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“The increasing role of small business in the Chinese economy”

Key words

China, small business, entrepreneurship, State ownership, private ownership

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The increasing role of small business in the Chinese economy

Introduction

This paper considers the changes in firm ownership since the Chinese government implemented its “open-door” policy in 1978. Most significant amongst these is the relative decline in State owned enterprises and the marked increase in the numbers of small business. By 1999, there were 10 million registered small businesses in China. We first discuss the background to change, then review the changes in legislation which have allowed different forms of ownership. The paper then shows how the changes in ownership forms have affected industrial output and employment. We conclude, with some caveats, that these changes offer opportunities to pursue an exciting research agenda.

Since China implemented its open-door policy in 1978 and moved towards a socialist market economy, it has experienced rapid economic growth. One characteristic of this change has been the relative decline of large State Owned Enterprises (SOEs) and the expansion of the number of small enterprises. Although the role of small businesses in creating economic development in the advanced economies is well documented, the exploration of the extraordinary growth of small business in the transition economy of China is less well understood. From a position of no privately owned small businesses in 1979, by 1999 there were more than 10 million SMEs registered in China (Chinese Statistics Bureau 1999), representing some 90 percent of all firms. These small firms made an increasingly important contribution to national income and employment at a time of relative decline of the contribution of larger firms. Moreover, these changes have to be set in the context of an

extremely turbulent and uncertain political environment. The purpose of this paper is to demonstrate the expanding role of small firms within the changing socio-political context of China.

Economic Transformation

China is the world's oldest state (Tam and Redding 1993), with a traceable history of over 3,000 years. Recently, there has been radical ideological and practical changes in State attitudes to enterprise and ownership. 1978 marked the beginning of a series of radical changes from the State controlled centralist command economy which had previously followed the Soviet model of central planning based on the control of inputs and outputs. China implemented major economic reforms to create an open door policy (Davies 1995). This represented a shift from a centralist planned economy to a new market based socialist economy. In the long run this was intended to prepare China for entering the global market (Tseng, Ip, and Ng 1999), a reflection of the commitment to admit China to the World Trade Organisation. Since that period, the country has experienced rapid growth. The World Bank reports GDP growth rates approaching 10 percent per annum, albeit from a very low base. Peng et al (2001) note the increasing academic interest in China, reflecting the dramatic rise in the Chinese economy. Indeed it is argued that the GDP of Greater China- (China, Hong Kong, Taiwan and Macao) may be on a par with that of the US and Greater Europe in the early part of this century (Lardy 1994; Overholt 1993). Buck et al (2000) argue that China adopted a "gradualist" path, whereby incremental, partial reforms started as localized experiments that spread inexorably to gradually replace central planning. These reforms "crossing the river by feeling the stones" were initiated by Deng Xioping in the period 1979-1990. The era of 1990-1997 was a time of "Rapid Economic Growth" which was characterised by Deng's Southern Tour when he voiced the epoch change with "to get rich is

glorious.” Schell (1994, p.342) compares Deng’s appearance in the south to “the shock value of the US president showing up in Las Vegas to proclaim its glittering strip of hotels and gambling casinos was the new American prototype of urban development.” Tan (1996) shows how the new environment has introduced a new class of private and collective firms, radically different from the SOEs and which are characterised as being more entrepreneurial.

From State to Private Enterprise

Malik (1997, p134) refers to the State Council announcement in 1984 about the comprehensive plan to reduce the State’s role, as, “(the) State would control the macro economy and individuals would control the micro economy according to the law of the market.” So, as Roy, Waters and Sherriff (2001) comment, new types of business enterprises have emerged from under the shadow of the formerly dominant SOEs to operate in marketized sectors that follow “different rules of the game.” Tan (2001) notes how the transitional economy has given birth to a new diversity in organisational forms and a plurality of property ownership types. Chow and Fung (1996) comment that small business and entrepreneurship have boomed in China in the post-reform environment and have made a significant contribution to the national economy. Tan proposes that (2001, p361) the Chinese entrepreneur has “become the Genie just released from its lamp”. Malik (1997, p185) comments in a similar way, that when Deng’s government permitted entrepreneurship, the “traditional entrepreneurial spirit sprang up in almost every corner of China.” Clarke and Du (1998) also refer to the unleashing of the entrepreneurial spirit. Tan (1996, 2001) proposed that the environmental turbulence brought about the rapid rise in entrepreneurship. Being smaller and faster (than SOEs), entrepreneurial firms adopt strategies that distinguish them from their larger and more established counterparts.

Nonetheless, Chan (1998) suggests that traditional Chinese business ideology and institutions are often considered unprogressively clannish and lacking in the transformational power of entrepreneurship. In contrast, Krug and Laszlo (2000), Fukuyama, (1995), Huntington (1993) and Redding (1990) all argue that in its extreme version, the cultural hypothesis proposes that it is the Chineseness of the Chinese which allows them to become entrepreneurial. Krug and Laszlo (2000) attribute the recent success of China's economic reforms to the success of Chinese entrepreneurs. However, Holt (1997) argues that Chinese managers do exhibit cultural differences which distinguish them in international comparisons. They are "more likely to avoid uncertainty and subsequently less likely to exhibit innovations or advocate change" (p 490). He also notes that the values associated with self-determination, risk taking and innovation were consistently less apparent among Chinese managers.

It may be that these negative factors are more apparent in the State owned sector, which is not characterised by change or adaptability. However, the problems that are endemic to socialist state-run enterprises have long been noted and documented. They include lack of incentives, over-staffing and bureaucratic bloating with a cumbersome and centralized decision making processes (Kaminski,1991; Kornai 1992; Jenner *et al* 1998). Tan (2001) explains that managers in SOEs remain part of the bureaucratic command system but are increasingly tied to an emerging market system, hence managers are commonly loaded down with objectives only partially related to market requirements.

Table 1 provides a summary of the key reforms which form a backdrop to the growth in the number of SMEs in China. The table illustrates the degree of fundamental change in policy which was required to create this new "socialist market economy."

Insert Table 1 here

Industrial Output in China

Table 2 illustrates the change in output accounted for by the different forms of company ownership. The most remarkable changes include a decline in the contribution of State Owned Enterprises from 77 percent in 1978 to just over 28 percent in 1999. Conversely, we see a dramatic rise in the relative output of Private Enterprises, from 0 to over 18 percent in the same time period; similarly the contribution of joint ventures (and others) rose from 0 to 26 percent. Collectively Owned Enterprises accounted for an increase, from 22 percent to 35 percent of the total industrial output. These shifts, in total, tell a story of radical reshaping of the economy in terms of enterprise ownership.

Place Table 2 about here

In Figure 2, we note that the rate of growth in output, in the period 1989-1999, is punctuated by a remarkable rise for all groups, except SOEs, in 1993. Most striking is the increase for Private Owned Enterprises (POEs). Whilst we cannot be certain about cause, we do note the correspondence with Deng's Southern Tour in 1992. It was during this trip that he, in effect, legitimised private enterprise by signalling the party's approval of individual entrepreneurship. In the light of Malik's comments (1997) about the general concern felt by

Place Figure 2 about here

entrepreneurs about whether they would be allowed to remain in business, it seems likely that this surge of recorded output was associated with this legitimisation. Moreover, in 1993 the party declared that the principle of the socialist market economy would replace the so-called socialist "commodity economy." This we would argue set the context for the

liberalisation of entrepreneurship and the growth in private production is the evidence of the acceptance of the new entrepreneurial role. An alternative view might be that the *recorded* statistics merely reflects the new legitimacy of private firms. We may be seeing either a shift from a “black” economy to a legitimate and formally recorded enterprise, or indeed a recorded shift from one category to another.

Employment

Place Table 3 about here

Table 3 shows the levels of employment by types of ownership. It is apparent that there is an across the board increase in employment in all types of ownership. However, in the later period, 1997-1999, only Private and Collective Enterprise have continued to increase employment. In 1999, approximately a quarter of workers were employed in SOEs, approximately one in three workers were employed in COEs, nearly 17 percent of workers are employed in POEs, and just under one in four workers were employed in OEs. In comparison, in 1990 SOEs (54.6 percent) and COEs (35.6 percent) accounted for more than 90 percent of employment in China, and POEs (5.4 percent) Others (4.4 percent) accounted for less than 10 percent of employment. This shows the dramatic change in relative importance of SOEs and POEs to employment in China.

Conclusions

Researchers need to be careful in the use and interpretation of data for China. This is also true for the data that has been sourced from the Chinese Statistics Bureau (1999). It can be argued that the data may be incomplete, and that there is the possibility of serious under-reporting of private activity because of the relatively hostile political climate towards private enterprise. For example, Malik (1997, p175) points out, “many private entrepreneurs use the umbrella of collective enterprise, joint ventures, small collective business (*getihu*).” This has

some fiscal benefits coupled with perceptions of legitimacy. Nonetheless the trend is clear, State owned business are declining in importance and private firms are increasingly important in the Chinese economy. In 1999, according to the Chinese Economic and Trade Committee, there were more than 10 million small and medium sized businesses officially registered. These comprised some 98 percent of all businesses, provided 60 percent of GNP, 40 percent of profits and taxes and some 68 percent of exports.

Small business in China is therefore big business. Although we are aware of the sea change, this shift raises some exciting research questions. We do not know exactly what these smaller firms are doing. We do not know if their structure is similar to Western SMEs and we do not know how these firms are financed. A whole new research agenda has been created.

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Table 1

Table 1. Key economic reform policies promulgated by the Chinese government

1979	Joint Ventures law; Price liberalization of farm products
1980	Fiscal autonomy to local government, Creation of special economic zones, Private income tax
1981	Individual enterprises encouraged in urban centres
1982	Price liberalization of industrial products, Patent Law and Trademark Law
1983	SOEs are taxed instead of profit sharing; Collective Enterprises are encouraged; People's Bank of China begins to assume some of the functions of a central bank
1984	14 Coastal cities are opened up to overseas investment, Director-responsibility system TVEs created
1986	Labour Contract System introduced
1988	SOE contract responsibility system; Regulations on private enterprises published; Enterprises and Bankruptcy Laws passed
1989	New regulations on mergers; Joint-Stock companies, commercialization of banks

1979	Joint Ventures law; Price liberalization of farm products
1990	Copyright Law
1991	Delegation of direct foreign trade rights to SOEs; Pension and Housing Reform; Establishment of the Shanghai and Shenzhen stock markets
1992	Deng's southern tour; Patent Law and Trademark Law revised: New operating mechanism and autonomous rights to SOEs
1993	Principle of "socialist market economy" replaces "socialist commodity economy"; Decision of the third plenum on establishing modern enterprise system; New Competition Law; New accounting standards introduced
1994	Foreign exchange reform; Fiscal and tax reform; Implementation of Company Law
1995	New Commercial Banking Law; People's Bank of China Law; Provisional regulations guiding foreign investment; Insurance Law

Table 2

Table 2 Industrial Output (in percentages) by Classification of Ownership 1978-1999

	1978	1980	1982	1984	1986	1988	1990	1992	1994	1996	1998	1999
SOE	77.63	75.97	74.40	69.09	62.27	56.80	54.61	51.52	37.34	36.32	28.24	28.21
COE	22.37	23.54	24.82	29.71	33.51	36.15	35.63	35.07	37.72	39.39	38.41	35.37
OOE	0.00	0.48	0.68	1.01	1.46	2.72	4.38	7.61	14.85	16.65	21.91	26.14
POE	0.00	0.02	0.06	0.19	2.76	4.34	5.39	5.8	10.09	15.48	17.11	18.18

(Chinese Statistics Bureau, 1999)

SOEs are enterprises wholly owned by the state.

COEs are enterprises where ownership is held by a collective group. They include both township and village enterprises.

OOEs, Other ownership types, are predominantly joint ventures but include some other forms of ownership.

POEs are private enterprises where assets are controlled by an individual or a partnership

Figure 1

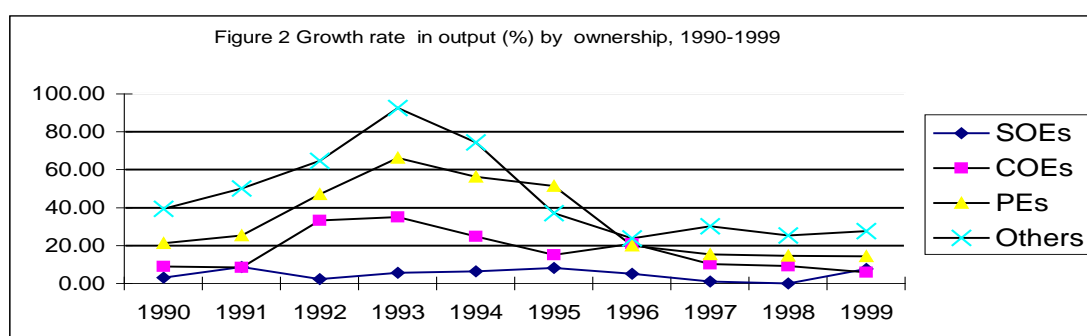


Table 3

Table 3., Employment by ownership 1990-1999 (in hundred thousands)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
SOEs	13064	14955	17824	22725	26201	31220	36173	35968	33621	35571
COEs	8523	8783	12135	16464	26472	33623	39232	43347	45730	44607
POEs	1290	1287	2006	3861	7082	11821	15420	20376	20372	22928
Others	1047	1600	2634	5352	10421	15231	16582	20982	27270	32962
All	23924	26625	34599	48402	70176	91895	107407	120673	126993	136068

(Chinese Statistics Bureau, 1999)