

Bert Keidel's discussion on Gary Jefferson et al. paper (and Gary Jefferson's response)

The Distributional Impact of Privatization

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Bert Keidel: Thank you very much, Minxin [Pei]. I will also make a few comments on this paper and then we'll ask Gary [Jefferson] to respond and then we'll open the floor to questions. I am delighted about a number of aspects of this paper. First is its collaborative nature of the way that Gary and his team have worked with the National Bureau of Statistics. It is the kind of collaboration that has been able to succeed in finding data, getting access to data, that are otherwise just not available and so I really commend the team for that hard work and good resolution.

The second thing is this paper puts right up front something it calls selection bias, which has been a real problem in our study of state enterprise reform in China for a long time. Researchers have, in many cases, blindly taken reformed enterprises and compared them with un-reformed enterprises and shown how successful the reform has been. And as the paper carefully shows, that's the result, really, of cherry picking, that those enterprises that are strongest to begin with, that have good financials and good markets and good locations are the best candidates for early shareholder conversion and we'll call it privatization. But the fact this paper, that it puts that directly up front I think is a very strong point for the paper.

I mentioned at the outset of this session that the promise of this paper for the overall project, which is *Winners and Losers in Enterprise Reform* is very great and that's because of the rapid transformation going on in China's enterprise ownership and control. The Chinese have been laying off a lot of workers, converting ownership and control mechanisms fairly rapidly.

We can't call it sudden or really extremely rapid. It's been measured. And they have used the financial system, for example, to make policy loans to help keep enterprises afloat that otherwise would have laid off more workers even faster.

I think this is an interesting phenomenon of an old fundamental sub-discipline in economics called welfare economics that says if you have losers that aren't compensated, as an economist you can't say there's been an improvement. And in China's case they seem to be taking that old saw to heart a little bit and restricting the degree to which workers are suddenly thrown out of employment without compensation and giving them, not necessarily compensation in terms of full wages, but rather a path towards new employment.

Part of it is the layoff system, the re-employment centers, what they call the unemployment insurance that you get if you no longer get your layoff benefits. And then, finally, a safety net that's below that for urban residents. This is combined with what have been, frankly, blandly discriminatory labor practices that give certain jobs in urban areas to laid off workers before they're given to rural migrants.

All of this has cushioned the impact of these changes, and I think China is a good example of how we want to be careful when we point to increases in inequality as an undesirable result of some of these reforms. Increases in inequality in China's case have a lot of beneficial effects because they reward those that are working harder, that are innovating. And, of course, there are exaggerations, there's a great deal of corruption although not as large as we see it in non-socialist countries in southeast Asia, for example. And yet we find with the Chinese reforms in the 1990s people with better education are finally getting paid more than those that didn't get a good education and that's an enormous change. The enterprise reforms are helping to bring about that shift in what it is that controls remuneration.

I think another preamble statement that I would like to make is that control rather than ownership in China is clearly the most important issue. Because the ownership classification very often doesn't give you a clue about who really controls the enterprise, and I'm referring here to the role of the party. The party can govern who is the manager, governs a lot of the goals of the enterprise in terms of its ancillary social investments and a party's role, even if it's a privately-owned enterprise as we've learned. Party is deeply integrated into how these enterprises function within the micro-society or the somewhat larger society.

And so the job is quite difficult to characterize Chinese reforms. And I think a study such as this, which is heavily focused on a wonderful set of micro-data, in some ways has to ignore the most interesting dimensions of what's happening in China for the issues of this conference. The paper's scope is quite narrow. It talks about conversion and I think we want to realize and Minxin has brought this up, the conversion doesn't mean privatization. In fact, as the paper says, there are enterprises that are large or medium sized that the state has decided to retain and convert to governance forms that are perhaps more efficient. Those that are smaller have been let go. It's clear that those who've been let go are really the large privatization experiment.

Many of the small state enterprises, if you looked as I did in the mid-90s at the statistics on profitability of enterprises by size, the small enterprises were the big losers. They lost a lot of money. The big enterprises, which included petroleum and other major state-owned enterprise sectors, were really quite profitable and so if we want to think about the problem at large we need to look at those sets of enterprises that this study isn't looking at.

That said, this paper is quite a contribution in the understanding of what is happening to those enterprises that have converted to a shareholding system. And I have some questions about

the actual data, so let me just say a few things then in terms of suggesting some questions. And then we'll turn it over to Gary to go back.

In your Table One where you describe these data, when I look at the statistics I have on state enterprises and collective enterprises, your state-owned seem to include shareholding cooperatives, [inaudible], and those, to my mind, are not at all state-owned. Those are mainly rural or quasi-rural enterprises that have a strange structure and the Chinese don't quite know how to fit them in to their enterprise law and they're essentially trying to stamp them out, but they won't be stamped out.

They're a very hybrid kind of local homegrown enterprise and there are very many of them and I think, if I'm not mistaken, they form a significant share of the state-owned enterprise numbers that you have. And they may be the ones that you're referring to that have a large non-state ownership in them. And I think that's probably something you want to correct and you want to take these shareholding cooperatives [inaudible] out of the state-owned category because it'll change your results pretty dramatically.

It seems to me, and I think you allude to this towards the end of the paper, that even though the statistical results are significant in terms of "t" statistics, the actual coefficients aren't very big. So we're not seeing much of a difference and I'd like to hear whether that's an accurate generalization or not. And I think you said we haven't yet seen much of a change, but that deserves a little more attention in the paper, that even though they're highly significant the coefficients themselves aren't very large. And so it doesn't seem as if it makes a big difference which way they've gone.

On page 10 you refer to this strange notion that the profits are higher in the state-owned enterprises and yet I think you don't need to present that as a conundrum because in this

paragraph before you've said that those profits include a lot of other expenditures. Housing, healthcare, things that state-owned enterprises do, and so that's quite common.

And also it seems to me that you've got quite a heterogeneous group of state-owned enterprises including, as I mentioned, petroleum and some other heavy industrial sectors, that are quite profitable whereas textiles, the silk industry, heavily owned, state-owned, loss making in many cases and supported by policy law. So there's a heterogeneity to your sample of state enterprises that deserves, perhaps, a little more attention. A lot of reforms in state-owned enterprises had to do with mergers and acquisitions, enterprises took over other enterprises instead of having them go bankrupt. And I'm not sure how that phenomenon fits into your data set.

Now maybe those are enterprises that reformed in many ways or something and I would like to see treatment of that, at least a mention of it. Also, you mentioned that unemployment in the converted firms doesn't seem to fall initially and you say that there may have been some deal about whether stakeholders have negotiation with those to take over the firm. Is it possible that, in fact, a lot of the workers were already laid off ahead of time to make the enterprise attractive?

I don't know. It may be that that's not the case, but it jumped out at me. Also, the years that you're looking, 1996 to 1999, are particularly difficult years for the Chinese economy because of the real collapse of domestic demand, particularly from the rural sector, that badly influenced profitability of state enterprises, particularly the smaller state enterprises. And I don't know what that sort of demand slump might do to the analytical results that you have. I wonder if you could say something about in your data set the major sector shares, and I've already alluded to that. Just, you know, what are some of the characteristics found in major sectors? And also by region because the performance in reforms by region is very different. And it may

be that some of your data for state-owned enterprises are the interior, which will have certain profitability characteristics that may not be as attractive, as opposed to those on the coast, which are much more dynamic.

And finally, I would change the title of the paper. I would call it *The Impact of Shareholding Reform in Chinese Industry* rather than *Ownership Reform* because ownership reform is such a broad title and this is much more narrowly focused on shareholding, which these are coded words. State-owned means that it has a certain structure and [inaudible] request to have a little more detail on what those mean is important.

But shareholding doesn't necessarily mean, as you pointed out, that it's not state-owned. The shares can . . . and, in fact, I think in shareholding also include a much larger group, maybe three times at large, enterprises that are limited liability companies that are also . . . the shareholder companies in China are about a fourth of your sample. The rest are limited liability companies that don't actually have shares, either listed or not, and so there must be a difference in the way that foreign investment or outside investment can participated. Those are some suggestions. We look forward to your comments.