China's Emerging Market for Property Rights: Theoretical and Empirical Perspectives

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CHINA'S EMERGING MARKET FOR PROPERTY RIGHTS: THEORETICAL AND EMPIRICAL PERSPECTIVES*

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ABSTRACT

This paper contrasts state-directed and market–mediated reform of enterprise ownership rights in transition economies, a distinction that corresponds to the alternative theoretical approaches of A.C. Pigou and of Ronald Coase to devising remedies for the externalities associated with commonly held resources. We evaluate China's emerging market for enterprise ownership rights from the perspective of conditions underpinning the Coase Theorem: the assignment of property rights, the degree of competition, and the nature of transaction costs. China's recent experience suggests that policies designed to expand the scope of decentralized exchange of ownership rights may succeed in raising productivity and efficiency even under conditions that deviate widely from the ideal assumptions underlying the Coase Theorem. China faces an important choice between restructuring ownership rights on the basis of market forces or administrative decisions.

Key words: China, ownership, property rights, Coase Theorem, transition, merger, transaction costs

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INTRODUCTION

All former socialist economies carry out reform programs that include three broad elements – macroeconomic stabilization, liberalization, and institutional reform [Fisher and Gelb, 1991]. Because it reflects the particular institutional legacy of each country and is also the most time dependent element of the reform process, institutional reform epitomizes the distinctive experience of the Eastern European economies, Russia, the Newly Independent States, and China. Each country's institutional reform is fundamentally an account of ownership reform, the distinctive process of unbundling the property rights previously controlled by the state and reassigning them to individuals and groups who assume responsibility for managing the nation's productive assets.

After twenty years of rapid growth under gradual reform policies that have sustained the dominant role of public ownership, China enters its third reform decade with a pledge – and critical need – to carry out deep ownership reform. China's leaders have followed this pledge with fresh reforms. China's efforts to advance enterprise restructuring must confront a dichotomy: is government the critical reform actor or will the market serve as the central venue for restructuring?

Our analysis of these matters focuses on three concerns. We develop an analogy between two broad strategies of ownership reform – the state-directed and market-mediated approaches – and the debates between A.C. Pigou and Ronald Coase regarding the appropriate remedy for externalities arising from a common property resource. We use this analysis to illuminate fundamental choices that China's leadership faces in continuing and completing its reform process. Finally, we examine China's progress in

establishing a property rights market from the perspective of the ideal conditions underlying the Coase Theorem.

Limited capacity for effective monitoring of enterprise assets as the fundamental cause of enterprise inefficiency and financial instability. Without effective monitoring, government-owned enterprises take on the characteristics of common property resources [Jefferson 1998, 2000]. China's major banks are themselves state enterprises that cannot effectively monitor their assets. Without a continuing inflow of bank loans, most of China's state-owned enterprises would shrivel and disappear. Because the banking system replenishes the dwindling resources of state enterprises, these firms and their chronically weak monitoring persist.

Such enterprises resemble public goods. That is, they suffer from the problems of substantial non-excludability and non-rivalry. As with public goods, excessive consumption of the assets controlled by government-owned enterprises generates negative externalities. Economists have developed two approaches for remedying the inefficiencies associated with externalities. A.C. Pigou (1920) proposed that government could eliminate gaps between private and social costs and benefits by imposing appropriately designed taxes and subsidies. Ronald Coase (1960) demonstrated how official efforts to establish suitable market institutions open the door to decentralized negotiation of efficiency-enhancing exchanges of rights linked to real or potential common property resources.

In an earlier study, we emphasized the contribution of experimentation, bottom-up initiative, and competitive pressures in China's reform experience [Jefferson and Rawski 1995]. This perspective invites further inquiry into the applicability of Coase's

perspective to the economics of transition. We begin with a theoretical summary that establishes links between public enterprises and public goods and between the analysis of Ronald Coase and China's reform experience. We then turn to empirical matters, studying China's emerging market for enterprise property rights from the perspective of the conditions underlying the Coase Theorem: property rights, competition, and low transaction costs.

This approach contributes new perspectives to the conceptual as well as the empirical analysis of transition economies. Even though China's circumstances are far removed from the ideal of well-specified property rights and zero transition costs, we find that Coase's analytic perspective can support an integrated analysis of important reform issues. On the empirical side, we see expanded markets for commercial property rights as a potential source of new momentum for China's flagging economic growth.

THEORETICAL PERSPECTIVE

Economists have long recognized the need for monitoring to maintain efficiency when production involves multiple individuals or organizations [Alchian and Demsetz 1972]. Effective monitoring is difficult even under private ownership, which empowers owners to create structures that protect their financial interests [Jensen and Meckling 1976]. Ambiguous ownership rights blur incentives and erode monitoring capabilities, increasing the potential for inefficiency, waste, and organizational slack.

Jefferson (1998) pursues this theme in the case of Chinese state-owned enterprises (SOEs). Their Chinese name, *quanmin suoyouzhi*, means "owned by all the people."

The vague nature of property rights associated with SOEs is not merely semantic. Multiple authority fragments external supervision and hobbles internal management. Even after decades of experience, there is no consensus on "how the agencies of state ownership can be established" [Wu Jinglian 1995, p. 89]. Similar difficulties arise in township and village enterprises (TVEs), which are typically organized as collectives under local government control.

Jefferson describes Chinese SOEs as “a kind of impure public good.” Ambiguous ownership and ineffective monitoring lead to opportunistic behavior by "workers, managers, and public officials, who extract value from the firm in excess of what they put in.” The firm’s "inability to. . . limit the overconsumption” by various stakeholders “transforms the state enterprise into a commons” (1998, p. 428).

If China’s SOEs function like fisheries, then why do they not disappear? The answer, Jefferson suggests is that the banking system, which supports China’s enterprise system, is also unable to monitor its resources effectively. Deposits that are loaned out become non-performing loans and thereby serve to replenish the losses of the enterprise system.

China’s SOEs thus exhibit both non-excludability and non-rivalry, the key characteristics of public goods. A further commonality arises, because the overconsumption associated with state enterprises and with public goods generates negative externalities. These may include *financial repression* as governments seek to sustain the flow of deposits to the banking system, *inflation*, which results from the need to monetize continuing fiscal and/or financial subsidies, and *crowding out*, which arises from public borrowing to recapitalize the banking system

These mechanisms for replenishing SOE assets soften budget constraints for banks as well as non-financial state firms. This invites further overconsumption, diminishes investment returns and promotes the accumulation of unrepayable debts. The accumulation of bad debt erodes the balance sheet of the banking system. It is through this channel that we link inadequate monitoring in the enterprise system, which makes SOEs resemble public goods, with financial instability, which emerges as an externality associated with persistent excess consumption of SOE resources.

Economic theory offers two distinct approaches to efficient use of common property resources. A.C. Pigou (1920) taught that governments can respond to externalities by imposing taxes or subsidies that eliminate gaps between private and social cost or benefit. Much of development economics follows from this tradition of emphasizing "problems of market failure and the need for informed official intervention" [McKinnon 1993, p. 1]. The "big push" of Rosenstein-Rodan (1943), strategies to exploit "the advantages of backwardness," mobilization efforts by the main combatants in World War II, the practice of central planning under socialism, and many types of regulation in today's market economies share similar features. In every case, government must collect and process sufficient information to design detailed systems of taxation, subsidy, or regulation.

The work of Ronald Coase directs attention from optimal intervention toward government's role in establishing institutions that permit decentralized bargaining to overcome difficulties in the efficient use of assets that embody the characteristics of public goods. For Coase, the key is to encourage decentralized agreements that rearrange and restructure ownership and control of productive assets. In the absence of transaction

costs or, alternatively stated, under conditions of perfect competition in the exchange of legal entitlements, the analysis now known as the Coase theorem shows how the delineation and protection of property rights permit interested parties to negotiate efficient solutions to market failures without the participation of the state [Coase 1960; Cooter 1987].

In the Chinese context, there is a practical motive for emphasizing Coase's approach rather than Pigou's. China's eight million industrial enterprises provide an endless vista of resources in need of restructuring. China's governments possess neither the knowledge nor the power to organize these vast resources effectively. Expansion of financial losses, excess capacity, and unemployment have persuaded growing numbers of Chinese economists and policy-makers that a decentralized, market-based approach offers the best prospect for unlocking the productivity potential of China's industries.

Is Coase's analysis applicable in the context of socialist transition? We begin with a brief review of Chinese law and policy related to the exchange of property rights. Next, we review China's conformance with specific conditions underlying the Coase theorem. Finally, we investigate the growth of China's market for ownership of industrial properties.

CHINA'S MARKET FOR OWNERSHIP RIGHTS: BACKGROUND

Demsetz (1967) identifies four basic property rights. Assets are assigned to specific agent(s), who enjoy exclusive ownership rights. Owners receive all residual income accruing from their assets. Owners control the use of their property. Owners can sell or lease their property and can negotiate with others to restructure or reconfigure the

distribution of ownership and control rights. During the 1980s and 1990s, China's enterprise reform focused on the second and third aspects of ownership. This gradual reform of management control rights is widely understood [Jefferson and Rawski, 1994; Naughton 1995]. Recent Chinese reforms focus on enterprise restructuring (*qiye gaizhi*), which is intended to sharpen the specification of ownership rights. We therefore concentrate our attention on Demsetz's final criterion: who can exercise the right of alienation in China's enterprise system?

At the outset of China's reform, there was no market for business property. "State-owned assets were like stagnant water, permanently immobile" [Gao and Chi 1997, p. 57]. Enterprise operations were so tightly controlled that even modest expenditures required the consent of a firm's government's supervisory agency (*zhuguan bumen*). Well into the first reform decade, the scope for independent business strategies remained so slight that Komiya (1987) likened Chinese enterprise directors to plant supervisors in Japanese multi-plant companies.

Chinese reform gradually moved toward devolving strategic decision-making to the enterprise level. The first major initiative appeared in a 1984 decision of the Communist Party's Central Committee, which declared that "enterprises should truly be turned into independent economic entities . . . who operate their businesses on their own, assume sole responsibility for their profits and losses, have the ability to transform and develop themselves and become legal persons with certain rights and duties" [Gao and Chi 1997, pp. 22-23].

The 1992 "Operating Principles for State Industry" moved further, endowing managers with control over a wide range of actions, including asset transfers. The

language is clear and specific: "Enterprises have the right to dispose of their fixed assets. . . . Enterprises have the right to operate jointly or to merge operations with other units" [FBIS 1992, p. 30].

Reform outcomes, however, emerge from the actualities of everyday business rather than statements of policy and principle. Reform implementation is gradual and uneven. Resistance, backsliding, and delay weaken the impact of official pronouncements on corporate governance. Jefferson, Lu, and Zhao (1999) find wide variation in the devolution of specific decision rights both among state firms and within the rural enterprise sector. Control over property rights is one of several areas in which the empowerment of managers has lagged behind the general decentralization of control over enterprise affairs [Wu Bo, 1997]. Despite ongoing reform efforts, Chinese writers report that "enterprises lack the power to adjust their property structure," in part because "even today, government and enterprises are not separated" [Gao and Chi 1997, p. 47; Yang and An 1999, p. 34].

The reality of Chinese enterprise operation is the target of our study. We harness the ideas of Ronald Coase to comprehend the evolution and prospect of Chinese enterprise reform. The concept of a common property resource provides an exact parallel between Coase’s problem of social cost and China’s problem of enterprise reform. In each case, markets for ownership rights offer opportunities for narrowing the gap between actual and potential output. We therefore examine the impact of Chinese reform experience on property rights, competition, and transaction costs, specific factors that the Coase theorem pinpoints as crucial supports for vibrant markets in ownership rights.

THE RIGHT OF ALIENATION

Clearly delineated and widely dispersed property rights create the possibility of decentralized bargaining over the rearrangement, sale, and exchange of ownership and control. Table 1 summarizes the legal and practical circumstances surrounding the sale of assets for major enterprise types as of 1999. We ask three questions, each corresponding to one column in the table: (i) does Chinese law or regulation explicitly assign the authority to alienate assets? (ii) regardless of the legalities, do specific individuals or organizations in practice possess the authority to dispose of enterprise assets? (iii) who are the main participants in decisions surrounding asset disposal?

For state enterprises, legal authority flows from Article 15 of the June 1992 "Regulations on Transforming State Firms," which provides that:

> Enterprises have the right to dispose of their assets. . . . [they] may make their own decision to lease, raise a mortgage on, or to transfer with compensation their general fixed assets. They may lease key facilities, whole sets of equipment, or major construction works to other units. With the approval of responsible government agencies . . . [assets] may also be mortgaged or transferred to other units with compensation [FBIS 1992, p. 30].

These provisions contain two ambiguities: it is not clear whether firms "may make their own decision" to transfer assets or whether transfers "require the approval of responsible government agencies." Article 18 of the 1988 State Enterprise Law stipulates that "mergers and break-ups. . . shall be approved by the government or by the government's supervisory agency (*zhuguan bumen*)." If approval is required, as is

typically the case, neither the 1988 law nor the 1992 regulations specify which agency possesses the right of approval. There is no agreement about "who effectively exercises the right to sell the state-owned assets in an enterprise" [Jiang Qingrui 1995, p. 91]. This confusion is partly attributable to China's tradition of "dual guidance" (*tiaokuai*), under which state firms, while subject to central directives and ultimately "owned" by the central government, are primarily supervised by provincial and local governments [Donnithorne 1967, pp. 151-154; Riskin 1987, chap. 7-8; Gao and Chi 1997, pp. 66-72].

In principle, transfers of state assets appear to require authorization from the State Council or its designated agent. In reality, State Council involvement is typically limited to actions involving firms regarded as "key" (*zhongdian*) enterprises either because of their scale or on account of their position in strategic industries. Thus the March 2000 merger of two petroleum enterprises was "approved by the State Council [as]. . . part of a 3-year-old strategy to reformulate China's oil industry" [Zhao, S.Q., 2000, p.5]. Control over "key" enterprises is typically shared by multiple agencies [Steinfeld 1998, p. 90-93]. Multiple supervision plus the involvement of the State Council means that decisions about property transactions involving key enterprises require protracted negotiations among multiple agencies. There are no clear lines of authority.

Transactions involving assets of state enterprises outside the category of key firms are quite different. Despite the legal ambiguities, local governments typically possess the authority to expedite transfers involving the assets of state enterprises under their jurisdiction. This is evident from the strong response to the policy of "retaining large state enterprises and freeing small state firms" (*zhuada fangxiao*). The number of state-owned industrial enterprises dropped by 13 percent from 1996-97 and then by 33 percent

in the following year [Yearbook 1997, 1998, 1999]. This reduction reflects local efforts to dispose of loss-making enterprises via lease, sale, bankruptcy or other forms of asset restructuring. Complaints from writers who regard local actions as precipitous and wasteful leave little doubt that local governments have the effective authority to alienate the assets of ordinary state enterprises [Sale, 1998].

China's rural collectives are governed by the Township Enterprise Law passed in 1996 [Compendium 1997, pp. 263-272]. The statute does not explicitly assign authority over transactions involving enterprise property. It does, however, specify that enterprise property belongs to the collective entity that established the firm (Article 10) and that firms should report mergers and similar transactions "to the administrative management department (*xingzheng guanli bumen*) for township enterprises" (Article 8).

Nonetheless, official oversight of township and village enterprise assets is not complete. Among firms situated in the public sphere, ownership rights are often unclear: there remains the perception of "ambiguous property rights….the property right belongs to the whole community, but no individual in particular" [Xi Mi 1994, p. 4]. This perception of ambiguity invites opportunistic behavior. "Spontaneous privatization" that illegally diverts collective funds to private individuals and businesses is "rampant in the country's more than 50,000 townships" [Wu Yunhe 1995].

In order to clarify ownership and stem the growing incidence of spontaneous privatization, local governments increasingly sanctioned the conversion of TVEs to shareholding enterprises. By 1998, 80 percent of rural collectives had undergone restructuring [Liu Zhenyu 1999, p. 26]. Large and important local firms typically become shareholding cooperatives, with local government agencies holding controlling

blocks of shares. The restructuring of smaller firms involves numerous options, some resulting in private control.

Chinese law now permits public-sector enterprises to become "legal persons" (*faren*) capable of independently assuming civil obligations. State and collective enterprises can now restructure themselves (*qiye gaizhi*) into shareholding corporations supervised by independent directors. The number of Chinese firms listed on Chinese or overseas stock exchanges has passed one thousand, with further increases expected. Other firms issue non-tradable shares to government bodies, enterprises, or workers. Agencies charged with the management of state-owned shares and other state assets now exist at every level of government.

Legal authority for asset disposition by shareholding firms appears to rest primarily with the shareholders. Article 182 of China's Company Law states that "Merger or break-up of companies should be discussed and decided by the shareholders' meeting." However, the term "company" (*gongsi*) encompasses two separate institutions: the "limited company" (*youxian ziren gongsi*), a closely held firm with two to fifty shareholders (Article 20) and the more widely held "public shareholding company" (*gufen youxian gongsi*). Any merger or break-up of a public shareholding company "must be approved by the department authorized by the State Council or by the province-level people's government" [Company Law, Article 183]. In addition, the prevalence of government shareholding ensures the participation of official agencies in decisions surrounding major asset dispositions even when, as in the case of limited companies, official approval is not formally required.

Asset disposition on the part of foreign-linked firms is rare. Legal authority to conduct such transactions rests with enterprise management and boards of directors. However the 1986 statute governing foreign-linked firms stipulates that "when enterprises with foreign investment undergo spin-offs, mergers, or other important modifications, they should report to their supervisory and approval agency for approval" [Foreign-Invested Enterprise Law, Article 10]. In addition to this legal provision, the power of managers and directors is constrained by internal checks and balances built into joint ventures and by the regulatory capabilities of local governments and supervisory agencies surrounding foreign-invested firms. These constraints may have weakened over time. During the 1980s, Communist Party branches were expected to establish a presence within joint ventures and sometimes challenge managerial prerogatives [Pearson 1991, p. 186-191]. By 1995, however, "the Party was essentially absent from joint ventures" [Pearson 1997, p. 71].

Operations of private companies are governed by a statute passed in August 1999. Article 17 stipulates that "an individual investor who has legal ownership over the assets of a solely-invested enterprise may, according to law, execute a transfer or inheritance [Individual Wholly-Owned Enterprise Law, p. 7].

Although the right of alienation seems clear, Article 15 states that "if a solely-invested enterprise experiences changing circumstances during its operating life, it should, according to law, apply to the registration agency for a change in its registration within 15 days." Since initial registration is a cumbersome procedure: special regulations for Beijing's Haidian District issued in early 2000 aim at limiting the registration process "to one month, instead of the usual three and a half" [Xiao 2000]. Since it is illegal for

private enterprises to operate without formal registration (Article 13), the re-registration provision may provide an opportunity for informal regulation of mergers or asset transfers by private firms. We have insufficient information to determine the extent to which private businesses are free to exercise their legal right to conduct mergers and other forms of asset transfer.

Summary

Under the impact of two decades of reform, the right of alienation within China's property-regime, summarized in Table 1, has evolved into a complex structure. While combining substantial legacies of the former socialist regime, the system increasingly clarifies ownership rights over public as well as private property. A succession of new laws and regulations reveals a distinct tendency to empower boards of directors and managers with the authority to initiate, if not always to conclude, transactions involving the acquisition, merger, and sale of enterprise assets. When asset transactions require official authorization, decision-making authority tends to gravitate to lower levels of government.

COMPETITION

Fierce competition for sales, for managers and skilled workers, for export contracts, and for foreign connections has become an inescapable feature of everyday business life for nearly every Chinese enterprise. The shift from widespread shortage to a buyer's market in which suppliers must struggle to capture and retain customers is among the most widely remarked outcomes of China's economic reform. Competition in markets for industrial goods is a plausible but by no means perfect proxy for potential

competition in the market for enterprise property rights. To ascertain the character of the market for ownership rights, we review circumstances affecting the supply and demand of corporate assets.

Supply of Industrial Property Rights

Reform effectively dismantled most barriers to the entry of new industrial firms. As a result, the number of industrial enterprises rocketed from 3.5 million in 1978 to nearly 8 million in 1997 [Yearbook 1985, p. 305; Yearbook 1998, p. 431]. With entry concentrated among rural collectives, private entities, and foreign-linked firms, the output share of the initially dominant state sector plunged from more than three-fourths to barely one quarter during the same two decades [Yearbook 1998, p. 433].

We use two measures of ownership concentration to proxy the extent of potential competition among sellers in the market for corporate assets. Table 2 summarizes the distribution of firms by ownership type in 508 four-digit industries during 1996. The figures confirm the numerical preponderance of enterprises outside the state sector: state firms account for more than 30 percent of the total number of firms in only 18 percent of the 508 industry classifications. In nearly two-thirds of the industries, the total number of SOEs accounts for no more than 20 percent of the total.

Table 2 shows that in most branches of industry, neither private firms, which remained few in number as of 1996, nor state firms predominated. Instead, the largest numbers of firms were to be found in categories that combine some mix of private and public ownership: urban and rural collectives, domestic joint ventures, foreign-invested firms, and shareholding enterprises.

Since state firms dominate the ranks of larger enterprises, state industry weighs much more heavily in the ownership profile when we use assets rather than numbers of firms to index the distribution of assets. Table 3 shows that in one-third of the industries, more than one-half of the assets are state owned. With few exceptions, private industry accounts for less than 10 percent of total assets at the branch level.

Despite the state sector's substantial share of total assets, we see that, even in 1996, state-owned firms controlled less than half of total assets in two-thirds of China's 4-digit industries. While state industry accounted for 57.1 percent of China's total industrial assets, Table 3 shows that the pattern of asset ownership was highly uneven, with much of state industry's share concentrated in a relatively small group of branches. Table 4 identifies the four-digit industries in which state firms and private firms held the smallest and largest shares of total assets. There is a large contrast between sectors like railway equipment and cigarette manufacture, which are essentially monopolized by the state sector, and branches included in the upper panel of Table 4 where the share of assets held by state enterprise is less than four percent. An interesting feature of Table 4 is that even in the locomotive industry, ranked ten out of 508 in its concentration of state assets, the state owns just two-thirds of total industrial assets.

This picture of limited state sector dominance is reinforced by Table 5, which focuses on the ownership of the four largest firms, based on sales in each industrial branch. The 1996 data show that state enterprises occupy all four of the top spots in only six percent of 508 branches. In one-third of these branches, no state firm is included among the four largest enterprises.

Our review reveals an expectedly broad distribution of potential participants in property rights transactions on the supply side. The dominance of state enterprises is limited to a rather narrow segment of the industrial landscape. Outside the segments essentially reserved for the state sector, we find a striking diversity of ownership types.

Demand for Industrial Property Rights

In principle, the demand side of China's market for industrial property rights includes all domestic residents and foreign entrepreneurs. More realistically, the class of potential asset buyers consists mainly of existing owners of Chinese industrial property, including foreign entities active in China's domestic economy.

One limitation to effective demand arises from the concentration of industrial assets in large enterprises. Partial data for 1997 show that 7,198 large firms, mostly in the state sector, control 56.1 percent of fixed assets. The combined fixed assets of the entire private sector, by contrast, are no larger than the assets of 40 average firms within the large-scale category [Industry Yearbook 1998, pp. 103-134].

Although such disparity makes it unlikely that small firms, including private companies, can purchase large enterprises, there is no legal barrier to tie-ups among large firms. Nor is there any legal obstacle to partial divestiture of assets or the formation of voluntary enterprise groups uniting domestic (and possibly offshore) businesses for the purpose of acquiring assets. The creation of asset management companies linked to China's four large commercial banks for the express purpose of working out bad debts presages an increase in debt-equity swaps and other assets transactions involving large and medium-sized state firms, who are the chief clients of these state-owned banks.

The existing concentration of assets is most significant in relation to borrowing capabilities. China's banks are not accustomed to advancing funds to support transactions involving enterprise property rights. Buyers may therefore be obliged to provide asset guarantees that match the value of newly acquired property without employing the target firm's assets as collateral against bank borrowing [Wei Feng 1999, p. 10]. Such collateral requirements favor the existing owners of China's largest enterprises. They also confer special opportunities to the small minority of firms that enjoy access to direct financing through domestic or offshore equity markets. Shareholding corporations, which accounted for only 5.5 percent of industrial assets in 1995, participated in 44.2 percent of the reported asset transfers in that year [Asset Yearbook 1996, p. 76; Yearbook 1996, p. 414].

Foreign and overseas Chinese investors are likely to constitute the most liquid and diverse source of demand for China's industrial assets. At the end of 1997, foreign and overseas Chinese wholly owned and joint-venture enterprises accounted for 17.5 percent of China's total industrial assets. With China's accession to the World Trade Organization and reduction of barriers to the conduct of business within China, effective demand from the offshore sector will surely grow. In particular, the opening of China's financial sector to expanded foreign participation will broaden the supply of funds to individuals and firms that can gain from property rights transactions.

Summary

Measured across China's 508 four-digit industries, the concentration in the hands of state industry of both firm ownership – number and size – and asset ownership is substantially less than that suggested by the aggregate data. Although, as we shall see,

the number and volume of transactions remain modest, the potential for rapid expansion on both sides of the market is substantial. Rapid expansion of assets held by shareholding companies, continuing development of China's stock and bond markets, and the accelerated liberalization of trade and investment in accord with WTO standards are creating the conditions for an increasingly active, competitive property rights market.

TRANSACTION COSTS

Transaction costs shape the locus of feasible arrangements. High transaction costs, like high costs of transportation restrict the scope of exchange. The challenge of reform is to develop decentralized mechanisms to replace official decision-making. The ingredients include accounting and auditing standards, codification of fiscal regulations, markets for managerial talent, commercialized bank lending, enforcement of debt obligations, commercial law, economic courts, securities markets, credit ratings, and arbitration mechanisms.

Creating such arrangements is slow and expensive. No mature economy, let alone China, approaches Coase's ideal of costless transactions. The practical question concerns the extent to which reform can reduce transaction costs and thus expand the range of feasible resource combinations. We examine three areas: the transparency of enterprise structures and operations, the sufficiency of transaction resources, and bankruptcy procedures.

Transparency of the Enterprise

Transparent corporate structures permit outsiders to judge enterprise profits and prospects on the basis of public information. The pre-reform plan system provided little

connection between financial outcomes and enterprise viability. By expanding the transparency of enterprise operations, reform has enhanced the feasibility of a market for corporate control. There are a number of significant developments.

The shift from plan to market has moved prices into closer alignment with domestic costs and international values. The reduction of price distortions means that profits and costs become increasingly useful as indicators of economic value.

Prior to reform, enterprise leaders frequently declined to answer specific inquiries, at times including even requests for their names. Today, China's ministries, provinces, cities, counties, issue statistical yearbooks crammed with information. Some firms publish their own yearbooks [e.g. Wuhan Steel, 1995; many issue annual financial summaries,[1] some certified by independent auditors. Beginning in 1993, The Ministry of Finance required state enterprises to implement accounting procedures intended to bring financial records into conformity with international standards.

Despite these important advances, difficulties abound. The shift from plan to market is not complete. While production plans are no longer important, governments at all levels continue to announce detailed prescriptions for investment spending, bank credits, output mix, export growth, and the organization of industry. Government intervention in market operations extends beyond what is customary even in highly regulated market systems like South Korea and Japan. The resulting uncertainty imposes substantial costs on incumbent managers and on outsiders seeking to gauge the financial prospects of China’s industrial firms.

Access to information, while expanded, is remains incomplete. Firms remain enmeshed in opaque government-business ties, which create financial obligations that are

not visible. Corporate groups often consist of former government offices and the enterprises previously attached to them. There are secret laws and regulations, which remain inaccessible to both foreign firms and non-Chinese attorneys.

Transaction Resources

Transaction resources facilitate exchange by lowering the cost of planning, arranging and enforcing contracts. We divide transaction resources into two categories. “Market transaction resources” are arrangements and skills dispersed within the economy that support low transaction costs. “Public transaction resources” are official arrangements that reduce the cost of exchange.

Market transaction resources. This category includes skilled individuals, such as lawyers, appraisers, accountants, and the associations that establish and maintain professional standards. It also includes the specialized economic organizations, such as banks, insurance companies, trust companies, credit cooperatives, credit rating agencies, clearing-houses, brokerages, securities markets, commodity exchanges, and transaction centers, that generate financial information and facilitate property-rights transactions. Many major international law firms, security houses, and investment banks have established offices in China or Hong Kong, thereby making increasingly accessible the professional services required to negotiate the full range of property rights transfers.

In reviewing the development of market transaction resources, we find a combination of strenuous activity, significant progress, and major shortcomings. China has exerted remarkable efforts to expand institutions and skills that can reduce transaction costs. Week after week, month after month, we observe new markets, assets, and

intermediaries, fresh attacks on anachronistic regulations, and novel programs to train cohorts of legal, financial and accounting specialists.

Despite the massive impact of these efforts, glaring weaknesses persist. China's banks have pushed strenuously to establish and defend commercial lending standards, even as officials compel them to extend non-commercial loans, mainly to state enterprises. Soft lending diverts funds from profitable opportunities. Financial weakness arising from the accumulation of unrepayable debt obliges officials to limit competition from new financial institutions. These circumstances obstruct financial innovation, including lending in support of property rights transactions.

Public Transaction Resources. Beginning with Wuhan in 1988, both local and provincial governments and, more recently, private initiative have established several hundred property rights transaction centers. The first set of regulations governing mergers and acquisitions appeared in 1989. In 1994, 18 municipalities (later increased to 50 and then to over 100) were selected as proving grounds for "capital structure optimization," a program designed to facilitate asset restructuring by means of bankruptcy, mergers, and acquisitions [Bankruptcy 1997, M&A 1997, Industry Development Report 1998, p. 106]. While these locally based transaction centers have enlarged the scope and volume of property rights transfers, typically involving state-owned enterprises, they tend to focus on local transactions. Although there is no formal restriction on interregional business tie-ups, "interregional acquisitions are few; deals tend to unite firms in a single region" [Wei Feng 1999, p. 10]

The broader system of Chinese law and regulation also limits the scope of property rights transactions. While China has promulgated an extensive body of

economic laws, this emergent system remains far from complete, and the gap between principle and practice is sometimes striking. Courts are not fully independent. Few judges and lawyers are familiar with the content and procedures of domestic and international economic law. Judgments, even if equitable, are difficult to enforce. The weak legal system tilts business dealings toward “relational contracting” based on personal ties and go-betweens. While these methods often provide viable substitutes for arms-length transactions, their use restricts business opportunities, weakens competition, and limits the scope of feasible exchange of ownership rights.

In addition to the cost of negotiating and implementing agreements, some localities impose fees and taxes amounting to 15-30 percent of the value of property being exchanged [Asset Yearbook 1996, p. 78]. Further difficulties arise from the pervasiveness of implicit taxation. Corruption reveals the limitations of any legal system. If the rules of business are not clear or if written regulations are subordinate to the will of individual leaders, agents may feel obliged to purchase the support of powerful individuals as a form of insurance against adverse administrative actions or legal rulings. Even if the rules are clear, ineffective enforcement may encourage business to purchase the support of officials, especially if transparency increases the chance of exposing graft.

The extent of corruption offers a rough comparative index of transaction costs. A 1996 "Global Competitiveness Report" ranked China ahead of India in each category, and ahead of Indonesia in all categories except tax evasion [as reported in India Today, 11-30-96, p. 55]. More recently, Transparency International’s corruption ranking place China 58th among 99 countries, behind Malaysia (32), South Korea (50), and the

Philippines (54), but ahead of Thailand (68), India (72) and Indonesia (96) [Pharr, 2000, p. 56].

Bankruptcy

Laws and procedures for bankruptcy help to establish ground rules for liquidating assets and for restructuring weak firms to restore profitability. China passed an experimental Bankruptcy Law in 1986. Several factors have limited the application of this statue, which took effect in 1988. The 1986 law focuses on liquidation: only six of 43 articles touch on reorganization, and these offer no detailed provisions regarding debt-equity swaps or refinancing [Li and Li 1995, p. 9]. Prior to the development of unemployment insurance and the expansion of layoffs in the late 1990s, China's tradition of employee tenure clearly hindered the implementation of the 1986 law. Another difficulty arises from the subservience of enterprises to administrative agencies, which in this instance is written into the law: China's bankruptcy statutes specify that only "the bankrupt enterprise's supervisory agency (*zhuguan bumen*) can petition for reorganization. The enterprise has no power to initiate such a petition on its own" [Yang Bin 1998, p. 11].

Researchers associated with China's large state-owned banks, which are the principal creditors of enterprises facing bankruptcy, indicate that the application of "standard" procedures for liquidating bankrupt firms produce "reasonable" results, with creditors typically recouping approximately 30 percent of the outstanding debt [Bankruptcy 1997].

But reviews of bankruptcy experience cite numerous examples of non-standard procedures that give short shrift to the financial interests of banks and other creditors.

These include exclusion of creditors from judicially-appointed workout committees, failure to enforce collateral agreements, diversion of assets to benefit workers, excessive fees, and procedural manipulation by local government to allow debtors to evade financial obligations [e.g. Hubei 1996, Qi and Yang 1996, Zhang Hui 1996, Zhang Jing 1996, Bankruptcy 1997].

Despite these difficulties, which lead to complaints that bankruptcy procedures "bankrupt the banks," the number of cases filed and settled and the volume of assets involved in bankruptcy procedures has increased over time. Bankruptcies adjudicated by the People's Courts (*renmin fayuan*) rose sharply from just 98 in 1989 to 710 in 1993 and 1625 in 1994 [Yi Jianjun 1996, p. 2]. In 1996, the national total of bankruptcies jumped to 6,232 cases [Saich, 1997]. During 1995/96, the Bank of Industry and Commerce (ICBC), one of China's four large state banks, was involved in 5,128 bankruptcy cases involving sums that accounted for 1.9 percent of the bank's total loan portfolio [Bankruptcy 1997].

Summary

Two impressions dominate our view of transaction costs surrounding China's market for industrial property rights. The reform process has brought gradual improvements that cumulate into massive reductions in transaction costs. Despite a flood of complaints about shifting and obscure rules, misunderstandings, and graft, overseas investment funds continue to arrive, new factories commence production, commerce grows. Long-term expansion of the scale and variety of business activity -- the clearest possible sign of a declining ratio of transaction costs to the discounted value of commercial opportunities -- is an undeniable reality of Chinese economic life. But

despite these gains, high transaction costs represent a formidable obstacle to the expansion of China's market for property rights.

CHINA'S EMERGING MARKET FOR PROPERTY RIGHTS

After reviewing China's progress in building the institutional foundations for the exchange of ownership rights, we review the development of the markets for transactions involving ownership of industrial property.

Volume of asset transactions

Although there are no comprehensive statistics of transactions in property rights, partial information confirms that the scale of activity has increased rapidly from a tiny base. Mergers, virtually unknown under the pre-reform system of socialist planning, first appeared in 1984 [Wang Shouan 1998, p. 150]. Large-scale activity began in 1988. One source states that 6,900 firms were acquired during the 1980s, involving total assets of RMB 8 billion [Asset Yearbook 1996, p. 355]. During the early 1990s, asset transfer agencies in Shanghai and four other cities assisted in transactions involving 2,900 firms and RMB 6 billion in assets [ibid.], implying nation-wide transactions volume of roughly RMB 8.3 billion per year in the urban sector.[2]

The central government's 1994 decision (Document #59) authorizing 18 cities (subsequently expanded to more than 100) to experiment with "optimization of capital structures" stimulated a sharp acceleration of mergers and also of bankruptcies, which in China are typically associated with mergers.[3] The number of mergers reached 20,000 in 1996. The volume of assets involved in merger and bankruptcy transactions jumped to

RMB160 billion in 1994 (mergers only) and to RMB 415.5 billion in 1997 [Wang Shouan 1998, pp. 150,152; Industrial Development Report 1998, pp. 4, 8].

These partial figures indicate that the annual volume of assets transactions rose 100-fold between the mid-1980s and 1997. Despite this rapid growth, the proportion of assets drawn into the exchange of ownership rights remains modest. In 1997, the volume of assets involved in mergers and bankruptcies throughout the economy amounted to 6.9 percent of the asset total for state-owned industry and 3.8 percent of the asset stock for all state enterprises [Asset Yearbook 1997, p. 402]. This amounts to approximately two percent of China's total reported industrial and commercial assets.

In mature economies like the U.S. or Europe, the total value of M&A activity in a given year is roughly equal to 12-14 percent of stock market capitalization. In 1996, when American stock markets had a market capitalization of about $15 trillion, some $1.8 to $2.1 trillion worth of M&A deals were transacted. In East and Southeast Asia, outside Japan, the ratio is less than half that of the U.S. [Granitsas, 2000, p. 67]. In comparison with other economies in the region, excluding Japan, China's rate of M&A activity was, therefore, not more than about one-third that reported elsewhere.

Key participants in China's property rights market

Experimentation with mergers and acquisitions focused on small firms. More recently, large enterprises have entered the market for ownership rights. Capital Steel, First Auto Works (FAW), and Konka, a Shenzhen-based television manufacturer, are among the large firms that have employed multiple mergers to expand the breadth and scale of their operations.

Initially, government was the prime mover in most mergers. Non-commercial objectives predominated, as officials sought to escape the burden of supporting loss-making enterprises by merging them with stronger firms. These policies persist. Enterprises that hope to be listed on the stock exchanges "must merge with or purchase a loss-making enterprise before they are listed" [authors' interview, May 1999]. One author says that buyouts in China "basically represent low-payoff government activity" [Wei Feng 1999, p. 9].

But in recent years, enterprises initiate acquisitions purely for business reasons: to acquire land-use rights, expand the scale of production, rationalize product lines, penetrate new markets, or ensure access to key inputs. Commercially motivated mergers include tie-ups among strong firms, such as the 1997 merger of four powerful petrochemicals firms in the Shanghai-Jiangsu region [Wang Shouan 1998, p. 152] China's banks have begun to promote mergers as a means of strengthening client firms and reducing their own inventory of bad loans. The China Construction Bank has helped to arrange 39 mergers among firms in the cement sector, "slashing the non-performing loans ratio of cement makers from 80 percent in…1996 to 34 percent" in 2000 [Wang Ying 2000].

During the 1980s, most mergers involved enterprises in the same trade, locality, and ownership system. Although these limitations still exist [Wei Feng 1999, p. 10], they have begun to erode. Mergers that link firms in different industries, regions, and ownership systems are no longer uncommon. The television producer Konka is one of many firms that now operates plants in several provinces. Conglomerates like Capital Steel span diverse industries. Asset transfers involving state and collective firms, or state

and private enterprises predate the recent policy of "retaining large state firms and releasing small ones," which has vastly expanded the opportunities for transactions formerly viewed as unorthodox.

Another novelty is the entry of foreign firms into China's nascent property rights market. By the end of 1996, 10 of China's 59 largest tire manufacturers, 12 of the 13 largest pharmaceutical firms, and 70 percent of the largest beer producers have come under the control of foreign firms [Birth and Development, 1997].

We also see a notable increase in the financial complexity of asset transfers. Initially, standard practice involved the acquiring firm gaining control of a target enterprise in exchange for full or partial absorption of the target's workers, retirees, and financial obligations. These transfers remain common, although policy shifts have repeatedly relaxed the financial requirements imposed on firms acquiring weak merger partners [Wei Xiangyun 1998, p. 40].

More recently, firms have begun to use capital markets as vehicles for mobilizing funds to finance corporate acquisitions. The Shenzhen-based Baoan group mounted China's first corporate raid in 1993, launching a surprise share-buying campaign that enabled it to become the largest holder of shares in Shanghai-based Yanzhong Ltd. [Wang Shouan 1998, p. 150]. Konka, the television producer, has repeatedly used share issues to finance corporate takeovers [Wang Shouan 1998, p. 160]. Although firms require official approval to gain access to domestic or international markets for shares or corporate bonds, some firms have succeeded in gaining indirect capital-market access through the device of purchasing shell corporations.

The creation of asset management companies associated with the four big banks adds a new dimension of enterprise re-organization. The government has provided these new entries with war chests amounting to hundreds of billions of yuan and instructed them to undertake debt-equity swaps and other approaches to workouts for heavily indebted firms. These amounts, while not large in relation to the total of bad bank debt, are quite substantial relative total non-performing assets. For example, Huarong, the AMC responsible for acquiring non-performing assets from the Industrial and Commercial Bank of China has purchased over 400 billion yuan of the Bank's non-performing assets, including stakes in over 70,000 enterprises. During 2000, Huarong began disposing of these assets, initially through auctions, judged to be the easiest method, and subsequently through direct restructuring, including mergers and acquisitions. Huarong executives are also confident that China's WTO membership will further the interest of major multinationals and investment banks in the purchase of large numbers of enterprises [Wang Ying, 2000a].

We anticipate that specification of control rights over publicly-held assets will continue to improve with the development of new systems of state asset management, the accelerated divestiture of assets under the 1998 policy of "retaining large public enterprises and releasing small firms," and the ongoing reorganization of rural enterprises.

Impediments to M&A Activity

Despite strenuous efforts to implement the policy of separating government from business, firms and property remain enmeshed in a dense web of public ownership, official control, and bureaucratic regulation. Enterprise managers do hold substantial

power and authority. In the areas of merger and acquisition or asset disposition, however, their capacity for independent action remains limited, even when legal provisions or national policies specifically ban official interference.[4]

Managers and workers of weak firms often resist proposed mergers. In some instances, labor unions or workers' associations wield effective veto power over enterprise restructuring. Managers may seek to obstruct proposed mergers in order to protect their own positions [Wang Kexia 1999, p. 7]. In such instances, the ambiguity of property rights may prevent a weak firm's owners from overriding insider opposition to change. As a result, restructuring may require direct official intervention.

Bureaucratic efforts to manage the restructuring process also create many difficulties, as when governments seek to escape the burdens of debt and redundancy by pushing strong firms into unprofitable alliances with weak partners. The recent merger between Shanghai's Baosteel and several floundering regional steel-makers, which saddled Baosteel with an enormously increased workforce, appears to represent this sort of forced merger, which Chinese authors describe as "forced marriages" (*lalangpei*).

Even when government plays no direct role in attempts to restructure specific enterprises, official policy exerts strong influence over the environment within which asset transfers occur. Ambiguous policy reflecting disagreements within official circles as well as shifting responses to changing economic circumstances, creates additional barriers to the expansion of China's market for enterprise assets. The policies of "separating government from enterprises" and "retaining large state enterprises and releasing small ones" encouraged governments at all levels to reorganize public-sector enterprises under corporate, shareholding, cooperative, or private ownership, which

facilitated the extraction of productive assets from the state sector (and by extension, from collectives as well). As local administrations move to transfer large numbers of enterprises and their assets out of the state sector, central officials attempt to slow down the process of restructuring, calling on "local governments to stop haphazardly selling off small State-owned enterprises" [Sale 1998].

CONCLUSION

Economics offers two broad visions of the policy process. One perspective, widely associated with the welfare economics of A.C. Pigou, shows how carefully selected combinations of taxes and subsidies can ensure optimum resource allocation within a fixed institutional setting. The second, which arises from the work of Ronald Coase, sees government's role as providing crucial support for decentralized bargaining over the structure and distribution of property rights. For Coase, it is this decentralized bargaining, rather than direct government action, that leads to more efficient allocation. Efficiency gains arise from unplanned institutional change, rather than from officially mandated changes in incomes and relative prices.

China's twenty-year economic boom rests on institutional experimentation and on policies that facilitate choice rather than mandating specific actions. China's recent experience invites interpretations that draw on Coase's vision of the links between state and economy. This paper explores the feasibility of viewing economic transition, specifically China's recent history of industrial reform, through the lens of Ronald Coase's analysis of the interplay among government policy, decentralized bargaining over ownership rights, and economic outcomes.

Focusing on state enterprises, we argue that limited monitoring capabilities, a problem that also afflicts China's collective-owned sector, leads stakeholders toward systematic over-consumption of enterprise resources. The resulting externalities exactly parallel the examples popularized by Coase's 1960 study of social cost.

Coase's analysis depends on specific idealized assumptions about the delineation of property rights, the competitiveness of markets in which these rights can be exchanged, and the absence of transaction costs. China's recent experience suggests that Coase's findings are durable even under conditions that deviate widely from the theoretical ideal. We find that incremental clarification of ownership, increased competitiveness of markets for property rights, and partial reduction in transaction costs have stimulated decentralized enterprise restructuring that has encouraged higher productivity, lower costs, and accelerated growth.

Evidence supporting this conclusion is impressionistic rather than conclusive. We know that Haier and Konka, firms whose success in selling brand-name appliances (refrigerators and televisions) to American households places them at the forefront of Chinese business, built their success in part on transactions in China's emergent market for ownership rights. More generally, the leading positions in China's twenty-year boom consistently rest with enterprise types (TVEs, foreign-linked joint ventures and, most recently, private firms) enjoying relatively clear specification of ownership and with regions (particularly Guangdong province) that have done the most to dismantle restrictions surrounding markets for property rights.

At present, China maintains a dual policy structure that emphasizes official management of enterprise restructuring for large firms and strategic industries while

relying on market forces to shape the evolution of firms and sectors outside what is seen as the strategic core of China's industrial economy. Official initiatives for the strategic core rest on the view that industrial strength requires large corporate entities that can use scale economies to reap cost advantages and develop globally recognized brand names. This approach emerges from an appreciation of past industrial policy in Japan and Korea, where by orchestrating alliances, incentives, bank lending, market access and other initiatives designed to establish strong and viable enterprises in key sectors, activist officials did more than merely "pick winners."

One of the implications of our analysis, which stresses the virtues of Coasian market-mediated restructuring as compared with Pigouvian state-directed restructuring, is the important role of size. In a world of no transaction costs, size does not matter. But with underdeveloped labor and capital markets, size does matter. It matters in two ways. First, since many of China's largest enterprises are the size of small cities, the liquidation of these enterprises and layoff of tens of thousands of workers would entail large, politically unacceptable, social disruptions. Second, due to unmanageable collateral requirements and liquidity constraints that arise from financial market limitations, often only governments can mobilize the funds required for restructuring the largest enterprises.

China faces an important choice regarding the degree to which new constellations of ownership rights will represent the outcome of market forces rather than administrative decisions. The administrative path claims powerful support for the case of China's larger enterprises. However, the market-based alternative seems increasingly feasible for even larger firms. New provisions for pensions, unemployment insurance, and other social

measures, while still incomplete even within the urban sector, have begun to shift the foundations of China's industrial economy. The number of enterprises viewed as "too big to fail" has fallen dramatically. In 1997 alone, firms put into bankruptcy, merger, or the program "to cut staff and improve results" shed 1.7 million workers [Economic Yearbook 1998, p. 707]. The notion that the fate of workers linked with weak firms can be entrusted to social programs and the market for labor undercuts the rationale for administrative direction of enterprise activity.

The problem of rigidities in China's emerging property rights market for restructuring large-size enterprises can be addressed by reducing transaction costs, such as developing a social security system. In addition to "greasing the wheels" for property rights transactions, a market-based policy can expand the scope of feasible property rights transactions by moving to dismantle some of China's corporate behemoths. It is far more probably that China will succeed in achieving efficient conglomerates that acquire brand recognition through the Haier model of market-mediated mergers and acquisitions than it will through administrative interventions involving forced marriages. Recent breakups and spin-offs in petroleum, telecommunications, banking, and insurance demonstrate that China's leaders are not irrevocably wedded to the pursuit of scale economies, even in strategic industries.

Although we see a market-based approach as more promising than administrative restructuring of enterprise ownership, it seems evident that each alternative commands strong allegiance within China's policy community. In the Chinese context, we see the choice between these competing approaches as carrying substantial implications for economic theory as well as for China's economic evolution. From a theory perspective,

events of the next few years will provide a natural test of the idea that Coase's theories apply in approximate form as well as under ideal circumstances. On the empirical side, we see an expanding market for property rights as a possible source of fresh momentum for China's sagging growth. Under these circumstances, continued study of the institutions surrounding China's nascent markets for corporate ownership rights seems essential for understanding the prospects for rising efficiency and economic growth in China’s enterprise sector.

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Table 1

Control Rights Over Alienation of Industrial Property, 1999

Type of Firm	Explicit Authority	Clear Authority	Main Actors
State firms – key	Management & Supervisory Agencies	No	State Council Supervisory Agencies Management
State firms – other	Management & Supervisory Agencies	Frequently	Local Government Supervisory Agencies Management
Collectives	The "collective entity" Management	Frequently	Local Government Management
Foreign-linked	Board of Directors	Sometimes	Management Official Partners Local Government Supervisory Agencies
Shareholding	Shareholders or Shareholders & Supervisory Agency (or Provincial Govt)	Sometimes	Management Supervisory Agency Official shareholders
Private (wholly-owned)	The single owner	Usual	Private owners

Note: Supervisory Agency refers to the *zhuguan bumen*

Table 2
Concentration of firm ownership by state ownership (SOE) and private ownership (PRI)

% of firms that are SOEs or PRIs.	% of 4-digit industries in which SOE firms account for….% of total	% of 4-digit industries in which PRI firms account for….% of total
0--10	22.24	69.29
10--20	41.14	0
20--30	18.7	0.2
30--40	8.07	0
40--50	4.33	0
50--60	1.77	0
60--70	0.98	0
70--80	0.98	0.2
80--90	0.39	0
90--100	0.39	0
Missing or "0"	0.98	0.79
Total	100	100

Source: *China Markets Yearbook 1996*.

Table 3
Concentration of asset ownership by state Ownership (SPE) and private ownership (PRI)

% of assets owned by SOEs or PRIs.	% of 4-digit industries in which SOE assets account for ….% of total	% of 4-digit industries in which PRI assets account for ….% of total
0--10	10.83	67.13
10--20	13.39	0.2
20--30	16.34	0
30--40	12.79	0
40--50	12.2	0
50--60	10.83	0
60--70	9.25	0
70--80	5.71	0
80--90	4.33	0
90--100	3.35	0
Missing or "0"	9.84	32.68
Total	100	100

Source: *China Markets Yearbook 1996*.

Table 4
Industries with highest and lowest concentrations of state and private ownership by assets

	Industry name	% of assets held by SOE firms	Industry name	% of assets held by PRI firms
Bottom10	Household Rubber Product	0.997	Wool Washing	0.062
	Iron Farming Tools	2.062	Mechanized Farm Tools	0.063
	Other Fishing Tackle Product	2.273	Household Glass Products	0.089
	Plastic Furniture	2.439	Forest Chemical Products	0.096
	Motorcycle Repairing	2.721	Household Ceramics	0.111
	Fish Meat and Fish Meat Product	2.857	Beer	0.135
	Other Artistic Products	2.961	Book, Newspaper and Magazine Printing	0.144
	Wool Printing and Dyeing	3.205	Pastry	0.158
	Leather Bags	3.341	Other Electricity Trans., Distribution and Control Equip.	0.162
	Other Leather Products	3.861	Silk Reeling	0.164
Top10	Nitrogenous Fertilizer	91.348	Pumps	73.269
	Beet Sugar	91.089	Hydraulic Turbines	27.907
	Aircraft Repairing	83.333	Wool Spinning	8.430
	Tobacco Stemming and Redrying	82.000	Slide Projectors	6.667
	Cane Sugar	79.318	Wool Printing and Dyeing	5.769
	Cigarettes	77.132	Construction Glass	5.373
	Hydraulic Turbines	72.093	Farming, Forestry, Husbandry and Fishery Inst. and Meters	5.263
	Photography and Film Machinery	71.429	Fishing Tackle Rope	4.348
	Passenger Trains	71.429	Steel Smelting	3.338
	Locomotives	66.667	Meat By-products	3.175

Source: *China Markets Yearbook 1996*.

Table 5
Percent of 508 four-digit industries in which 0-4 of the largest enterprises are state owned
(based on 1996 sales)

0	33.46
1	27.17
2	21.65
3	11.61
4	6.1
Total	100

Source: *China Markets Yearbook 1996*.

ENDNOTES:

[1] For example, Tsinghua Tongfang Co. Ltd., a publicly-listed shareholding company with Tsinghua University as its major shareholder, posts annual company reports on its web site http://www.thtf.com.cn/.

[2] Since the five cities held 14.6 percent of industrial assets in 1995, we can roughly estimate the annual volume of urban asset transfers at [6/0.146] * 0.2 or RMB 8.3 billion, assuming that the transactions volume covers five years, 1990-1994. Asset data (for independent accounting units) are from Urban Yearbook 1996, pp. 243-257.

[3] Local governments generally select a firm or entity to take over an insolvent enterprise prior to declaring bankruptcy. Courts often view such action as prerequisite to hearing bankruptcy cases.

[4] A 1996 survey of 18 state enterprises in Harbin, all designated as experiment points for China's "modern enterprise system," found that the 1992 provisions ensuring managerial autonomy in these areas were "fully implemented" in 22% of the firms, "basically implemented" in 33.3% (for asset disposition) or 38.9% (for M&A) and "partly" or "never" implemented for 44.5% and 38.9% respectively [Wu Bo 1997].

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