

Chinese Way of Reforming an Enterprise System Characteristics in Comparison with East European Reform

Kazuo ZAIKI

Faculty of Integrated Arts and Sciences, Hiroshima University

Research Associate, Institute for Peace Science, Hiroshima University

SUMMARY

Socialist countries had been making efforts for a long time in order to change their enterprise system into more efficient one. Privatization of state-owned enterprises is one of the most current and important strategies to achieve this goal. However, there is a crucial difference of policies between China and East European countries.

East European countries have already terminated a socialist planned economy. They are now in the process of conducting transition economy and establishing a fully capitalistic free-market system. As the part of this transition, they are trying to change in principle all of state-owned enterprises to private ones.

Chinese government declares that they aim to build up a socialist market economy. Although they now permit state-owned enterprises to issue and sell stocks in a market, they don't intend that all of them shall be fully privatized. They don't want to give up central control over enterprises. It seems that state-owned enterprises still remain for a while in China.

However, as regards methods of creating market-oriented actors, privatizing

state-owned enterprises is not only one way. Another way is to let entrepreneur and investors set up a new company. China adopts this way, introducing direct investments of foreign capitals.

In Short, China takes two-truck policy. They separate ownership from management of a state-owned enterprise and privatize its management activities as much as possible, emphasizing management autonomy and responsibility on self-paying basis. At the same time, they promote setting up new private companies which operate independently of a governmental planning. So that we can say that China's economy is now composed of two different sectors, namely planned and non-planned one. It is undoubtedly said that the latter is a principal driving force for high growth of Chinese economy.

The problem is, however, that the number of state-owned enterprises which are making only loss is estimated at least a third of total ones. As far as these enterprises are concerned, it seems that the best way of rationalization would be a liquidation rather than a privatization. But they cannot do it because they are obliged to find new jobs for workers who lose jobs. This problem delays a fundamental reform of state-owned enterprise in China.

Chinese way of reforming state-owned enterprises is not very much radical as compared with the way adopted in East European countries. In this field, they try to practice the privatization and market economy step-by-step. China persist in a socialist ideology, let's say, they still pursue an ideal of full employment, and therefore they can conduct a reform only gradually. But China would offer another model of transition economy, if they could overcome the former East European failure. Because a group that departed later is in a position to learn the former's lesson.

1. Introduction

For a long time China and East European countries have been trying to rationalize enterprise system. One of the current issues is to privatize state-owned enterprises. But there are some crucial difference between Chinese way and East European way. In this paper we would like to state several features of the Chinese case, comparing it with East European case.¹⁾

We think that privatization has two different dimensions. One is the “ownership” and the other is “management”. In the following statement, we will put more emphasis on the aspect of management. In other words, we use the term “privatization” as the word which indicates the process of creating market-oriented enterprises.²⁾

2. Chinese way of privatization

First of all, when we compare the China's case of privatization with East European case, we can point out two characteristics. One is related with the fact that China is still a socialist country. Speaking of economic system, China, as well as East European countries, both of them are trying to establish a market economy. But Chinese government has not yet completely abandoned a central planning system. What they are trying to do is to reduce a central control over state-owned enterprises and give them more economic autonomy one hand, and they are trying to enlarge the part of non-state-controlled economy on the other hand. However, East European countries have already give up a socialist ideology and they are trying to change a whole enterprise system into a free-market one. In this sense, Chinese reform can be characterized as a step by step policy, at least not so radical as East European one.

Another characteristic of Chinese privatization is that China is adopting so-called two-track policy. As for creating market-oriented actors, it is possible

to take two ways. One way is to privatize the existing state-owned enterprise. Another way is to let entrepreneurs and investors set up new companies. In East European countries, privatization mainly means the former, namely to change state-owned enterprises into private-owned ones. In China, we can observe that both methods are adopted. But so far the Chinese government evidently puts more emphasis on the latter, namely on promoting entrepreneurs and investors to set up new companies.

We said that the Chinese government is adopting a step by step policy, but this statement does not mean the privatization process is slow. On the contrary the number of companies which operate independently of a central planning is on the great increase. So that if we take some indicators, let's say the rate of increase in number of market-oriented companies, we can say the privatization process in China is much faster than in East Europe.

As a result, now Chinese economy is composed of two components. One is a planned economy sector and the other is a non-planned economy sector. We all know that Chinese economy has been expanded rapidly. From 1979 to 1994, the average growth rate of GDP is 9.4%, if we take the period from 1992 to 1994, the average growth rate reaches 13% (see [6]p.18). This economic expansion depends heavily on the rapid growth of non-planned economic sector. This is the second point we would like to discuss.

Here, non-planned economy is composed of four types of actors. The first one is a company which is managed by a local government, namely town and village. The second one is a small-sized company which is managed by individual persons. The third one is a private-owned company which is relatively big-sized. The fourth one is a foreign capital affiliated company.

In terms of ownership, so-called township-village enterprise, the company which is managed by a local government, is a public-owned company. In this point it can be classified into same category as state-owned company. Nevertheless it is distinguished from a state-owned enterprise in several points. First, this type

of company is managed on self-paying basis. And they are permitted to produce and sell products independently of central planning. Its management is free of a lot of administrative constraints which bother a state-owned enterprise. As a matter of fact, in terms of economic behavior, it is not too much to say that now it has become hard to distinguish this type of company from a private company. According to statistics, from 1980 to 1993, the number of township-village enterprises has increased by 16 times. The number of employees in 1993 is 113 million. In terms of amount of money, in 1993, their products account for almost 40 per cent of total amounts of industrial products(see [2]p.21-27).

Another contributive factor to China's economic growth is a foreign capital. Though there are several types in foreign capital affiliated company, we think that it is all right to regard them all as capitalist companies. In the end of 1994, the number of foreign capital affiliated company is about 100 thousand and they have over 140 million of employees. Their production share has been expanding rapidly. In terms of amount of money, in 1993 their products account for almost 40 per cent of total amounts of industrial products(see [2]p.21-27).

3. Problems of reforming a state-owned enterprise

Now we would like to turn to topics on the reform of state-owned enterprises.

In contrast to rapid growth of non-state-owned economic sector, the growth of state-owned sector has made slow progress. One of the biggest problems is perhaps the fact that the number of enterprises which are operated at deficit has been increasing. According to what Chinese researchers say, one third of state-owned enterprises are assumed to be operated at deficit and another one third of enterprises are assumed to be operated without profit. The increase of deficit enterprises inevitably deteriorates economic efficiency of state-owned sector. In terms of amount of money, in 1978, their products

account for 78 per cent of total amounts of industrial products. But in 1993, this number reduced to 43 per cent(see [2]p.21-27).

There are a lot of factors which deteriorate economic performance of state-owned enterprise, but the most important problem is assumed to be in the fact that heavy financial burdens are imposed on state-owned enterprises. Among others we would point out two problems. One is “overemployment”, or surplus of workers. It is estimated that state-owned enterprise has employees on an average 10-30 per cent more than actually required(see [5]p.209). Moreover enterprise has an obligation to pay wages to retired employees.

Another financial burden for an enterprise is expense of social service. In China, for many years, the state-owned enterprise has undertaken not only a task as production unit, but also a task as unit which offers social service to its employees and their family. So that enterprise runs a hospital, kindergarden, school, market restaurant, so on. In a word, labor costs, pension payment, and medical expense, these are regarded as three big burdens for enterprise.

In 1992, Chinese government enacted new laws aiming at restructuring of management of state-owned enterprise. According to laws, it is possible to take four remedies to enterprise operated at deficit. One way is to change sorts of products. The second way is to be merged into other enterprises that are operated well. The third way is to stop production. The fourth way is a liquidation.

However, it is very difficult to put them into practice. First of all, any excellent enterprises do not want to merge loss-making enterprises. Second, it is also difficult to put liquidation in practice. Because it is necessary for government to find a new job to employee who lose a job. And it is also necessary to pay allowance to them while they don't find a new job. Moreover there would be an unsolved question. That is who at all should be supposed to pay allowance of retired employees, if concerned enterprise would be liquidated(see [8]p.142). Chinese government recently set up social insurance

system and is making efforts to spread it to enterprises and employees as many as possible (concerning more detail, see [3]p.213-217, [4]p.29-35). But so far all of enterprises, especially loss-making enterprises have not participated in this system yet, simply because they cannot afford money for insurance.

4. Comparison between two way of privatization

As regards creating market-oriented actors, it is possible to take two ways. One way is to privatize the existing state-owned enterprises. Another way is to let investors and entrepreneurs set up new enterprises. The East European countries mainly take the former way and China mainly takes the latter way. But which way is better to achieve a goal of privatization? When it comes to the problem of creating a competitive private enterprise in a free-market, it seems to be possible to say that the latter way is more effective than the former way. We think that the experience in East European countries show us the ground.

For example, the East European experience tells us that there arise the following problems when they try to change the existing state-owned enterprises. First, according to the East European system, managers and workers are granted the priority to purchase stocks of their own companies with more or less discount price. As a result a majority of the stocks are allocated to managers and workers of the concerned company. It means that the decision for the management is left to those people who have no experience in a free-market system. Most state-owned enterprises have unprofitable section and surplus workers. In order for these inefficient enterprises to survive in a free-market system, managers have to venture to streamline the enterprise. But managers and workers generally resist any rationalization of the management and organization that lead to unemployment. Therefore, at least for the early stage of privatization, all of the workers and organization would be taken over to a new company.

Second, the new company would take over the existing equipments and machines, and utilize them for a while. In the former socialist countries, because of the reason that there was no competition among enterprises, most state-owned enterprises used fairy old-fashioned equipments and machines. Buildings of factory were also age-old. Needless to say, with the out-dated equipment and machines is it very difficult to produce high quality products that are needed in a market. Even if these enterprises were privatized, the situation would remain unchanged. It is easily expected, therefore, that these companies would remain inefficient after privatization. Third, it would be probable to suspect that the former state-owned enterprise discharge polluted air and water. Then the privatized enterprise that takes over the state-owned enterprise would be responsible for the pollution. Obviously these enterprises are not attractive for private investors, especially for foreign investors.

Let us consider another case in which private investors set up a completely new company. In this case, needless to say, an owner of this company dose not have to take over the exsiting workers and organizations. All workers and managing staffs could be newly employed. The new owner dose not have to take over old-fashioned equipment and machines, neither is he responsible for any pollution.

As was mentioned above, it would be too simple and optimistic to expect that privatizing the existing state-owned enterprises automatically produces efficient market-oriented actors. If we want to take more effective way, first of all, we should bankrupt inefficient state-owned enterprises that makes only loss. Then we should take measures that promote private investors to establish new companies. Simply saying, new economic system should be undertaken by new actors not old ones, in other words, a free-market system should be performed by newly established companies (as for more detailed discussion, see[9]).

5. Difficulty in liquidation of a state-owned enterprise

Actually it is not easy for government to bankrupt state-owned enterprises, mainly because with the bankruptcy a lot of workers lose their jobs. It would be too optimistic to assume that newly established enterprises absorb the unemployed workers. If the unemployment problem would be too serious, it might make a society unstable. Such an instability would be more serious for a government in socialist country than one in capitalist country.

Even in socialist countries, the right of management is usually decentralized to manager of enterprise, they operate enterprise with so-called self-supporting accounting system. So that a responsibility of managing state-owned enterprise is first of all taken by the concerned enterprise. But if the enterprise would be completely unable to take a responsibility, let's say it could not make up a deficit, then there would be no other way than the government finally takes over a responsibility of the enterprise. Therefore in the socialist era, the East European governments had a huge amount of expenditure to finance deficit-ridden enterprises. It was one of the biggest problems that lead a collapse of socialist economy in East Europe.

New governments in East Europe have tried to terminate such a loose budget policy. That has been a main purpose of the privatization as the post-socialist policy. East European governments hope that (in stead of a government regulation) a natural selection works with a market mechanism to bankrupt inefficient enterprises. If the government administratively closes an enterprise, workers who lose their jobs by governmental regulations would make a fierce attack on the government policy. If impersonal forces of market mechanism order inefficient enterprises and workers to be purged, they could not directly criticize a government policy. The natural selection to purge incompetent actors is a reasonable work of the market economy, so that they are forced to understand its consequence.

As mentioned previously, as a method to create a competitive private enterprise, it is not always a fine policy to privatize the existing state-owned enterprise. However, it seems that creating a competitive private enterprise is not the first goal of privatization in East Europe. We think that the goal of privatization at the first stage is to liquidate loss-making enterprises rather than to create competitive private enterprises.

Now we should conclude this paper. So far we can say that the Chinese privatization program has been carried out in two different sectors. One is performed in non-planned sector and the other is in planned sector. In non-planned sector, a free market system is gradually being functioned, market-oriented and competitive actors are emerging. They are undoubtedly a principal driving force for high speed economic growth in China. In this point, we think that China goes a step ahead in comparison with East Europe. But in planned sector, namely as far as the problem of state-owned enterprise concerned, China seems to be behind East Europe. Because China still suffers problem which East Europe suffered before because of socialistic ideological reason. Namely, they cannot liquidate a deficit-ridden state-owned enterprise unless they solve the question of unemployment (concerning concrete regulation, see [1] p.2-4).

Recently Chinese government has tried to separate ownership from management and to privatize the management activities. Simply saying, they give more autonomy of management to enterprise. And at the same time they emphasize the self-supporting accounting principle and responsibility of state-owned enterprise. But this policy is exactly what socialist governments in East Europe tried and unfortunately failed in the long run. Could Chinese government overcome the former East European problems or they would follow the same way of failure. It is often said that a group that departed later is in a position to learn the experience of the former. We should continue focusing our attention upon the Chinese reform.

Notes

- 1) A shorter and less developed version of this paper was presented at the workshop on “Japanese Experience and East European Transition Economies”, at the ISA-JAIR JOINT CONVENTION, Makuhari, Chiba, Japan, September 20-22, 1996.
- 2) As for process of privatization, at first, privatization means a transition of ownership from a state to private persons, then it comes to the problem of privatizing management activities. The first step of privatization is a necessary condition for the second step.
- 3) The law of enterprise bankruptcy was already enacted in 1984 (as for more detail, see [8]p.224-225).

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