Privatisation of State and collective SMEs in urban areas

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Abstract:
Since the acceleration of reforms in the State sector in the mid 1990s, attention has been focused primarily on the fate of big companies. Some measures, such as the policy of building 156 groups of international size, the raising of funds on the international stock markets in order to restructure big state companies such as SINOPEC, Petrochina, Baogang (China's biggest steel maker), or the 1998 decision to wipe out the debt of almost 1000 big state companies by re capitalising the four biggest state commercial banks, do indeed mark a sharp break with the reforms implemented during the 1980s. However the principle of *zhuada fangxiao* (keeping the big (State companies) and letting the little ones go) established at the 3rd plenary session of the XIVth central committee of the Chinese Communist Party (CCP), authorising the State to with draw from small and medium-size State enterprises (SMEs) and urban collectives[i], could have more far-reaching consequences for the Chinese economy than the reforms aimed at the big State companies.
Industry and service sectors show in fact relatively low degree of consolidation in China, in comparison with the developed economies, and State and collective SMEs still account for two thirds of employment in urban areas[ii]. This reform affects even more directly the provinces of the Northeast and of the interior, where economic activity is still very largely dominated by the State and collective sector. Moreover, since privatisation is one of the favoured means of restructuring, the reform could lead to profound changes when it comes to the redistribution of property rights and the roles of the State in the local economy.
However, so drastic is the lack of figures and studies at the national level (which are published), that it is difficult to evaluate the extent and the impact of this reform. For example, it is impossible to establish the exact number of State and collective SMEs which have been privatised, much less to find out the stake maintained by the State in partially privatised companies. Studies in Chinese are generally published by local authorities who seek to justify the choices made and the administrative action taken in restructuring State and collective SMEs[iii], and answer only very partially the questions raised above. We will, however, using those publications as well as case studies which we have carried out in various municipalities in China, endeavour to answer, at least partially, some questions linked with the restructuring of urban State and collective SMEs. We will firstly try to define the methods used by local government to reform these companies. We will then seek to answer the thorny question of how many companies have been privatised, and to identify the main beneficiaries of the redistribution of property rights. Finally, we will seek to analyse the efficiency of these reforms when it comes to restructuring companies.

Various kinds of state disengagement

Local governments have resorted to various ways of reforming State and collective SMEs. For example, in the province of Guangxi, between 1993 and 1998, 1,205 state SMEs (about 15% of the total number of SMEs in Guangxi)[iv] were reformed in various ways: 93 were made into joint stock companies in which the state remained the major stakeholder; 222 companies were made into joint stock companies and sold to their workforce in the framework of the so-called co-operative share holding system (*gufen hezuo zhi*); 29 were sold to a Chinese investor (without it being specified whether it was the director of the company, a local investor or one from another province); 44 were merged with another company in the region; 469 were leased (under the *chengbao* system[v]); 30 went into liquidation; and 318 were reformed using other means (without them being specified). In the province of Ningxia, where 97% of companies are SMEs, the provincial government decided in 1996 to reform 603 companies, about 63% of the total number of State SMEs in the region.[vi] In a sample of 379 companies affected by the reform, 121 companies, 32% of the total, were made into joint stock companies in which the State remained the majority stakeholder; 111 companies, 29.3%, were made into joint stock companies and sold to the workforce under the co-operative share holding system; 38 companies, 10.1%, were sold to a home investor (again without stipulating the character of the investor); 77 companies, 20.3%, were merged with companies in the region; and finally, 32 companies, 8.4%, were liquidated. Another example, this time in a more highly developed coastal city, the municipality of Shunde in Guangdong province has implemented since 1992 an ambitious programme to reform its 1,001 State companies. Only 94 remain under the direct ownership of the municipality in infrastructure, certain high technology industries, or those considered to be strategic at the national level. The government maintains a minority interest in another 70 companies.[vii] All the other companies have been sold or leased. Still in the municipality of Shunde, another monograph[viii] describes the reforms of State and collective companies implemented by the local government. In joint foreign-Chinese companies (where the capital of the Chinese part is owned by the local administration), the local authorities have authorised an increase in the share of foreign capital, leading to a control of the capital by the foreign party. As for the big collective companies (3 household goods companies with nationally-known brands, Kelon, Wanjiale, and Meidi), the local authorities encouraged their flotation on the stock market (in Shenzhen and Hong Kong in the case of Kelon). The author of the monograph indicates (without however giving any figures) that many of the companies which have been privatised, have resorted to the system of co-operative share holding (*gufen hezuozhi*). In these companies, the municipality gradually reduced its share of the capital and allowed the workers to resell their stock after two years (mainly to the management teams of the company). In the cases of the most debt-ridden companies, the municipality sought to sell them, using four different methods:

1. Transfer of shares to another company, which then creates a subsidiary, with a ban on making more than 5% of the workforce redundant in the first three years.
2. Transfer of shares to private individuals who are generally the company's managers. They are allowed 5 years to finance the purchase of the company and are given multiple debt reductions.
3. Piece by piece sale of the various assets of the company, which often amounts to a gradual liquidation of the company.
4. Finally in the case of commercial companies, leasing to private individuals according to the inclusive contract system (*chengbao*).

These examples show that the disengagement of the State has happened in various ways. Similarly, on the transfer of management to a private individual (with the State still holding all the company's capital), privatisation has been the principal means of restructuring. Among the various methods of privatisation, certain general principles have been accepted by the central authorities (see Table 1); they have chosen to favour the sale of State shares rather than the free distribution of shares, whether inside the company as in Russia, or outside (to the population as a whole) as in former Tchekoslovakia. The sale of capital to employees (in the form of shares) has in fact been the most widely used method to reform State and collective urban SMEs in difficulties. The various monographs produced in the provinces of the interior[ix] - which we have compared with our interviews in Hubei, Shaanxi and in Liaoning - indicate that this method has been applied in almost a third of State and collective urban SMEs affected by the reforms (which amounts to much less if one refers to the total number of State and collective companies). The first experiment on a large scale, and which had comprehensive media coverage, took place in Zhucheng in 1994, in a small city in the province of Shandong, where 210 State and collective companies (out of a total of 288) were privatised.[x] This kind of share holding was extended to all the cities in China in the wake of the XVth Congress of the CPC in the autumn of 1997.

Although less frequently used than co-operative share holding, another method has consisted of totally privatising the capital of companies by auctioning it off in the centres for the sale and exchange of State assets (*guoyou zichan jiaoyi zhongxin*), which have been set up in all the larger municipalities. Total privatisation, accompanied by sale of the capital to investors outside the company, has mostly involved companies with heavy debts.

Finally the last method applied by local government, has been based on partial privatisation with the maintenance of majority or minority ownership by the State. This method has been widely favoured by local authorities in companies in good financial condition as it has made it possible to combine the continuing State ownership with financial deals which are attractive to local cadres and company managers who have acquired part of the capital of these companies.

The extent of privatisation

If one refers to the numerical data published by the municipalities in an effort to work out how many State and collective SMEs have been privatised, one could conclude that a widespread move to privatisation has taken place in China. In the city of Shenyang, 102 State companies are said to have been sold off in June 1998[xi]. Other official sources, which can hardly be said to tally, state that Shenyang sold 192 State SMEs in 1997[xii]. Another source, in this case a foreign one, quoting the statements made by the State Commission on economics and trade, indicated that almost 60% of State SMEs in the province of Liaoning, one of the fortresses of the State sector, had been sold off[xiii]. Also in the Northeast region, the Mayor of Harbin, stated at the end of 1998 that 123 State companies were on sale in his municipality and that they were expected to find buyers quickly[xiv]. In Chonking the official "New China" agency stated in 1998 that private companies in the region had acquired 161 State companies[xv]. In Shanghai, the municipality was planning in 1997 to privatise 1000 State SMEs in the trade sector over the next three years. In the summer of 1998, 179 of these companies were said to have been already sold[xvi]. In the province of Sichuan, the city of Leshan is said to have sold 80% of its 400 State SMEs. The remaining 20% of companies, because of their desperate situation, have not found a buyer[xvii]. The Chinese economist Wu Jinglian recently estimated that close to half of State SMEs (which numbered 85,000 in 1996) have been affected by one form of privatisation or another[xviii].

In fact, faced with the lack of precise statistics made public on a national level, it is extremely difficult to know the extent of the privatisation of State and collective SMEs. One of the first pitfalls to avoid lies in confusing the selling of State assets with the privatisation of companies.

Not only have local authorities kept 100% ownership of a relatively large number of urban State and collective SMEs, but they have also resorted to the leasing of companies, which does not alter the property structure in any way. In these case, the local authorities have maintained their control over the businesses through State asset management companies. Following the example of Shanghai, Wuhan and Shenzhen in 1994, all China's large municipalities have reformed their State asset management systems administration, by transferring to a municipal State asset management Commission (*guoyou zichan guanli weiyuanhui*), presided over by the Mayor and by the local Secretary of the CCP, all responsibilities for State asset management which had been previously held, in a fragmented way, by the various industrial offices of the municipality. The Commissions then delegated the task of day-to-day management to local State asset management companies (*guoyou zichan guanli gongsi*)[xix]. While they have made possible a simplification of the organisation chart of

the administrative apparatus of municipalities responsible for the management of State and collective SMEs, in fact these companies behave as did the old municipal industrial offices[xx].
Moreover, even when all or part of the capital has been sold, this does not necessarily mean that it has been acquired by a private investor, whether Chinese or foreign. On the contrary, a part of the transactions in the assets of State and collective SMEs, which is difficult to estimate given the lack of statistics at the national level on property reform, but probably considerable if one goes by the monographs at local level, has taken place within the State and collective sector. The processes of mergers and acquisitions have in most cases been organised by the local administrative authorities who have simply transferred all or part of the capital of a company to another State company organised as a group or holding company. The province of Hebei, for example, announced at the beginning of 1998 its intention to create big industrial groups. The provincial government wanted to establish two industrial conglomerates covering activities such as cement, steel, machines, fertilisers, glass, textiles and pharmaceuticals. One of these groups was to form around the North China Pharmaceutical Co., one of the country's biggest pharmaceutical companies. As well as these big conglomerates, the province also wanted to favour the emergence of five smaller groups operating in several industries. These five groups were each to have annual minimum sales of 10 billion yuan. Lastly, the provincial government wanted to create thirty groups of more modest size with sales of about 5 billion yuan[xxi]. Most of these groupings, decided on in a purely administrative way, were achieved by merging State and collective SMEs with other State companies to form larger groups, without leading to privatisation of property rights. We have noted the same phenomenon in our case studies in Wuhan and Shenyang.
Where foreign private investors are concerned, we know that there have been one-off transactions at knockdown prices of production equipment belonging to State and collective SMEs which have gone out of production[xxii]. But in general, given the considerable number of companies put on the market, very few foreign investors have ventured to take over these companies, because of the high transaction costs of such operations and the unalluring nature of the assets of these companies: high debt levels, obsolete technology, inefficient management, and shrinking market share. We have been unable to find any statistics established at a national level on the number of State and collective SMEs taken over by foreign investors, but during our research in the provinces of Liaoning, Hubei, Shaanxi and Jilin, the authorities in charge of privatisation and sale of State assets confirmed to us that such cases concerned only one or two companies, and sometimes, as in Wuhan, none at all. The failure of sales for a token yuan, during a European tour by the authorities of the province of Liaoning in 1998, of State companies in the city of Shenyang, testifies to these difficulties. China's accession to the WTO may favour developments in this area, but as of now, the transfer of assets of urban State and collective SMEs to foreign investors seems very limited.
On the other hand take-overs by Chinese investors have been much more numerous. During our case studies on Chinese corporate groups[xxiii], we were able to note that private companies had launched into aggressive external growth by taking over State SMEs in difficulties in other provinces. The Xin Xiwang (New Hope) group in Sichuan, for example, China's biggest private group, the leader in the animal foodstuffs sector, has taken over 13 State SMEs in various provinces since 1993[xxiv]. However, here again, data at the national level is unavailable and we have been unable to find statistics indicating the share of the assets of State or urban collective companies bought out by the private sector[xxv].
In general, therefore, the figures for sales and exchanges of State assets available to us in the monographs produced by the municipalities are a poor indicator for determining the extent of the privatisation of urban State and collective SMEs.
The China Statistics Annual shows a sizeable decrease in the number of State companies in industry; these have fallen from 127,000 in 1996 to 61,300 in 1999[xxvi]. However, this figure includes all State companies regardless of size, and does not tell us if this drastic reduction is due to the closing of State companies, to the merging of public sector companies, or to the transfer to the heading of "joint stock companies"(*gufenzhi jingji*) of some of the State companies which have in fact been transformed into joint stock companies; this comprised about 14,200 companies in 1999. Very few large State

companies are considered to have been liquidated. The data published by the State Commission for Economy and Trade provided the figure of 11,270 State companies liquidated between 1988 and 1996, with 8617 cases of liquidation only for the year 1995 and 1996[xxvii]. No figures have been published since on liquidations in the State sector. Nevertheless, even though we know that the rate has certainly been lower than in 1996, because of the recession in Asia and the social consequences of company closures, we can ban on an average figure of 3,000 to 4,000 companies being liquidated each year between 1997 and 1999. Such a rate would indicate that between 15,000 and 18,000 State companies have closed down since 1996, a year when there were nearly 6,000 liquidations. Let us examine mergers in the State sector, which have been one of the policies widely favoured by the authorities since 1997. Based on the indications on the monographs produced by the municipalities, we can estimate that between 10% and 15% of State SMEs have merged with other State companies. From these approximations, one would arrive at a figure of between 23,000 and 30,000 State companies privatised in the industrial sector, or between 18% and 23% of public sector companies in relation to the peak of the year 1996. It is a sizeable figure which, if it were confirmed by studies at the national level, would signal profound changes in the Chinese economy.

Who are the new owners?

Who are the new owners of the capital of the urban State and collective SMEs which have been privatised? Local political leaders and the management teams of the State and collective SMEs would appear to have been the major beneficiaries of the redistribution of property rights. Local leaders had no wish to see the most profitable companies escape their grasp. Personal gain, local financing of the CCP, and continuance of local patronage systems are all factors that explain to varying degrees the determination to maintain control over the most profitable companies. As we have been able to ascertain in our field study, which are also confirmed by other studies[xxviii], local political leaders have total control over the privatisation process, from the evaluation of assets to the fixing of prices and the allocation procedures. In cases of complete privatisation, local leaders, especially in medium-sized cities, quite frequently become the new official owners of companies by means of stand-ins or by incorporating the privatised company into a group which they control, as X.L.Ding has shown in his study of the misappropriation of State assets[xxix]. From this point of view, privatisation allows them to officialise all the networks they have established or helped to establish outside the State sector, usually based on the misappropriation of State assets, and to organise the whole into a group structure of the financial holding company type, whose heart or centre is a completely or partially privatised State company. When it is the management of a company which gets control of the assets, they still need the co-operation of the local bureaucracy. Property reform makes it possible to negotiate a deal with the bureaucrats who receive in exchange part of the capital of the privatised company[xxx]. The selling off of profitable State assets to the benefit of local government officials or company managers has been sufficiently widespread to trigger a campaign of criticism from Peking at the end of 1998, thereby slowing for a short while such behaviour on the part of local government.

As far as workers' share holding is concerned, it has expanded mostly in loss-making companies. Except for those which have not been sold in the asset exchange centres (*guoyou zichanjiaoyi zhongxin*), loss-making companies have been privatised by selling all or part of the capital to the company's employees in co-operative share holding scheme. The first experiment in the privatisation of State SMEs and certainly the one most extensively studied [xxxi], was carried out in 1994 in Zhucheng in the province of Shandong, and gradually extended to the whole of China, after the XVth Congress of the CCP in 1997. In July 1994, of the 288 State SMEs in the city of Zhucheng, 210 companies were entirely privatised for a total of 250 million yuan in shares. Almost 90% of the employees bought shares, at 1,000 yuan a share. The employees bought between 2 and 5 shares each, while the company managers bought twice as many. The employees were unable to resell their shares outside the company. Because of this, the only shareholders outside the company are the handful of employees who decided to leave the company, but were unable to sell their shares to new or existing employees. All these companies have little prospect of being floated on the stockmarket and the shares circulate only inside the companies, according to the various regulations specific to each company. In the years immediately following the initial sale of shares to employees, managers, with the help of loans from local banks, sought to buy back the shares of the employees of the companies, and quickly became the majority shareholders. The workers got rid of their shares all the more quickly at a small profit to the extent that they sought to recover their savings which were invested in shares which were non-negotiable outside the company. In some larger cities, such as Wuhan or Chengdu, informal markets (*guitai jiaoyi zhongxin*) appeared, which made it possible for workers to sell their shares to people outside the company. However, after the raft of scandals which broke in 1997 and 1998, these informal markets were forbidden by the central authorities[xxxii]. In Zhucheng, the dilution of employee share holding gathered momentum after 1997, when because of a lack of capital, the local authorities decided to raise company equity by 750 million yuan, or three times the previous issue. The contribution of employees (which was the majority holding in 1994) amounted then to only 180 million yuan (or 24% of the total), the rest of the financing having been provided by the banks and outside investors who came into the capital of companies[xxxiii]. The various case studies carried out in Zhucheng show that the biggest shareholders are now the management teams who control an overwhelming majority of the capital of companies. The case of Zhucheng is a perfect illustration of the contradictions of the privatisations carried out in the form of co-operative share holding. Not only, in management terms, as is shown in the experiments carried out in Russia[xxxiv], is this kind of share holding not propitious to efficient restructuring (insufficient capitalisation, pressure from the workers as a group in a favour of bigger dividend payments, to the detriment of the reinvesting of profits). The unaltered power structure in the company, which remains dominated by the director and the Secretary of the CCP, as well as with the workers' inability to resell their shares outside of the company, favour a concentration of capital in the hands of managers who buy back the shares from the workers collective. Despite the principle of equity which justifies this kind of privatisation, it is unlikely that China will see the development of any significant worker share holding, other than the entirely different one embodied in Chinese households' penchant for buying the shares of companies quoted on the Shanghai and Shenzhen stock markets.

The effectiveness of restructuring

What can be said about the influence of the reforms on the quality of the restructuring of State and collective SMEs?

The most positive outcomes have been obtained by companies which were acquired by outside investors, whether Chinese or foreign. These companies have not only been freed from the stranglehold of the local bureaucracy, but they have also benefited from new, more dynamic management, from a brand name with high consumer notoriety and new markets provided by the new owner as well as a reduction of their debt load by the banks, negotiated by the new owner with the local authorities. All these improvements have profoundly altered the management of the company, which is now carried out by the new owner and no longer by the local bureaucrats alone. The case studies we have carried out in leading State, collective or private groups, which have taken over State and collective SMEs show that within months the financial situation of these companies has considerably improved. With each new acquisition of State and collective SMEs, the private group Xin Xiwang (New Hope) from Sichuan followed the same strategy: two key players, the company director and the financial manager, were immediately replaced by senior managers from Xin Xiwang, with a view to inculcating rapidly financial discipline and new methods of personnel and production management in the acquired SME[xxxv]. In fact this process of "subsidiarisation" with the arrival of an active investor able to bring know-how and with the power to reform the company, has already proved its effectiveness in the capitalist economies[xxxvi], as well as in the restructuring of companies in the former socialist countries of Eastern Europe[xxxvii].

Where mergers between companies at the local level are concerned, the results have been considerably less spectacular. In reality, the smaller the size of the company and the lower on the administrative supervision ladder it is, the more often mergers and acquisitions are carried out in an authoritarian manner by the local authorities, and the less preoccupied they are with companies' strategy or the possibility of creating synergies of production, technology, financing or distribution networks. The Chinese economic press has been full of examples of this phenomenon since the launching of the reform agreed at the XVth Congress of the Party in 1997. We have noted in our studies of the activities of the State asset management companies in the major cities, which are directly entrusted with the mergers of these companies on behalf of the municipal governments, that the formation of these groups had more to do with financial tinkering aimed at avoiding bankruptcies and concealing losses made by companies, than with the real work of restructuring with respect for the interests of the companies concerned[xxxviii].

As for those companies whose capital has been sold to the workforce, the results would seem pretty negative. Once again it is difficult to get an idea at the national level as no serious impact study has been published (or perhaps even carried out) by the central authorities. When we compare the results of our studies carried out in the provinces of the interior and in the Northeast with those of the provincial studies published in the Chinese economic literature, two major kinds of problem emerge, which have, moreover, been widely documented in other countries in transition, particularly in Russia[xxxix]. On the one hand, the injection of capital from the acquisition of shares by employees is insufficient to wipe out the debts and meet the need for restructuring which includes a drastic modernisation of the production system. The companies in the city of Zhucheng, which in 1994 were the first to benefit on such a scale from this kind of privatisation, were forced in 1997 to resort, as described above, to raising equity again[xl]. The intervention of the local State banks was widely seen as a rescue mission and a partial renationalisation of the city's companies. The banks also lent heavily to company managers during the initial sale of shares, and again when the managers bought back the workers' shares in order to gain majority control of the companies[xli]. Thus, after a three-year experiment, the State returned overwhelmingly to the funding of companies through the banks which, with limited abilities and beholden above all to the orders of the local authorities, are likely to exercise as weak a control over companies as in the past. On the other hand, the power structure and the incentive system which emerge from this kind of privatisation are often unable to generate any real reforming impulse in a company. There are some company directors with undeniable managerial know-how who can take advantage of their new autonomy vis-a-vis the administration to spark daring reforms, as is shown in some of the success stories highlighted in the Chinese economic press. However the impact on control is generally limited, for two main reasons. Firstly, managers are still appointed by local political leaders and are still considered to be local government officials. Their membership of the Party is also still crucial for their careers. This factor makes it impossible to break with relations of political allegiance which are sometimes contrary to the interests of the company, but above all encourages rent-seeking strategies (which mostly lead to corruption), since company managers consider themselves to be both underpaid and not responsible for the destiny of the company (even if they are majority shareholders). Secondly, in spite of privatisation, no alternative power emerges within the company, even where the employees are the majority shareholders. The lack of independent unions, the growth of unemployment and the end of jobs for life have permanently deprived employees of any means of bringing organised and official pressure to bear on their future or on that of the company[xlii]. In a context similar to what has happened in Russia, none of the new institutions arising from privatisation such as boards of directors, supervising committee are able to exercise internal control over the behaviour and decisions of company bosses who, in most cases, concurrently hold the positions of chairman of the boards of directors and supervision, chairman of the company and Party Secretary. These institutions once again, do no more than rubber-stamp decisions taken by company bosses in consultation with local government officials. Lastly, the workers' incentive system was supposed to have been improved by their new status as owners of the company. Where this influence existed, it was exercised only briefly, long enough for the workers to resell their shares, and to realise that they had not gained any decision-making power or any real control in the company because of privatisation. In reality, the factors mentioned above, such as the danger of unemployment and the end of jobs for life, have proved to be much more powerful factors in modifying the attitude of workers on the job than has the holding of a few shares[xliii].

Thus this kind of privatisation is far from being a sufficient condition of success in the restructuring of this category of company. In fact, any improvement in the performance of these companies depends above all on an improvement in the system of external control (de politicisation of the banks which would make it possible to increase the budgetary constraints on companies, deregulation or abolition of local protectionism in order to expose these companies to competition) and the establishment of a social insurance system, which would make it possible to deal with the social costs linked to the bankruptcies which are likely to increase in this category of company. The more external controls improve, the better are the chances for internal disciplinary mechanisms to improve, for only those companies in this category which succeed in reforming their management, and in reducing as far as possible the waste of resources produced by the quest for secure incomes, will survive.

Whatever the methods used, the effectiveness of restructuring has nonetheless varied very widely from one region to another. According to the monographs and the information collected during our case studies, there is a fairly clear-cut difference between the coastal regions and those of the Northeast and the interior. In the autonomous region of Guangxi, after five years of reforms, almost 70% of companies had not recorded any improvement in their profits, while 25% had registered a decline in profitability[xliv]. In Wuhan the head of the municipal asset management commission told us in 1999 that State and collective SMEs had shown little improvement in their financial situation[xlv]. Coastal cities such as Dalian, Shanghai, and Canton, and provinces such as Shandong, Jiangsu, Zhejiang and Fujian, are apparently doing much better. The profitability and debt ratios of State companies by province in Table 2, show that, with some exceptions (Yunnan where high profits come from the tobacco industry which is entirely State-owned, Tibet whose values are too low to be significant, and Heilongjiang which has surprising profitability given the size of its State sector), the coastal provinces are much better off than those of the Northeast and of the interior where the State sector share remains above the national average.

This corroborates the work of Nicolas Lardy on the state of the banking sector and particularly on provincial variations in the deposit/loan ratio. The provinces of the Northeast and of the interior had ratios superior to one, indicating according to Lardy a banking system which heavily subsidises local companies (mainly in the urban State and collective sector) and a lack of profitability in the region's economic activity which translates into bank deposits which are insufficient to cover loans. Ratios in the coastal provinces on the other hand were all below one, for the profitability of economic activity stimulated by the growth in direct foreign investment and in the number of private companies, makes it possible for banks to cover their loans to companies with the deposits made by companies and households (consumer and personal loans are virtually unknown)[xlvi].

Thus restructuring in the coastal provinces has benefited from a much more propitious environment. Coastal cities have received almost 75% of foreign direct investment since the beginning of the reforms. They have also experienced rapid growth in the private and collective rural sector since the mid 1980s. These two developments have led to drastic changes in the structure of production property ownership, with the State's share falling below 40%. The dynamism of the local economy based on gradual integration with the world market and on the development of a network of private or semi-private (collective status) SMEs, has helped job creation and held back the rise in unemployment resulting from restructuring. The coastal State and collective SMEs have had to evolve in a much more competitive environment. More receptive to the market, they were induced to restructure their businesses long before the introduction of the grand restructuring plans decided on by the central government. Sales and exchanges of State assets have been much brisker and the take-over or leasing of the management of State and collective SMEs have benefited from the existence of a marketplace with more numerous and more competent buyers than in the provinces of the interior or the Northeast. In Qiqihar for example, a city of 1.42M inhabitants in the province of Heilongjiang, the municipality put up for sale 80 State SMEs in a local State assets exchange centre. Also available there were the 1,078 State SMEs of the province of Heilongjiang, put up for sale by the various municipal governments. Of the 80 companies in Qiqihar, 21 had debts exceeding the value of their assets. A whole range of incentives were offered to potential buyers: tax exemptions for 3 to 5 years, possible debt reductions (interest and capital repayment holidays for two years). In spite of these incentives, very few companies were able to find buyers because of their appalling financial situation[xlvii]. In dynamic contrast, in Shanghai at the end of 1998, almost 2,700 companies had exchanged, sold or bought State assets, to the tune of 33 billions yuan ($US 4 billions)[xlviii].

While it is difficult to have a detailed vision of the situation in the whole of China, we were able to confirm during our interviews in Wuhan and Shanghai, the same apathy on the market for State and collective SMEs, and the same mediocre quality of take-over bids for companies which usually ended up being sold off to the companies' management teams or sold to the employees under the co-operative share holding system, with inconclusive results. The author of a monograph on the reform of State SMEs in the province of Guangxi, with a candour unusual in this kind of study, emphasises the fact that many "comrades" in the government think that property reform is enough to improve the bottom line of companies. He also underlines the lack of capital suffered by the SMEs, a legacy of the planning period, but also a result of the policies of increasing taxation of companies which continue to have to face high social taxes. He also points out the flouting of policies decided on by the central government on how to reform companies, a flouting which leads to sometimes fraudulent practices in the use of assets: for example a Finance Ministry directive forbids companies to use their (net) capital to help with reducing the workforce (redundancy or early retirement payments). Companies, however, have not observed this rule thereby reducing even further their ability to recapitalise[xlix]. This phenomenon is confirmed by several monographs on the provinces of the Northeast and the interior of China[l].
The price of land has also been a determining factor in the financing of restructuring. Examples of State companies in Shanghai in difficulties using the sale of their sites in the centre of the city to finance restructuring and a move to the outskirts of the city have been extensively documented[li]. Other coastal cities have used the same strategy. In Xiamen, for example, 35 State companies in the old centre of the city have availed of this option in order to restructure, selling a total of 330,000 sq. metres of land to the tune of 1,24 billion yuan. These companies moved to the outside of the city and were thus able to recapitalise and acquire new technology[lii]. Such sales have been much less numerous in the provinces of the interior and the Northeast, and when they have taken place, they have brought in much less money to the companies concerned[liii].
The coastal regions have also managed to set up a more effective (but nonetheless inadequate) social security system than the regions of the interior, which has made it possible for them to progress more rapidly with the restructuring of their companies. In China the social security system is mainly organised at municipality level, which means that only the economically dynamic cities have been able to in the last few years gradually to finance an unemployment, retirement or health insurance fund[liv]. But it is the regions of the Northeast and of the interior which have to restructure the largest number of inefficient companies which have the most need for an effective social security system.
Lastly, the dynamism of a local economy more and more extensively based on private property rights has pushed the local bureaucracy in the coastal provinces to change its intervention in the economy. Though it remains unavoidable, it has become less rapacious (in tax terms) and much more enterprising and now has to face demands for modernisation of its institutions from local companies as is shown in the monographs produced by various foreign researchers[lv].

In conclusion, despite the difficulty of finding precise statistical data on the extent of the reform of urban State and collective SMEs, we have sought to show that the movement towards disengagement of the State from these companies has already widely begun, even though it has not exclusively taken the form of privatisations, as in other formerly socialist countries in transition. It is difficult to establish the exact extent of the privatisations, but according to what we have shown, these may have affected about a quarter of companies and have generally taken the form of sales of capital to the employees of companies. However, this kind of share holding, generally used for loss-making companies, has every likelihood of proving to be transitory. As the experience in Zhucheng has shown, it leads after a few years to the rapid concentration of ownership in the hands of the company managers. We have also sought to show that the effectiveness of reform methods including privatisations, is heavily dependent on the economic and institutional environment in which they are applied. A privatisation programme, especially one such as co-operative share holding, conducted in an environment where companies are unaccustomed to competition, where management teams have no particularly sophisticated management know-how, where the recapitalisation stemming from privatisation is insufficient, where the legal environment does not make possible the protection of the interests of minority shareholders, where the local bureaucracy continues to dominate the decision-making of companies and where the local banks continue to subsidise companies heavily, in such an environment a privatisation programme has every likelihood of producing poor results. Accordingly, the central State, faced with China's accession to the WTO, will have to speed up reforms such as that of social security, of the commercial banks, and of the legal environment, especially in the provinces of the Northeast and of the interior which will be the most affected by the competition from foreign products, if it wishes to favour the restructuring programmes of the State and collective SMEs. These reforms are all the more urgent, since in the kind of disengagement of the State being currently promoted in China, the privatisations are not recognised as a national policy, codified, and supervised by independent organisations. In such a context, local leaders have every chance of grabbing the best assets in a strategy of short term maximisation of their incomes within the framework of complex financial deals, while leaving the fate of loss-making companies in the hands of management teams with little competence and few resources with which to restructure them. This type of property redistribution which was seen in Hungary just before and after the Fall of the Wall[lvi], does not always lead to efficient restructuring without structural policies which limit the local *nomenklatura*'s pursuit of monopoly income. As can be seen, there areas still whole areas in the study of the reform of the urban State and collective SMEs about which we have little information. These reforms, however, deserve the more detailed attention of the central authorities who could thus better co-ordinate restructuring policies. At stake is the fate of tens of millions of employees and thousands of companies, especially in the provinces of the Northeast and of the interior, who will have to learn to swim quickly, or risk going under in the face of the challenges and rapid developments at work in the Chinese economy.

table n°1: Rules applicable in SME's privatisation in China

	Internal	**External**
Free distribution		
Asset sale	**Cooperative shareholding** - Managers - Employees	- Complete privatisation with asset sale to external investors - Partial privatisation with a minority stake hold by the state

Tableau n°2 : Financial Ratio in the banking system among provinces (2000)

	Profits/cost of	Assets/debt (%)	Share of the State

	production		sectors (%)*
Moyenne nationale	2,89	61,98	48,6
Heilongjiang	15,43	64,88	83
Tibet	14,42	35,6	78
Yunnan	8,80	52,81	81
Fujian	6,36	60,62	33
Guangdong	5,80	57,22	28
Shanghai	5,57	50,95	51
Zhejiang	5,25	52,24	21
Beijing	3,63	60,16	73
Shandong	3,24	62,87	40
Hebei	3,20	59,92	55
Jiangsu	2,61	60,3	31
Hubei	1,94	65,03	60
Jilin	1,55	66,78	84
Henan	1,12	65,56	51
Anhui	0,83	61,31	64
Liaoning	0,76	59,96	66
Shanxi	0,59	65,54	67
Sichuan	0,57	63,66	66
Guizhou	0,36	69,02	81
Hunan	0,12	70,21	66
Guangxi	-0,02	69,81	69
Xinjiang	-0,16	63,35	88
Hainan	-0,63	73,73	72
Mongolie Intérieure	-0,65	61,54	84
Qinghai	-0,75	66,48	87
Ningxia	-0,90	67,78	78
Shaanxi	-0,95	69,77	77
Jiangxi	-1,09	70,34	81
Tianjin	-1,60	65,92	31,8
Gansu	-1,85	69,83	78
Chongqing	-2,36	67,5	71

Source : Zhongguo tongji nianjian, 2000, p. 433 (Annuaire des statistiques de Chine).
* only firm with a turn over superior to 5 millions yuans

[i]We have restricted our study to the urban State and collective sector. The demarcation of the State urban sector poses little problem for there are very few State companies in rural areas. On the other hand it is relatively difficult to demarcate the urban collective sector. Chinese statistical categories differentiate urban collective companies from those of the towns and cantons which are commonly called rural companies (*xiangzhen qiye*). However, among the urban collective companies are to be found firms of very different kinds. Some, and these are the ones which concern us, are in fact carbon copies of State SMEs and are controlled directly by municipalities. They emerged from the nationalisation of private SMEs at the end of the 1950s, or were set up in the 1960s and 70s, but were considered too small to obtain the status of

State companies, and to benefit from the largesse in social security and housing reserved to the State sector. Others, especially rural collective companies, operate with less clear property rights. They emerged from the de-collectivisation of the popular communes at the end of the 1970s and the beginning of the 1980s, or were created from scratch during the 1980s, either by local governments or by private individuals who asked for the protection of local government at a time when the private sector had no legal protection or constitutional recognition. some of these companies interest us directly to the extent that a large number of hamlets and cantons have been made into cities, thereby automatically changing the status of the rural collective companies into urban companies. The municipality's control is nonetheless direct and similar to that which exists in State SMEs. Companies in the last sub category (those set up by private individuals), however, operate in a way very close to private companies and fall outside the area of our research.

[ii] *Zhongguo Tongji Nianjian* (China Statistics Annual), 2000.

[iii] See for example the review *Guoyou Zichan Guanli* (State Assets Management) which regularly publishes local monographs on the restructuring of State and collective SMEs .

[iv] Wu Pinggui, "Dui shenhua guoyou zhongxiaoxing qiye gaige de sikao" (Reflections on the deepening of the reform of state SMEs), *Guoyou zichan guanli*, No. 4, 1999, pp. 35-37.

[v] The *chengbao* system has been widely applied in the State sector since the mid-1980s and calls for the signing of a contract between a private individual who takes over the management of the company and the local administration, in which appear profit, production and tax objectives.

[vi] Xu Qing, "Dangqian zhiyue Ningxia guoyou zhongxiao qiye gaizhi nandian wenti youxi" (Analysis of the problems in the reform of the State SME system in the province du Ningxia), *Ningxia Shihuikexue*, No. 3, 1999, pp. 47-52.

[vii] *China Daily*, January 18-24th 1998, "Business Weekly".

[viii] Wang Hong, Shunde qiye chanquan gaige de jiaocha" (Enquiry into the reform of the property of companies in Shunde), *Gaige*, No. 1, 2000, pp. 43-46.

[ix] Lei Yingquan, Huang Xingguo, Hu Yuqing et Ren Zhiqin, "Dui Sichuansheng qiye guoyou zichan linke guanli youguan qingkuangde yanjiubaogao" (Research report on the situation of the management and ownership of State assets in the companies in the province of Sichuan), *Guoyou Zichan Guanli*, n°4, 1999, pp. 50-51. Ma Rengui, "Guozi guanli tizhi gaige de youyi tansuo. Nanning shi zujianguozi jingying gongsi qingkuang de diaocha" (Exploration of the advantages of the reform of the State assets management system. Enquiry on the situation of State asset management companies established by the city of Nanning), *Guoyou Zichan guanli*, No. 3, 1999, pp. 63-64. Xu Qing, *op. cit*.

[x] Dong Ying, "Shandong Zhucheng gufen hezuozhi qiye yanshi fenxi" (Analysis of the co-operative share holding system of the city of Zhucheng in the province of Shandong), *Gongye Jingji yanjiu*, No. 11, 1999, pp. 5-11.

[xi] *Asian Wall Street Journal*, June 5th 1998.

[xii] *Xinhua*, February 4th 1998.

[xiii] *Far Eastern Economic Review*, February 18th 1998, pp. 10-16.

[xiv] *China Daily*, November 11th 98.

[xv] *Xinhua*, February 4th 1998.

[xvi] *South China Morning Post*, May 22nd 1998.

[xvii] *Far Eastern Economic Review*, February 18th 1998, pp. 10-16.

[xviii] Paper at the international conference "Corporate Governance of State-Owned Enterprises in China", organised by the OECD, the Centre for the Development of the State Affairs Council, and the Asian Development Bank, January 18-19th 2000 in Peking.

[xix] For a description of their workings see Christopher McNally, "Shanghai's Way Forward. A Prelude to China's Next Stage of Enterprise Reforms", in *China Perspectives*, No. 14, November-December 1997, pp. 33-39; and Shanghaishi guoyouzichan guanli moshi yanjiu kejizu, "Shanghai shi guoyou zichanguanli moshi zhong de lingkong xitong", in *Zhongguo Gongye Jingji*, No. 3, 1999, pp. 19-24.

[xx] Jean-François Huchet et Xavier Richet, "Entre bureaucratie et marché : les groupes industriels chinois à la recherche d'un nouveau gouvernement d'entreprises", Working paper, Centre d'Etudes Français sur la Chine Contemporaine, October 2000, 35 pp.

[xxi] *South China Morning Post*, March 27th 1998

[xxii] Cao Yanzheng, Qian Yingyi et Barry R. Weingast, "The Sale Goes on. Transforming Small Enterprises in China", in *Transition*, February 1998, pp. 5-7.

[xxiii] Jean-François Huchet et Xavier Richet, *op. cit*.

[xxiv] Interview, New Hope, Chengdu, April 20th 1998.

[xxv] The statistics on the growth of production according to property rights which appear in the China Statistics Annual do not make it possible to distinguish between what is linked to internal or external growth in the progress of the private sector.

[xxvi] *Zhongguo Tongji Nianjian* (China Statistics Annual), 2000.

[xxvii] *Asian Wall Street Journal*, May 19th 1997.

[xxviii] Sally Sargeson and Jian Zhang, "Reassessing the Role of the Local State: a Case Study of Local Government Interventions in Property Rights Reform in a Hangzhou District", in *The China Journal*, No. 42, July 1999, pp. 77-99.

[xxix] X. L. Ding, "The Illicit Asset Stripping of Chinese State Firms", *The China Journal*, No. 43, January 2000, pp. 1-28.

[xxx] Sargeson, *op. cit*.

[xxxi] The information below comes mainly from Dong Ying, “Shandong Zhucheng gufen hezuozhi qiye yanshi fenxi” (Analysis of the co-operative share holding system of the city of Zhucheng in the province of Shandong), *Gongye Jingji yanjiu*, No. 11, 1999, pp. 5-11, and from Zong Han, “Gufen hezuozhi de fazhan ji qi jiaojian” (Development of co-operative share holding), *Zhongguo Gongye Jingji*, No. 2, 2000, pp. 9-12.
[xxxii] Interview with members of the State assets management Commission in Wuhan and Chengdu, April-May 1998 and May 2000.
[xxxiii] Dong Ying, *op. cit*.
[xxxiv] Joseph Blasi, “Corporate Ownership and Corporate Governance in the Russian Federation”, Ira W. Lieberman, Stilpon S. Nestor and Raj M. Desai, *Between State and Market. Mass Privatization in Transition Economies*, Washington D. C., The World Bank & OECD, 1997, pp. 162-170.
[xxxv] *Ibid*.
[xxxvi] Michael C. Jensen, “The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems”, in Chew D. H. (ed.), *Studies in International Corporate Finance and Governance Systems. A Comparison of the U.S., Japan, & Europe*, Oxford, Oxford University Press, 1997, pp. 18-37.
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[xxxviii] Jean-François Huchet, “Concentration et émergence des groupes dans l'industrie chinoise», *Perspectives Chinoises*, No. 53, mai-juin 1999.
[xxxix] J. Blasi, *op. cit*.
[xl] Dong Ying, *op. cit*.
[xli] Zong Han, *op. cit.*
[xlii] Trini W. Y. Leung, “S'organiser pour défendre ses droits; Contestations ouvrières en Chine dans les années 1990”, in *Perspectives Chinoises*, No. 48, juillet-août 1998, pp. 6-23. Andrew Walder, “Urban Industrial Workers: Some observations on the 1980's”, in A. L. Rosenbaum ed., *State and Society in China: the Consequence of Reforms*, Boulder, Westview Press, 1992, pp. 103-20.
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[xliv] Wu Pinggui, *op. cit*.
[xlv] Interviews, April 1998 and September 1999.
[xlvi] See Lardy Nicholas R., *China's Unfinished Economic Revolution*, Washington DC., Brookings Institution Press, 1998, p. 89.
[xlvii] *Far Eastern Economic Review*, February 18th 1998.
[xlviii] Lu Zhongyuan, “Ruhe fangzhi guoyou zichan yingyun jigou biancheng fanpai gongsi”, Shanghai, Wuhan, Shenzhen de shixian ji qishi” (How to prevent institutions in charge of State assets from becoming bureaucratised companies), *Zhongguo gongye jingji*, No. 7, 1999, pp. 18-20.
[xlix] Wu Pinggui, *op. cit*.
[l] Cao Yanzheng, et al., *op. cit*.; Wu Pinggui, *op. cit*.; Lei Yingquan, et al., *op. cit*.; Xu Qing, *op. cit*.
[li] Cheng Enfu, “Shanghai guoyou zichan yunxing fenxi” (Analysis of the workings of State assets in Shanghai), *Guoyou Zichan Guanli*, No. 3, 1999, pp. 44-49.
[lii] Chenhong Xujing, “Guanyu Xiamenshi guoqi Gaige de jiaocha” (Research into the reform of State companies in the city of Xiamen), *Guoyou zichan guanli*, No. 4, 1999, pp. 52-54.
[liii] Interview with the State assets management commission of the city of Wuhan, April 1998
[liv] Jean-François Huchet,”Quelle retraite pour la Chine? Vers l'établissement d'un système nationale de protection sociale?”, in *Perspectives chinoises*, No. 36, juillet-août, 1996, pp. 32-42.
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