

Minxin Pei's Comments on Gary Jefferson et al paper on China

The Distributional Impact of Privatization

February 24-25, 2003

1. a. What it means: conversion – corporate governance in particular: does governance change?
Comments on the paper: a carefully researched paper based on sophisticated econometric analysis of the performance indicators of converted SOEs and COEs in China. The relationship between conversion and stock market-listing: does conversion bring any material economic advantages to firms: access to capital markets, loans, etc? conversion improve performance. The answers given are mixed. Some
b. Failure rate: do converted firms fail? How do they compare with other forms of improvement, but no dramatic impact.
ownership
2. d. One intriguing finding that needs more research on: the large fall of share of state ownership.
Questions: the paper does not answer: micro-level details (the authors looked only at the aggregate data)
There are broad issues that ought to be put on the agenda: explanation is additional investment from non-state investors, but what about the possibility of illicit or insider privatization of state assets?
1. The political economy of privatization or corporatization in China?
a. China's leaders have resisted going down that route until the early 1990s; tried all sorts of things (all failed) to revive SOEs? Why the change of hearts?
e. Outright privatization: backing up SOEs completely and quickly privatized
▪ Members of the ruling elites (lower level) have developed a different perspective on (obvious) such conversion/corporatization (perhaps influenced by the Russian and Eastern European experience -such reforms can be used to advance their private interests; through illicit insider privatization; but competitive outright privatization must be resisted because that would have neutralized the political advantages enjoyed by the insiders. So settled on the form of "corporatization" which allows the insiders to use their political clout for insider privatization
▪ Insider privatization and the banking problem: SOEs and COEs have large debts owed to state-banks. Corporatization can be used to leave debts with subsidiaries of pre-conversion SOEs and create more healthy SOEs in which asset-stripping by insiders can continue.

- Such asset-stripping must be completed before democratization – as long as other stake-holding groups -- workers -- are politically disenfranchised, insiders can maximize their gains (as long as they give some crumbs to the workers – employment at lower wages)
- Illicit privatization and emergence of a new class: some indication of the connection between such privatization and new entrepreneurs -about 25 percent of all firms were converted from SOEs and COEs; the heads of these new private former heads of these SOEs and COEs; about 50 percent. (the joke about a bureau chief bankrupting an SOE first and then bought it for a song)

2. Political implications of privatization-Chinese style:

a. Rising inequality --the concentration of assets in the politically privileged group -- members of the ruling elites and their cronies; this can be magnified if newly privatized firms gain access to the capital market

b. socialization of liabilities -the privatization of debt-ridden SOEs and COEs in a murky process creates huge uncollectible debts to state banks

c. potential source of worker protest -conversion/privatization does not take into account workers' interests; corruption -asset-stripping has become a major source of contention between management and workers