

# What Is in the Non-State Sector?

- Firms which are not Non-State
  - Traditional State-Owned Enterprises (SOEs)
  - Stock companies in which the state has controlling shares (called state controlled enterprises)
- Types of ownership forms in the non-state sector
  - Private ownership firms
  - Non-private ownership firms (collectives and cooperatives)

# Varieties of Non-State Ownership Forms

- Private ownership
  - Individual family business
  - Private companies hiring more than 8 employees
  - Foreign invested
  - Share holding companies (private parties have controlling shares)
    - Listed
    - Not listed
- Non-private (but also non-state) ownership
  - Rural Township-Village Enterprises (TVEs): rural collectives
  - Urban collectives
  - Joint ventures with TVEs or collectives controlling
  - Share holding companies (neither the state nor private parties have controlling shares)

## Two Stages of Development

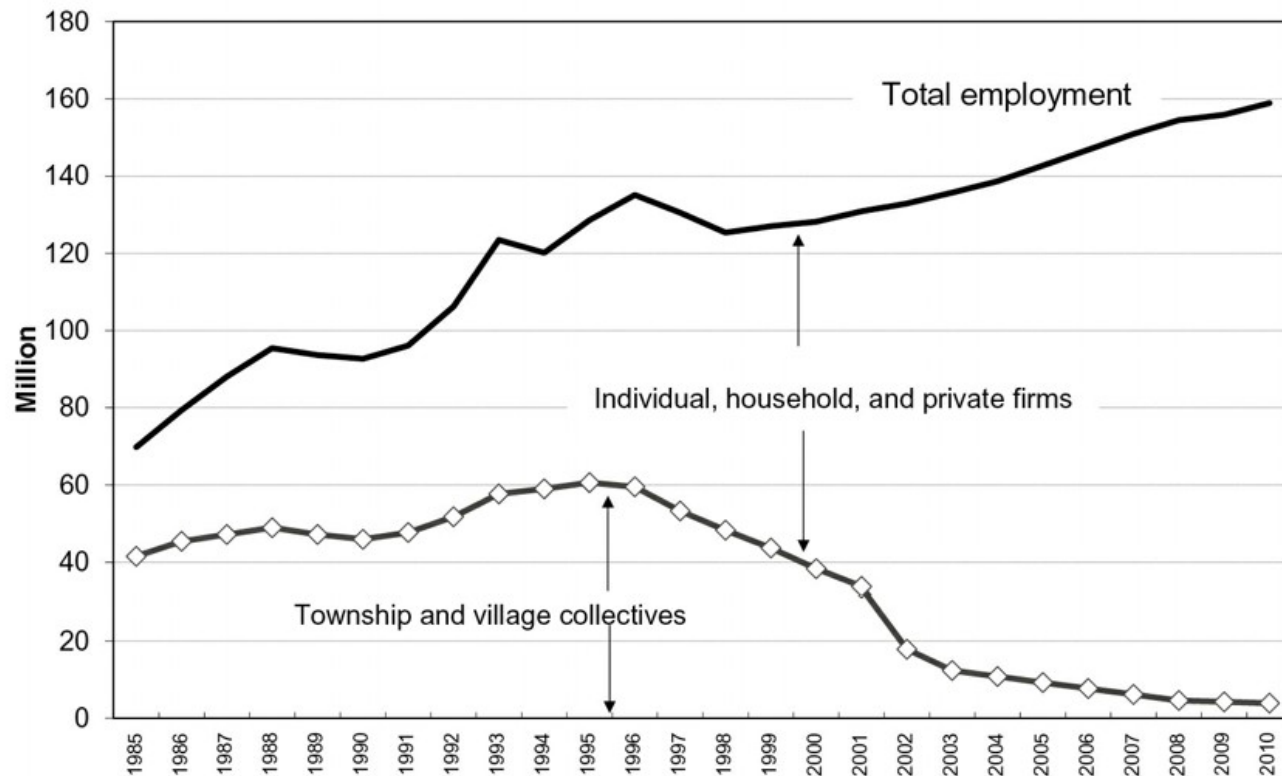
- First Stage: from 1978 to mid-1990s
  - Slow start of private firms
  - Very rapid growth of collective firms, especially rural TVEs
  - No privatization of collectives
- Second Stage: from mid-1990s onward
  - Rapid growth of privately owned firms
  - Fast privatization of collective firms
  - Fast emergence of share holding ownership forms
    - Publicly traded stock companies
    - Closely held stock companies

## From 1978 to mid-1990s

- The major growth engine: rural industry
  - Most new non-state enterprises in other planned economies under socialism were in service sector, not in industry
  - Most new industrial enterprises in developing countries are not in rural areas
- Rural enterprises = TVEs + rural private enterprises
- There are separate (but also related) reasons for rapid growth of rural industry and rapid growth of TVEs

## Share of Industrial Output by Ownership

	1978	1993	Changes
SOEs	78%	43%	-35%
Non-State	22%	57%	+35%
Urban	13%	10%	-3%
Rural	9%	36%	+27%
TVEs	9%	27%	+18%
Private	0%	9%	+9%
Others	0%	10%	+10%



**Figure 13.2**

TVE employment.

Sources: TVE Bureau (2003); *TVE Yearbook* (2011).

# How the TVEs Changed China?

- During the first 15 years of reform, TVEs made the most important contribution to growth
- TVEs changed the landscape of China's industry, as well as its economic institutions
- The ownership form of TVEs is unique
  - Neither state-ownership
  - Nor private ownership
  - A corporate form between entrepreneurs and community (township or village) government
- TVEs are uniquely Chinese
  - Not in other transition and developing economies
  - Not in other East Asian economies

# Why TVEs?

- Why is TVE a puzzle?
  - We usually think government ownership is bad
  - Reform is to transform government ownership to private ownership
  - But TVEs represent a major anomaly: government ownership is the key to reform success
- Understanding TVEs
  - Historical reasons
  - Political reasons
  - Economic reasons



## Prior to 1979

- 1958: Communes set up small scale industrial enterprises such as steel mills but was short lived
- 1970s: Re-emergence of “Commune-Brigade Enterprises” (CBEs), the predecessor to TVEs
- Annual growth rate: 26% between 1970 and 1976
- By 1978: 49 billion Yuan output, of which 39 billion Yuan from industry (9% of national total industrial output)

## Prior to 1979

- Main motivation: agricultural mechanization drive
  - Typical business: machine repairing, food processing
  - Limits: only to serve agriculture
  - Grey areas: subcontracting for SOEs in nearby urban areas (Southern Jiangsu province near Shanghai)

## The Golden Period: 1979-mid-1990s

- Government Policies: a gradual process from tolerance to encouragement
  - Lifted restrictions on lines of business (most industrial lines, not only agricultural supporting industries)
  - Provided some tax relief (three years tax holidays)
  - But other support was limited (e.g., limited credit from state banks)
- The Effects of Agricultural Reform
  - Township and Village government focused on rural industry after the household responsibility system
  - The success of agriculture reform supplied labor, capital, and market for rural industry growth

## The Golden Period: 1979-mid-1990s

- TVEs at the peak (1992): 52 million employees
  - Townships
    - 48,200 townships
    - On average 8.2 township enterprises in each township
    - Total of 400,000 township enterprises with 26 million employees
  - Villages
    - 806,000 villages
    - On average 1.4 village enterprises in each village
    - Total of 1.1 million village enterprises with 26 million employees

## Industrial Subsectoral Composition of TVEs (1985)

Metallurgy	3.4%	Forestry	3.0%
Electric power	0.4%	Food	7.9%
Coal	3.8%	Textiles	12.5%
Petroleum	0.1%	Garments	3.7%
Chemicals	8.4%	Leather	1.6%
Machinery	25.5%	Paper	2.4%
Construction materials	18.9%	Cultural	3.0%

## TVEs vs. Private Firms

- Distinct feature of TVE: Alliance of Entrepreneurs and Community (Township or Village) Government
- What do entrepreneurs contribute?
  - Ideas
  - Management skills
  - Connections (people)
  - Connections (supplies and marketing)

## TVEs vs. Private Firms

- What does township and village government contribute?
  - Political protection and government connections
  - Initial capital investment
  - Help obtain loans from rural credit cooperatives/banks
    - Negotiation
    - Collateral provision
    - Loan guarantee
  - Selection and rewarding managers
    - Profit sharing
    - Leasing

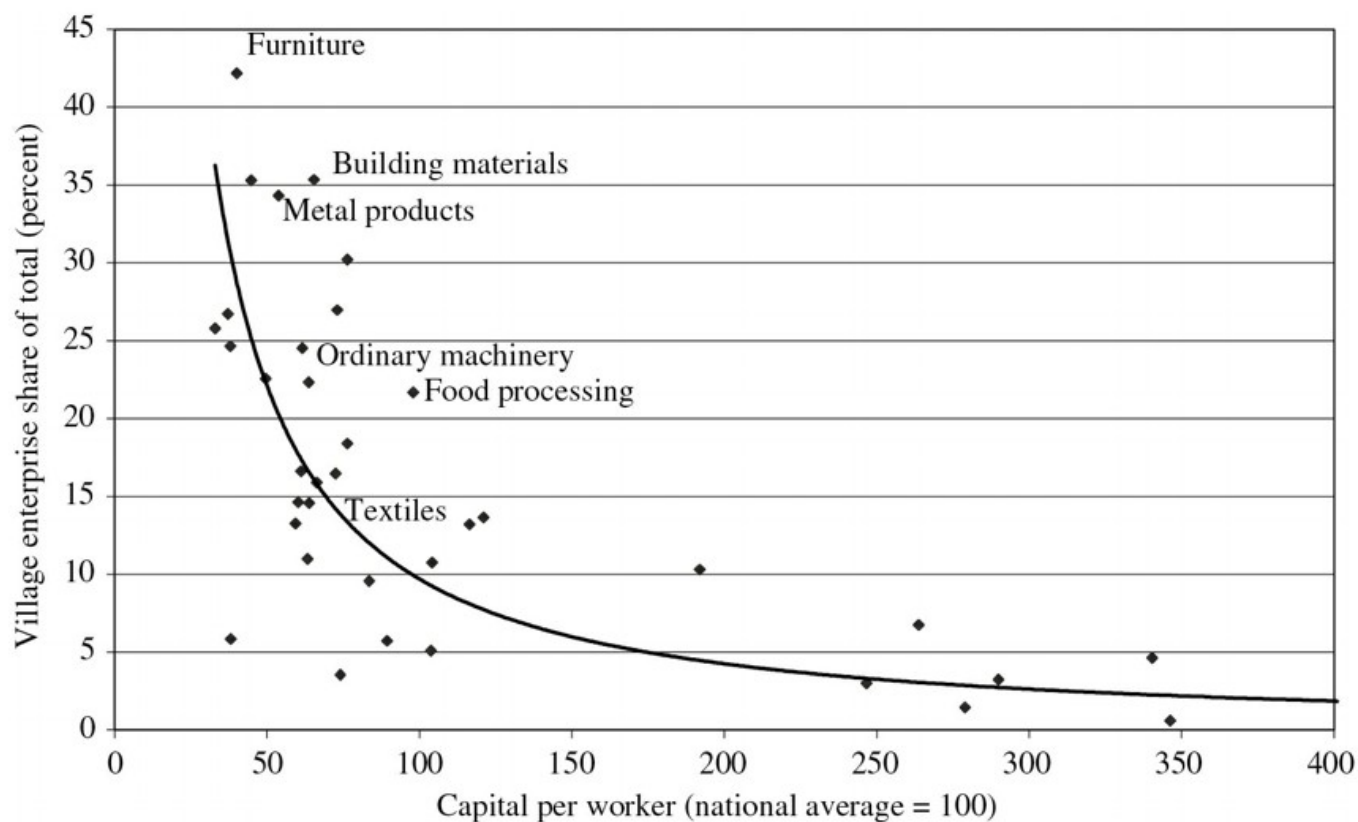
## TVEs vs. Private Firms

- How does township and village government benefit?
  - Use of after tax profits
    - Retained profits earmarked for local public expenditure (40%)
    - Retained profits for reinvestment (60%)
  - Private benefits
    - Cars, banquets, cell phones, offices, hotel rooms, traveling
    - “corruption”
  - Promotion
    - Not clear



# Economic Conditions for Rural Industry

- Distortions under central planning created enormous opportunities for rural industry to enter using China's comparative advantage.
  - Very cheap labor in rural areas
  - High prices for industrial goods due to state monopoly
  - Persistent shortages, especially in consumer goods
  - Small scale operation advantage: low overhead, flexibility
- Early entry is very profitable: average rate of profit on capital was 32%, or 40% if tax revenue also included, in 1978
  - Even without state subsidies in input prices and capital



**Figure 13.1**

Village-enterprise share of total output  $\times$  capital intensity, 1995.

## Geographical inequalities

- TVEs did not grow spectacularly everywhere.
- Most spectacular development was concentrated in:
  - Jiangsu province
  - Zhejiang province (private)
  - Guangdong province Pearl delta region (Hong Kong connection)

## Why Privatize TVEs

- Government ownership has costs
  - Some TVEs were collectives in name only (in Wenzhou)
  - But most TVEs were real collectives
- Changing economic conditions
  - Markets became more competitive, profit rates declined rapidly
  - Private firms enter, attracting able entrepreneurs away
  - When TVEs grew larger, more costly to manage with government involvement
- Changing political conditions
  - Private property rights become more secure

# Patterns of TVE Privatization

- A local government driven process, no national privatization program
  - Some started in mid-1990s, some started in late 1990s
- Various methods of TVE privatization
  - Sale (at discount) to managers and employees
  - Sale to outside domestic investors
  - Sale to foreign investors
  - Going public (IPO)
- Various corporate forms after privatization
  - “stock cooperatives”
  - Private firms
  - Joint ventures

**Table 12.1**

Distribution of shares in privatized TVEs (three sites in Shandong and Jiangsu, 2000)

Shareholders	Percent
Managers	53
Other board members	25
Workers (nonmanagerial)	18
Local government	3
Others	2

**Table 12.2**  
TVE employment by ownership, 2003

	Million	Percent
Domestic capital enterprises	128.4	94.6
Private firms	38.7	28.5
Other	31.0	22.8
Individually run	29.9	22.0
Collective	12.4	9.1
Limited liability	10.3	7.6
Stock cooperatives	3.7	2.7
Joint stock	1.8	1.3
Jointly operated	0.7	0.5
Hong Kong/Taiwan invested	4.9	3.6
Foreign invested	2.4	1.8
Total	135.7	100.0

## Domestic De Novo Private Firms

- Varieties of private firms: Domestic privatized firms, de novo private firms, and foreign firms
- From rural to urban areas, from local to national or even international
- Takeoff of domestic de novo private firms (start from scratch) in urban areas in mid-1990s
- A class of new rich.
- Crony capitalism “Chinese style”.



## Problems of private firms in China

- Political status
- Government regulation
  - Registration difficulties
  - Business line restrictions
- Financing
  - Hard to get bank loans
  - Hard to go raise funds from the public (even Ant group and Didi).

# Problems of private firms in China since 2021

- Facts:
  - Fintech companies (Suspension of Ant Group IPO in November 2020 and fines against Ali Baba and Tencent for abuse of market power for blocking access to goods offered on other platforms). Ant ordered to spin off its consumer credit data operations.
  - E-commerce: Alibaba, Tencent, Baidu, Bytedance and other firms accused of monopolistic practices (undisclosed mergers, exclusive contracts, misleading marketing....). Anti-monopoly regulations + worker protection rules.
  - Sharing economy: Didi IPO halted over data security, crackdown on power-bank-sharing, bike-sharing, short term rentals (Airbnb)...

# Problems of private firms in China since 2021

- Facts (continued):
  - Severe regulations on algorithms that do consumer discrimination, do not protect minors, do not allow easy censorship;
  - Migration of cloud services (Alibaba and Tencent) to government infrastructure in the name of data protection;
  - Prohibition of crypto-currencies;
  - real estate: "three red lines" (liability to asset ratio less than 70%, net debt over debt+equity ratio less than 100%, cash to short term debt ratio less than 100%) to deleverage the sector. Pilots for real estate taxes.
  - Regulation of packaging in food and cosmetics, high frequency trading and virtual reality

# Other crackdowns

- Closing down school tutoring sector and attacks on links between expensive neighborhoods and school placements.
- Attacks on celebrity fan culture”: censorship, attacks on “feminine” stars
- Draconian gaming curfews
- Attacks on rich people evading taxes (Zhao Wei)

# Problems of private firms in China since 2021

- Regulation of competition in the high tech sector is a necessity (big problem in the US with danger of capture).
- “Leading role of CPC” to prevent capture of regulators by big private firms.
- “Crony capitalism” Chinese style: some private firms benefit from connections with CPC officials to bypass regulations. Potential problem.

# Political interpretations of the crackdown on the private sector.

- The CPC is concerned about inequality.
- The CPC wants to prevent the private sector from being too independent and powerful to challenge the CPC's power and control. Explains earlier crackdown than in the US but may lead to limit of size of private sector!
- The CPC gave high tech firms protection against foreign competition (no Facebook, Amazon, Netflix, Google) in China and wants loyalty in exchange.
- Due to crony capitalism, local enforcement may be lukewarm, but will lead to continuation of the anti-corruption campaign.
- A lot of this smacks of totalitarianism, but no willingness to return to Cultural Revolution. Generational divide.