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Policy Brief

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China's Private Future

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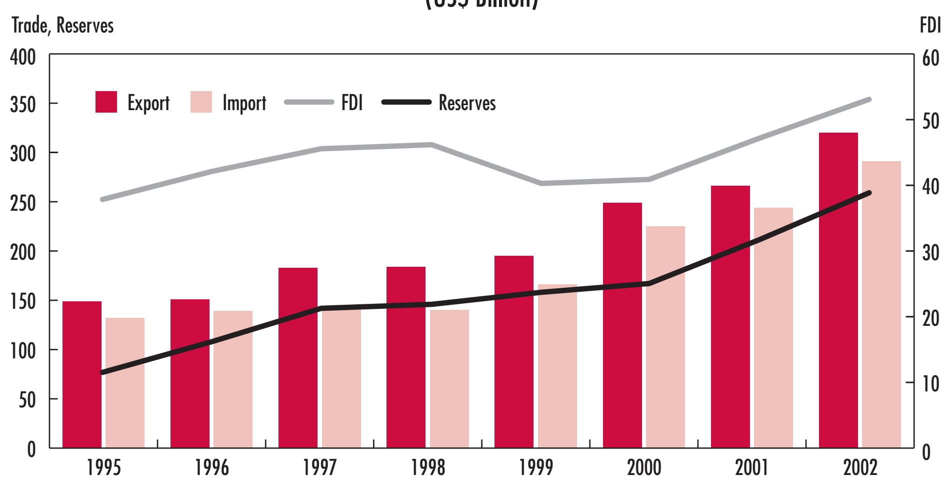
China's market reforms since the late 1970s have contributed to more than two decades of sustained, rapid growth that has made China a trillion dollar plus economy with per capita income that will exceed $1,000 in 2003. Adjusted to reflect the real purchasing power of domestic currency, the World Bank estimated China's per capita income as equivalent to more than $4,000 in 2001, and its adjusted gross national income of $5.4 trillion was second only to that of the United States.

In 2002, Chinese exports and imports exceeded $600 billion, foreign exchange reserves topped a quarter of a trillion dollars, and foreign direct investment inflows surpassed $50 billion.

Figure 1.
China's Foreign Trade, Direct Investment, and Reserves: 1995-2002
(US$ Billion)



Sources: Trade and FDI: Ministry of Foreign Trade and Economic Cooperation
Foreign reserves: People's Bank of China

Notes: Trade and FDI figures for 2002 are linear extrapolations of 11/02 data

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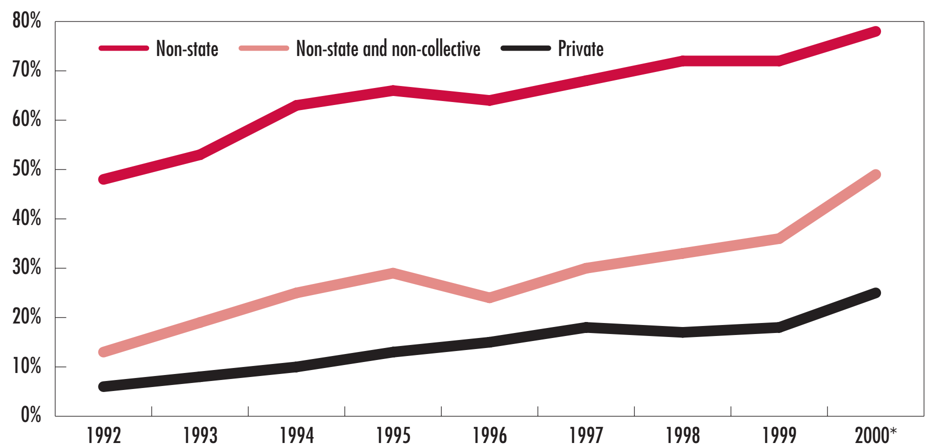
These aggregate numbers, impressive as they are, obscure the depth of structural change that has occurred over the past two decades. More than two-thirds of today's economic activity is in the non-state sector.

In 2002, the share of Chinese output produced in the state sector will fall below a third; even after subtracting the contribution from firms that are owned collectively, the share in the economy of the purely private sector will be considerably more than half. Figure 2 shows just how rapidly private ventures have supplanted state-owned enterprises as the driving force behind the growth of industrial output. Domestic private enterprise also has become a major source of jobs: 27.5 million privately owned firms (most of which are sole proprietorships and partnerships) employ more than 75 million people; and all non-state owned firms, including foreign-invested companies and collectives, account for many more.

Figure 2.
Shares of Gross Industrial Output by Ownership: 1992-2000



* Projected: series break in 1999

Sources: *China Statistical Yearbook*, various issues
Notes: Apart from domestic private ventures, non-state and non-collective firms include share-holding corporations, foreign-invested firms and other.

A recent survey of Chinese private firms supports the view that the climate for private enterprise has improved remarkably lately.[1] The study, which included a survey of private enterprises in five Chinese cities — Beijing, Nanhai, Shenyang, Wenzhou, and Xi'an — representing diverse economic characteristics and different experiences of reform, pointed to the admission to Communist Party membership of private entrepreneurs and China's accession to the World Trade Organization (WTO) as highly significant events in 2001 that improved official attitudes toward private enterprise.

But, in China, most silver linings still have a cloud. Their overall positive sentiment notwithstanding, the surveyed firms indicated that Chinese private enterprise still encounters formidable difficulties. Even comparatively well-established firms suffer from local idiosyncrasies in implementing policies. And firms are constrained by lack of access to formal sources of finance; inadequate information; difficulties in recruiting qualified personnel, especially senior managers and technicians; and deficiencies in the way markets work.

These opinions of private Chinese firms find a common chord in the 2000 survey of its membership by the American Chamber of Commerce in China.[2] Although most of Amcham's members remain bullish on China — 85 percent of them planned to expand their China operations either moderately or strongly — the surveyed companies identified the five most frequently encountered impediments to working in China: bureaucracy (67 percent), human resources (56 percent), transparency (43 percent), corruption (42 percent), and market access (38 percent).

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[1] From a survey conducted by Tsinghua University and the All-China Federation of Industry and Commerce for a study of private enterprise in China financed by the Asian Development Bank.

[2] See The American Chamber of Commerce, People's Republic of China, 2001 White Paper: American Business in China.

Domestic and foreign private firms agree that much remains to be done to increase the transparency of China's policy, legal, and regulatory regimes, and to ensure that officials interpret consistently policies that affect the operation of private ventures. In this regard, China's efforts to reformulate its laws, policies, and regulations to conform to international standards as required by its accession to the WTO have the potential to improve the environment for home-grown private enterprise as much or more than they do for foreign traders and investors.

A straightforward way to reduce bureaucracy, and to limit what is seen, especially by foreign firms, as the ubiquitous corruption of officials, is to eliminate unnecessary regulations and hence the scope for bureaucratic discretion in interpretation. The survey of Chinese private firms indicated that they would appreciate, in particular, actions to streamline licensing requirements and inspection procedures. For small firms, dealing with factory visits by officials can be devastatingly time-consuming, and both licensing and inspections create situations ripe for bribery.

In their increasingly frequent complaints about "fake products" and the blatant appropriation of the goodwill associated with brands, copyrights, patents, services, and so on, Chinese private firms are becoming much more akin to foreign firms in striving to protect their proprietary assets.

Domestic firms report being highly discomforted by the extremely competitive nature of China's markets. This should not alarm officials. To the contrary, cause for concern arises when local officials intervene to limit competition and protect the established ventures.

Foreign and domestic firms share the problem of attracting skilled managers and technical personnel, a problem that China, still early in its development, can expect to wrestle with for decades. One immediate way to improve matters is to initiate plans to certify or accredit the training programs available from commercial and other suppliers. As well, all barriers to the mobility of senior managers and technicians should go, including the notoriously restrictive residence regulation. The mobility of skilled personnel would be enhanced, in particular, by greater ease in disposing of and acquiring dwellings, as well as greater portability of pension benefits.

Improving the flow of information to firms will be another longer-term exercise involving many agencies, and enhancing the coordination among them should concern officials on a continuing basis.

Domestic private firms are most disadvantaged relative to state-owned enterprises and foreign-invested firms in their access to formal sources of finance. China's financial system has shunned domestic private ventures. To enable small- and medium-size enterprises (SMEs) to obtain more credit, banks need greater flexibility to raise lending rates. But higher interest rates alone will be insufficient to boost lending to SMEs. Banks supply liquidity to small enterprises, not risk capital. Banks will lend only when loans are secured by collateral that they can recover quickly in the event of default. Hence, an expedited system to recover collateral if a borrower defaults is also necessary.

Overwhelmingly, China relies on private enterprise to generate the fast, sustained growth required to create jobs and to continue to raise the material well-being of the Chinese people. To do so, reforms still need to be implemented purposefully to ensure that all firms, regardless of ownership or origin, face the same rules of competition and enjoy the same protection of their property rights under law.

Outgoing Chinese President and Communist Party General Secretary Jiang Zemin left no doubt about Chinese enthusiasm for private enterprise in his departing message at the 16th Chinese Communist Party Congress (November 11, 2002):

> "*Maximize the important role of various forms of non-state ownerships, such as individual and private ownerships, in promoting economic growth, creating jobs, and invigorating markets. Relax the entry to the domestic capital market; adopt policies in areas of financing, taxation, land use, and foreign trade, in order to achieve fair competition. Strengthen supervision and regulation according to law, to expedite the healthy development of the non-state sector. Improve the legal provisions for the protection of private property.*"

By following those instructions, China would virtually ensure its continuing economic success.

About the Authors

Nicholas C. Hope is Deputy Director at the Center for Research on Economic Development and Policy Reform (CREDPR), Stanford University. Prior to joining CREDPR, he had a long and distinguished career at the World Bank, holding among others, the positions of Chief, of the External Debt Division, Director of Resident Staff in Indonesia, and Country Director of China and Mongolia. A Rhodes Scholar from Tasmania, he received his Ph.D. in economics from Princeton University. His research interests are East Asian economies, and in particular, financial sector reform and private enterprise development in China.

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