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

Thomas Clarke and Du Yuxing

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
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.  

Furthermore the practice of drawing up Five Year
Plans supplemented by annual targets for the econ-
omy 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 involv-
ing many participants and culminating in the final-
isation of a complex, multivariate input–output
model for most economic sectors. Under the influence
of the reforms, especially after the mid-1980s 'manda-
tory' planning has increasingly been supplanted by
'guidance'. This means that most targets are nego-
tiated between the individual enterprise and the rel-
vant ministry in the capital or local government".  

The great economic successes of the last twenty
years are more readily attributable to the freedom
which this decentralised structure provided, com-
bined with the release firstly of farmers' energy in
the "household responsibility system" from 1978 and
later the tremendous unleashing of the entre-
preneurial 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".  

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".  

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 sec-
ondly because the government is intent on intro-
ducing 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 mer-
  gers and discouraging new entrants.
- Releasing state companies from the burden of pro-
  viding health care, pensions and housing by estab-
  lishing national health and retirement schemes, and
  making it easier for workers to buy homes.
- Broadening the government programmes of retrain-
  ing to an estimated 15 million factory workers
  (12.5% of the SOE work force) who will lose their
  jobs through consolidation.  

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
经济学. 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 pro-
gramme 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 decent-
ralised form of socialism, coincided with serious
drought and famine, which disrupted implementa-
tion of the second five year plan 1958–62. China
remained isolated from other economies, which was
compound 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 auton-
omy seized during the chaotic years of the Cultural
1979-1990 “Crossing the River by Feeling the Stones”
Deng Xiaoping 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 Xiaoping 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.

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

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**Table 1: China’s Industrial Reforms: 1979–1995**

<table>
<thead>
<tr>
<th>Year</th>
<th>Reforms</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>Law on joint ventures; price liberalisation starts in agriculture.</td>
</tr>
<tr>
<td>1980</td>
<td>Fiscal autonomy to local governments; special economic zones created; private income tax introduced.</td>
</tr>
<tr>
<td>1981</td>
<td>Individual enterprises encouraged in urban centres.</td>
</tr>
<tr>
<td>1982</td>
<td>Price liberalisation of industrial products starts; patent law and trademark law enacted.</td>
</tr>
<tr>
<td>1983</td>
<td>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.</td>
</tr>
<tr>
<td>1984</td>
<td>14 Coastal cities are opened up to overseas investment; director-responsibility system and “above plan” pricing and production autonomy introduced; TVEs created.</td>
</tr>
<tr>
<td>1986</td>
<td>Labour contract system replaces virtual lifetime employment for urban new recruits.</td>
</tr>
<tr>
<td>1988</td>
<td>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.</td>
</tr>
<tr>
<td>1989</td>
<td>Regulations on mergers, joint-stock companies and commercialisation of banks.</td>
</tr>
<tr>
<td>1990</td>
<td>Copyright law enacted.</td>
</tr>
<tr>
<td>1991</td>
<td>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 bureaus and state investment companies and the firm has management autonomy. Establishment of the Shanghai and Shenzhen stock markets.</td>
</tr>
<tr>
<td>1992</td>
<td>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.</td>
</tr>
<tr>
<td>1993</td>
<td>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.</td>
</tr>
<tr>
<td>1994</td>
<td>Foreign exchange reform; fiscal and tax reform; implementation of company law.</td>
</tr>
<tr>
<td>1995</td>
<td>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.</td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real output (GNP)-billion yuan*</td>
<td>650</td>
<td>763</td>
<td>1275</td>
<td>1854</td>
<td>2315</td>
<td>2623</td>
<td>2927</td>
<td>3214</td>
</tr>
<tr>
<td>Population: million</td>
<td>963</td>
<td>987</td>
<td>1159</td>
<td>1143</td>
<td>1172</td>
<td>1185</td>
<td>1199</td>
<td>1211</td>
</tr>
<tr>
<td>Real output per capita: yuan</td>
<td>684</td>
<td>773</td>
<td>1010</td>
<td>1622</td>
<td>1975</td>
<td>2214</td>
<td>2441</td>
<td>2654</td>
</tr>
</tbody>
</table>

Notes: * 1990 prices.
† Partly forecast.
Table 3. Increase in gross output value of industry by ownership type (million yuan)

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SOEs</td>
<td>13063.75</td>
<td>14954.58</td>
<td>17924.15</td>
<td>22724.67</td>
<td>26200.84</td>
</tr>
<tr>
<td>COEs</td>
<td>8522.7</td>
<td>10084.75</td>
<td>14101.19</td>
<td>20213.21</td>
<td>31434.04</td>
</tr>
<tr>
<td>IOEs</td>
<td>1290.3</td>
<td>1609.1</td>
<td>2506.8</td>
<td>4402.05</td>
<td>8853.23</td>
</tr>
<tr>
<td>Others</td>
<td>1047.56</td>
<td>1599.58</td>
<td>2633.58</td>
<td>5352.06</td>
<td>10421.35</td>
</tr>
<tr>
<td>Total</td>
<td>23924.36</td>
<td>28248.01</td>
<td>37065.71</td>
<td>52691.99</td>
<td>76909.46</td>
</tr>
</tbody>
</table>


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.)

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’”.

“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)

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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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 3. Distribution of gross output value of industry by ownership type

<table>
<thead>
<tr>
<th>Year</th>
<th>SOEs</th>
<th>COEs</th>
<th>IOEs</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>77.63</td>
<td>22.37</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>1979</td>
<td>78.47</td>
<td>21.53</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>1980</td>
<td>75.97</td>
<td>23.54</td>
<td>0.02</td>
<td>0.48</td>
</tr>
<tr>
<td>1981</td>
<td>74.76</td>
<td>24.62</td>
<td>0.04</td>
<td>0.58</td>
</tr>
<tr>
<td>1982</td>
<td>74.40</td>
<td>24.82</td>
<td>0.06</td>
<td>0.68</td>
</tr>
<tr>
<td>1983</td>
<td>73.35</td>
<td>25.74</td>
<td>0.12</td>
<td>0.78</td>
</tr>
<tr>
<td>1984</td>
<td>69.09</td>
<td>29.71</td>
<td>0.19</td>
<td>1.01</td>
</tr>
<tr>
<td>1985</td>
<td>64.86</td>
<td>32.08</td>
<td>1.85</td>
<td>1.21</td>
</tr>
<tr>
<td>1986</td>
<td>62.27</td>
<td>33.51</td>
<td>2.76</td>
<td>1.46</td>
</tr>
<tr>
<td>1987</td>
<td>59.73</td>
<td>34.62</td>
<td>3.64</td>
<td>2.02</td>
</tr>
<tr>
<td>1988</td>
<td>56.80</td>
<td>36.15</td>
<td>4.34</td>
<td>2.72</td>
</tr>
<tr>
<td>1989</td>
<td>56.60</td>
<td>35.69</td>
<td>4.80</td>
<td>3.44</td>
</tr>
<tr>
<td>1990</td>
<td>54.60</td>
<td>35.62</td>
<td>5.39</td>
<td>4.38</td>
</tr>
<tr>
<td>1991</td>
<td>52.94</td>
<td>35.70</td>
<td>5.70</td>
<td>5.86</td>
</tr>
<tr>
<td>1992</td>
<td>48.09</td>
<td>38.04</td>
<td>6.57</td>
<td>7.11</td>
</tr>
<tr>
<td>1993</td>
<td>43.13</td>
<td>38.36</td>
<td>8.25</td>
<td>10.16</td>
</tr>
<tr>
<td>1994</td>
<td>34.07</td>
<td>40.87</td>
<td>11.51</td>
<td>13.55</td>
</tr>
<tr>
<td>1995</td>
<td>34.00</td>
<td>36.59</td>
<td>12.86</td>
<td>16.57</td>
</tr>
</tbody>
</table>

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."

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 Xiaoping."

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

![Figure 4. Percentage industrial output by type of enterprise.](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>SOEs</th>
<th>COEs</th>
<th>IOEs</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>10346</td>
<td>12814</td>
<td>2275</td>
<td>164</td>
<td>25599</td>
</tr>
<tr>
<td>1991</td>
<td>10664</td>
<td>13237</td>
<td>2492</td>
<td>216</td>
<td>26609</td>
</tr>
<tr>
<td>1992</td>
<td>10899</td>
<td>14246</td>
<td>2700</td>
<td>282</td>
<td>28117</td>
</tr>
<tr>
<td>1993</td>
<td>10920</td>
<td>15738</td>
<td>3313</td>
<td>536</td>
<td>30507</td>
</tr>
<tr>
<td>1994</td>
<td>11214</td>
<td>15302</td>
<td>4424</td>
<td>759</td>
<td>31699</td>
</tr>
</tbody>
</table>

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

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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.  

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 cooperative 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) |
|----------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| 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 | 29.0 | 39.8 |
| 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 |

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. 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.

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). 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 8. Number of industrial enterprises by ownership type (unit: 1,000)**

<table>
<thead>
<tr>
<th>Year</th>
<th>SOEs</th>
<th>COEs</th>
<th>IOEs</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>104.4</td>
<td>1668.5</td>
<td>6176.0</td>
<td>8.8</td>
</tr>
<tr>
<td>1991</td>
<td>104.7</td>
<td>1577.2</td>
<td>6386.7</td>
<td>10.8</td>
</tr>
<tr>
<td>1992</td>
<td>103.3</td>
<td>1640.6</td>
<td>6584.0</td>
<td>14.2</td>
</tr>
<tr>
<td>1993</td>
<td>104.7</td>
<td>1803.6</td>
<td>7971.2</td>
<td>32.1</td>
</tr>
<tr>
<td>1994</td>
<td>102.2</td>
<td>1863.0</td>
<td>8007.4</td>
<td>44.5</td>
</tr>
</tbody>
</table>


**Table 9. Foreign direct investment in China**

<table>
<thead>
<tr>
<th>Year</th>
<th>Project agreements</th>
<th>Investment agreed</th>
<th>Actual use of foreign capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Increase (± %)</td>
<td>Unit: 1 billion U.S. dollars</td>
</tr>
<tr>
<td>1979–1982</td>
<td>922</td>
<td>6.0</td>
<td>1.2</td>
</tr>
<tr>
<td>1983</td>
<td>470</td>
<td>2.7</td>
<td>53.1</td>
</tr>
<tr>
<td>1984</td>
<td>1856</td>
<td>5.9</td>
<td>123.8</td>
</tr>
<tr>
<td>1985</td>
<td>3073</td>
<td>2.8</td>
<td>52.2</td>
</tr>
<tr>
<td>1986</td>
<td>1498</td>
<td>3.7</td>
<td>30.9</td>
</tr>
<tr>
<td>1987</td>
<td>2233</td>
<td>5.3</td>
<td>42.8</td>
</tr>
<tr>
<td>1988</td>
<td>5945</td>
<td>5.6</td>
<td>5.7</td>
</tr>
<tr>
<td>1989</td>
<td>5779</td>
<td>3.6</td>
<td>17.8</td>
</tr>
<tr>
<td>1990</td>
<td>7273</td>
<td>12.0</td>
<td>81.6</td>
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<tr>
<td>1991</td>
<td>12978</td>
<td>58.1</td>
<td>385.3</td>
</tr>
<tr>
<td>1992</td>
<td>48764</td>
<td>111.4</td>
<td>91.6</td>
</tr>
<tr>
<td>1993</td>
<td>83437</td>
<td>114.4</td>
<td>91.6</td>
</tr>
<tr>
<td>1994</td>
<td>47549</td>
<td>82.7</td>
<td>25.8</td>
</tr>
<tr>
<td>1995</td>
<td>37011</td>
<td>91.3</td>
<td>10.4</td>
</tr>
</tbody>
</table>


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

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

Source: CERD Consultants
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:

- Corporatisation of large-sized enterprises (1993)
- 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 Shenzhen 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.

At the local level this network capitalism can translate into the guanxi business connections upon which deals are often based. At an international level the overseas Chinese have sustained a form of network capitalism that has built the greatest trading companies of Asia.

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. 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.

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.

References
6. ibid.
10. ibid, p. 41.
12. ibid.
13. ibid.


20. Goodhart and Xu op cit, p. 66; B. Naughton, Chinese Institutional Innovation and Privatisation from Below, AEA papers and Proceedings 84, 2.


22. OECD, Financial Market Trends, 64 June, Table 2, p. 54 (1996).


25. J. Wu op cit.


