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1. “Daring Innovation” of Lang Xianping

In the summer of the year 2004 the Leading Professor\footnote{“Zui gao xueshu jibie (shouxi) jiaoshou” – “professor of the highest academic rank” or “leading professor” (ranks which was given to Lang Xiaping at Hong Kong English Language University).} of the Hong Kong English Language University economist Lang Xianping (Larry Lang) became the focus of public attention in the Mainland China. Already before that Professor Lang’s CV looked impressive. Being born in 1956 in Taiwan, he defended his PhD in Finance in US and since then lectured at different Economic and Financial Colleges and Universities in Michigan, Ohio, New York and Chicago. He also served as executive adviser to World Bank and consultant at Financial and Economic Department of Hong Kong government. His name occupies the 122<sup>nd</sup> place in the World’s list of most often quoted economists and two of his articles belong to 28 World most quoted articles on corporate finance. Between 1998 and 2001 having received the place of World Bank’s Adviser on corporate governance he focused his research on the problem of defending the interests of small shareholders.

In summer 2004 Lang Xianping started examining the reform of state owned enterprises (SOE) in the People’s Republic of China. And there his public pronouncements and articles invoked a great deal of controversy and eventually marked the beginning of a big public discussion which turned out to be one of the most spectacular events in Chinese public thought since 2000. Although the most intensive part of this discussion took place between autumn 2004 and spring 2006, its strong reverberations and connotations can be felt in Chinese media, Internet, research publications and even Party and State official documents of the most recent period.

The story began between June and August 2004 when Lang Xianping made a number of consequent public statements, most notable one during his speech at Fudan University in Shanghai on the 9<sup>th</sup> of August. The Focus of Professor Lang’s critical attention was the “evaporation” of the state capital from the state owned enterprises (SOE) in the process of what is called in China the “reform of SOE property rights”. He insisted that this state capital which was created by “blood and sweat of toiling masses” during the decades of socialist construction in the process of reform went through a number of unlawful deals and twists and ended up in private hands. The topic was not brand new for Chinese audience but this time Lang Xianping pronounced loudly such things that were before either discussed somewhat low profile or simply were not put into light. Moreover, Lang did not simply mention the fact of the state capital running off but made unprecedented and concrete accusations. He
pointed at some leading and what was always believed successful Chinese companies which produce electronic consumer goods such as Haier\(^2\) and TCL and went on criticizing heavily the concept of property reform itself. What was actually a political critic was accompanied by scholarly questioning.

Regarding Haier, Lang Xianpin told a story of how this originally Mainland state brand simply became a shell of Hong Kong based private joint stock company. According to him, Haier’s council of shareholders\(^3\) got 98.6% of the newly established “Haier Investment” company (with only 1.4% of shares in the hands of Haier itself) and in 2000 established joint venture with two Hong Kong based companies starting to produce mobile phones. In 2001 one of the two Hong Kong company’s affiliated corporation bought both of the companies. As a result of this grey deal “Haier Investment” got almost 30% of joint venture’s stock thus becoming the second biggest shareholder and renaming the venture into “Hailer Zhongjian”. In April 2004 Haier company decided to merger its best washing machine producing facilities as well as the rest of 35.5% shares of former Hong Kong mobile phone producer with “Hailer Zhongjian” thus controlling almost 60% of its stock. By means of this four step operation main part of Haier’s capital left for Hong Kong and became de-facto private. The central actor of the play was Haier’s council of shareholders whose investment activity was purely illegal from the beginning. (Cao 2005)

Another object of Lang Xianping’s offensive became the owner of “Gelinkeer” company Gu Chujun. In 2001 the latter bought one of the biggest Chinese state producers of refrigerators and subsequently occupied the 20th place on the list of China’s Forbes edition. According to Lang, when asked about the origins of such amount of money which he has Gu used to say that “my money has international background” and even boasted that the “only thing I have unlimited is money” and “money is not a problem, if there is a good facility I will buy it without any hesitation.” Lang stated that Gu Chujun controlled the main facilities of “Gelinkeer” company through “Greencool Capital Limited” which was registered in Great Britain. His dubious fund rising practices were based on machinations with big amounts of ready cash left in his hands during the time gap between the customer’s payment to the producing company and the latter’s payment to shippers and advertisers. Lang Xianping’s description of Gu’s methods of taking control of state enterprises is written in the language of Chinese idioms and full of moral indignation. Here Gu encamps state property to put it under the auspices of his 100% private company. There Gu takes advantage of somebody’s trouble to buy controlling parcel of shares cheaply. In the third case he starts to behave like a boss when in fact he was only an invited guest. Next method of Gu can be “exchanging the gifts”, when he helps to pay the debt of state joint stock company to its affiliated company thus getting hold of the latter. The last two methods can be described as “big washing” and “making an attractive face” which mean in the first stage artificial lowering of facility’s price depicting it as thoroughly loss making and in the second stage swiftly turning newly bought “loss-maker” into a profit-maker (Li and Wang 2004; Cao 2005; Deng 2005; Lang 2006).

Lang Xianping addressed a number of critical questions to Hainan based TCL, another big state company which underwent “property reform”. Stating that TCL has low operating profit but high return on capital Lang assumed that the company must have low manufacturing costs. With such low costs TCL must have high net profit. But in fact TCL’s net profit is only 26th in the branch. With the net profit growth rate only in 16th place and with joint capital growth rate only in 23rd place TCL, according to Lang, simply cannot be an attractive venture for shareholders. Still its earnings per share are inadequately high. Why is it all so? – asked Lang Xianping (Cao 2005; Lang 2006).

And then he began questioning the concept of property reform itself. Lang began by saying that this concept in China was not the result of substantial research but simply the outcome of someone’s slapping his forehead (“pai naodai”). In Lang’s view the main problem with Chinese SOEs was not the vagueness of property rights (as was supposed by the reforms’ theoreticians) but the overwhelming lack of trust and responsibility of the state companies’ managers. Pointing to the fact that in many developed countries state shareholding is a wide spread practice he went on saying that

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2 Haier in fact became in recent years one of very few internationally recognized Chinese brands.

3 Institution which consists only of the company personnel and according to the Rules promulgated by high state organs of PRC such as Committee on Structural Reform in 1997 (Document # 28) cannot be legal shareholding body and is not allowed to be engaged in investment activity.
the role of state hired manager at such company can be compared to the role of a nurse which is supposed to look after the baby. In China in principle it must be so too, but Chinese managers always behave the way as if the state owes them something. The property rights’ reform in China actually limits itself to the right of managers of state companies to become de-facto owners of state property instead of managing and augmenting it for the sake of the nation. As if, goes on Lang, when you hire a house-maid to clean your apartment and eventually this house-maid becomes the owner of it. What is called MBO (management buy out) in International practice became MBI (management buy in) in Chinese case. The rules of such deals in China, according to Lang, are totally unlawful and illegal. Managers in most cases simply bought state shares from the government at a low cost. He pointed out to the main problem of such sort of Chinese style MBO saying that in doing it state and private enterprises united in their attempts to devour state property. The price of the state property which is to be sold to managers is defined by a deal between higher state officials and managers and the process of their bargain is hidden from public scrutiny. According to Lang, in today’s China the question is not about how just is competition between state and non-state economic actors but about which of them is quicker in the race for acquisition of a bigger part of what was before solely nation and state property (Li and Wang 2004; Cao 2005; Lang 2006).

While East European and especially Russian privatization in 90s is perceived as the paragon of social injustice and low economic effect by a considerable portion of Chinese experts’ community and public opinion Lang Xianping wrote that current Chinese property reform carries striking similarities with the Russian case.

Lang also questioned the view widely shared by leading Chinese economists who were behind the reform that “non-state ownership is more effective than state ownership” and that joint stocking of state owned enterprises can substantially help in restructuring the companies’ management. In Chinese case, Lang believes, this step only increases managers’ “moral hazard”. He openly called on Chinese authorities to stop the process of “restructuring” state companies in order to prevent further weakening of state property in real sector (Cao 2005; Deng 2005; Lang 2006).

Lang Xianping’s view of banking reform was also special. He claimed that his comparative research done on 958 joint stock banks from 78 countries testifies to the fact that there is no direct link between bank profit and the structure of its parcel of shares. That is why the reform of property rights in the banking sector (decrease in state participation, cooperation with foreign banks) is of much less importance than other tasks of economic reform (Li and Wang 2004).

In one of the subsequent articles published in Hong Kong weekly “Yazhou Zhoukan” in November 2005 Lang went on accusing Chinese government of blind pursuit of economic goals which neglects the interests of “weak social strata” (“ruoshi qunti”) who carries the burden of most of reforms including education, pension and health system reforms. Lang compared today’s China to the period of primitive capitalism which in the Western history two centuries ago became the hotbed of the socialist revolution. He called the contemporary Chinese society the “worst society in the 5000 years of Chinese history” and emotionally questioned if such country can be called “socialist” one (Ma 2008).

2. Discussion grows apace.

In subsequent days the companies which were attacked by Lang, like Haier and TCL, limited themselves to colorless statements of refutation of what they called “professor’s allegations”. Only Gu Chujun used his Hong Kong lawyer to send the letter to Lang Xianping which contained the demand for official apology. Lang publicly insisted that he his positions cannot be changed and he will go fighting injustice to the end. As for intellectual community, it kept total silence. Lang even regretted that nobody from Chinese economists - his brothers-in-arms supported him (Cao 2005; Ma 2008).

At the end of August there came a sort of official reaction when the deputy head of Development Research Center (Enterprises Department) of the State Council Zhang Wenkui gave an interview to “21 Shijie Jingji Baodao” weekly. Zhang acknowledged that during the property

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4 Managers become de-facto owners of the entrusted property.
reform of state enterprises a part of state appointed managers were eager to buy some stocks of their enterprises at a low cost. But, according to Zhang, this is reasonable because the salaries of these managers were calculated in the times of planned economy and thus are inadequately low. Many of these people in fact did their best to upgrade and develop enterprises entrusted to them and fully deserved such favorable treatment. Zhang stressed that even after property reform SOE in China still pay special attention to their social obligations, employment etc. which, according to him, is incomparable with what happened after privatization in Russia (Cao 2005).

Lang Xianping pressed ahead trying to mobilize intellectual support. In the last days of September 2004 a group of Chinese economists in Beijing held a seminar on SOE development. Lang made an emotional speech in which he drew a distinction between “mainstream” (zhuli) Chinese economists who were behind the property reform and “non-mainstream” (feizhuli) economists who, as himself, were critical of it (Cao 2005; Deng 2005; Lang 2006). Lang said that the most prominent representatives of the first camp were invited to the seminar but did not appear except for Zhang Wenkui. The second group was well present and included those who resolutely supported Lang in the months to come. Among them there were Zuo Dapei, Yang Fan, Han Deqiang, Yang Bin etc. Lang Xianpin criticized “mainstream” group (Zhang Weiying, Li Yining, Zhou Qiren and one of the most well-known Chinese economists Wu Jinglian) for being protagonists of “neo-liberalism” which was “the cornerstone of all blunders of economic reforms in recent 20 years”. Immediately after the seminar a number of “non-mainstream” participants decided to send an open letter to the Chairman of PRC Council of People’s Deputies Wu Bangguo, General Secretary of the CCP Central Committee Hu Jintao and Premier of the State Council Wen Jiabao. The letter signed by Zuo Dapei, Yang Fan and Han Deqiang demanded investigation of Haier and TCL economic activities, immediate halt of stock sale to SOE managers, introduction of special columns in “Renmin Ribao” and other leading newspapers where the results of investigations and different views on the subject can be published, dismissal of the heads of State Property Regulation Committee, revise of the SOE reform concept, which, according to the authors, greatly narrows the social basis of ruling party, turning CCP into the “private party of the rich men” (Cao 2005; Ma 2008).

Intellectual counterattack followed from Zhang Weiying, deputy Director of the “Guang Hua” Management College at Beijing University, who gave a long interview to liberal weekly “Jingji Gauncha Bao”. Zhang started mentioning that at the early stages of economic reforms in China nobody spoke about the necessity to restructure the state property. This restructuring was not the result of anybody’s beforehand planning or conspiracy but naturally came out from the practical experience. In certain sense state property reform was a forced one. Zhang admitted that there is a problem with pricing of the sold state-owned stocks. The root of this problem is in the Chinese stock market itself which “is not competitive enough” and thus prone to “inadequate information”. Zhang said that currently the basis for pricing of the sold stocks is the so called “net value” (jing zihan jiage) of an asset and insisted that it is very difficult to define if the state capital runs off in any case, irrespective whether the stocks are sold on the prices which are higher or lower than this basis. “Those who buy, buy not the past but the future of the concrete state asset”, - he stressed. While selling state assets, continued Zhang, one must “look in four directions”: “look forward”, meaning the need to upgrade the enterprise’s efficiency, “look back”, meaning to secure the interests of those who contributed to the development of this enterprise in the past, “look left and right” meaning to see if the general balance of interests, primarily those of working personnel is guaranteed and “look upwards” which means considering the demands and rules of government institutions and State Law. Zhang Weiying underlined that researchers must stay independent from wide public sentiments and the view of majority is not necessarily a right one. All in all he made clear that reform of SOE can not and will not be stopped simply because there is a danger of state capital running off (Cao 2005; Deng 2005).

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5 Zuo Dapei is researcher in the Economic Institute of Chinese Academy of Social Sciences (CASS), Yang Fan is Professor at the College of Commerce of the Politics and Law University of China, Han Deqiang is researcher at the College of Economic management at Aviation and Aeronautics University of China.

6 Chinese economists using this term mean the current price of fixed assets without counting their debt volume.
In mid-September 42 economists held a conference in Nanjing on SOE reform where they unequivocally backed Lang Xianping.

In late 2004 and 2005 the discussion broke the frame of intellectual community’s statements and articles. Chinese Internet exploded into avalanche of emotional feedback while almost 90% of respondents supported Lang Xianping’s position and no more than 5% signed up to the “mainstream” stance (Cao 2005).

Since late September 2004 state institutions responsible for SOE property restructuring began making some movements. First, The State Property Regulation Committee (SPRC) issued its “Position on Current SOE Property Reform” published on 29th of September in “Renmin Ribao”. The document underlined that the main direction of SOE reform is “separation of property rights and economic activity rights”. Managers buying shares at their enterprises “may seriously damage the construction of effective state corporate governance structure”. Big state assets must stay in full state property. A couple of days later “Jingji Gauncha Bao” published interview with the deputy Head of the SPRC Shao Ning who said that the problem with state capital running off is “extremely complicated”. According to Shao, although there are “big drawbacks” in the fields of law and institutions, reform cannot be stopped and its main direction is right (Cao 2005). A month later a group of SPRC functionaries from the pages of “Renmin Ribao” called on to stop selling stocks to managers of SOE at all. In mid-December deputy Premier of State Council Huang Jun stressed: “It must be clear that at big SOE managers cannot buy shares. At medium and small-seize SOE this practice should be treated differently in different cases.” In April 2005 this view was officially documented in “Provisional Rules on Transferring Property Rights to the Managers of Enterprises”. “Rules” also demanded that all deals connected with medium and small-seize SOE management buying shares must go through controlling organs of SPRC in order to be of open character (Cao 2005). This paper, albeit very much blurred, became in fact the final word of the Chinese state in the ongoing controversy. In July 2005, almost one year after first accusations of Lang Xianping against Gu Chujun, the state organs began investigation in the latter’s activities and in September same year he was arrested on a charge of bribery and seven other offences. Nevertheless the overall impression from official words and deeds was that party-state nomenclature is deeply split over the issue of SOE property reform.

The discussion meanwhile continued and grew in scale and emotion. Some participants from “non-mainstream” camp went as far as saying that China needs her own Putin to strike a resolute blow against “those unscrupulous and predatory new rich” (Cao 2005) This statement, as one may judge, was inspired by former Russian Presidents’ attack on Moscow based private oil company “UKOS” headed by famous “oligarh” Mikhail Khodorkovski, now in jail. It should be said however that by invoking such analogy Chinese “non-mainstreamers” showed rather poor knowledge of Russian political, economic and institutional realities that are very different from those of today’s China.

Soon it became clear that using International economic terminology for describing developments in China may be at least doubtful. Some experts like Professor of History from Qinghua University Qin Hui pointed to Lang Xianping’s incorrect mentioning of MBO and MBI. According to Qin, in developed and developing countries, both MBO and MBI mean that managers buy shares of the enterprises which are in their charge and hence these terms are not antonyms (Cao 2005).

Another discussant Chan Jianglai wrote that strictly speaking MBO meant the practices widely used by managerial stuff of some big American corporations fighting the consequences of the oil crisis since mid-70s. When the price of stocks plummeted managers decided to issue extra shares and buy them themselves in order to prevent the radical change of the ownership thus saving in many cases the companies’ property for original owners. This example is essentially different from what was going on in China (Chan 2007).

But the core of the discussion was certainly not about what terminology is appropriate. It looks like that absolute majority of participants simply used such terms as MBO or MBI to try to

7 In Russia all main economic and political foundations of “state socialism” were totally dismantled between 1991 and 1996. In China these foundations are not only still in place but can play pivotal role in guaranteeing macroeconomic balance, institutional stability, political control over society and territorial integrity.
describe and perceive the Chinese empirical reality which, they assumed, may be not in full coincidence with the original meaning of these words in US or other developed countries.

3. Main views and approaches.

To our mind the participants of the discussion can be divided into three big groups.

The first group included those who resolutely opposed Chinese style “MBO” and called on to stop it as soon as possible. Most of this group who were defined as “non-mainstream” by Lang Xianping was either members or very close to the so called “New Left” - a much bigger faction in current Chinese social thought. Actually, most of those who signed up to Lang’s critic represented economic platform of the “New Left”. In the most consistent way this view was expressed by Gao Liang, head of the State Property Research Center at the Institute of Structural Reform and Zuo Dapei, researcher at the Institute of Economy of Academy of Social Sciences. Having spoken a number of times at the famous Beijing based left-wing think tank “Wu You Zhi Xian” Gao Liang openly supported Lang Xianping’s ideas and stressed that the concept of “property reform” in China proceeds from SOE defeatism. To his mind, this reform today is actually equal to privatization. Those who believe that “private is more effective than state” in doing their best to grab state property artificially lower the efficiency of SOE. Those who oppose it (state organs, workers’ councils etc.) immediately turn into “reform obstacles” by official propaganda. Privatization in Russia caused long recession. Example of East-Central European privatization is not helpful for China either because the countries of the region are very small and soon found themselves under control of transnational corporations and NATO. China must proceed from the interests of country’s strategic security and social stability. SOE reform in the way of privatization seriously undermines both and is unacceptable (Deng 2005).

Zuo Dapei was more detailed and, having no big official position, more outspoken. His views can be found in numerous articles, texts of his speeches made at “Wu You Zhi Xiang” left-wing think tank as well as in his book “Buxu Zaimai” (“No Permission to Further Sale”) published in China in late 2006. Zuo’s point of departure is that in people’s state the property rights of the state must be in the hands of the people. The problem here is that during three decades of reforms in China the institutional basis for that was not established. Management contract system in late 80s, according to him, undermined managers’ discipline and greatly weakened financial and statistical control of the state over its property, namely SOE. At the same time the state seriously interferes into SOE economic activities, still proceeds from “political achievements” criteria and nominates and dismisses managers along nepotistic lines. All this breeds managers’ voluntarism, dysfunctional administration and overwhelming corruption. Such state of affairs often causes the problem of “unclear owner” or, as Zuo Dapei puts it, the “ice-cream dilemma”. Just as in hot summer ice-cream melts very quickly and you have to sell it as soon as possible to prevent its total meltdown, the Chinese state facing the lowering efficiency of SOE wants to get rid of them the sooner the better. And they sell them to managers at disproportionately low price – the so called “net value”. This price does not include SOE debt which, according to Zuo, is twofold. The first is the SOE indebtedness to the bank (credit interest rates), the second is its indebtedness to the working personnel (wage arrears, postponed social payments of different sort etc.). The size of the debt at most of the SOE exceeds 50% and in some cases comes close to 90% of their asset value. Such deals, so believes Zuo Dapei, create undeserved wealth of the managers who capitalize on the state and simultaneously impoverish working class. Chinese MBO, being tremendously unjust, is unable to upgrade SOE efficiency either. “Ice-cream dilemma” is not escaped. It may be even enhanced when managers would try to transfer “illiquid” property to some others’ hands, might be to foreign capital. Zuo Dapei admitted that private property can operate more efficiently than the state property but only in case when it is financed by the owner’s own capital. Today most of economic actors, including private ones, prefer to look for some others’ financial recourses.

Zuo Dapei vehemently opposed Zhang Weying’s words about the need to “treat managers benevolently” saying that those who really deserve benevolence from the state are the working people, the personnel of the SOE which are being sold. He called on to immediate stop of all forms of MBO in China and stressed the urgent need to establish a clear and effective structure of managing of the
state property. According to Zuo, such structure must consist of three levels. On the first highest level there are SPRC and other central controlling organs accountable to the elected all-China Council of People’s Deputies which represents the “joint will of the whole people”. The second level includes the organs which are responsible for profitable operation of SOE. Interestingly enough, Zuo did not mention here what kind of organs they should be – party, government, CNP or something else. On the third level there are SOE. The SOE main shareholders should be their employees who would be much more eager to work hard for their own interests then for the corrupt state or private owners, so Zuo Dapei (Zuo 2006).

Other strict opponent of MBO was the Rector of Yangjing Huaqiao University Professor Hua Sheng. Sharing Zuo Dapei’s view that Chinese MBO actually are nothing more than unjust “big free meal” for SOE managers, he wrote that in this country the concept of MBO itself suffers from intrinsic contradiction. If the government deals with state property in efficient way than there is no need for any MBO. If the government efficiency itself is low than MBO is even less suitable because in this case micro-level managers are prone to corrupt practices and the main task is not to give more power to them but to improve the overall systemic arrangement from the macro-level down (Deng 2005).

Another prominent scholar, head of the Research Center on Chinese Economy Lin Yify confessed that his viewpoint is “basically the same with that of Lang Xianping”. Lin gave a number of interviews in which he opposed privatization of SOE using mainly economic reasoning. His general idea was that SOE in China are overburdened with political and social duties. They have high concentration of capital and manpower which is the legacy of central planning. Laborer in China is associated with the means of production. Under such circumstances, Lin believes, it is almost impossible to improve efficiency and profitability, be the enterprise state or private. The preliminary step to reform SOE should be elimination of this political and social burden. But in none of his interviews Lin Yifu suggested a comprehensible roadmap to achieve the goal (Cao 2005).

The second, not a very big and consistent group, included those who were in principle not against such MBO but thought that it must be carried out in fully open, socially acceptable (just) and generally limited way. One of the most vocal from this group was Professor of Chinese University of Politics and Law Yang Fan. Yang rejected his identification with the “New Left” although admitted that he is a “non-mainstreamer”. Having written that the discussion should overcome the “framework of Left and Right identification” Yang called on to stop MBO at least for a time being. His argument was close to that of Zuo Dapei but he did not exclude managers’ privatization for small local enterprises. While dealing with big local enterprises he suggested “equal attention to justice and efficiency” and “respecting the workers’ choice” meaning that personnel at such SOE is not “against market” but “opposes corrupt management” and thus local governments should act together with the workers. As regards to 196 nation scale SOE, Yang Fan proposed to establish “strategic production” on their basis but added that 169 of them belong to “competitive branches” thus a sort of thoughtful diminution of state presence may be possible. The Chinese state which has controlling parcel of shares in such big SOE should “follow the plan on the market basis” and develop world famous national brands, probably in cooperation with foreign firms but by no means allowing transnational corporations to take the upper hand. These ideas were also in principle shared by Han Deqiang (researcher at the Chinese Aviation and Aeronautics University) and Wang Xiaodong (professor at Chinese Youth Political Institute) (Deng 2005).

Later Yang Fan identified himself as a staunch adversary of the Chinese neo-liberals suggesting that there is no less than an “American conspiracy” to support them. Authors of this conspiracy are not American people or scholars but US “right-wing intellectuals” who used ideological vacuum in China since the beginning of the reforms. They took a grip over many Chinese economists by means of the system of academic promotion and even controlled much of the county’s media. Yang Fan was sure that there is a big interest behind all this (Cao 2005; Deng 2005).

The third faction who clearly supported Chinese MBO (“mainstreamers” or “Chinese neo-liberals”, according to Lang Xainping) can itself be divided into two smaller groups. The view of

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8 He said that “New Left” is a “political label” invented by “neo-liberals” and he has disagreements with the real “Left” on some aspects of SOE reform.
the first one seems to be close to those who stood for “social justice” in doing MBO. Slight but very important difference from the latter was that they were ready to accept MBO even in case it “is not fully open and just” saying that “the question is too complicated” and “total social justice is impossible to secure”. They believed, at least expressed such belief publicly, that MBO is the only method to find the owner for the state property and make it more efficient anyway. Besides already quoted Zhang Weiying and Zhang Wenkui we can also enlist here Han Chaohua (Academy of Social Sciences, expert on micro-economy), Huang Sujian (economist from the People’s University), Han Zhiguo (head of “Bang He Caifu” research institute), Cheng Zhiwu (overseas Chinese economist), Zhang Wuchang (Professor from Economics and Finance College of Hong Kong University) etc.

Han Chaohua and Huang Sujian concentrated on the process of pricing of the sold state property. Han stressed that today the price of state shares acquired through MBO is defined by the bargain between government bodies and SOE management. In case the price seems unjust the main fault is on the side of the government which agrees to sell property so cheaply.

Huang Sujian accused Lang Xianping and his supporters of oversimplification in understanding the process of state assets’ pricing. He wrote that while letting state shares go to managers local governments consider not only (and probably not mainly) the state asset’s “net value” but the possibilities of its existence, market for its goods, employment capacities, personnel income, debt volume etc. Managers as a buying side first of all consider quality and liquidity of the assets, size of the SOE social burden, quantity of unnecessary manpower etc. All in all there is a complicated bargain involved and if the price of the deal is lower than estimated price of the asset this does not necessarily mean that state capital runs off.

Han Zhiguo believed that due to unclear division of the property rights between central and local governments the only way for the latter to consolidate their tax revenue and political prestige is to allow MBO at the state assets (Li and Wang 2004; Deng 2005).

Cheng Zhiwu wrote that in reforming China where corruption is everyday practice there is no wonder that MBO at SOE caused state capital run off. But the main question is whether this run off is the reason or the result of corruption. For Cheng the answer is clearly the second one. He writes that in generally corrupt environment the best way to fight corruption is to “transfer property back to the people” (huan chan yu min) in order to limit the basis of corruption and to guarantee property’s security. Some extra corruption in the process of such transfer seems inevitable. But if the transfer is stopped out of fear of such “extra corruption” and current SOE system remains unchanged than the only result would be continuation and even growth of overall corruption (Deng 2005).

Detailed and emotional critic of Lang Xianping’s approaches and accusations can be found in two books written by his liberal opponents Wu Dingjie (PhD in Finance from Zhongshan University) and Chan Jianglai (PhD student in Economics at Fudan University) published consecutively in Guangzhou in 2006 and in Shanghai in 2007. The first one called “The Real Face of Lang Xianping” (“Lang Xianping Zhen Xiang”) tells about his scholarly life, research methods and social activity making no secret that the author disagrees with Lang in all important points. The second book called carefully enlists serious factual mistakes and theoretical shortcomings in what Lang Xianping has written. Chan, for example, insists that TCL had nothing like MBO, main shareholder (non-state) remained unchanged and that the state parcel of shares at this company even grew currently exceeding 25%. He also questioned Lang’s understanding of “corporate trust” and “common law” and their applicability in China. A part of the book simply consists of quotations from Lang Xianping’s works. Numerous inaccuracies and awkward style make readers cast doubt on Professor Lang’s professional credentials. It is clear that by means of this book those whom Lang called “mainstreamers” wanted to level his reputation, at least as initiator and participant of this discussion.

The second group of the third faction was probably the smallest one but it were these people who showed – to our mind - somewhat deeper understanding of the “property reform”. They supported Chinese “MBO” but made it clear that irrespective how it is called or whether state capital runs off or not, the whole story is not about pure improvement of economic efficiency but there began a systemic property transition with highly unpredictable outcome.

Let us start with Zhu Hengpeng, researcher at the Institute of Economics of the Chinese Academy of Social Sciences. Zhu pointed out that Chinese public opinion and media highly overestimate the degree of real influence of economic theoreticians over the state economic policy.
Intellectual economists may arrive at certain consensus but it may not at all be shared by the people and political leaders. Putting this theoretical consensus into practice by economic interest groups is even less likely. What is happening in China is not Russian or East-European type of purposeful large scale privatization but a sort of spontaneous enlargement of non-state economic actors. As long as the market reforms are implemented the tendency to such enlargement is absolutely inevitable irrespective of what was initially planned by this or that reform. Spontaneous retreat of the state has unavoidable illegal dimension which involves state capital “evaporation” and joining up of political power and economic might. It is not that privatization itself should be blocked but such kind of corrupt practices during privatization (Cao 2005).

Zhu’s view is developed by Qin Hui, professor of History at Qinghua University. Qin remarked that be it Lang Xianpin (saying that he supports the idea of “big state” to help the poor) or most of his “mainstream” critics (accusing Lang of cursing party, government and the rich), everybody wants to sign up to Chinese state and depict opponent as its adversary. Qin ironically writes that it is a sort of discussion “with Chinese characteristics”. According to him, both sides simply make fool of Chinese public. With the absence of democratic system of social and political checks and balances the first group of discussants would be unable to establish effective state while the second one would be equally incapable of creating efficient private property and lawful administration. Being a historian, Qin draws a parallel with Song dynasty when Wang Ahshi’s “pro-big state” reforms and Si Maguang’s “liberal market” approach both failed under corrupt absolute monarchy, eventually causing political disintegration and systemic collapse. In a later article Qin dismissed the left-wing critic of Russian privatization. While admitting that privatization in post-Communist Russia between 1992 and 1996 was far from just, Qin stressed that it was nevertheless implemented under “Eltsin’s democracy” which allowed wide public discussion. He believes that it is due to this fact that Russian public, although widely dissatisfied, still showed greater tolerance towards the results of privatization than Chinese public to the ongoing “property reform” (Cao 2005).

SPRC official Zhou Fangsheng drew attention to the fact that in Western countries with developed market economies MBO is a standard property exchange deal between independent and equal economic actors. In China such measure serves as a form of systemic transition from state owned to mixed economy. Moreover, property reform in China takes place in extremely uneven environment of economic restructuring (Deng 2005).

Most of the participants in the discussion paid major attention to the state assets’ problems in real sector. Xu Tianqing, Professor at Chinese Economy Research Center of Beijing University, was one of very few who made a critical estimation of Lang Xianping’s approach to the reform in banking sector. While quoting his conclusion about the lack of connection between bank profit and property structure, Xu remarked that Lang’s research on 958 banks in 78 countries quite surprisingly did not include four biggest Chinese state banks. These banks occupy monopolistic positions in current financial system of China possessing 65% of the country’s banking capital. In fact their influence is much bigger taking into account the pivotal role which they play in implementing state macro-economic policy. In all now existing three Chinese joint stock banks9 the state has blocking parcel of shares. Non-state banking in China is still rudimentary, writes Xu Tianqing. He concluded that any monopoly means inefficiency and corruption and that further reform of the property rights on the basis of Chinese state banks’ joint stocking becomes imperative (Li and Wang 2004).

Such are three main groups of approaches in the discussion which was initiated by Lang Xianping in summer 2004. Enumeration of the full list of contributors is obviously beyond the scope of this article.

The author of this article tends to share Lang Xianping’s argument in the parts where Lang points to the lack of social justice in the Chinese SOE so called “MBO” transition and where he writes about growing “moral hazard” of the SOE management. To our mind, these two points are really very hard to be disputed. But at the same time we believe that this transition of Chinese SOE from “public property” to “management’s property” should be perceived in a more broad systemic reform context. From this point such transition looks to us unavoidable and, so to say, natural. To put it in other words, it is very hard for us to imagine that “managerial contracts” could be implemented in China in any

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9 Xu Tianqing wrote his contribution to the discussion in 2005.
other basically different way and style. Thus we support the view according to which this transition was, at least to great an extend, a “forced one” and came as a result of many overt and covert socio-economic and political processes characteristic for the “partial” and “gradual” market reforms introduced in the Chinese industrial state sector since late 70s.

On the other hand, we believe that those experts (irrespective of how they evaluate Lang Xianping’s approach) who perceive this transition as “privatization” are fundamentally wrong. In order to understand why and where they are so wrong one should proceed to the analysis of the general systemic context of the market transition “Chinese style”.

4. From “Public” to where? Still on the road of the “Biggest Myth”

In the year 2002 the observer of “The Economist Intelligence Unit” and the author of “The China Dream” Joe Studwell coined a fabulous phrase: “The biggest myth about China in 1990s was that country ceased to be socialist” (Studwell 2002). Lang Xiaoping’s critic of property reform as well as the discussion it invoked testified to the fact that this myth still persists. In the book called “Wu Qu” (“The Area of Mistake”) which was published in late 2006 in Beijing Professor Lang once again generalized his position:

1. Transition of the state assets to private hands (from the state organs to the managers) “under the blanket” of the property reform is illegal. Chinese style MBO turned into MBI and must be stopped.
2. The price of the asset to be sold is the subject of covert bargain between the state organs and the management of given SOE and disproportionately low.
3. It is not the privatization which is needed but the establishment of efficient system of trustful corporate governance in already existing state sector.
4. State sector properly run is by no means less efficient than private sector. This conclusion relates also to banking and finance (Lang 2006).

These points are not unique also in International perspective. I personally remember how on the eve and during privatization in Russia in the 90s local communists and nationalists were indignant: “What the hell they are doing with the state assets! All this is unjust and state sector exists in all developed market economies!” As one can see, Lang Xianping and his “New Left” supporters in Mainland did not go very far from this claim. I am not going here to dwell upon the problem of social justice. This is an endless topic, especially (because of historic reasons) for the reforming communist and post-communist countries. In our view, what unites Lang Xianping, Chinese “New Left” and Russian anti-privatization campaigners of the 90s is the underlying belief that state sector in Leninist economies is actually efficient enough and that it can operate - in case of proper administration! in the way it operates in the countries with mature market economies. And thus it does not need substantial change during transition to the market. The falsity of this view is that in developed economies state owned assets constitute a part of a complicated property setting at the heart of which lies the capital market that is non-existent under classical communist state political and economic monopoly. What is called “privatization” in post-communist transition is in fact one of the basic means to create such system of capital turnover or capital market under conditions of which both state and private assets would operate in the new setting and with the new quality. In other words successful fulfillment of market transition presupposes profound change in the state’s economic nature while politically it might become democratic or stay authoritarian (Aslund 2007).

So, the basic question is whether the current property reform in China (be it MBO or MBI, according to Lang Xianping) creates such system of capital turnover? In our view the answer is negative. Here it is worth to draw a general picture of what happened to Chinese SOE in recent couple of decades. Mid- and late 80s were marked by the gradual establishment of the so called “double-track” price system and expansion of the “management contract system” which went hand in hand. Under new regulations the managers of SOE (both central and local) enjoyed the rights to sell and buy

10 See for example Lang Xianping’s proposal to establish in China the trustful system of SOE corporate governance.
11 Concurrently existing plan fixed and free market prices.
produce at free market prices. But only that part of the produce which was over and above the plan (Naughton 1994). State and party organs of different levels were called up to guarantee that the produce within the limits of the plan is not transferred to the sector where free market prices were used (Zhang 2006). This was an arduous task, especially bearing in mind that some goods were still only within plan and thus not allowed for free trade at all, some were in both pricing sectors, some (minority) – only in the free market. It should be clear that these price arrangements varied tremendously between branches, enterprises and regions. Economists and even high ranking CCP politicians were engaged in vehement discussion on the price reform. Some demanded strict unification of the “double-track” system around the whole country. Some supported the idea of returning to planned fixed prices. Some – the group of radical reformers - insisted on the need to abandon “double-tracking” and follow the single track of free market pricing. All agreed that “double-track” breeds big corruption (Yang and Li 1993). There were two unsuccessful attempts to free the prices radically in a systemic way in 1986 and 1988 (Shirk 1993). The first plan of such “shock therapy” was buried already on the stage of preparation facing regional resistance. The second plan widely announced in spring 1988 caused panic buying, near hyperinflation, deep split in political leadership and finished up in Tiananmen Square bloodbath in June 1989.

What happened later looks like that feeling unable to guard effectively the frontier between fixed and free pricing and facing regional lobbies the central government let the overhaul of the “double-track” system in the way that did not change the rules basically but made life somewhat easier for both controllers and producers. Not the central organs but regional authorities and management of the enterprises were to bear the brunt of the new arrangement. From outside this overhaul even may look like that “double-track” was dismantled and prices were freed. But it was not the case. In some regions local governments proclaimed almost all prices free but in fact compensated to the SOE (and not only to them!) on the contract basis the difference between still existing fixed and market prices. (This was the so called “Shijiazhuang Model”). In other regions, like for example in Jiangsu province, authorities used complicated calculation techniques to figure out “joint average prices” which were a sort of arithmetical mean between fixed and free prices (Yang and Li 1993). To say nothing about the fact that central and local governments as well as many SOE still had special departments of their own which were responsible for price control and regulation. Varieties of such practices depending on locality, branch or enterprise were abounding. Most of them started as experiments in mid- and late 80s but it was between 1990 and 1995 that they were, so to say, fully farmed out to regional political and economic authorities. To put it in the simplest way, local administrations on contract basis handed to the enterprises the right to appropriate the difference between fixed and market prices through various channels. Administrations correspondingly assumed the duty to help or even save these enterprises in case they face financial or other difficulties. Criteria of political rationality still prevailed within given institutional conditions. While in some Chinese literature such practice was named “exchange of planned rights and planned duties”, it was not sufficiently researched from systemic perspective either in China or abroad (Sheng 1996).

There is substantial reason to believe that these processes were not the result of somebody’s thoughtful plan. Economic life in a big highly regionalized country under one party political monopoly and with concurrent existence of fixed and market pricing naturally gave birth to such modes of behavior. In many respects these processes went contrary to the hopes of the pro-reform economists. According to such well-known proponents of “incremental reform” in the “double-track” setting as Fan Gang and Zhang Jun, with the time going on the “new market track” will proceed from the margins of a command economy (“old track”) inside it and gradually replace it in “non-revolutionary” reformist way (Fan 1996; Zhang 2006; Csanadi 2006). What took shape in reality was something different. With undeniable reduction of central directive planning and expansion of free market on the margins of the system many if not the most of really important economic agents on domestic market began operating on the basis of countless varieties of what was in fact contract pricing. In most cases the deal was struck between local governments and enterprises and in the end was still bureaucratically coordinated because in the given setting it were the party and state organs, albeit at regional level, whose decision guaranteed the right of the given agent to appropriate the fixed

12 Some experts argue that it was indeed what happened in China in 1992-93 (Yang and Li 1993)
and market price difference. This difference was itself a price – a price of the deal. The form of ownership was not of pivotal importance, although SOE were certainly in a privileged position. In such setting the rational behavior of non-state agents was not to rush to free market but to use all means at hand to obtain the contract status granted by authorities (He 2000). In our view it was already not the “double-track” system (more or less clear cut division between “plan price” and “market price” in certain relationship with each other) but a “multiple-track” with innumerable versions of contract pricing at its heart. In other words, the forces of market pricing indeed invaded the state planning from the margins of the system but instead of replacing it conducted to structural disintegration.

Joint stocking of SOE which started since late 1993 at a big scale under the slogans of “socialist market economy” and “system of modern enterprises” did not change this setting in principle. Moreover, it widely used already existing contract price mechanisms. The idea to establish independent system of State Property Regulation Committees (SPRC) – with the role of state holdings - accountable only to the Council of People’s Deputies was buried as early as in spring 1996 not without participation of Zhu Rongji, by that time State Council’s Vice Premier (author’s interview). Zhu’s logic was understandable. He was afraid of losing control over the government by making the latter losing control over state property deals. Eventually the SPRCs of different levels were granted only the status of departments of corresponding governments. And in most cases it were these governments or companies closely affiliated with them who became the state holdings in reality (He 2000; Li 2005; Zhang 2006; Yang 2007). Because most of these holdings were 100% state owned and state shares (“A” type shares) until spring 2006 were not subject to trade, new joint stock companies had no councils of shareholders but only boards of directors which, as well as other executive organs, were nominated along the lines of party-state nomenclature. Chairmen of the boards of directors were in most cases the secretaries of CCP committees (Zhang 2006). Such practice became de-facto legal since autumn 2004 (author’s interview). So the conflict between managers and party secretaries burning since mid 80s was effectively contained. Chinese stock market is highly segmented and until now remains under very strict bureaucratic control over all procedures and deals from how to enter the market up to division of place and forms of stock turnover. It is not that much the mechanism of capital turnover but the means of speculative capitalization of SOE (Li 2005; Tan 2006; Yang 2007; Shang 2008).

There is no wonder that in such a setting managers began contracting the right to use the entrusted state property and – where possible- to obtain it from the holding state companies by not necessarily legal means. This process was again not very much planned but undoubtedly a great deal spontaneous. It did not stop after Lang Xianping’s accusations and subsequent discussion. In fact it even accelerated since spring 2006 when the part of “A” type shares (state owned shares) became tradable in compliance with new directives to “reduce the amount of state shareholding”. The main problem was how to price them. After some not very convincing attempts to stage more open procedures and amidst tremendous views’ diversity the practice of covert price contracting once again prevailed (Li 2007). The sides of the deal remained basically the same: party-state authorities on the one hand and managers on the other. Important to mention that such “reduction of state shareholding” did not overcome the compartmentalization of the Chinese stock market. Big portion of state shares is still not subject to trade and the rules of other stock turnover remain divided according to the stock’s type.

The tendency of managers to obtain (buy) state property from party-state authorities through covert contracting financed in most cases by state bank credits is very hard to recognize as “privatization”. Except for the cases when foreign investor steps in, all important financial, administrative and political leverages remain in the hands of the state. Banking sector is still a great deal party-state monopoly (He 2000; Cheng 2006). The market system of capital turnover is not established. There are seventeen branches of industry in today’s China where national private investment is forbidden (Ma 2008). Even the prices on the market are in fact not fully deregulated. CCP power monopoly still dictates certain criteria of politically rational behavior (Csanadi 2006). Fan Gang remarked in October 2004 that what was under way might be privatization from the point of the concrete state asset. But from the point of the state as a whole it is neither privatization nor capital run off but simply the turn of the state property from one form into another, namely from “engaged”
form (“jingying xing xinshi”) into cash (xianjin) or “non-engaged” form (“fei jingying xing xinshi”) (Deng 2005).

Lang Xianping and his supporters were perfectly right in saying that such “property reform” does not necessarily bring improvement in companies’ efficiency. According to some estimation, while between 2004 and 2006 on the country’s average “restructuring” embraced approximately 50% of joint stock state assets, at 99% of them it was unsuccessful either from institutional or operational points. At 81.7% of examined loss making SOE the damage happened due to “clumsy internal regulation”. Managers’ “moral hazard” was obviously on the rise.

5. Conclusion

Hong Kong Professor Lang Xianping’s harsh critic of state property reform in China in the summer of 2004 as well as subsequent big theoretical clash between economists and in the public opinion, in our view, testified to the fact that Chinese way from Leninist economic system is in fact not that much unique. The author of this article tends to believe that what Lang indignantly called “illegal privatization” and what his “mainstream” opponents depicted as “inevitable” or even “forced” “property restructuring” necessary to improve SOE efficiency was neither, nor but the logical and natural stage of institutional disintegration of the Leninist state property structure. The “latent transition” of the state assets from the hands of impersonal party-state organs to the hands of the concrete managers who run this property on the day-to-day basis is by no means anybody’s “big conspiracy” but in many respects a spontaneous deal which took place in all former socialist countries, most actively in the periods of economic reforms prior to the collapse of communist regimes. The “Chinese characteristics” of this “latent transition” relate to peculiar conditions of “double-track” price reform which, contrary to the East European and Soviet scenarios, took place earlier than institutional and property restructuring. “Double-track” price system was introduced in China in mid 80s and despite outwardly convincing arguments that the “new market track” will in due time gradually replace “old plan track” (theory of “incremental reform”) evolved by mid-90s into what we call “multiple-track” based on countless varieties of contract pricing. The system remained party-state centered and in its core bureaucratically coordinated but highly decentralized. Its main economic agents favored neither strict plan, nor free market but status quo of granted (bought) contract rights to appropriate the difference between fixed and free prices. Joint stocking of SOE since mid 90s was put in the “multiple-track” price setting, thus increasing tendency to the institutional disintegration of the state property. “Multiple-track” contract pricing began being supplemented with “multiple-track” contract for disposal of the state property. To our mind, this is obviously not a privatization in strict economic meaning but necessary and perhaps unavoidable stage prior to it.
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ABSTRACT

In summer 2004 Hong Kong based famous economist Lang Xianping (Larry Lang) made a number of harsh critical statements regarding state property reform in Mainland China. This critic provoked big discussion among leading Chinese economists (perhaps the biggest one in the recent decade) and seriously polarized public opinion. The core of the discussion were the questions concerning economic nature and socio-political consequences of the state assets passing via semi-legal ways into private hands, managers’ “moral hazard”, state sector efficiency and trustful corporate governance in today’s China. Many observers, irrespective whether they agree or oppose to Lang Xianping’s critic, tended to recognize the current “property transition” at Chinese state assets as privatization. The article below argues that the processes going on and even accelerating in the recent couple of years in Chinese state sector are by no means a privatization in the strict sense. They represent a sort of a contract between the party-state organs and state assets’ management allowing the latter to dispose of the assets in the already existing setting of “multiple-track” contract pricing which took shape by mid-90s. Although not a classical privatization these steps constitute an important and perhaps unavoidable stage prior to it.

KEY WORDS: state property, reform, privatization, capital market, double-track, multiple-track