

ASIAN DEVELOPMENT BANK

The Development of Private Enterprise in the People's Republic of China

Prepared by
Centennial Group Holdings
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Acronyms

ACFIC	All-China Federation of Industry and Commerce
ADB	Asian Development Bank
Anova	analysis of variance
CCPIT	China Council for the Promotion of International Trade
CEO	chief executive officer
CGC	credit guarantee company
CGCC	China General Chamber of Commerce
CPC	Communist Party of China
CPPCC	Chinese People's Political Consultative Conference
DC	domestic consultant
FDI	foreign direct investment
FTC	foreign trade corporation
GDP	gross domestic product
IA	industry association
IC	international consultant
IFC	International Finance Corporation
IT	information technology
ITC	International Trade Center
LC	local chamber
LLC	limited liability company
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
NGO	nongovernment organization
NPC	National People's Congress
PBC	People's Bank of China
R&D	research and development
SAIC	State Administration for Industry and Commerce
SETC	State Economic and Trade Commission
SEZ	Special Economic Zone
SF	survey firms
SOE	state-owned enterprise
SME	small- and medium-sized enterprise
TVE	township and village enterprise
WTO	World Trade Organization

Note

In this study, \$ refers to the United States dollar.

Executive Summary

Since the International Finance Corporation completed its study of private enterprise in the People's Republic of China (PRC) 2 years ago, the PRC's private firms perceive an appreciable improvement in the climate for their activities. The still controversial opening of Party membership to private entrepreneurs ("capitalists") and the realities of the changes that will accompany the PRC's accession to the World Trade Organization have raised the status of private business and created a real commitment in public officials to "level the playing field" for all enterprises, regardless of size, origin, and ownership class. Entrepreneurs give governments at all levels high marks for their efforts to improve policies, laws, regulations, and rules affecting private enterprise. Local governments, in particular, are rated less highly on how well improved policies are being implemented. Officials are faulted for their lack of knowledge of their own policies, as well as the inconsistency with which different arms of the same local government interpret the rules.

The new view of private enterprise is as rational as it is realistic. Private enterprises are becoming an ever more important source of PRC growth and employment. In 2002, the share of GDP produced in the nonstate sector will exceed two thirds, with the share produced by truly private activity comprising comfortably more than half. Private firms are still located predominantly in the coastal provinces, and they remain relatively small. However, their rapid emergence throughout the country indicates comparatively free entry into markets. Although foreign-funded firms—members of the more broadly defined private sector—have become leading exporters, domestic private firms continue to focus primarily on supplying the domestic market for goods and services. To unleash their full growth potential, private firms continue to need more accommodating policies.

To identify those policies, this study included a survey of private enterprises, mainly comprising members of the China General Chamber of Commerce (CGCC),¹ in five cities in the PRC. Because coastal and central and western PRC vary in the openness of their local economies, and differ considerably in the status of their private enterprises, the five survey cities were selected to represent all three regions, with their distinct economic characteristics and different experiences of reform. Beijing is the national capital. Shenyang is the capital of Liaoning province in northeast China, the industrial heartland in the pre-reform era. Xi'an, an ancient capital of China and center of history and culture, is the capital of Shaanxi province and gateway to the western region. Wenzhou is an eastern coastal city in Zhejiang province, which is nationally known for the vigorous development of its private sector. Finally, Nanhai is situated about 50 kilometers south of the provincial capital, Guangzhou, in Guangdong province. Of these five cities, Beijing and Wenzhou were also surveyed in 1999 as part of the International Finance Corporation study.

The firm-level survey comprised 724 completed questionnaires and interviews with 82 chief executives of enterprises spread fairly evenly across all five cities. By comparison with the average private firm in the PRC, the average size of the survey firms was large. The average survey firm employs 16 times as many people as the average national private firm; even the median survey firm employs seven times the national average number of employees in private firms. Attempts to apply the conclusions of the survey must recognize the potential biases

¹ The CGCC was the main beneficiary of the technical assistance project financed under Technical Assistance Grant No. 3543-PRC "Private Sector Development" (TAR: 33447-01) of the Asian Development Bank (ADB).

inherent in the sample,² but that notwithstanding the better-established firms in the survey still see themselves as disadvantaged by local idiosyncrasies in policy implementation. And they are constrained in their activities by lack of access to formal sources of finance; inadequate information in all areas; difficulties in recruiting highly qualified personnel, especially senior managers and technicians; and deficiencies in the way markets work. The survey firms have a positive view of the contributions of the CGCC, its local chapters, and industry associations. At the same time, they would appreciate, and be prepared to pay for, more and better services from the CGCC system.

All of the major impediments to the growth of private firms identified by the International Finance Corporation study continue to constrain those firms. But the new survey suggests that governments on all levels should direct immediate priority to easing the constraints imposed by (i) access to finance, (ii) availability of managerial and technical skills, (iii) availability of information, (iv) nontransparent and/or inconsistent implementation of policies and regulations, and (v) inappropriate competition policies and other deficiencies in the organization of markets. The PRC's governments have initiated many actions to improve the situation, although some of them seem ill-designed for the purpose (e.g., guarantees for bank lending to smaller firms), and progress in other cases seems unduly slow. An area that needs urgent attention is the discretion residing with local officials to interpret policies inconsistently, as well as to pester entrepreneurs for nontransparent payments. Better training of officials and more widely disseminated information about policies could help, as would more reliably enforced penalties for officials who abuse their office. The current emphasis on training local officials in the requirements of World Trade Organization membership could be extended usefully to improve their implementation of measures that affect primarily domestic firms. The table following this summary lists priority actions recommended by the report in each of the five areas mentioned above. The proposed Action Plan for relaxing the remaining constraints on private sector is defined by three time periods: short term (within a year); medium term (1 to 3 years); and long term (beyond 3 years).

The CGCC and similar organizations can help to improve matters by representing members' interests more effectively with governments, and by providing better information in many areas. To do so, the CGCC will need to take advantage of the profound changes in the PRC economy as well as the improved climate for private business and transform its role and function. There is considerable potential for the CGCC to reorient itself from the historical role of linking private enterprise to the state system, and to emphasize service to members. But any expansion of the activities of the CGCC and its local chapters should respond to the demands of members as indicated by their willingness to pay for the CGCC system's services. Over time, the CGCC should expect the budgetary support provided by governments to decline; certainly, the governments' support cannot be expected to finance a sustained expansion of activity. The survey of CGCC members indicates what they would value most—better information, better professional advice, and better representation with governments at all levels. To deliver better services in these areas, the CGCC system will need to raise the skills of its employees, requiring both enhanced training and recruitment.

² The richness of the survey data can be appreciated by reference to Annexes 2 and 3 of this study.

Action Plan for Relaxing the Constraints on the Private Sector in the People's Republic of China

Priorities	Short Term (within a year)	Medium Term (1 to 3 years)	Long Term (beyond 3 years)
1. Improving Access to Finance			
<ul style="list-style-type: none"> ● Make interest rates more flexible 	<ul style="list-style-type: none"> * Expand lending rate band to 100% for small- and medium-sized enterprises (SMEs) 	<ul style="list-style-type: none"> * Free lending rates for loans to SMEs 	<ul style="list-style-type: none"> * Completely liberalize lending and deposit rates
<ul style="list-style-type: none"> ● Supervise credit guarantee companies (CGCs) 	<ul style="list-style-type: none"> * Establish a regulatory agency for CGCs * Monitor CGCs' performance * Investigate scope for collateral guarantees 	<ul style="list-style-type: none"> * Merge or close failed CGCs * Introduce reguarantee facility * With banks and CGCs, initiate pilot program for collateral guarantees and collateral information systems 	<ul style="list-style-type: none"> * Phase out credit guarantees * Depending on results of pilot program, establish collateral guarantees and collateral registration at CGCs nationwide
<ul style="list-style-type: none"> ● Clarify property rights to expedite the recovery of collateral 	<ul style="list-style-type: none"> * With banks, CGCs, and legal authorities, develop expedited system for recovery of collateral in events of default 	<ul style="list-style-type: none"> * Introduce in a pilot program (selected provinces, one bank, court or arbitration system) to handle collateral recovery quickly 	<ul style="list-style-type: none"> * If successful, extend program to all banks and countrywide
<ul style="list-style-type: none"> ● Improve accounting and audit practices 	<ul style="list-style-type: none"> * Clarify rights to land use, including where relevant ownership rights, and develop functioning land use markets so that real property can serve more effectively as collateral for loans * Through State Economic and Trade Commission (SETC), Tax Departments, and State Administration for Industry and Commerce (SAIC),reiterate the need for appropriate standards for bookkeeping * Convene a panel to affirm standards for SMEs 	<ul style="list-style-type: none"> * Enforce penalties for inadequate financial reporting 	
<ul style="list-style-type: none"> ● Continue general banking sector reforms 	<ul style="list-style-type: none"> * Continue to improve banks' portfolios by assignment of nonperforming loans to asset management companies, by freeing banks to make all loan decisions on the basis of sound commercial practices, by improving bank supervision and regulation, and by recapitalizing the state commercial banks and establishing realistic provisioning policies (and practices) * Introduce competition (both foreign and domestic) in accordance with World Trade Organization (WTO) provisions * Improve the quality of audit and disclosure by enterprises and banks * Implement the revised commercial law, especially as it relates to enforcement of contracts * Encourage the People's Bank of China (PBC) to investigate ways to introduce a credit information system to apprise banks and enterprises of the credit standing and loan servicing records of prospective clients 		
<ul style="list-style-type: none"> ● Continue to develop capital markets 	<ul style="list-style-type: none"> * Continue to improve the quality of regulation and supervision of capital markets, including in particular higher standards for disclosure * Complete integration of A and B markets * Promote development of active trading of government securities to establish a yield curve * Encourage corporations with satisfactory performance and financial reporting standards to issue corporate bonds * Develop a municipal bond market * Introduce several over-the-counter markets and markets specializing in high-tech companies 		

Priorities	Short Term (within a year)	Medium Term (1 to 3 years)	Long Term (beyond 3 years)
2. Enhancing Management and Technical Skills			
<ul style="list-style-type: none"> ● Facilitate the provision of training 	<ul style="list-style-type: none"> * Appoint a professional body/bodies to accredit training programs from commercial suppliers 	<ul style="list-style-type: none"> * Certify courses offered by licensed training institutions * Encourage China General Chamber of Commerce (CGCC), Industry Associations (IAs), and similar organizations to establish rosters of reliable trainers for clients and to seek feedback on the quality of training programs from participants 	
<ul style="list-style-type: none"> ● Improve labor mobility 	<ul style="list-style-type: none"> * Develop plans to increase the mobility of senior managers and technical personnel, in particular, by enabling them to dispose of housing and take pension and other benefits to new positions * Continue measures to permit greater mobility of labor (especially rural-urban migration) nationwide 	<ul style="list-style-type: none"> * Develop pilots that allow all workers to increase the portability of pensions, housing, health insurance, etc. 	<ul style="list-style-type: none"> * Mainstream portable benefits countrywide
<ul style="list-style-type: none"> ● Empower managers to make independent personnel decisions 	<ul style="list-style-type: none"> * Promulgate the principle that all hiring by private firms are independent of governments and the Party 	<ul style="list-style-type: none"> * Extend principles to all SMEs and collectives * Allow salaries/benefit decisions to be made by managers/boards of firms 	<ul style="list-style-type: none"> * Free all firms, including large state-owned enterprises (SOEs), to appoint personnel on the basis of merit * Delink all enterprise remuneration from official salaries and official influence
3. Improving Quality and Quantity of Information			
<ul style="list-style-type: none"> ● Coordinate responsibilities of different agencies to collect and distribute information 	<ul style="list-style-type: none"> * Clearly designate various agencies' responsibilities to collect and disseminate information 	<ul style="list-style-type: none"> * Reduce inconsistencies/ambiguities in the information provided by different agencies 	
<ul style="list-style-type: none"> ● Improve the dissemination of information on policies and regulations; internal and external markets; access to technology; availability of training services, finance, personnel, etc; and so on 	<ul style="list-style-type: none"> * Effectively use the Internet as a medium for dissemination * Upon registration, SAIC to provide all new firms with a pamphlet documenting the classes of information they should use and where to find that information 	<ul style="list-style-type: none"> * All relevant agencies (SAIC, SETC, IAs, CGCC, China Council for the Promotion of International Trade, Tax Departments, SSB to establish and publicize websites that contain comprehensive information of value to private firms * For CGCC, in particular, recruit library and data management skills, and establish a training program for staffs of CGCC and the local chapters in collecting and disseminating information to the membership 	

Priorities	Short Term (within a year)	Medium Term (1 to 3 years)	Long Term (beyond 3 years)
4. Implementing Policies/Laws/Regulations More Effectively			
<ul style="list-style-type: none"> Remove special privileges and level the playing field for all 	<ul style="list-style-type: none"> Extend the benefits promised to foreign firms under the PRC's WTO accession protocol to all domestic private enterprises Continue the process of extending equal treatment to all firms irrespective of ownership or origin 		
	<ul style="list-style-type: none"> Ensure consistent interpretation of regulations 	<ul style="list-style-type: none"> Using the model of the current training program preparing government officials at all levels for the requirements of the WTO, extend that training to improve those officials' knowledge of domestic policies, regulations, and the like, and how they apply to domestic private firms Build and maintain a comprehensive database on all policies, laws, and regulations that affect private firms, and disseminate the information as in 3 above 	
<ul style="list-style-type: none"> Simplify administrative procedures to make government services more easily accessible and reduce the scope for bureaucratic discretion 	<ul style="list-style-type: none"> Review licensing requirements for enterprises with the view to eliminating unnecessary ones 	<ul style="list-style-type: none"> Establish a single point at which new firms can satisfy all their registration requirements (a domestic "one-stop shop") 	<ul style="list-style-type: none"> Monitor officials' performance and dismiss officials who abuse their office
	<ul style="list-style-type: none"> Establish timetables for routine inspections (health, safety, environment, etc.) of enterprises and announce them publicly Eliminate all ad hoc fees and levies on enterprises and replace them by legitimate, transparent tax schedules 		
<ul style="list-style-type: none"> Elicit comments on policies/laws/regulations 	<ul style="list-style-type: none"> Encourage the CGCC and IAs to establish regular exchanges with local officials on behalf of their memberships to provide feedback on how their clients are affected by the implementation of existing statutes, and to recommend changes that would facilitate the activities of private enterprises 		
5. Improving Market Organization			
<ul style="list-style-type: none"> Secure property rights (especially intellectual property rights) of private firms 	<ul style="list-style-type: none"> Review penalties for infringement of proprietary assets of firms and recommend changes to make protection of domestic firms consistent with that required for the property of foreign firms 	<ul style="list-style-type: none"> Enforce the laws protecting the proprietary assets of individual firms and penalize those who infringe them 	
<ul style="list-style-type: none"> Define and safeguard quality and standards 	<ul style="list-style-type: none"> Governments and private bodies to develop a framework for establishing and conforming to quality and standards 	<ul style="list-style-type: none"> Implement the framework and improve the enforcement of standards 	

Priorities	Short Term (within a year)	Medium Term (1 to 3 years)	Long Term (beyond 3 years)
<ul style="list-style-type: none"> • Minimize local protectionism 	<ul style="list-style-type: none"> * As emphasized by Prime Minister Zhu Rongji in his speech to the National People’s Congress NPC in March 2002, take steps to ensure free access of Chinese firms to all parts of the domestic Chinese market * As needed, promulgate new laws to prohibit disruption of inter-provincial commerce, and introduce penalties for local officials who impede the legitimate activities of nonlocal firms 	<ul style="list-style-type: none"> * Enforce laws that prohibit the protection of local markets, and monitor local legislative initiatives to ensure that they do not act as a restraint on inter-provincial commerce 	