrow, *Privatization: An Economic Analysis* (Cambridge, Mass.: MIT Press, 1988).

[26] David M. Newbery, "Transformation in Mature versus Emerging Economies: Why Has Hungary Been Less Successful Than China?" *China Economic Review* 4, no. 2 (Autumn 1993): 89-116.

[27] Brus and Laski, *From Marx to the Market*, 137.

[28] Ibid.

budget constraint) and introducing competition, it ought to be possible to solve the agency problem among SOEs and improve their performance.[29] In practical terms, supporters of MS have placed much emphasis on turning SOEs into joint-stock companies and enhancing the role of the capital market in order to strengthen monitoring. By comparison, limited attention has been paid to the development of competition, which is often taken for granted.

The relative neglect of the issue of competition and its implication for resource allocation in contemporary MS discourse has both theoretical and practical causes. At the theoretical level, it can be partly attributed to the preoccupation of the fourth and fifth generations with the agency issue, which I would argue is in turn embedded in the initial conceptualization of MS by the founding fathers. As shown earlier, the debate between Mises and Lange was actually focused on the question whether it was possible to achieve efficient resource allocation under socialism, where there is no effective market for producer goods. However, Lange's solution was to mimic the effects of profit maximization in a competitive market, thus elevating profit maximization to a heightened status. Although it is beyond the scope of this article to trace this to the economic reform programs in former socialist countries, it is nevertheless significant that profit maximization became a main criterion for judging the performance of socialist firms in these countries (and subsequently in China), as identified by Kornai.[30] However, from the perspective of modern economics, Stiglitz has argued that such conceptualization of MS is based on a neoclassical economics model which assumes competitive markets, and that it is out of touch with today's world, where market imperfection is the norm rather than the exception.[31] At the practical level, since loss-making was a wide-

[29]Peter Nolan and Xiaoqiang Wang, "Beyond Privatization: Institutional Innovation and Growth in China's Large State-Owned Enterprises," *World Development* 27, no. 1 (January 1998): 169-200; and Pranab K. Bardhan and John E. Roemer, "Market Socialism: A Case for Rejuvenation," *Journal of Economic Perspectives* 6, no. 3 (Summer 1992): 101-6.

[30]Bardhan and Roemer, *Market Socialism*, 9.

[31]Joseph E. Stiglitz, *Whither Socialism?* (Cambridge, Mass.: MIT Press, 1994).

spread issue in the early phases of economic reform under the communists and in capitalist countries (although for quite different reasons), much attention has been paid to the issue of firm-level efficiency.

The above discussions suggest that in the transition from state socialism to MS, there are three critical economic challenges: first, how to resolve the agency problem among the SOEs; second, how to establish competitive markets; and third, how to deal with market imperfection. All these fundamentally hinge on the role of the state sector. This is because, during the transition, competition is largely absent to start with, and therefore has to be nurtured. However, a dominant state sector is likely to make this task more difficult as the sizable SOEs could easily develop into oligopolies, and the state may be tempted to support the public sector through biased policies and regulation. On the other hand, without competitive markets, monitoring of the performance of SOEs is bound to be ineffective. Furthermore, one-sided emphasis on financial performance, rather than allocative efficiency, could cause economy-wide harms. These considerations further suggest that the real difficulty of MS may be political: the crucial question is whether a government that intends to maintain the dominance of public ownership would be capable of adopting pro-competition legislation and policies, resisting the temptation to support the state sector through policy favors and rigorously discharging its regulatory responsibility to curtail market power.

The Chinese experience, which is characterized by rapid expansion of township and village enterprises (TVEs) in the 1980s and large-scale corporatization (rather than privatization) of its SOEs since the mid-1990s, is highly relevant to the proposals of the fourth and fifth generations of MS. However, while the growth of TVEs has received a great deal of attention and is sometimes used to support the idea that ownership by local governments (or decentralized public ownership), rather than private ownership, is able to underpin rapid economic growth,[32] or that ownership does not

[32]Russell Smyth, "Property Rights in China's Economic Reforms," *Communist and Post-Communist Studies* 31, no. 3 (December 1998): 235-48.

really matter for enterprise performance,[33] the experience of the corporatization of Chinese SOEs has so far received only limited attention.[34]

In what follows, we shall first provide an overview of the Chinese engagement with the notion of market socialism through the formulation of an SME. We will then show that the Chinese government has indeed adopted a series of biased policy measures in order to maintain the dominance of public ownership at the expense of overall economic efficiency and market development, especially in the stock market. It has so far also failed to check the market power of the large SOEs. Indeed, it is evident that the party-state intends to exploit this market power in order to safeguard state assets. Nevertheless, this has not prevented the continued decline of the public sector thanks to foreign competition and the vigorous growth of the domestic private sector.

## The Chinese Experiment with Market Socialism

An outstanding feature of the Chinese experiment is the way that various reform measures have been rolled out in successive waves, each invariably preceded by a major theoretical debate. This section therefore begins with a review of these theoretical debates, followed by an investigation of the practical experience.

*The Debates*

Since the late 1970s, there have been three major waves of debate on the direction of the reform, with the first two emanating from within the Chinese Communist Party (CCP) but eventually involving intellectuals outside the CCP as well.[35] During this process, Chinese officials and intel-

[33]See note 31 above.

[34]For a review, see Le-Yin Zhang, "The Roles of Corporatization and Stock Market Listing in Reforming China's State Industry," *World Development* 32, no. 12 (December 2004): 2031-47.

[35]For an insightful commentary on these debates, especially the background to the current debate, see Ma Ling, "The Third Grand Debate on Reform and Its Orientation," *Zhongguo*

lectuals alike have engaged in protracted, wide-ranging debates about the pros and cons of socialism and its application to China, and how reforms could help to strengthen the Chinese socialist system.[36] As demonstrated by Sun, the issue of ownership and the roles of the plan versus the market preoccupied all participants of the debates.[37] As a consequence, the party-state gradually abandoned the central role of planning and eventually chose to adopt the idea of an SME in 1992.

The first major debate, which focused on what should be the criteria for testing the truth (i.e., validity) of ideas and theories, took place in the late 1970s. Hu Yaobang (胡耀邦), Deng Xiaoping (鄧小平), and their supporters triumphed with the argument that practice, rather than Mao Zedong's (毛澤東) teaching, should be the sole criterion of truth. This debate led to a shift in the Party's priorities concerning economic development at the Third Plenum of the CCP's Eleventh Central Committee, thus opening up an era of economic reform in China.[38] The second debate took place in the early 1990s, before Deng's famous southern tour. It asked whether it is valid to judge policy instruments (e.g., marketization and joint-stock companies) by their perceived relationship to capitalism or socialism. This debate gave rise to the so-called "convergence" thesis, which recognizes the growing convergence of socialism and capitalism in the scope of planning versus the market. Its conclusion was marked by Deng's pronouncement during his southern tour that such scope does not distinguish socialism from capitalism.[39] Finally, in close connection with the installment of a new generation of leaders, especially Hu Jintao (胡錦濤), the current Party general secretary, a third debate has been going

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*gaige luntan* (China Reform Forum), August 2006, no. 4, at http://www.gjmy.com/gjmywz/view/view_zj/200608/10040.html (accessed August 24, 2006).

[36]Liu Guoguang, "Some Issues Relating to the Theory of the Socialist Market Economy," in *China's Economic Reform: A Study with Documents*, ed. Christopher Howe, Y.Y. Kueh, and Robert Ash (London: Routledge/Curzon, 2003), 98-107; and Yan Sun, *The Chinese Reassessment of Socialism, 1976-1992* (Princeton, N.J.: Princeton University Press, 1995).

[37]Sun, *Chinese Reassessment of Socialism*, 85-120.

[38]Ibid., 32.

[39]Ibid., 208.

on for the past two years, focusing on the question of whether there should be any more reforms in the face of mounting problems of inefficiency, inequality, and corruption, all closely associated with the operation of the state sector. However, in contrast with the earlier ones, the current debate has been initiated by individuals outside the establishment and conducted over the Internet, rather than within select policy circles.[40] It may be observed that, while the conclusion of the second debate ushered in the SME, the current debate essentially questions the validity of this brand, and more specifically whether it is necessary to further reduce state ownership.

Following our discussion in the above section, let us briefly review these debates by addressing three specific questions. First, what measures were proposed to resolve the agency problem among SOEs? Second, what consideration was given to the value and the establishment of competitive markets? And third, to what extent was it realized that the purpose of maintaining dominant public ownership may constrain, if not contradict, the government's action to promote competition and curtail market power?

From the very beginning, the issue of improving SOEs' efficiency has received a great deal of attention. On one side, as early as 1979, Dong Fureng (董輔礽) suggested that the extant form of state ownership, coupled with centralized management and planning, was the root problem of the Chinese economy as it contributed to many of its structural flaws. According to Dong, these flaws included: centralized regulation of the economy, giving rise to rigidity and disparity between plan and demand; the way in which the state's power to appoint managers rendered them accountable to orders from the above, rather than to the interest of enterprises and workers; and how the inability to link the means of production to their real owners, or to link workers' interests to enterprise performance, stifled local initiative and innovation. His answer was to grant "enterprise ownership" to SOEs in order to give them the powers of an independent producer.[41]

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[40]See note 31 above. However, establishment intellectuals have become involved in the debate.

[41]Ibid., 93. Originally from Dong Fureng, "On the Question of the Form of Our Socialist Ownership," *Jingji yanjiu* (Economic Research), 1979, no. 1.

Although Dong's stance was radical at the time, by 1984 there was enough consensus for the final resolution on urban reform to include the "separation of state ownership from state management."[42] By 1985-86, several new forms of ownership-management separation had been proposed. These included the contract responsibility system, the leased management system, and the joint-stock system. The last, proposed by Professor Li Yining (厲以寧) of Beijing University in 1986, envisages the transformation of state ownership into stocks, to be jointly owned by the state and by enterprises.[43]

However, conservative reformers objected to this separation for a number of reasons, including fear of losing macroeconomic control. They argued that the leading role of the socialist economy "should consist not just of state ownership or the state's extraction of taxes based on that ownership. It also consisted of actual economic power afforded by the state's control over products and economic infrastructure."[44] Conservative reformers were particularly opposed to the joint-stock system, questioning the rationale for this system under socialism given the socialist economy's ability to pool resources, worried that it might lead to eventual privatization, and that individual ownership of stocks might give rise to a parasitic social stratum living off dividends and bonuses.[45] Some of these worries were shared by reformers advocating the priority of market reform and objecting to the one-sided emphasis on ownership reform. As a result, the contract responsibility system prevailed between 1984 and 1986. Nevertheless, following the initial failure of price reform in 1987 and thanks to the reformist leadership's eagerness for new reform ideas, the joint-stock system was approved by the Third Plenum of the CCP's Thirteenth Central

[42]"Resolution of the CCP Central Committee on the Economic Structural Reform," in *Shi'erda yilai zhongyao wenxian xuanbian* (Selected important documents since the Twelfth Congress), ed. CCP Central Committee Documentary Research Center (Beijing: Renmin chubanshe, 1987), 766-95.

[43]Li Yining, "Proposal on Ownership Reform of Our Country," *Renmin ribao* (People's Daily), September 26, 1986, cited in Sun, *Chinese Reassessment of Socialism*, 100.

[44]Ibid.

[45]Sun, *Chinese Reassessment of Socialism*, 100-102.

Committee in September 1988 for trial implementation.[46]

By comparison, the adoption of the idea of a competitive market is relatively recent. Research shows that the idea of a socialist market economy was put forward in China as early as 1979, largely on account of the positive effects of competition.[47] However, it was consistently overshadowed by the concept of a "socialist commodity economy," which recognizes the role of exchanges, but denies the competitive market a central role in resource allocation, because of its perceived linkage with capitalism. This misgiving was not dispelled until 1992, when Deng Xiaoping publicly dismissed such a perception and asserted that socialism could also have a market economy.

Similarly, the instrumental value of competition has been overshadowed by insistence on the fundamental value of public ownership. At the Fourteenth Party Congress in 1992, Jiang Zemin (江澤民), the then general secretary of the CCP, declared that "the objective of economic restructuring is to develop a socialist market economy, keeping the public sector as the dominant one and remuneration according to one's work as the principal mode of distribution, supplemented by other sectors and other modes."[48] Jiang's declaration shows that the Chinese SME shares with MS one important feature, namely an insistence on dominant public ownership. By emphasizing "remuneration according to one's work," however, it shows that the SME plays down the role of public ownership as a means to achieve equitable income distribution, at least for the near future. Nevertheless, according to Sun, the issue of distribution received persistent attention throughout the debates, with attention focused on whether the principle should be distribution according to work.[49] In particular, Su and Zhang, in the volume they edited, explicitly addressed the distribution issue. They recognized that the original intention of Marx was to strive for a system

[46]Ibid., 78.

[47]For an insider's account of the earlier discussion, see Liu, "Some Issues," 99.

[48]Jiang Zemin, "Jiang Zemin's Speech to Party Congress," *China Daily*, Supplement, October 21, 1992.

[49]Sun, *Chinese Reassessment of Socialism*, 203.

conducive both to the growth of productive forces and the development of the person. Accordingly, they defined the twin goals of Chinese socialism in terms of the development of productive forces for the current stage and common prosperity in the long run.[50]

Public ownership in the Chinese SME is defended in principle as part and parcel of the "basic system of socialism" in China, which has been officially characterized by the Four Cardinal Principles (keeping to the socialist road, upholding the people's democratic dictatorship, leadership by the Communist Party of China, and Marxism-Leninism and Mao Zedong Thought).[51] This is confirmed by what Xue Muqiao (薛暮橋), an influential government official and economist, said in his interview with a journalist from the Shenzhen (深圳)-based *Special Economic Zone Times* in 1991: "As long as the system of public ownership of the means of production remains central [to our economy], we cannot say it is a capitalist market economy. Therefore it is still the system of public ownership which differentiates it, and not the market economy."[52]

Moreover, to conservatives, public ownership was an instrument for maintaining the state's control over the means of production. Thus Jiang's speech went on to say that successful reform of the SOEs, to "increase their vitality and efficiency," is the key not only to establishing the socialist market economy, but also to "consolidating the socialist system and demonstrating its superiority."[53] Evidently, the CCP is committed to maintaining the public sector's dominant position in the economy in the hope that the sector's success will enable it to claim that socialism is superior to capitalism in promoting the development of productive forces, thus justifying its claim to political dominance.[54]

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[50]Su Shaozhi and Zhang Xiangyang, eds., *Sanzhong quanhui yilai Makesi zhuyi zai Zhongguo de fazhan* (The development of Marxism in China since the Third Plenum) (Beijing: Renmin chubanshe, 1989).

[51]Ibid., 2.

[52]Liu, "Some Issues," 101.

[53]See note 48 above.

[54]This is apparently a point that Jiang revisited time and again after 1992. See Jun Hu,

Following the decision to adopt an SME at the Fourteenth Party Congress, the Chinese government introduced a basket of marketization measures in 1993-94, aiming to create a set of essential conditions for a market economy. These measures included further reforms in pricing, banking, taxation, and fiscal relationships, as well as corporatization of SOEs.[55] However, there was and continues to be a lack of discussion about how competition is to be established, while it is intended that the public sector should maintain its dominant position. This paucity is evidenced by the fact that Sun's comprehensive review of the Chinese "reassessment of socialism" hardly touches on the issue of competition. The implicit assumption seems to be that the market would introduce competition automatically.

In summary, then, the Chinese SME insists on dominant state ownership, treating it as indispensable, especially in political terms. It adopts the joint-stock system to deal with the agency problems among SOEs. On the other hand, it has assigned to the market the central role in resource allocation. However, relatively little attention has been paid to the notion that a government intending to maintain the dominance of the public sector may be constrained in its role of promoting competition and curtailing market power. In order to find out how effective the joint-stock system has been in resolving the agency problem and how the effort to maintain dominant public ownership has affected the development of market competition, we investigate below the Chinese SME experience by focusing on China's effort to reform the state industrial sector. This is because industry is the most important and dynamic part of the Chinese economy. As of 2005, industry accounted for 42.0 percent of China's GDP and 93.6 percent of China's exports.[56]

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*Zhongguo shehui zhuyi shichang jingji yanjiu* (A study of the socialist market economy in China) (Jinan: Shandong renmin chubanshe, 1999), 285-86.

[55]CCP Central Finance and Economy Leading Small Group, ed., *Dangqian jixiang zhongda jingji tizhi gaige* (Some important reform measures for economic restructuring at the present) (Beijing: Renmin chubanshe, 1994).

[56]National Bureau of Statistics, *Zhongguo tongji nianjian* (China statistical yearbook) (Beijing: Zhongguo tongji chubanshe, 2006), 3-2; 18-5.

*Practice*

*Corporatization*: China's state industrial sector has undergone three stages of reform, each with a different emphasis. From the late 1970s to the mid-1980s, the emphasis was on increasing the operational autonomy of enterprise managers. This was followed, between the mid-1980s and 1993, by the introduction of long-term performance contracts between enterprise managers and government departments. And finally since November 1993, when the Third Plenum of the CCP's Fourteenth Central Committee called for the introduction of a "modern enterprise system" (MES), the emphasis has shifted to corporatization.[57] This last combines ownership reform with the introduction of a formal structure of corporate governance and a greater role for the equity market.

Along with the effort to reform the state sector, however, the Chinese government has pursued an open-door policy since the late 1970s, especially encouraging foreign direct investment (FDI) in manufacturing.[58] This has not only opened up a new channel of finance, but also provided Chinese non-state enterprises with valuable technology, managerial know-how, and the ability to compete both at home and abroad. China has been the largest recipient of FDI in the developing world since 2003.

The new emphasis on ownership reform is an acknowledgment that China's pre-1993 initiatives failed to substantially improve the SOEs' efficiency, as reflected in their steadily declining market share and continuing disproportionate claim on the country's scarce resources.[59] The SOEs' inefficiency is also manifested in their relatively low total factor productivity growth. Although this issue is hotly debated, an influential review (of more than thirty studies) concluded that from 1980 to 1992, "total factor productivity growth in the non-state sector is about twice that

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[57]Nicholas R. Lardy, *China's Unfinished Economic Revolution* (Washington, D.C.: Brookings Institution Press, 1999), 22-24.

[58]Le-Yin Zhang, "Location-Specific Advantages and Manufacturing Direct Foreign Investment in South China," *World Development* 22, no. 1 (January 1994): 45-54.

[59]Lardy, *China's Unfinished Economic Revolution*, 25-29; and World Bank, *The Chinese Economy: Fighting Inflation, Deepening Reforms*, vol. 1 (Washington, D.C.: The World Bank, 1996).

of the state sector."[60]

From the viewpoint of the principal-agent theory, the lack of progress demonstrates the limitations of past reforms, which emphasized strengthening incentives rather than improving monitoring through competition.[61] Seen in this light, the MES reform appears to have much to offer. In official parlance, it is characterized by "clear property rights," "delimited responsibilities and rights," "separation of enterprises from the government," and "scientific management." It has five essential features. First, the enterprise is an independent legal person, separated from its owners (most notably the state). Second, the enterprise is an autonomous unit, accountable for both its losses and profits. It has the obligation to pay taxes and to increase or safeguard the value of its capital. Third, in accordance with their contribution of capital, the owners enjoy the rights to choose the managers, share the income, and take part in major decision-making. In the case of bankruptcy, the owners' liability is limited to their equity contribution. Fourth, the enterprise organizes its operation by responding to market signals, aiming to raise productivity and improve economic efficiency. Long-term loss-making enterprises should go bankrupt according to the law. Fifth and finally, there is a system of incentives and constraints.[62]

Practically, the MES reform calls for the corporatization of SOEs, namely their conversion into *gufenzhi* (股份制, shareholding) companies, either companies with limited liability (CLLs) or shareholding companies with limited liability (SCLLs). According to the Company Law, introduced in 1994, CLLs are relatively small with a minimum registered capital of 100,000 *yuan* (US$1 = 8.28 *yuan*) and a minimum of two shareholders. By comparison, SCLLs are larger with a minimum required initial capital

[60]Gary H. Jefferson, Inderjit Singh, Junling Xing, and Shouqing Zhang, "China's Industrial Performance: A Review of Recent Findings," in *Enterprise Reform in China: Ownership, Transition, and Performance*, ed. Gary H. Jefferson and Inderjit Singh (New York: Oxford University Press, 1999), 137.

[61]This is partly supported by a study of the effects of the long-term performance contracts on the SOEs. See Mary M. Shirley and Lixin Colin Xu, "Empirical Effects of Performance Contracts: Evidence from China," *Journal of Law, Economics, and Organization* 17, no. 1 (Spring 2001): 168-200.

[62]*Dangqian jixiang zhongda jingji tizhi gaige*, 68-69.

of 10 million *yuan* and a minimum of five shareholders. Only SCLLs may raise funds through initial public offering (IPO) and stock market listing. However, the Company Law makes an exceptional provision for a small number of solely state-owned companies to be incorporated.

It was expected that, in the reformed multi-shareholder structure, since the state is only one of a number of shareholders, any government department that represents the state on a board of directors would not be able to dictate decisions. This would have the combined effects of reducing government interference in enterprise affairs and strengthening enterprises' incentives to maximize profits. It was also hoped that the diversified ownership structure would enhance monitoring and harden budget constraint, leading to better performance. On the other hand, with limited liability, the state would no longer have to be infinitely responsible for the enterprises' losses.[63]

Until 1997, however, corporatization remained experimental, mainly among a small number of selected SOEs. This was changed by the following decisions of the Fifteenth Party Congress in 1997: (1) public ownership should remain the mainstay of the Chinese SME, but may take multiple forms, including *gufenzhi* companies; (2) dominance of the public sector does not imply dominance in all economic activities; rather, the public sector has to be in control of "strategically important sectors"; and (3) a three-year campaign was to be launched to fundamentally transform the performance of the large- and medium-sized SOEs (LMSOEs) through the introduction of a set of coordinated measures, especially corporatization.[64]

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[63]Chen Qingtai, "Modern Enterprise System," in *Dangqian jixiang zhongda jingji tizhi gaige*, 159-77; and Dong Fureng, "Carefully Nurture the Stock Market," *Renmin ribao* (Overseas edition), March 3, 1999, 8.

[64]Jiang Zemin, "Zai Zhongguo gongchandang di shiwuci daibiao dahui shang de baogao" (Report to the CCP's Fifteenth Congress), in *1998 Zhongguo fazhan baogao* (China development report 1998), ed. National Bureau of Statistics (Beijing: Zhongguo tongji chubanshe, 1998), 3-21; State Council Economic Restructuring Office (SCERO), *Zhongguo jingji tizhi gaige nianjian 1999* (Yearbook of China's economic restructuring 1999) (Beijing: SCERO, 1999), 218-24; and Institute of Industrial Economics, Chinese Academy of Social Sciences (CASS), *Zhongguo gongye fazhan baogao* (Report on China's industrial development) (Beijing: Jingji guanli chubanshe, 1999), 352.

The specific goals of the campaign were to incorporate a majority of the LMSOEs and to end loss-making in some 6,000-plus LMSOEs by the end of 2000.[65] The focus on the LMSOEs followed the decision by the Fourth Plenum of the CCP's Fourteenth Central Committee in 1995 to concentrate on the reform and enhancement of this part of the state sector while letting go the smaller SOEs,[66] which appears to have been informed at least partly by the results of a study by the State Asset Management Bureau (國有資產管理局) in 1995. The study concluded that the one thousand largest SOEs accounted for a lion's share of the state sector's total assets and sales value, and that they performed much better than the rest of the state sector in terms of generating profits and tax revenues.[67] In essence, the campaign is underpinned by the belief that corporatization could revitalize a large number of LMSOEs.

The campaign also included several other policy measures, including expanded scope for mergers and bankruptcy, more subsidized loans for technical upgrading, making the stock market to "help,"[68] and adopting the much-debated idea of converting the debts owed to state-owned banks by selected SOEs into equities held by the state.[69]

The debt-to-equity swap involves the takeover of SOEs' debts by four fully state-owned financial asset management companies (AMCs) established in 1999, one to work with each of the four state-owned commercial banks. The swap is financed by long-term public borrowing.[70] By

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[65]Sheng Huaren (盛華仁), "A Report on the Progress of the Reform and Shaking-off Difficulties among State-Owned Enterprises" (Speech to the nineteenth meeting of the Standing Committee of the Nineth National People's Congress on December 27, 2000), in *Zhongguo jingji tizhi gaige nianjian* (2001), 42.

[66]*Zhongguo jingji tizhi gaige nianjian* (1999), 122.

[67]See Hu, *Zhongguo shehui zhuyi shichang jingji yanjiu*, 285.

[68]This is a direct translation of the government's own expression "*bangzhu*" (幫助), referring mainly to taking advantage of the stock market to raise finance for the reformed SOEs, but also improving the SOEs' governance.

[69]*Zhongguo qiye guanli nianjian 2000* (China enterprise management yearbook 2000) (Beijing: Qiye chubanshe, 2000), 285.

[70]Huisheng Yang, "Banking Reform: The Continuing Challenge of Creating Sound Commercial Banks," in *Financial Reform in China: Bridging the Gap between Plan and Market*, ed. Henk van Gemert (Maastricht: Shaker, 2001), 101.

mid-2001, the four AMCs had taken over a total of 1,393.9 billion *yuan* of nonperforming loans from the state-owned commercial banks,[71] equivalent to 55 percent of China's total inward FDI stock in 1999.[72] As a result of the swap, SOEs' debts to state-owned banks have been effectively transferred to the government. Furthermore, in early 2004, the central government also used US$45 billion of China's large foreign exchange reserves to write off nonperforming loans from two state-owned commercial banks, namely the Bank of China and the Bank of Construction.[73] Nevertheless, by the end of 2004 nonperforming loans from the four state-owned commercial banks still officially accounted for 15.6 percent of total outstanding loans, compared with 4.9 percent from the shareholding commercial banks.[74]

The impact of the corporatization program is considerable according to a recent study. First, the number of state industrial enterprises, defined as those either owned or majority-controlled by the state, fell from 118,000 in 1995 to 41,100 in 2002. Second, as of 2002, 11,676 state industrial enterprises (28.4 percent) were registered as corporations. Even more significantly, these corporations produced more than 60 percent of the state industrial sector's gross output. Third and finally, the number of people employed in the state industrial sector declined steadily from a peak of 44.98 million in 1993 to 15.46 million in 2002.[75] By the end of 2005, the number of state industrial enterprises had further fallen to 27,477, and the number of employees to 12.91 million.[76]

In what follows, we will attempt to assess how the government's support for the state sector has affected its handling of the stock market and the corporatization process, and how these have in turn impacted on the

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[71] *Renmin ribao* (Overseas edition), November 29, 2001.

[72] The total stock in 1999 was US$306 billion. See the United Nations, *World Investment Report 2000: Cross-Border Mergers and Acquisitions and Development* (New York and Geneva: United Nations, 2000), Annex B, 297.

[73] *Renmin ribao* (Overseas edition), November 29, 2004, 1.

[74] Ibid., January 14, 2005, 2.

[75] Zhang, "The Roles of Corporatization and Stock Market Listing," 2032, 2036-37.

[76] *Zhongguo tongji nianjian* (2006).

development of the stock market, the SOEs, and Chinese industry as a whole.

*Government manipulation of the stock market and its consequences*: China's stock market was born at the beginning of the 1990s, with stock exchanges opening first in Shanghai in 1990 and then in Shenzhen in 1991. For most of the 1990s, stock market listing was subject to strict ceiling controls and administrative allocation of quotas (regarding the number of shares to be issued, the amount of capital to be raised, and the number of companies to be listed). Explicit priority for stock market listing has been given to former SOEs, especially the larger ones.[77] Particularly since 1997, as an important part of the three-year campaign to strengthen the SOEs, priority for listing has been given to three categories of SOE: (1) the 100 enterprises experimenting with MES at central level; (2) the 120 (as of 1997) enterprises that were experimenting with enterprise groups (企業集團, *qiye jituan*, or conglomerates); and (3) the 520 (as of 1997) designated key-point SOEs.[78]

Consequently, the stock market has been dominated by former SOEs. It is estimated that, by the end of 2000, half of all the SOEs in the above-mentioned three categories had been listed.[79] By comparison, the chances of non-state enterprises gaining stock market listing are extremely small. For instance, TVEs only represented 4.1 percent of the total number of listed companies in 1999.[80] As of October 2002, of the 1,216 companies listed on either the Shanghai or Shenzhen stock exchanges, only 82 were privately-owned. Apart from a hundred or so collectively-owned enterprises, all the rest were SOEs.[81]

Moreover, through the device of a distinction between tradable and non-tradable shares, the state has so far retained control of most listed

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[77] According to Clause 51 of the Securities Law, an SCLL seeking stock market listing must have a minimum of 50 million *yuan* of equity capital.

[78] *Zhongguo gongye fazhan baogao* (1998), 47.

[79] Zhang, "The Roles of Corporatization and Stock Market Listing," 2035.

[80] *Zhongguo qiye guanli nianjian* (2000), 290-91.

[81] *The Economist*, October 12-18, 2002, 12.

SOEs. Only tradable shares are offered to the public and openly traded on the stock market, while non-tradable shares are retained by the state and various institutions, mostly SOEs, as legal persons. As of 2002, state shares and legal person shares accounted for 39.0 percent and 25.4 percent, respectively, of all shares of listed companies. In this way, 80 percent of all listed companies were ultimately state-controlled.[82]

Coupled with the lack of investment opportunities elsewhere in the financial system, the tightly controlled supply of tradable shares for a time created an extremely strong sellers' market, which served as a fertile ground for rent-seeking activities. Companies quickly learned that getting to and staying on the stock market was a most lucrative business. In order to fulfill the requirements of the Securities Law that an enterprise seeking public listing must have a minimum of three-year's operational history and that either itself or its predecessor must have been profitable in the last three financial years, many companies have resorted to dubious measures, ranging from pro-forma accounting to outright fraud. The well-known case of Yinguangxia (銀廣夏製藥廠) is an illustration of this phenomenon.[83] Indeed, the listed companies and their parent SOEs proved to be very adept at "playing" the stock market. They made spectacular deals by shifting assets and profits around, often just in time to save a listed company from ejection. Indeed, such practices were so prevalent that misguided small investors speculated heavily on these so-called "capital restructuring" shares.

Given cases like Enron, it might be argued that misinformation is common practice in the market place. There is, however, one fundamental difference: in China, most of the listed companies that cheated were state-controlled SCLLs, whose parent companies were often government departments with important regulatory responsibility.[84] Moreover, the cheating

[82]*Shanghai zhengquan bao* (Shanghai Securities News) and National Information Center, *2002 shangshi gongsi nianbao baogao* (2002 annual report on listed companies), chap. 6, at http://www.cnstock.com/ssnews/2003-05-26/default.htm (accessed May 26, 2003).

[83]The company reported a net profit of 417 million *yuan* (US$50 million) in 2000, rather than a loss of 150 million *yuan*, as was actually the case according to official investigations. See *The Economist*, March 23-29, 2002, 91.

[84]For an insider's account, see Zhang Yujun, "The PRC Securities Market: An Overview of

is frequently committed with the explicit knowledge, and indeed cooperation, of other government departments, all in the spirit of "helping" the state sector. For example, in the case of Daqing Petrochemical (大慶石化), the fraud involved backdating the company's registration record three years, implicating government departments at both the provincial and municipal levels.[85] This illustrates the extraordinary inadequacy of the government's role as an unbiased market regulator.

For a time, the stock market worked wonderfully for the government. It was extremely responsive to government policy measures. For example, as part of the three-year campaign, the government doubled its share quotas in 1997, which more than tripled the total amount of funds raised from the stock market. When the market looked weak, a few encouraging words from officials or a slight relaxation of control seemed to be all that was needed to make the market bounce back again. This explains why the Chinese stock market is sometimes described as a *zhengce shi* (政策市, literally policy-led market). Indeed, the market expanded enormously in the late 1990s (see table 1 and figure 1). Particularly in 2000, the year in which the three-year campaign reached its climax, the value of the Chinese stock market rose by some 45 percent, topping the global league table of stock markets. In that year, listed companies managed to raise an impressive total of 210 billion *yuan* (i.e., a third of the total in the 1990s), of which more than 154 billion *yuan* (73.3 percent) was raised in the domestic market.

It should be acknowledged that the government has since 1999 experimented with a reduction in its holdings in listed companies.[86] However, combined with a string of bad press reports about listed companies and their parent companies, the proposal in mid-June 2001 by the State Council

Its Regulatory Capability and Efficiency" (Paper presented at the International Conference on China Financial Sector Reform, JFK School of Government, Harvard University, 2001). Zhang was president of the Shenzhen Stock Exchange at the time. Full text is available at http://www.ksg.harvard.edu/cbg/FinSectConfpapers/.

[85]*Renmin ribao* (Overseas edition), March 2, 2002, 7.

[86]See *The Economist*, February 2-8, 2002, 79, for an interesting discussion of this.

**Table 1**
**Expansion of the Chinese Stock Market**

| Year | Shares[a] issued (100m) | Total amount raised[a] (100m *yuan*) | Funds raised at home[b] (100m *yuan*) | Weight of funds raised at home (%) |
|---|---|---|---|---|
| 1991 | 5 | 5 | 5 | 100 |
| 1992 | 20.75 | 94.09 | 94.09 | 100 |
| 1993 | 95.79 | 375.47 | 314.54 | 83.8 |
| 1994 | 91.26 | 326.78 | 138.05 | 42.2 |
| 1995 | 31.60 | 150.32 | 118.86 | 79.1 |
| 1996 | 86.11 | 425.08 | 341.52 | 80.3 |
| 1997 | 267.63 | 1,293.82 | 933.82 | 72.2 |
| 1998 | 105.56 | 841.52 | 803.57 | 95.5 |
| 1999 | 122.93 | 944.56 | 897.39 | 95.0 |
| 2000 | 512.03 | 2,103.08 | 1,541.02 | 73.3 |
| 2001 | 141.48 | 1,252.34 | 1,182.13 | 94.4 |
| 2002 | 291.74 | 961.75 | 779.75 | 81.1 |
| 2003 | 281.43 | 1,357.75 | 823.10 | 60.6 |
| 2004 | 227.92 | 1,510.94 | 826.87 | 57.1 |
| 2005 | 567.05 | 1,882.51 | 338.13 | 18.0 |
| **Total** | **3,948.28** | **13,525.26** | **9,173.87** | **67.8** |

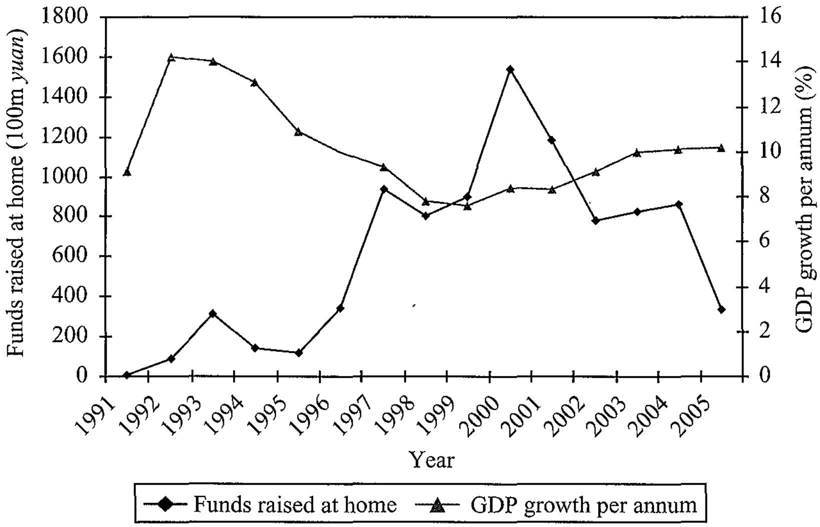
**Notes:**
[a]Includes shares issued both inside and outside China.
[b]Includes A shares and B shares.

**Source:** *Zhongguo tongji nianjian* (2006).

to dispose of the state's holdings at current market prices caused a panic in the market, as investors anticipated a large fall in share prices. In the next twelve months, share prices fell so sharply (at one point by a third) that the government was compelled to scrap the entire plan in 2002.[87] Despite this, the predominance of poorly-performing SOEs in the stock market and uncertainty about non-tradable shares dampened the enthusiasm of small investors to such an extent that the Chinese stock market was de-

[87]*Renmin ribao* (Overseas edition), June 25, 2002, 1.

**Figure 1**
**Trend of the Stock Market and Economic Growth in China**




**Source:** *Zhongguo tongji nianjian* (2006).

pressed for the next four years. Share indices of the Shanghai and Shenzhen stock exchanges in February 2005 were 40-50 percent lower than their levels in June 2001.[88] The Chinese stock market was the worst-performing market in the world in both 2003 and 2004 despite rapid economic growth.[89] According to Chinese data, the share index of the Shanghai Stock Exchange fell by 55 percent between its peak in June 2001 and June 2005.[90] The government was understandably alarmed by the fact that the stock market was gradually losing its capital-raising ability.

In order to rejuvenate the stock market, the government began experimenting with a new scheme (股權分置, *guquan fenzhi*) in May 2005

[88]*The Economist*, February 26-March 4, 2005, 81.
[89]*The Economist*, February 8, 2005, 90. Also see figure 1.
[90]http://news.xinhuanet.com/stock/2005-06/03/content_3040736.htm (accessed May 26, 2006).

that was aimed at tackling the imbalance between tradable and non-tradable shares and the rights of associated shareholders.[91] Recognizing that making non-tradable shares tradable would bring share prices down and therefore further harm the interests of the minority tradable shareholders, the government required listed companies or their majority (non-tradable) shareholders to compensate the minority (tradable) shareholders for gaining the right to trade. A range of compensatory options were offered, including gift shares, (non-tradable) share cancellation, share options, and cash distribution.[92] By April 2006, 793 listed companies, accounting for 57.6 percent of the total number of limited companies and 66.4 percent of total capitalization, had either initiated or completed this reform. On average, tradable shareholders gained 2.97 shares for every 10 shares they held as a result of *guquan fenzhi*. However, since non-tradable shares accounted for on average two-thirds of the total shares in Chinese listed companies, this reform could only reduce state shareholding by about 10 percentage points. Therefore, the state's majority shareholding position is still protected. Although the stock market made a rapid recovery, its future is by no means assured. The fact that only 33.8 billion *yuan* was raised in the domestic market in 2005, or 18.0 percent of the total (see table 1), is indicative of the depth of the problem.

*Effects on the SOEs—ownership*: Unsurprisingly, the SOEs have resisted the pressure of ownership diversification under corporatization. This appears to have been made possible by the exceptional provision in the Company Law that permits the existence of solely state-owned CLLs (SSOCLLs). Rather than being an exception as the Company Law clearly intends, this mode has been widely adopted, especially among the largest SOEs, as powerful government departments at different levels have sought to protect their own interests. A well-established mode of operation is

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[91]On September 4, 2005, the China Securities Regulatory Commission issued rules governing this reform, entitled "Shangshi gongsi guquan fenzhi gaige guanli banfa" (Methods governing the reform of shareholding rights of listed companies). http://www.csrc.gov.cn/cms/upload (accessed May 26, 2006).

[92]http://news.xinhuanet.com/stock/2005-06/23/content_3123689.htm (accessed May 26, 2006).

to set up an SSOCLL, which would then act as a holding company that controls numerous CLLs and SCLLs. Zhang found that, while on average only 1.34 percent of the converted SOEs adopted sole state ownership, as large a proportion as 13.75 percent of the largest SOEs (with 5,000-plus employees) did so.[93] Nevertheless, as a result of corporatization, the state conceded majority control in 37 percent of corporatized SOEs in a nationwide sample.[94]

The emphasis on retaining sole control over larger SOEs is consistent with the government's policy of retaining control over important industries. Following the decision of the Sixteenth Party Congress in 2002, a new system of managing the SOEs has emerged. This essentially involves the establishment of centralized control, in the shape of a newly-installed China State Assets Supervisory Commission (CSASC, 國有資產監督管理委員會), over initially 196 large SOEs (both commercial and industrial) and the devolution of the remainder to subnational control.[95] Significantly, in early 2005, the CSASC indicated that any central enterprise under its supervision would have to undergo further restructuring if it was not among the top three enterprises in its industry.[96] Therefore, contrary to the requirement of promoting competition, the larger Chinese SOEs are not being broken up, but are being made more powerful. This is supposed to serve the purpose of nurturing between thirty and fifty internationally competitive Chinese corporations. Scholarly opposition, based on limiting market power, voiced by such eminent economists as Wu Jinglian (吳敬璉), has so far been ignored.

*Effects on the SOEs—corporate governance*: Related to the above, the evidence is that corporate governance among SOEs has not been

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[93] Zhang, "The Roles of Corporatization and Stock Market Listing," 2037.

[94] Yi-min Lin and Tian Zhu, "Ownership Restructuring in Chinese State Industry: An Analysis of Evidence on Initial Organizational Changes," *The China Quarterly*, no. 166 (June 2001): 305-41.

[95] See Zhang, "The Roles of Corporatization and Stock Market Listing," 2045. The reported number of so-called central enterprises had fallen to 181 by the beginning of 2005. See *Renmin ribao* (Overseas edition), January 1, 2005, 2.

[96] *Renmin ribao* (Overseas edition), January 1, 2005, 2.

strengthened in any fundamental manner due to limited ownership diversification and continuing soft budget constraint. This is despite the fact that formal organizational structures have been widely adopted as a result of corporatization.[97]

Among the listed companies, the dominance of the non-tradable shareholders has had several adverse effects. First, takeover bids through the stock market are largely precluded, which renders the stock market powerless to discipline managers.[98] Second, outside shareholders, mostly individual investors, have had little influence. As a result, the state and its representatives from different government departments still dictate enterprise affairs. Thus the appointment of senior management in listed companies still follows the traditional route, emphasizing political trustworthiness rather than professional skills. One reflection of this is that in 2001, more than 60 percent of all enterprise managers of listed companies did not hold any shares in the companies they managed.[99]

Budget constraint on LMSOEs has not hardened for several reasons. First, the stock market has generated large sums of equity capital for SOEs, which is inherently less constraining than debts. If funds raised through overseas offering and listings are included, Chinese enterprises had raised a total of 1,352.526 billion *yuan* (or US$165.979 billion) by the end of 2005 (see table 1). In the peak year 2000 alone, stock market listing raised 210.3 billion *yuan*. Assuming that 80 percent of this flow went to the SOEs, this would have generated 168.2 billion *yuan*, or 36.7 percent of the total investment in fixed assets (IFA) for the state industrial sector that year.

The second reason is that the slow pace of reform in the banking sector means that, by and large, debts are no more constraining than they used to be. This is manifested in the fact that, during 2001-03, domestic

[97]For details, see Zhang, "The Roles of Corporatization and Stock Market Listing," 2040.

[98]Limited transfer of the non-tradable shares did take place, but only with strict government approval, to predetermined buyers and outside the stock market. Between April 1993 and September 1999, deals on non-tradable shares were conducted for only seventeen listed companies. See *Renmin ribao* (Overseas edition), June 9, 2001.

[99]*Renmin ribao* (Overseas edition), June 8, 2002 (China capital market weekly page).

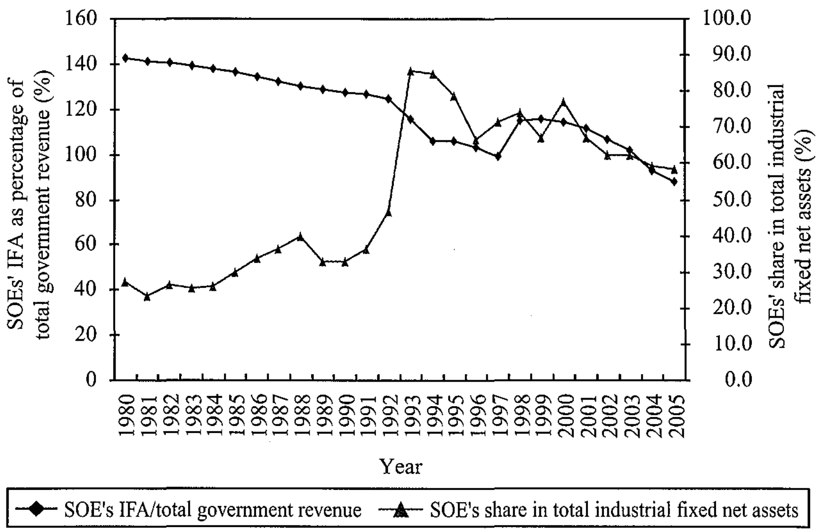
bank loans accounted for 24.6 percent of the IFA of SOEs, compared with less than 11 percent for collectively-owned enterprises and 18 percent for other enterprises (see Appendix). Finally, the debt-to-equity swap implemented in the late 1990s and early 2000s represented a very significant loosening of budget constraint.

As a matter of fact, the drive since the late 1990s to strengthen the LMSOEs has reversed the progress that had been made over the previous decade. The last few years have witnessed the reversal of a long-term trend in the financing of IFA in the SOEs, namely declining reliance on state appropriations and increasing contributions from self-raised funds and foreign investment (see Appendix). The fact is that the contribution of state appropriations declined steadily from 26.5 percent in 1985 to 4.6 percent in 1996, but rose after this to 14.2 percent in 2002 (it fell to 10.4 percent in 2003). In contrast, the contribution of self-raised funds rose from 40.4 percent in 1985 to 52.9 percent in 1997, but dropped to 47.8 percent in 2002 (it rose to 50.7 percent in 2003).[100] Given the huge amount of funds raised from the stock market, which count as self-raised funds, these changes can only suggest that, since the late 1990s, the state sector's reliance on government grants and subsidized domestic bank loans has increased, and its capacity to generate internal funds and attract foreign investment has diminished.

In public finance terms, the post-1993 era marks a fundamental change in the financing of the state sector: this sector has become much more reliant on debts and equities than government grants and subsidies. As figure 2 shows, since 1993, IFA in the state sector has become nearly as big as, if not bigger than, the government's total revenue every year, a pattern totally unprecedented. This indicates that through the helping hand of government policies such as privileged access to the stock market and bank loans, the state sector has been enabled to take advantage of the monetization of the economy. The question is whether this is justified economically.

[100]The weight increased momentarily in the early 1990s as a consequence of the government's recentralization drive following the 1989 political unrest.

**Figure 2**
**SOEs' Decline and the Socialization of Their Finance in China**




**Sources:** SOEs' IFA series: Department of Investment and Construction Statistics, National Bureau of Statistics, *Zhongguo guding zichan tongji shudian 1950-2000* (Statistics on fixed assets of China 1950-2000) (Beijing: Zhongguo tongji chubanshe, 2002) for 1980-2000; and *Zhongguo tongji nianjian* (2002, 2003, and 2006) for rest of the IFA series and the series on SOEs' share in total industrial fixed net assets.

*Effects on the SOEs—economic performance*: The government claims that the three-year campaign had great beneficial effects. According to Sheng Huaren, head of the State Council's Commission for Economy and Trade, by October 2000, of the 6,599 targeted SOEs (including those SCLLs with controlling state equity), 4,098 enterprises (62.5 percent) were no longer loss-making, although some of them had simply been closed down or taken over by others. He estimated that by the end of 2000, 65 percent of the targeted LMSOEs would have shaken off loss-making status.[101] Government supporters could also point to the fact that, after a dip from

[101]Sheng, "A Report on the Progress of the Reform," 41-48.

80.5 billion (47.3 percent of the national total) in 1997 to 52.5 billion (36.0 percent of the national total) in 1998, total profits of state-owned or state-controlled industrial enterprises climbed to 651.975 billion *yuan* in 2005 (44.01 percent of the national total).[102] Moreover, as far as financial performance is concerned, the gap between state industry and non-state industry, measured by profits as a percentage of total capital (i.e., net fixed asset value plus average circulating capital), has narrowed from 31.9 percent in 2003 to 7.6 percent in 2005.[103]

However, caution is required here for a number of reasons. First, given the massive recapitalization and layoff described above, some improvement is to be expected. Indeed, it was indicated by Sheng Huaren himself that 80 percent of the SOEs designated for the debt-to-equity swap would immediately shake off loss-making as a result of the swap.[104] Second, despite some signs of overall improvement, the performance of the state sector as a whole remains poor. As of 2000, for which the latest comparative data are available, 36.4 percent of the traditional SOEs and 34.1 percent of the state sector as a whole were making losses, compared with 15.9 percent for collectively-owned enterprises (COEs), 26.4 percent for foreign-invested enterprises (FIEs), and 12.6 percent for domestic private enterprises.[105] The situation in 2002 was similar: the incidence of loss-making was 35.27 percent among SOEs, 15.04 percent among COEs, and 25.91 percent among FIEs.[106]

Even more importantly, a study of large and medium-sized industrial enterprises (LMIEs) by Jefferson and others finds that although the shareholding groups had relatively high levels of sales profitability, they had the slowest growth of material factor productivity over 1996-99.[107] The

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[102]*Zhongguo tongji nianjian* (2006), parts 14-1 and 14-8.

[103]This is calculated using Zhang's formula. See Zhang, "The Roles of Corporatization and Stock Market Listing," 2044. The peak was 81.9 percent in 1998.

[104]Sheng, "A Report on the Progress of the Reform," 44.

[105]*Zhongguo gongye tongji nianjian* (2001), 48.

[106]See Zhang, "The Roles of Corporatization and Stock Market Listing," 2043.

[107]Gary Jefferson, Albert G. Z. Zhu, Xiaojing Guan, and Xiaoyun Yu, "Ownership, Perfor-

**Table 2**
**The Top Five Profit-earners in State Industry, 2001-2005**

| Category | 2001 | 2003 | 2005 |
|---|---|---|---|
| Total gross profits in state industry (%) | 100 | 100 | 100 |
| Coal mining and dressing | | | 5.14 |
| Petroleum and natural gas extraction | 38.8 | 30.0 | 42.1 |
| Tobacco processing | 7.4 | 7.1 | 6.2 |
| Smelting and pressing of ferrous metals | 6.4 | 11.0 | 10.4 |
| Transport equipment | 8.2 | 13.4 | |
| Electric power, steam, and hot water | 19.5 | 13.9 | 15.1 |
| **Subtotal** | **80.3** | **75.3** | **78.9** |

**Sources:** NBC, *Zhongguo tongji nianjian* for 2002, 2004, and 2006.

authors also noted that the SOEs were much less inclined to export and tended to make profits in areas where the state sector dominates. This raises the possibility that the state sector may have been able to improve its financial performance despite continued inefficiency, partly by exploiting market power in certain industries.

There is at least *prima facie* evidence to support this hypothesis. Between 2001 and 2005, five sectors alone accounted for more than three-quarters of state industry's total profits, with four of them remaining roughly the same each year. The four constant earners were petroleum and natural gas extraction, tobacco processing, smelting and pressing of ferrous metals, and production and supply of electric power and heat (see table 2). Significantly, these are typical industries whose market structure is characterized by imperfect competition and monopoly.[108] Moreover, if this hypothesis is proved to be true by future studies, it would mean that profitability is no longer a meaningful criterion for judging the performance of SOEs in the context of China.

mance, and Innovation in China's Large- and Medium-Size Industrial Enterprise Sector," *China Economic Review* 14, no. 1 (Summer 2003): 89-113.

[108]Paul A. Samuelson and William D. Nordhaus, *Economics*, 15th edition (New York: McGraw-Hill, 1995), 152.

*Macroeconomic Impact*

Coupled with the largely SOE-serving banking system, the government's manipulation of the stock market has ensured a continuous inflow of financial resources to the state sector. More crucially, there appears to be a direct link between the state industrial sector's orientation and the Chinese economic model that the state fosters through its monetary and fiscal policies. To put it simply, this model is characterized by continuous massive investment in fixed assets, which is in turn supported by high savings ratios and state control over interest rates and the external capital account. However, this is accompanied by rapidly falling marginal returns on capital, indicating considerable investment inefficiency at the macroeconomic level. Official statistics show that China's coefficient of investment in fixed assets declined from 0.62 in the first half of the 1990s to 0.23 in the second half of the decade.[109]

Nevertheless, due to the state sector's diminished capacity to reinvest, its share of IFA has declined (see figure 2). The increase from 1998 onwards in the state sector's share of total industrial fixed net assets (FNAs) is interesting and needs to be explained. It is the combined effect of two principal factors. The first factor is artificial: from 1998 onwards, statistics on total FNAs cover only SOEs and those non-SOEs that have an annual sales value of five million *yuan* or more, which inflates the share of the state sector. The recapitalization that took place during the three-year campaign is the other key factor.

Moreover, as shown in tables 3 and 4, the state sector's share of the total number of industrial enterprises fell from 32.8 percent in 2000 to 10.1 percent in 2005, while their contribution to gross industrial output value (GIOV) declined from 47.3 percent to 33.3 percent. By comparison, the private sector (domestic private sector plus foreign-invested enterprises) has seen its share rise from 31.1 percent to 66.2 percent in terms of number

[109]See Department of Investment and Construction Statistics, National Bureau of Statistics of China, *Statistics of Investment In Fixed Assets of China (1950-2000)* (Beijing: Zhongguo tongji chubanshe, 2002), 14.

**Table 3**
**Distribution of Chinese Industry[a] by Number of Enterprises**

| Group | 2000 (%) | 2001 (%) | 2002 (%) | 2003 (%) | 2004 (%) | 2005 (%) |
|---|---|---|---|---|---|---|
| All | 100 | 100 | 100 | 100 | 100 | 100 |
| Domestic | 82.5 | 81.7 | 81.0 | 80.3 | N.A. | N.A. |
| Of which: | | | | | | |
| State-controlled | 32.8 | 27.3 | 22.7 | 17.5 | 12.9 | 10.1 |
| Collectively-owned | 23.2 | 18.1 | 15.1 | 11.5 | N.A. | N.A. |
| Private enterprises | 13.6 | 21.1 | 27.1 | 34.5 | 43.2 | 45.5 |
| Others | 12.9 | 15.1 | 16.1 | 17.0 | N.A. | N.A. |
| Foreign | 17.5 | 18.3 | 19.0 | 19.7 | 20.7 | 20.7 |

[a]Includes SOEs and those non-SOEs with annual sales value of 5 million *yuan* or more.

**Sources:** National Bureau of Statistics, *Zhongguo tongji nianjian* for 2003, 2004, and 2006. N.A. = data not available.

**Note:** Foreign-funded enterprises include those with investment from Hong Kong, Macao, and Taiwan as well as from foreign countries.

**Table 4**
**Distribution of Chinese Industry by Gross Industrial Output Value (GIOV)**

| Group | 2000 (%) | 2001 (%) | 2002 (%) | 2003 (%) | 2004 (%) | 2005 (%) |
|---|---|---|---|---|---|---|
| All | 100 | 100 | 100 | 100 | 100 | 100 |
| Domestic | 72.6 | 71.5 | 70.7 | 68.8 | N.A. | N.A. |
| Of which: | | | | | | |
| State-controlled | 47.3 | 44.4 | 40.8 | 37.5 | 34.8 | 33.3 |
| Collectively-owned | 13.9 | 10.5 | 8.7 | 6.6 | N.A. | N.A. |
| Private enterprises | 6.1 | 9.2 | 11.7 | 14.7 | 17.4 | 19.0 |
| Others | 5.3 | 7.3 | 9.5 | 9.9 | N.A. | N.A. |
| Foreign | 27.4 | 28.5 | 29.3 | 31.2 | 32.7 | 31.7 |

**Note:** Definitions and sources: Sames as for table 3. **N.A.** = data not available.

of enterprises, and from 33.5 percent to 51.7 percent by GIOV.[110] Even more significantly, one study (using data up to 1999) concluded that, by 2000, half of China's LMIEs would probably no longer be under the control of the state.[111] Indeed, one newspaper reported that in 2005, only 220 of the largest 500 Chinese manufacturing enterprises, measured by principal business revenue, were owned or controlled by the state.[112]

It is notable that collectively-owned enterprises have registered an even faster decline than those in the state sector by various measures. From 2000 to 2003, the share of collectively-owned enterprises declined from 23.2 percent to 11.5 percent in terms of number of enterprises, and from 13.9 percent to 6.6 percent in terms of GIOV (see tables 3 and 4). This contrasts with the experience in the 1980s when the numerous TVEs constituted the most dynamic part of the Chinese economy and made a key contribution to China's rapid economic growth, providing competition for SOEs.[113]

So why have the COEs declined since the late 1990s? The answer is likely to be varied and complex, and therefore cannot be fully explored here. Nevertheless, it is useful to remind ourselves of the causes of the TVEs' earlier success. According to Putterman, in the 1980s, the COEs had greater maneuverability and sharper incentives than SOEs on the one hand, and superior access to funds and inputs as compared to private enterprises on the other.[114] Since the 1990s, however, the balance has shifted. The collective sector has been squeezed between an expanding private sector (in the products market) and the struggling state sector (in the capital market).

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[110]Indeed, it should be acknowledged that official statistics, such as those in tables 3 and 4, understate the true size of the private sector. This is because these statistics only cover those non-state enterprises whose sales value is 5 million *yuan* or more.

[111]Jefferson, Zhu, Guan, and Yu, "Ownership, Performance, and Innovation," 97.

[112]*Renmin ribao*, August 21, 2006, 1.

[113]See, for example, Newbery, "Transformation in Mature versus Emerging Economies," 96-97.

[114]Louis Putterman, "On the Past and Future of China's Township and Village-Owned Enterprises," *World Development* 25, no. 10 (October 1997): 1639-55.

## Conclusion

This article represents a preliminary effort to examine the relevance of the Chinese SME to market socialism. It is apparent that the Chinese SME has features that cross-cut both the fourth and fifth generations of MS. These include, on the one hand, insistence on dominant public ownership, the political predominance of the Communist Party, and persistent soft budget constraint. On the other hand, there has been large-scale corporatization, rapid expansion of the equity market, selective retreat of the SOEs to a small number of capital- and regulation-intensive industries, and the decline of the once dynamic collective sector.

In relation to the three principal challenges during the transition to market socialism, as identified in the beginning of this article, the well-orchestrated three-year campaign failed to fundamentally resolve the agency problem among the SOEs in order to improve their performance and stem their decline. Meanwhile, the related policy measures have caused serious damage to both the nascent stock market and the collective sector, including the once dynamic TVEs. Moreover, preoccupation with the state sector has prevented the state from more readily promoting competition and establishing market-enabling institutions. Indeed, it is possible that, by sheltering LMSOEs in industries with limited competition, the state is causing considerable inefficiency across the economy. As a result, competition is curtailed in the domestic market, especially in industries where the state sector still dominates. The role of the market (e.g., the stock market) in optimizing resource allocation is also subdued. And taxpayers will have to bear the cost of the inefficient SOEs for many years to come. This suggests that the Chinese SME not only falls short of realizing the aspiration of MS in terms of inequality, but also suffers from a fundamental contradiction between the political objective of maintaining a dominant state sector and the economic imperative of introducing a full-fledged competitive market economy.

So what implications does the Chinese experience hold for the debate on the viability of MS? One of the most intriguing questions in the case of China is the political implication of public ownership for the incumbent party-state and why one-party-dominated public ownership is inimical to competition in the real world, and how these questions have affected the CCP's handling of public ownership in China.

The evidence presented in this article suggests that the Chinese party-state has found it necessary to improve at least the financial performance of the SOEs, and has achieved some success. In this undertaking, while the party-state continues to apply soft budget constraint in the form of subsidized loans, the writing-off of nonperforming loans, and so on, it has also made use of less traditional and less tractable macroeconomic tools, including financial suppression and privileged access to the stock market. Moreover, it has elected to concentrate LMSOEs into a small number of capital-intensive industries, especially in the producer goods sector, which then feed on the investment-driven economic growth model promoted by the state through macroeconomic instruments. By doing so, however, the party-state is slowing down the development of a competitive stock market, dampening competition in the producer goods sector, and generally lowering investment efficiency.

Another dynamic in this relationship is the state's ability to mobilize increased financial resources, as a result of the monetization of the economy as well as economic growth, which has helped finance the restructuring of the ailing state sector. Moreover, the massive downsizing of the state sector that accompanied the *gufenzhi* reform, coupled with the state's expanded financial capacity, has reduced the pressure on the authorities to further downsize the state sector, which could partly explain why under the post-2002 leadership of Hu Jintao, *gufenzhi* reform seems to have stalled. However, it is acknowledged that, with reduced financial pressure and the restructuring of the state sector's industrial profile, there is also real political resistance to further diversifying state ownership, particularly because the remaining unreformed enterprises are more difficult cases.

It may also be asked why China is unable to use *gufenzhi* to solve the agency problem, as a capitalist system can, and what light the evidence in this article can shed on this question. While the extant literature attributes this to the missing owner and the lack of effective monitoring of the monitor through the capital market in an economy dominated by public ownership, the Chinese case shows that the continuing operation of soft budget constraint through both the traditional state-owned banking system and the new stock market, and the growing market power of the LMSOEs, reduce the effects of managerial efficiency. More importantly, though, this article challenges the conventional emphasis on the agency problem in MS discourse, and suggests that it is perhaps just as important, if not more so, to examine the effects of dominant public ownership on allocative efficiency, especially when the incumbent party-state attempts to exploit the SOEs' market power in order to strengthen the state sector.

Finally, this article demonstrates that the Chinese brand of MS in the shape of SME is a self-legitimization exercise that offers little comfort for those committed to MS with dominant public ownership. Bardhan and Roemer once argued that "competitive markets are necessary to achieve an efficient and vigorous economy, but ... full-scale private ownership is not necessary for the successful operation of competition and markets."[115] In the light of China's experience, this argument misses the point: the real question is not whether competitive markets are sufficient to achieve an efficient and vigorous economy, but whether it is possible to build competitive markets without large-scale private ownership. However, there is no need for despair. The Chinese experience also demonstrates that while the state's effort to maintain dominant public ownership is hardly conducive to the smooth development of competitive markets, the market, given a chance, is quite capable of overcoming such dominance.

[115]Bardhan and Roemer, "Market Socialism: A Case for Rejuvenation," 101.

**Appendix**
**Sources of Finance for Investment in Fixed Assets in Chinese Enterprises[a]**

| Enterprises and year | State appropriations | Domestic loans | Foreign investment | SRF | Others |
|---|---|---|---|---|---|
| | | State-owned enterprises | | | |
| 1985 | 26.4 | 23.1 | 2.8 | 40.4 | 7.3 |
| 1992 | 6.3 | 30.4 | 8.0 | 46.5 | 8.7 |
| 1995 | 4.9 | 23.4 | 7.8 | 48.2 | 15.7 |
| 1996 | 4.6 | 23.6 | 6.7 | 50.8 | 14.3 |
| 1997 | 4.7 | 23.0 | 5.1 | 52.9 | 14.3 |
| 1998 | 7.1 | 23.5 | 4.4 | 50.3 | 14.8 |
| 1999 | 10.0 | 24.0 | 3.9 | 47.7 | 14.4 |
| 2000 | 10.8 | 26.1 | 2.5 | 46.9 | 13.7 |
| 2001 | 12.6 | 23.7 | 2.0 | 49.1 | 12.6 |
| 2002 | 14.2 | 24.4 | 2.2 | 47.8 | 11.4 |
| 2003 | 10.4 | 25.7 | 1.6 | 50.7 | 11.6 |
| | | Collectively-owned enterprises | | | |
| 1985 | 1.5 | 37.6 | 0.9 | | 60.0[b] |
| 1992 | 0.1 | 36.7 | 2.6 | 39.8 | 20.8 |
| 1995 | 1.7 | 25.3 | 6.2 | 54.8 | 12.0 |
| 1996 | 1.5 | 21.0 | 8.4 | 56.7 | 12.5 |
| 1997 | 1.8 | 17.6 | 7.2 | 59.7 | 13.9 |
| 1998 | 2.1 | 14.9 | 6.2 | 55.6 | 21.1 |
| 1999 | 5.6 | 13.2 | 4.4 | 63.5 | 13.3 |
| 2000 | 6.5 | 12.1 | 3.9 | 65.6 | 11.8 |
| 2001 | 5.4 | 11.0 | 3.3 | 58.9 | 21.4 |
| 2002 | 6.9 | 10.6 | 4.5 | 68.5 | 9.6 |
| 2003 | 4.2 | 11.4 | 5.0 | 71.6 | 7.8 |
| | | Others | | | |
| 1985 | .. | .. | | 100.0 | .. |
| 1992 | .. | .. | 4.2 | 84.1 | 11.7 |
| 1995 | 0.3 | 12.5 | 20.0 | 57.0 | 10.2 |
| 1996 | 0.3 | 12.5 | 21.2 | 55.4 | 10.6 |
| 1997 | 0.2 | 13.2 | 20.9 | 56.0 | 9.7 |
| 1998 | 0.3 | 14.4 | 18.3 | 52.4 | 14.6 |
| 1999 | 0.5 | 14.4 | 12.3 | 57.9 | 14.9 |
| 2000 | 0.6 | 16.1 | 9.0 | 53.6 | 20.8 |

**Appendix (Continued)**

| Enterprises and year | State appropriations | Domestic loans | Foreign investment | SRF | Others |
|---|---|---|---|---|---|
| | | Others | | | |
| 2001 | 0.6 | 16.7 | 7.8 | 53.8 | 21.1 |
| 2002 | 0.5 | 18.1 | 6.9 | 47.9 | 26.6 |
| 2003 | 0.4 | 19.3 | 6.4 | 50.8 | 23.2 |

a: include both industrial and commercial ones.
b: Includes self-raised funds (SRF).

**Sources:** Pre-1996 from Gary H. Jefferson, Albert. G. Z. Hu, and Inderjit Singh, "Industrial Investment, Finance, and Enterprise Performance in Chinese Industry," in *Enterprise Reform in China: Ownership, Transition, and Performance*, ed. Gary H. Jefferson and Inderjit Singh (New York: Oxford University Press, 1999), table 10.2, 221; 1996 onwards from *Zhongguo tongji nianjian* 1998, 1999, 2000, 2002, 2003, and 2004. Calculated by author.

**Note:** The subtotals in original statistics (1996-2003) do not add up to the recorded total. The percentage shares have been calculated by using the actual sum as the denominator.

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