Congressional-Executive Commission on China Issues Roundtable:
"Ownership with Chinese Characteristics:
Private Property Rights and Land Reform in the PRC"
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February 3, 2003

Good afternoon. Thank you for the opportunity to address the issue of property rights in China, especially the pace of enterprise privatization, capital-market liberalization, and the implications of ownership reform for human rights and civil society.

The primary goal of the fourth generation of leaders in China is to maintain strong economic growth and increase prosperity throughout China. To do so, they will have to confront a number of serious problems, particularly the debt-ridden financial system and the inefficiency of state-owned enterprises (SOEs). China's big four state-owned banks are technically insolvent, with nonperforming loans (NPLs) estimated to range from 25 to 40 percent or more of outstanding loans. SOEs account for more than two-thirds of all bank loans but produce less than one-third of the total value of industrial output. That massive waste of capital under China's socialist market economy cannot be stopped without fundamental reform—in particular, privatization and the rule of law.

Pumping more funds into state-owned banks to keep them afloat will only postpone the day of reckoning and increase the overall cost of reform. Likewise, turning SOEs into shareholding enterprises, with government as the major owner and with most shares being nontradeable, will not transform those firms into profitable entities. History has taught us that without private ownership and the threat of bankruptcy, there is little incentive to reallocate capital to its most highly valued uses. Until state banks and enterprises are fully privatized and effective limits are placed on the power of government, waste and corruption will continue.

China's largest SOEs remain under firm control of the government, but many medium- and small-sized SOEs have been restructured. Moreover, since 1978, Beijing has allowed experimentation with different forms of ownership, and there are now more than 20 types of ownership, including private firms, collective firms (e.g., township and village enterprises, many of which are private), joint stock companies, and foreign-funded enterprises. The exact scope of the private sector is difficult to calculate because private firms often "wear a red hat" and conceal their true identity in order to gain access to state bank loans at subsidized interest rates and other government favors. A reasonable estimate is that the private sector now accounts for about 33 percent of GDP.

The great success of private and cooperative enterprises over the past 25 years—they now account for more than two-thirds of the value of industrial output—has resulted in official recognition of the importance of the nonstate sector as an engine of economic growth. Article 11 of the Chinese Constitution, amended in 1999, now reads: "Individual, private and other non-public economies that exist within the limits prescribed by law are major components of the socialist market economy."

Private firms were illegal in 1978, and SOEs dominated the economic landscape. Today there are nearly 2 million private enterprises employing more than 24 million workers, and the number of private enterprises is growing by more than 30 percent per year. In Shanghai and other coastal cities, SOEs are becoming small islands in a sea of private enterprise. Much of the growth of the private sector has been spontaneous, in the sense that privatization took place without central direction as opportunities for trade increased, especially in the special economic zones (SEZs). Local jurisdictions were allowed to experiment with new ownership forms, and, when they were successful, others sought to imitate that success. Only later did the central authorities put their stamp of approval on the institutional innovations.

The growth of private enterprise has occurred despite the lack of transparent legal title and restrictions on access to state bank credit. Informal private capital markets have evolved to fund the private sector, and overseas Chinese have been an important source of investment funds. The strong performance of provinces with greater economic freedom, such as Fujian, Guangdong, and Zhejiang, has created a new middle class and a demand for better government and more secure property rights.

Capitalists are now free to join the Chinese Communist Party, and several well-known private entrepreneurs are already members of the National People's Congress. As more entrepreneurs join the party, there will be mounting pressure to change the status quo. At the 16th National Congress of the CCP in November 2002, President Jiang Zemin gave a clear signal that the private sector is an important part of China's future. He said, "We need to respect and protect all work that is good for the people and society and improve the legal system for protecting private property." The party charter now includes "The Three Represents"—a doctrine that commits the party to embrace "the fundamental interests of the majority of the people," not just the proletariat.

Chinese citizens can now own their own businesses, buy shares of stock, travel widely, hold long-term land use rights, own their homes, and work for nonstate firms. The depoliticization of economic life is far from complete, but the changes thus far have created new mindsets and expanded individual choice. The many restrictions and human rights violations that remain should not detract from the progress China has made since 1978 in raising the standard of living for millions of people and giving rebirth to civil society.

China's accession to the World Trade Organization, in December 2001, has resulted in a long-term commitment to economic liberalization and legal reform. The policy of engagement is working to change China's legal system and to better protect property rights and, hence, human rights. At the 16th party congress, Jiang called for improving markets (including "the capital market" and "markets for property rights"), abolishing "trade monopolies and regional blockades," and deregulating interest rates. The outgoing leader of the world's largest communist party told the new leaders, "We must give full scope to the important role of the non-public sector."

That rhetoric should be taken seriously. The nonstate sector is providing a safety net for unemployed workers from SOEs. As restructuring takes place, China will need a rapidly growing private sector to maintain strong economic growth. Strengthening the private market sector will require a clear commitment by the national government to giving equal protection to private property rights and to liberalizing capital markets so that entrepreneurs have access to domestic capital that is now locked up in inefficient SOEs. Real reform, however, will require more than "revitalizing" SOEs and "recapitalizing" state-owned banks; it will require a firm commitment to widespread privatization of state-owned assets. Until the government and party are shut out of banks and enterprises by privatization, corruption will continue and NPLs will mount. What China needs is real, not pseudo, capital markets with freely tradeable shares, liquidity, and trust.

Markets work best when property is fully protected by the rule of law and people are free to choose. We should not forget the words of James Madison, the chief architect of the U.S. Constitution: "The personal right to acquire property, which is a natural right, gives to property, when acquired, a right to protection as a social right." China is beginning to recognize the right to private property, but only as a right bestowed by the state not as a natural (inalienable) right. Consequently, private property can never be secure until there is a fundamental revolution in political philosophy that places the individual, not the state, at the center of the moral universe and limits the power of government.

Recent changes, however, are encouraging:

- Qualified foreign institutional investors will be allowed to buy equity stakes in SOEs through the A-share (local currency) stock exchanges in Shanghai and Shenzhen;
- Strategic foreign investors will be allowed for the first time to buy the nontradeable shares of listed and unlisted SOEs;
- Foreign joint-venture investment funds will begin operation;
- Private commercial banks are being established in rural areas;
- China's first civil code has been drafted, including an entire chapter dedicated to the protection of private property rights;
- China's top judge, Xiao Yang, president of the Supreme People's Court, has called for safeguarding private property rights and told a national conference in Beijing: "Efforts should be made to enhance awareness of the need for equal protection of all subjects in the marketplace."
- Farmers will have more secure land-use rights as a result of the Rural Land Contracting Law adopted in August 2002;
- Shenzhen, the first SEZ in China, is embarking on a bold political experiment, with Beijing's approval, to limit the power of the local cadres, introduce checks and balances, and cultivate the rule of law.
- A new think tank devoted to studying political reform is planned for the Central Party School in Beijing;
- Numerous rules and regulations not in conformity with WTO norms are being scrapped and there are plans to streamline the central government's complex bureaucracy.

All those reforms are being driven by the need to be competitive in an increasingly global economy. To attract and retain capital in the future, China will have to continue to improve its *institutional* infrastructure.

As China liberalizes its financial sector, removes remaining barriers to trade, and improves its legal structure, the range of choice for millions of Chinese will increase. That increase in economic freedom is sure to have a positive effect on creating what Liu Junning, an independent scholar in Beijing, has called "a constitutional order of freedom in China."

The United States can help transform China by continuing the policy of engagement, ensuring that China honors its WTO commitments as well as its bilateral trade agreement with the United States, and adopting a more liberal visa policy that permits Chinese students and scholars—especially those in law, economics, and the humanities—to learn about and experience firsthand a free society.

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