Corporate Governance in China: Explosive Growth and New Patterns of Ownership

Thomas Clarke and Du Yuxing

China is simultaneously growing and transforming from a command to a market system. The process of reform began earlier than in Eastern Europe, but the state owned enterprise sector remains an intractable problem. What has accounted for the remarkable rate of economic growth sustained over the last 20 years, are the spontaneous entrepreneurial efforts of the collectively owned Township and Village Enterprises (TVEs), and the Private and Individual Enterprises (IOEs). Together with the widespread distribution of shareholding, this could represent the foundations of a stakeholder economy. The success of further economic reform will depend on the perception of the Chinese people's stake in the future of their country.

Introduction: Whither China?

As the most populous country on earth, the last great communist state and the economy destined to become the largest global industrial power by the middle decades of the next century, China holds a particular fascination for planners.

The language of stakeholding is probably as alien to discourse among Chinese policy makers as is the language of privatisation ("We do not use that word here" said a senior economic adviser to the Chinese government recently). However in the slow and reluctant abandonment of a command economy and the gradual but often impatient assumption of a market system there is a vacuum at the centre of policy making which the conception of a stakeholder economy might help to fill. If the Chinese people are to engage fully in this process of economic transition, a clear conception of their stake in the future of the country could prove a useful prerequisite.

Having lost belief in the capacity of the command economy to achieve the shift away from traditional heavy industries, to foster technological progress, to improve product quality, or to provide less environmentally damaging growth, there is a profound suspicion about the capacity of the market economy unassisted to provide for continued economic growth, the alleviation of poverty, or an equitable distribution of income and wealth. An irony is that the achievement of an acceptable transition to a social market economy depends to a degree upon the ability of the state to plan effectively.[1]

Institutional Foundations

The command economy of China was never structured like the centrally planned economies of Eastern Europe and the former Soviet Union, with highly centralised functionally specialist ministries. In contrast the Chinese system is organised in a decentralised multi-layer and multi-region form. Central government ministries control only a small proportion of State-Owned Enterprises (SOEs) and most are under

Pergamon

PII: S0024–6301(98)00008–9

Long Range Planning, Vol. 31, No. 2, pp. 239 to 251, 1998

0024–6301/98 $19.00+0.00

the control of regional governments. At regional government level functions are further divided along geographic and functional lines, with provincial governments controlling county governments and provincial SOES and county governments controlling township governments and county SOEs. This structure creates great duplication, but also a good deal of local autonomy from the centre.[2]

Furthermore the practice of drawing up Five Year Plans supplemented by annual targets for the economy was in China a protracted process of negotiation: "The plans, both five-yearly and annual, are typically the result of a complex process of aggregation involving many participants and culminating in the finalisation of a complex, multivariate input–output model for most economic sectors. Under the influence of the reforms, especially after the mid-1980s 'mandatory' planning has increasingly been supplanted by 'guidance'. This means that most targets are negotiated between the individual enterprise and the relevant ministry in the capital or local government".[3]

The great economic successes of the last twenty years are more readily attributable to the freedom which this decentralised structure provided, combined with the release firstly of farmers' energy in the "household responsibility system" from 1978 and later the tremendous unleashing of the entrepreneurial spirit of the town and village enterprises than to the command economy itself. "It is wrong to regard China's economic revolution as ever having followed a deliberate programme".[4]

The 15th Party Congress Proposals 1997

In the run up to the 15th Party Congress in September 1997, President Jiang Zemin addressed ranking cadres on the need for greater privatisation of the Chinese economy and Zhu Rongji the vice-prime minister in charge of the economy, who became the next premier in 1998 toured the state enterprises of the industrial north of China, stressing the importance of major restructuring. The government agenda is to promote a wave of mergers to consolidate unwieldy industries, allowing thousands of state factories to be sold or pushed into bankruptcy. (China has 123 car and truck plants producing 1.47 million units, one-sixth of the three U.S.A. auto companies' production; and 189 motorcycle factories). The aim is to focus on 1000 conglomerates that can compete globally, similar to the industrial groups of Japan and South Korea. As Denis Simon director of Anderson Consulting's China Strategy Group puts it, "China needs to recast its entire industrial architecture".[5]

Such wrenching reform, at a time when 15% of the urban population of China is unemployed, is only possible firstly because of the continuing growth of the economy (9.5% in the first six months of 1997), with low inflation and large trade surpluses and secondly because the government is intent on introducing social security reform as the essential platform upon which to reconstruct the economy. The essential proposals are:

- To concentrate on transforming the best 1000 state companies into modem conglomerates, allowing many of the remaining 100,000 SOEs to be merged, sold, or closed.
- Greatly reducing the number of redundant factories making cars, motorcycles, beer, consumer appliances, and other goods, by encouraging mergers and discouraging new entrants.
- Releasing state companies from the burden of providing health care, pensions and housing by establishing national health and retirement schemes, and making it easier for workers to buy homes.
- Broadening the government programmes of retraining to an estimated 15 million factory workers (12.5% of the SOE work force) who will lose their jobs through consolidation.[6]

Economic Reform

China started the process of industrialisation along the lines of the Soviet model much later than in Russia, and adopted a very modified structure due to prevailing conditions. China began to reform the economy much earlier than in Eastern Europe and Russia; and has experienced more rapid economic growth in recent years than the post-Soviet economics.[7] The detailed economic reforms of this period (Table 1) can be divided into three broad phases:

1949–1978 Collectivisation and Large-Scale Heavy Industrialisation

After securing control over the economy, a programme of five year plans began with the first in 1953–1957 with the Soviet bias towards heavy industry and against consumption. The Great Leap Forward, intended to accelerate the transition to a decentralised form of socialism, coincided with serious draught and famine, which disrupted implementation of the second five year plan 1958–62. China remained isolated from other economies, which was compounded by the withdrawal of Soviet aid in 1960. Despite the comprehensive planning system a large part of the economy was outside the scope of the government's central planning apparatus, partly because of the structure of political and economic decentralisation, but also because of the local autonomy seized during the chaotic years of the Cultural Revolution (1966–1976).

TABLE 1. China's industrial reforms: 1979–1995

1979	Law on joint ventures; price liberalisation starts in agriculture.
1980	Fiscal autonomy to local governments; special economic zones created; private income tax introduced.
1981	Individual enterprises encouraged in urban centres.
1982	Price liberalisation of industrial products starts; patent law and trademark law enacted.
1983	SOEs begin to be taxed instead of turning over profits; bank lending to SOEs begins to replace allocations from state budget; collective enterprises are encouraged; People's Bank of China begins to assume some of the functions of a central bank.
1984	14 Coastal cities are opened up to overseas investment; director-responsibility system and "above plan" pricing and production autonomy introduced; TVEs created.
1986	Labour contract system replaces virtual lifetime employment for urban new recruits.
1988	SOE contract responsibility system begins; on the basis of negotiated multiyear contracts, managers (and sometimes workers') rights of control and obligations to the state defined; regulations on private enterprises published; enterprise and bankruptcy laws passed.
1989	Regulations on mergers, joint-stock companies and commercialisation of banks.
1990	Copyright law enacted.
1991	Delegation of direct foreign trade rights to (some) SOEs; beginning of pensions and housing reform; encouragement of enterprise groups and corporatisation, whereby the state's ownership rights take the form of shares managed by state asset administration bureaux and state investment companies and the firm has management autonomy. Establishment of the Shanghai and Shenzhen. stock markets.
1992	Deng's southern tour; new operating mechanism and autonomous rights to SOEs give SOE managers authority to "use and dispose of the property entrusted to them by the state for management and business purposes"; phasing out of production targets and price controls; patent law and trademark law revised.
1993	Principle of "socialist market economy" replaces "socialist commodity economy"; decision of the third plenum on establishing modern enterprise system; promulgation of a competition law; new accounting standards introduced.
1994	Foreign exchange reform; fiscal and tax reform; implementation of company law.
1995	New commercial banking law; People's Bank of China law; provisional regulations guiding foreign investment; insurance law; move to a five-day week; legislation to regulate the securities and debt markets; draft of ninth five-year plan.

1979–1990 "Crossing the River by Feeling the Stones"

Deng Xioping initiated a prolonged period of gradual, pragmatic reform ushering in a period of dynamic growth of the economy. Controls on land use were lifted which promoted a sustained increase in agricultural output. Rapid growth in manufacturing was stimulated by a new emphasis on light industry; lifting controls on inputs and outputs so enterprises moved nearer to the market; tolerating the growth of new forms of enterprise including collectively owned and privately owned enterprise; and establishing the first export processing zones, which led to opening up of the 14 coastal cities and ultimately allowing virtually all provinces and cities to attract foreign capital. In 1988–1989 overheating of the economy caused a period of relative austerity and retrenchment.

1990–1997 Rapid Economic Growth

Coinciding with the period of the eighth five year plan 1991–1995 was a period of unprecedented economic growth. Deng Xiaping toured the Special Economic Zones (SEZs) in the southern provinces, praised their economic achievements, particularly the export activity of Guangdong province neighbouring Hong Kong and signalled a renewal of the commitment to decentralisation and rapid growth, ("To get rich is glorious.") This was in the aftermath of the collapse of the Soviet Union and the fall of the communist regimes of Eastern Europe. The 14th Party Congress in November 1993 called for the creation of a "socialist market economy" and called for a comprehensive programme of reform.[8]

Economic Growth

The sustained economic growth of China since the process of economic reform began in 1979 is quite remarkable (Fig. 1). For good reason the Chinese authorities avoid the expression "economic miracle" as there is much to be done, China remains a very poor country in GDP per capita terms, and much could go wrong. However what has been achieved so far, taking into account the reliability of aggregate comparative data, compares well with countries that for periods have had the "economic miracle" title attached to their name. During Germany's fast recovery and economic boom GDP growth averaged 9% between 1948–1960. Similarly Japan averaged 9% GDP growth during 1948–1960. The celebrated Asian Tigers achieved around 8% GDP growth Hong Kong (1961–1994); Singapore (1961–1994); Republic of Korea (1956–1994); Thailand (1987–1994); Malaysia (1987–1994). From an exceptionally low base, for the past 20 years China

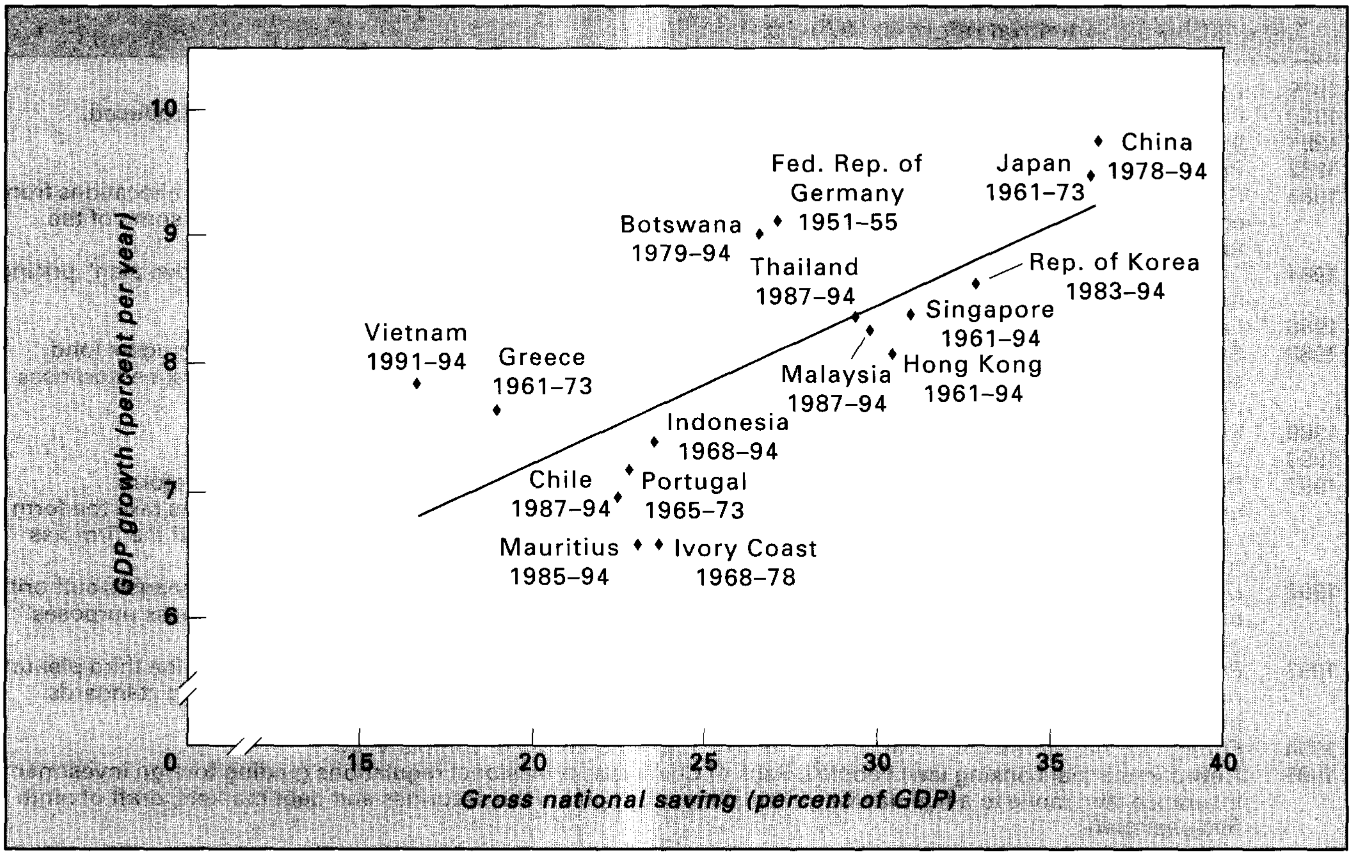


FIGURE 1. Benchmarking China against other high growth economies—Cumulative inflows 1989–1995. Source: World Development Report 1996, *From Plan to Market*, World Bank, Oxford University Press, 1996, p. 42, Fig. 2.8.

according to the World Bank has on average managed a better savings and GDP growth rate of approaching 10% per annum.[9]

This rate of growth could only have been accomplished by maintaining a very high savings and investment rate, however, "under central planning, high investment alone does not guarantee fast growth. The composition and quality of investment, as well as of human capital and technological know-how are also critical".[10] China has reached a point where productivity gains are likely to become an increasingly important source of growth as enterprise efficiency is improved, "Chinese growth rates have been and are predicted to remain, at a level consistent with a (Rostow-style) take-off into self-sustaining growth".[11] With such a vast population the critical indicator for China is GNP per capita and the prolonged improvement in this, together with the recent sharp improvement in India's performance, represents in the words of Goodhart and Xu "a massive uplift for mankind as a whole".[12]

In China this economic improvement has occurred

TABLE 2. The economic growth of China 1978–1995

	1978	1980	1985	1990	1992	1993	1994	1995†
Real output (GNP)-billion yuan*	650	763	1275	1854	2315	2623	2927	3214
Population: million	963	987	1159	1143	1172	1185	1199	1211
Real output per capita: yuan	684	773	1010	1622	1975	2214	2441	2654

Notes: * 1990 prices.
† Partly forecast.
Source: Yearbook of China, 1990, 1995; *People's Daily* (Overseas Edition) 20 October (1995); Goodhart and Xu, p. 56 (1996).

TABLE 3. Increase in gross output value of industry by ownership type (million yuan)

	1990	1991	1992	1993	1994
SOEs	13063.75	14954.58	17824.15	22724.67	26200.84
COEs	8522.7	10084.75	14101.19	20213.21	31434.04
IOEs	1290.3	1609.1	2506.8	4402.05	8853.23
Others	1047.56	1599.58	2633.58	5352.06	10421.35
Total	23924.36	28248.01	37065.71	52691.99	76909.46

Source: *China Statistical Yearbook*, p. 377 (1995).

despite the existence of problems similar to those faced by the Eastern European countries including:

- How to control loss-making state owned enterprises;
- Relatively declining fiscal revenues accruing to the central government;
- Endemic and occasionally severe inflationary pressures;
- The lack of an institutional infrastructure of a market economy (including laws on bankruptcy and property rights; standardised and transparent accountancy; convertible currency and open financial markets, etc.)[13]

A key to the explanation of dramatic improvement of the Chinese economy is the sectoral distribution of growth (Table 3). The output of state owned enterprises increased significantly during this period, but it was the explosive growth in industrial output of the collectively owned enterprises, private enterprises, shareholding companies, joint venture and foreign owned companies that really made the difference (Table 4). Figure 2 illustrates how without reform of the economy there would have been no startling improvement in economic performance.

The State-Owned Enterprise Sector (SOEs)

The strategy of "reforming out of the established system" allowed the finances of the state sector to further deteriorate, contributed to inflationary pressures, promoted rampant corruption as given the co-existence of a planned and market system "the whole economy becomes a breeding ground for 'rent-seeking activities' ".[14]

"A growing proportion of SOEs are losing money. According to a new study by the World Bank, about half of all industrial SOEs made a loss in 1996, up

TABLE 4. Different types of ownership—the official classification

State Owned Enterprises (SOEs)
Industrial enterprises where the assets or income are owned by the state. Joint state–private industries and private industries which existed before 1957 were transformed into state industries.

Collectively Owned Enterprises (COEs)
Industrial enterprises where the assets are owned collectively, including urban and rural (township and village enterprises) (TVEs).

Private and Individual Owned Enterprises (IOEs)
Small private businesses.

Other Ownership Types (Others)
Despite the name, other forms of ownership are of increasing significance in the Chinese economy. Includes:

Shareholding Companies
Chinese companies converted into shareholding or limited liability companies.

Joint Ventures
Wholly Foreign Owned Enterprises (WFOES)

Source: Adapted from *China Statistical Yearbook* p. 377 (1995) and *Jingji Cankao Bao* 18 March (1997).

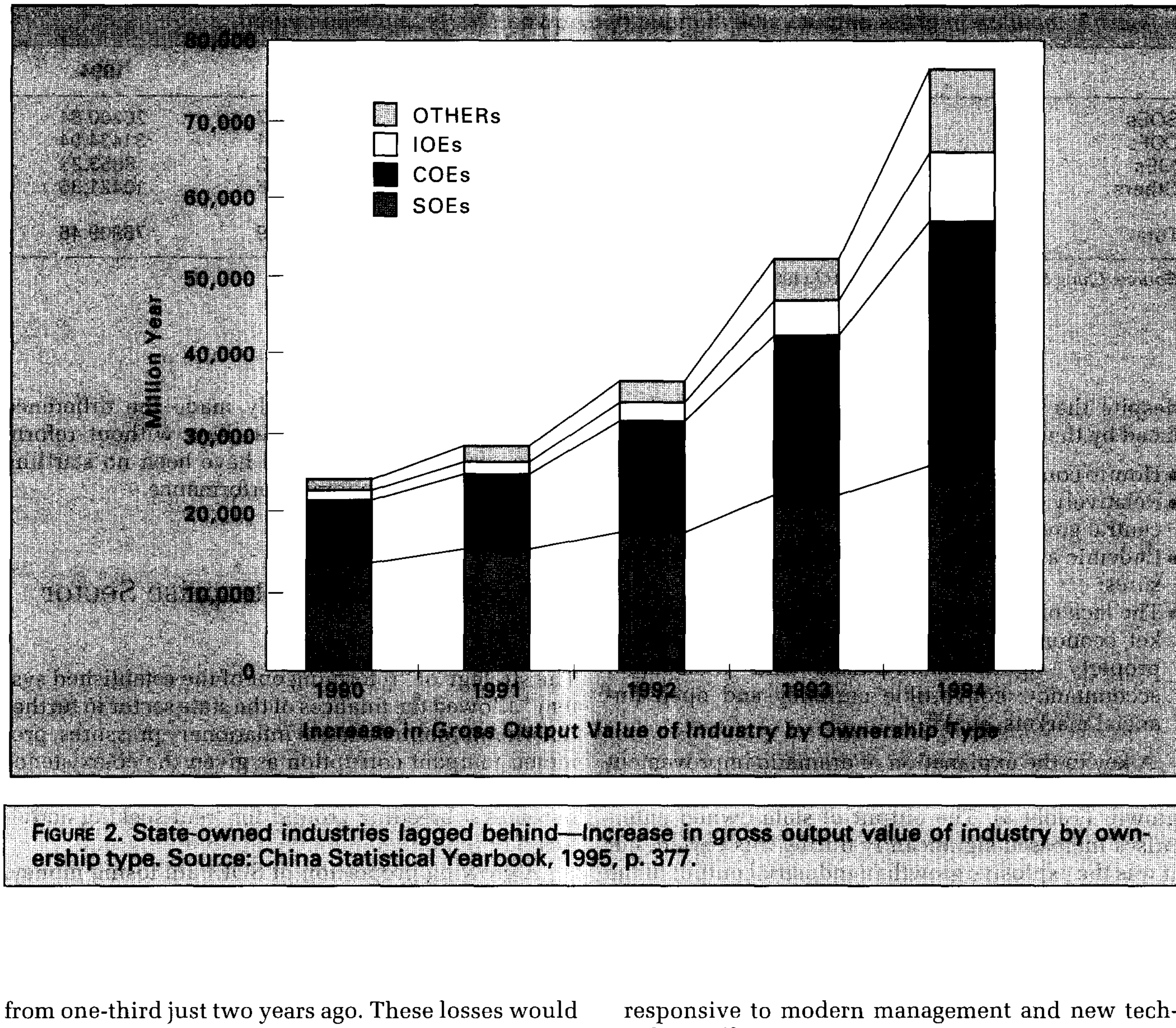


FIGURE 2. State-owned industries lagged behind—Increase in gross output value of industry by ownership type. Source: China Statistical Yearbook, 1995, p. 377.

from one-third just two years ago. These losses would undoubtedly be greater were it not for the fact that the enterprises have access to subsidised credit."[15] Official Chinese estimates are even more pessimistic, that 43% of SOEs are loss-making and another 30% only make a profit by false accounting.

Among the explanations of the relative lack of efficiency of the state sector are the major factors that:

- The SOEs had fixed production and prices, the non-state sector is capable of responding to high demand with higher prices;
- The SOEs had an employment and social welfare function, the non-state sector could take advantage of the unlimited labour supply from rural areas at lower wages;
- The SOEs were guided in their investment towards strategic and comprehensive production, the non-state sector could selectively invest in the most profitable market sectors.
- The SOEs tended toward traditional management and old technologies; the non-state sector was more responsive to modern management and new technologies.[16]

The only way out of these dilemmas it was increasingly realised was for the state sector to adjust to the market system. This adjustment is particularly difficult while the SOEs provide for the social welfare of employees. A senior economist of Hong Kong's Standard Chartered Bank argues that while SOE losses are mounting, their ability to create wealth measured by value added is improving. However much of the money raised by state firms is soaked up by welfare payments, including wages for laid-off workers. In addition SOEs pay a disproportionate amount of taxes, which encourages the understatement of profits, and the overstatement of losses.[17]

Inadvertently China has become what used to be known as a "mixed economy", where public and private enterprise coexist. Further analysis of the distribution of industrial output by ownership type suggests the dwindling significance of the state sector, and the huge surge of the other sectors, particularly

Table 5. Distribution of gross output value of industry by ownership type*

Year	SOEs	COEs	IOEs	Others
1978	77.63	22.37	0.00	0.00
1979	78.47	21.53	0.00	0.00
1980	75.97	23.54	0.02	0.48
1981	74.76	24.62	0.04	0.58
1982	74.40	24.82	0.06	0.68
1983	73.35	25.74	0.12	0.78
1984	69.09	29.71	0.19	1.01
1985	64.86	32.08	1.85	1.21
1986	62.27	33.51	2.76	1.46
1987	59.73	34.62	3.64	2.02
1988	56.80	36.15	4.34	2.72
1989	56.60	35.69	4.80	3.44
1990	54.60	35.62	5.39	4.38
1991	52.94	35.70	5.70	5.66
1992	48.09	38.04	6.67	7.11
1993	43.13	38.36	8.35	10.16
1994	34.07	40.87	11.51	13.55
1995	34.00	36.59	12.86	16.57

Source: *China Statistical Yearbook*, p. 414 (1993); p. 373–375 (1994); p. 377 (1995) and p.75 (1996).

the private and foreign owned sectors which did not exist in 1978 and together now account for nearly 30% of total output. Most significantly of all, the collectively owned enterprise sector has overtaken the state owned enterprise sector in contribution to gross output. This suggests that however successful the reforms of the state sector might prove, state owned enterprise will in future be of diminishing importance to the Chinese economy (Table 5, Figs 3 and 4).

Since the government stopped financially subsidising most SOEs, they have turned to the state banks that make "policy loans". These loans are unlikely ever to be repaid and rather than going towards investment, are mostly used to pay for wages, working capital and employees health costs. Nicholas Lardy of the Brookings Institution estimates that subsidies in the form of policy loans to SOEs have run at more than 10% of GDP since the late 1980s. Together with the vast infrastructure investment associated with rapid economic development, this has accounted for a huge increase in banks lending from 1000 billion yuan in 1988 to 5000 billion in 1996, with around 20% of this non-performing loans. "People continue to put their savings in banks, because they have faith in an implicit guarantee from the government. If ever the government's willingness to stand behind the banks came into question, financial panic would ensue. One Chinese official contends that, by Zhu Rongji's own admission, the only thing that keeps the economics chief awake at night is the possibility of financial crisis". However the overall ratio of domestic government debt to GDP is only 6%, which is very low by international standards, and leaves scope for finding ways of writing off the debt and recapitalising the banks.[18]

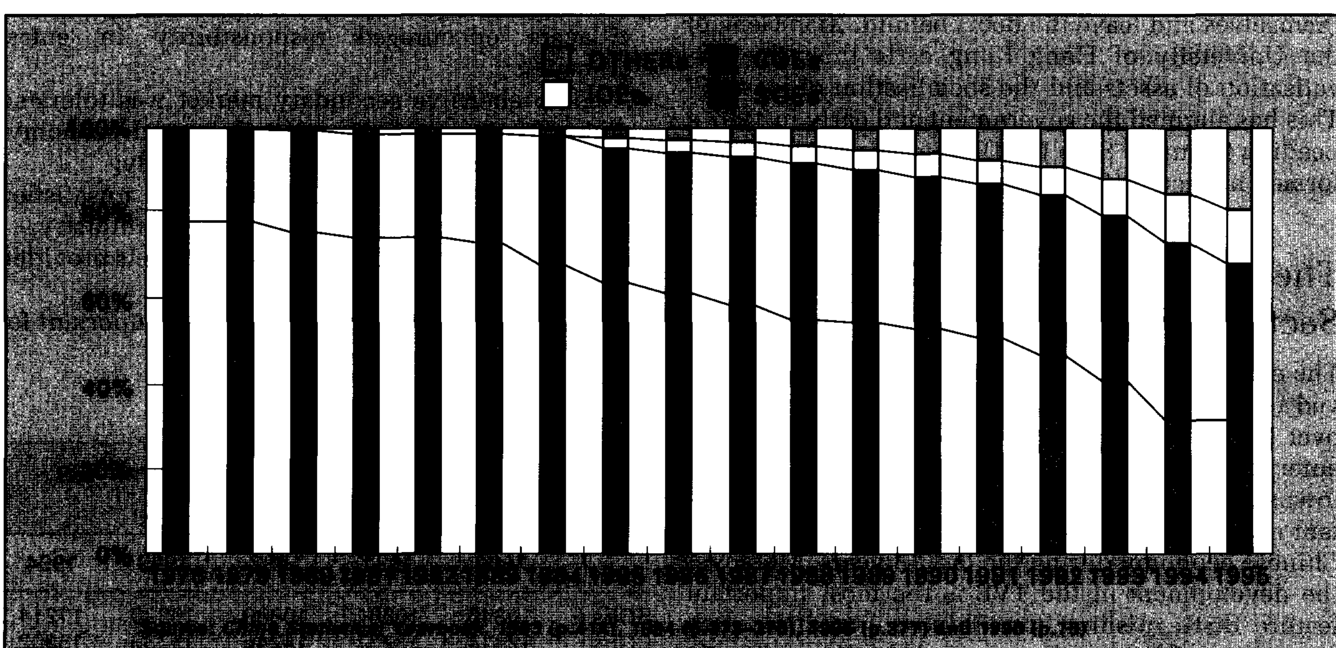


Figure 3. The relative decline of state-owned enterprises—Distribution of gross output value of industry by ownership type.

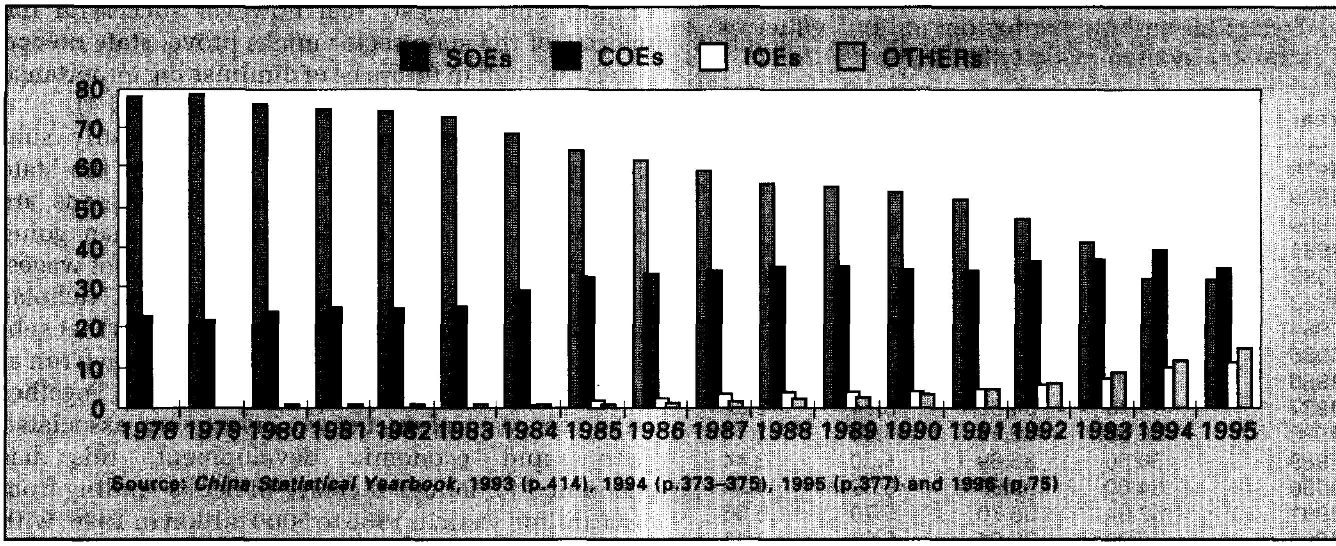


FIGURE 4. Percentage industrial output by type of enterprise.

Continued losses by the SOE's has provoked the government to seek more radical solutions, though these often facilitate further corruption.

"A process of spontaneous privatisation is under way in many of China's smaller state firms: shares are sold to other companies, to foreigners or to firms' own management and workers. Though the scale of this is difficult to gauge, a growing number of smaller firms are evidently being stripped bare by managers and local government officials who seize the assets for themselves and leave the debts behind. Xiao Geng of the University of Hong Kong calls this 'the privatisation of assets and the socialisation of losses'." This has alarmed the government and early in 1997 a Leading Group to Stop the Drain of State Assets was formed headed by Zhu Rongji.[19]

The Township–Village Enterprise Sector (TVEs)

The collectively owned enterprises (COEs) have proved the most robust sector of the Chinese economy over the last 20 years and the township and village enterprises (TVEs) the most dynamic of all. "The township–village enterprise has been the most important engine driving the unprecedented growth of the Chinese economy during the last 15 years. Moreover the development of the TVE is the most important feature distinguishing the Chinese transition path from those of Eastern Europe and the former Soviet Union... The phenomenal growth of TVEs was neither planned nor expected by the Chinese government, as publicly acknowledged by Deng Xiaping".[20]

The collectively owned enterprises have become the major employer and now account for almost half of the total industrial workforce. The TVEs have alone created 95 million jobs in the last 15 years, and contributed 31% of GDP in 1994. (Table 6, Figs 5 and 6). The explanation of the rapid growth of the TVEs include the following factors:

- Rural reform provided the incentive and increased productivity in agriculture the capital to invest in entrepreneurial undertakings;
- Kinship and implicit property rights among Chinese villagers encouraged responsibility in entrepreneurs;
- A comprehensive secondary market was tolerated under the "two-tiers" system (planned economy/market system) which developed quickly;
- The SOE sector left considerable unsatisfied demand to be met, particularly in light industry;
- Financial discipline, limited local budgets provided a hard constraint;
- The support of local government was important for

TABLE 6. Employment by ownership type 1990–1994 (10,000 persons)

	1990	1991	1992	1993	1994
SOEs	10346	10664	10889	10920	11214
COEs	12814	13237	14246	15738	15302
IOEs	2275	2492	2700	3313	4424
Others	164	216	282	536	759
Total	25599	26609	28117	30507	31699

Source: Adapted from *China Statistical Yearbook*, p. 84–85 (1995).

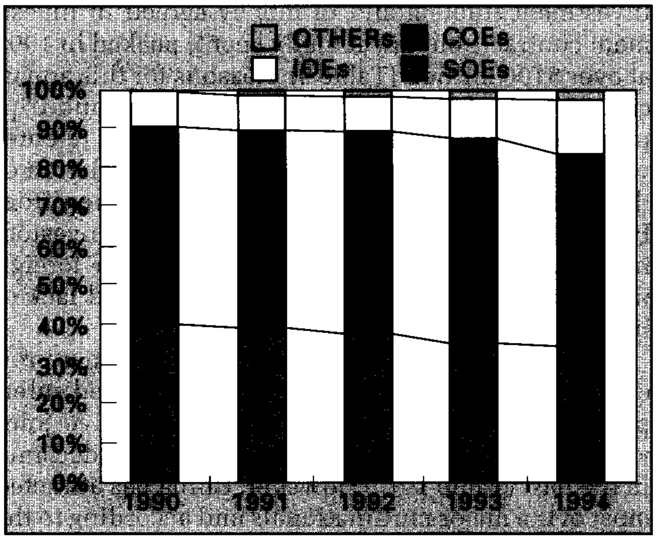


FIGURE 5. Employment in different types of enterprises: 1990–1994.

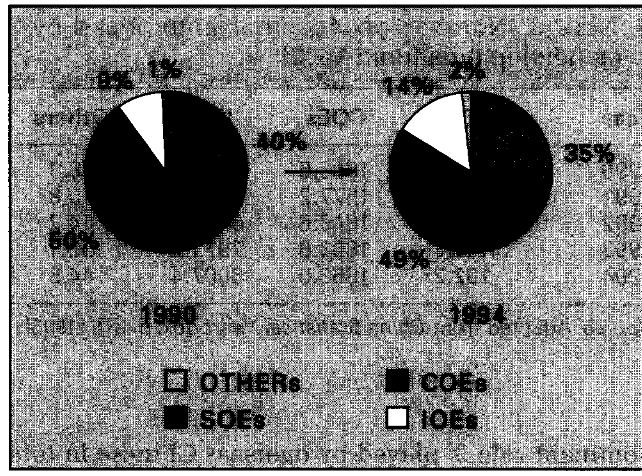


FIGURE 6. Changes in employment structure: 1990–1994.

TVEs, they supported the enterprises by providing infrastructure, and in return received their most significant source of revenue;

- The distribution of industry widely throughout China, provided a technological precondition for local rural industrialisation.[21]

Regrettably one of the side-effects of this spontaneous and often chaotic industrialisation has been a despoliation of much of the countryside and a weakening of the agricultural capacity to feed China.

As a product of the spontaneous initiatives of local people the TVEs vary considerably in institutional arrangements. Based on residency and implicit property rights, they tend to display elements of both co-operative and private enterprise. Regionally the TVEs differ greatly in terms of the local government influence, whether there are joint ventures with foreign capital etc. Some TVEs have become large enterprises employing several thousand people and with the turnover of small conglomerates. At this stage in their existence it is likely there will be an abrupt move to more defined property rights, and the formation of shareholding companies, though the basis of the distribution of shares is still to be worked out.

Private and Individual Owned Enterprises (IOEs)

The private and individual owned enterprise sector in China is basically composed of small and medium sized enterprises. As recently as 1978 officially this form of enterprise did not exist, and yet there are now over 8 million of them trading. This reveals the vigour of the ancient Chinese entrepreneurial spirit, but also the desperation of people who have had to create their own jobs often with tiny amounts of assets at their disposal. (Tables 7 and 8).

Foreign Investment and Ownership

It is among the foreign invested companies that the greatest prosperity is experienced in China. China had the third largest cumulative Foreign Direct Investment (F.D.I.) period 1985–1994, however the

TABLE 7. Rate of growth of industrial output by class of ownership 1981–1994 (Year to year percentage)

	1981	1986	1989	1990	1991	1992	1993	1994
State enterprises	2.5	6.2	3.9	3.0	8.6	12.4	5.7	6.5
Collective enterprises	9.5	18.0	10.5	9.0	18.4	39.3	36.0	29.8
Individual enterprises	35.1	54.1	31.0	27.5	36.4	58.8	77.5	63.8
Total	4.3	11.7	8.5	7.8	14.8	27.5	28.0	26.1

Source: China Statistical Yearbook (1995).

Table 8. Number of industrial enterprises by ownership type (unit: 1000)

Year	SOEs	COEs	IOEs	Others
1990	104.4	1668.5	6176.0	8.8
1991	104.7	1577.2	6386.7	10.8
1992	103.3	1640.6	6584.0	14.2
1993	104.7	1803.6	7971.2	32.1
1994	102.2	1863.0	8007.4	44.5

Source: Adapted from *China Statistical Yearbook*, p. 375 (1995).

dominant role is played by overseas Chinese in total direct investment in China. Many conglomerates in South-east Asia are controlled by ethnic Chinese and these firms were responsible for 80% of the total pledged foreign investment in 1994.[22] The flood of foreign investment into China reached a peak of $42 billion in 1996 and is likely now to fall as contracted investment (the amount of money agreed in investment contracts but not actually spent) peaked in 1993 at over $100 million (Table 9). Reasons for this apparent slowing of FDI include the end of "round-tripping" whereby money would leave China to re-enter with the benefit of tax advantages; the completion of the transfer of labour intensive manufacturing from Hong Kong and Taiwan, the two biggest investors in China; and finally a frustration of some foreign investors with red tape, increasing taxes and lack of intellectual property protection.[23]

This frustration is evidenced in the growing preference for investment in wholly foreign owned enterprises, rather than the equity or co-operative joint ventures which overseas investors were guided into in the past (Table 10).[24] However, China has attracted most of the major multinationals and according to the OECD recorded the third largest cumulative foreign direct investment in the period 1985–1995 (Table 11). More startling still, throughout the period of restructuring of Russia and Eastern Europe as market econ-

Table 9. Foreign direct investment in China

	Project agreements		Investment agreed (Unit: 1 billion U.S. dollars)		Actual use of foreign capital	
Year	Number	Increase (± %) on previous year	Amount	Increase (±%) on previous year	Amount	Increase (±%) on previous year
1979–1982	922		6.0		1.2	
1983	470		1.7		0.6	
1984	1856	294.9	2.7	53.1	1.3	97.8
1985	3073	65.6	5.9	123.8	1.7	32.0
1986	1498	51.3	2.8	−52.2	1.9	12.8
1987	2233	49.1	3.7	30.9	3.3	23.5
1988	5945	166.2	5.3	42.8	3.2	38.0
1989	5779	−2.8	5.6	5.7	3.4	6.2
1990	7273	25.9	6.6	17.8	3.5	2.8
1991	12978	78.4	12.0	81.6	4.4	25.2
1992	48764	275.7	58.1	385.3	11.0	152.1
1993	83437	71.1	111.4	91.6	27.5	150
1994	47549	−43.0	82.7	−25.8	33.8	22.7
1995	37011	−22.2	91.3	10.4	37.5	11.1

Source: *China Statistics*, 1997, Vol. 2, 16.

Table 10. Foreign direct investment in China by type of venture in 1995

Projects	Number of projects	Contracted U.S. $ million	Dispersed U.S. $
Equity joint ventures	20508	38839	19356
Co-operative joint ventures	4826	17791	7502
Wholly foreign owned enterprises	11784	33601	10298
Joint exploration	8	57	590
Total	37126	90288	37736

Source: CERD Consultants

Table 11. The most important host countries for FDI cumulative flows 1985–1994

	U.S. $ million
United States	402445
United Kingdom	172277
China	92761
France	85474
Spain	72570
Belgium–Luxembourg	63041
Canada	51409
Australia	49298
Netherlands	45292
Singapore	44057
Italy	32521
Mexico	31292
Malaysia	25213
Sweden	24349
Argentina	19780
Germany	18779
Hong Kong	14868
Switzerland	14714
Thailand	14568
Brazil	13499

Note: Definitions of FDI differ greatly across countries.
Source: IMF; OECD/DAF; OECD 1996.

omics from 1989–1995, World Bank figures suggest China received four times the FDI of the whole post-Soviet sector (Table 12).

Shareholding Companies

Recent reforms have promoted a burgeoning capital market in China. Firstly in the transformation of the state sector, a series of reforms have pushed enterprises closer to the capital market, as Jinglian Wu, an economic adviser of the State Council summarises the measures:

Table 12. FDI in China & other "transitional economies"—cumulative inflows 1989–1995

	U.S. $ millions
Poland	6459
Hungary	10634
Czech Republic	3996
Slovak Republic	483
Bulgaria	397
Romania	1101
Russia	3900
Kazakstan	719
Ukraine	950
Vietnam	351
China	121704

Source: World Bank, p. 64 (1996).

- Corporatisation of large-sized enterprises (1993)
- Liberalisation of small-sized enterprises (1995)
- Strategic restructuring of the state sector (1996)

The target of each of these reforms is to reduce the scope of the state sector by diversifying ownership, this might involve state enterprises being listed on the stock exchange, acquisitions and mergers, employee and management buy-outs, debt-equity swaps and in the last analysis, going bankrupt.[25]

Restructuring of the state sector combined with the dramatic advance of the market sectors of the Chinese economy have prompted the development of securities industries. China's two main securities exchanges were officially opened in Shanghai and Shenzhen in 1990 and 1991 respectively. "A" shares were aimed at domestic investors, and for those companies which could comply with international accounting standards "B" shares were offered to overseas investors. By 1996, 288 "A" share companies were listed on the Shanghai Stock Exchange with a market capitalisation of 535 billion yuan and 43 companies had achieved a "B" share listing with a market capitalisation of 19 billion yuan. On the Shenzen Stock Exchange 230 "A" share companies were listed with a market capitalisation of 402 billion yuan, and 43 "B" share companies with a market capitalisation of 20 billion yuan. In addition selected Chinese firms are listed on the Hong Kong stock exchange, and the most promising in New York. Government treasury bond issuance has increased, and external bond issues expanded.[26]

The Chinese have embraced shareholding with all the enthusiasm of recent converts, though the volatility of dealing suggests they are looking for a quick return rather than a long term investment, as one industrialist complained, "They are trying to milk the capital market rather than develop companies. We need to return to a commitment to create wealth rather than manipulating wealth. The values of the capital market are those of the gambling den presently". However another authority added, "Differentiation is beginning to occur on the Chinese stock market between good stock and bad stock, good companies and bad companies, good management and bad management". The emerging significance of the stability of the interconnected Asian securities markets was suddenly felt in the market crash of November 1997.

Network Capitalism

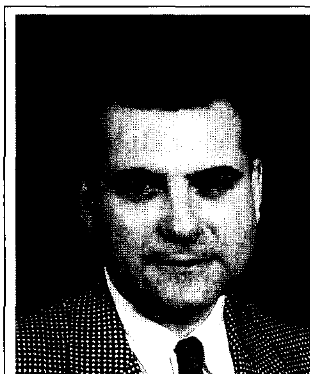
There are unique social aspects to the recent rapid development of the Chinese economy, Boisot and Child suggest the Western preoccupation with the relevance of property rights to economic performance has failed to recognise that property rights "can be a complex mixture that does not constitute a simple binary set of possibilities—'state' vs 'private'. In

China, a bundle of property rights is exercised by different bodies and de facto property rights tend to emerge from continuing processes of negotiation between central, regional, community and private interests... The Chinese system of network capitalism works through the implicit and fluid dynamic of relationships. On the one hand this is a process that consumes much time and energy. On the other hand, it is suited to handling complexity and uncertainty".[27] At the local level this network capitalism can translate into the *guanxi* business connections upon which deals are often based.[28] At an international level the overseas Chinese have sustained a form of network capitalism that has built the greatest trading companies of Asia.[29]

A Stakeholder Economy?

The rapid growth and transformation of the Chinese economy has benefited people generally in terms of increased consumption, however it has not benefited people equally. Owners of capital have profited from high capital income. Farm workers who have moved into industry have enjoyed higher wages. However workers in the state-owned enterprises have suffered a loss of real income due to rising prices and efforts to compensate for this have contributed to the lack of capital investment which compounds the weakness of the sector.[30] Secondly the population of the vast hinterland of China have been left behind in the race to economically develop, and the mass migration to the coastal cities is a looming disaster.[31]

In their enthusiasm for rural land reform, eagerness to join the collective entrepreneurship of the TVEs, to launch independent private businesses, to become shareholders, and to play an active part in the processes of economic reform, the Chinese people have built the foundations of a dynamic stakeholding economy. Compared to the drudgery of peasant existence or the servitude of traditional state owned enterprise this is progress indeed. However the deep insecurity which is the result of centuries of economic instability reminds them how precarious these material gains are.

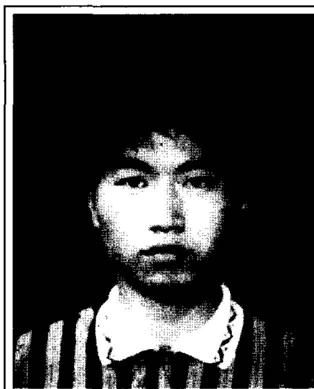


Thomas Clarke is Visiting Professor at the China Europe International Business School (CEIBS) in Shanghai.

References

1. P. Nolan, *China's Rise, Russia's Fall: Politics, Economics and Planning In the Transition From Stalinism*, St Martin's Press, (1995); P. Nolan, The China Puzzle, *Challenge*, Jan–Feb (1994).
2. C. Goodhart and C. Xu, The Rise of China as An Economic Power, *National Institute Economic Review* February, 56–80 (1996).
3. United Nations Industrial Development Organisation, *China: Managing Investment-led Growth*, Industrial Development Review Series, Economist Intelligence Unit, London p. 21 (1996).
4. *Economist*, 13 September (1997).
5. *Business Week*, 25 August (1997).
6. *ibid.*
7. World Bank, *From Plan to Market*, World Development Report, Oxford University Press (1996); J. Child, *Management in China During the Age of Reform*, Cambridge University Press, (1994); P. Bowles and X. Dong, Current Successes and Future Challenges in China's Economic Reforms, *New Left Review* **208** November–December, 49–77 (1994).
8. United Nations Industrial Development Organisation, *op cit*, pp. 1–22; T. G. Rawski, Chinese Industrial Reform, *AEA Papers and Proceedings* May (1994); C. Riskin, *China's Political Economy*, Oxford University Press (1991).
9. World Bank, *op cit*, p. 42.
10. *ibid*, p. 41.
11. Goodhart and Xu, *op cit*, 58; W. H. Overholt, *China The Next Economic Superpower*, Weidenfeld and Nicolson, London, (1993); J. Rohwer, *Asia's Rising*, Nicholas Brealey Publishing, (1995).
12. *ibid.*
13. *ibid.*
14. Wu Jinglian, Chinese Economy, *CEIBS* (1997).
15. *Economist* 13 September (1997); World Bank, *China's Management of Enterprise Assets: The State as Shareholder*, June (1997).
16. C. Pu, Understanding Special Features of the Chinese Economy, *CEIBS* p. 14 (1997).
17. *Economist* 3 May (1997); Y. Zhu, Major Changes Under Way in China's Industrial Relations, *International Labour Review* **134** (1), (1995); T. MacMurray and J. Woetzel, The Challenge Facing China's State Owned Enterprises, *McKinsey Quarterly* **2**, 61–74 (1994).

18. *Economist* 13 September (1997); Y. R.Wong, China's Economic Reform: The Next Step, *Comparative Economic Policy,* **XIII** January (1995); N. Lardy, The Role of Foreign Trade and Investment in China's Economic Transition, *The China Quarterly* **144,** December, 1065–1082 (1995).
19. *Economist* 13 September (1997).
20. Goodhart and Xu *op cit,* p. 66; B. Naughton, Chinese Institutional Innovation and Privatisation from Below, *AEA papers and Proceedings* **84,** 2.
21. C. Pu, *op cit,* p. 12; World Bank, *op cit,* p. 51; J. C. Oi, The Role of the Local State in China's Transitional Economy, *The China Quarterly* **144** December, 1132–1149 (1995).
22. *OECD, Financial Market Trends,* **64** June, Table 2, p. 54 (1996).
23. *Economist* 1 March (1997).
24. W. Vanhonaker, Entering China, *Harvard Business Review* April, (1997); S. Young, C. Huang and M. McDermott, Internationalisation and Competitive Catch-up Processes: Case Study Evidence on Chinese Multinationals, *Management International Review* **36**(4), 295–314 (1996); A. J. De Keijzer, China Business Strategies for the 1990s, Pacific View Press, Berkeley, California (1992).
25. J. Wu *op cit.*
26. M. Spencer, Securities Markets in China, *Finance and Development,* IMF 28–31 (1995); A. Chen, Chinese Industrial Structure in Transition: The Emergence of Stock-Offering Firms, *Comparative Economic Studies* **36**(4), Winter (1994).
27. M. Boisot and J. Child, From Fiefs to Clans: Explaining China's Economic Order, *Administrative Science Quarterly* **41,** 614–625 (1996); L. Putterman, The Role of Ownership and Property Rights in China's Economic Transition, *The China Quarterly* **144,** December 1047–1064 (1995).
28. K. R. Sin and J. L. Pearce, Guanxi: Connections As Substitutes for Formal Institutional Support, *Academy of Management Journal* **39**(6), 1641–1658.
29. P. Lasserre and H. Schutte, *Strategies for the Asia Pacific,* Macmillan, (1995); C. Engholm, Doing Business In Asia's Booming "China Triangle", Hall, Englewood Cliffs, New York, (1994); M. Weidenbaum, The Chinese Family Business, *California Management Review* **38**(4), Summer (1996); M. Chen, *Asia Management Systems,* Routledge, London, (1995).
30. C. Pu, *op cit;* M. Maurer-Fazio, Labour Reform in China, *Comparative Economic Studies* **37**(4), (1995).
31. B. L. Weinstein, Developing China's Hinterland: From Autarky to Anarchy? *Challenge* March–April (1996).



Du Yuxing is a Research Associate of the China Europe International Business School and a graduate of Jiatong University.