

## 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),<sup>1</sup> 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

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inherent in the sample,<sup>2</sup> 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.

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