Rethinking of the “State Advance, Private-Sector Retreat” Phenomenon in China

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Abstract

After the introduction of the “Reform and Openness” policy in 1978, the proportion of SOEs in the Chinese national economy decreased. However, in response to the negative effect of the world financial crisis in 2008, the Chinese government implemented economic stimulus measures worth 4 trillion RMB. The government invested mainly in infrastructure sectors and supplied preferential loans to SOEs to increase investment. Many market-oriented entrepreneurs and scholars criticized this policy and named it “state advance, private-sector retreat”. The present paper suggests new perspectives on this issue which are dynamic, classified and two-dimensional viewpoints based on analysis of the telecommunications and color television set manufacturing industries.

Keywords:
China, state owned companies (SOEs), “state advance, private-sector retreat”, color TV industry, telecommunication industry
I. OBJECTIVE OF THE PAPER

The objectives of the paper are to propose a dynamic, classified and two-dimensional viewpoint to analyze the “state advance, private-sector retreat” phenomenon in China and to analyze the telecommunications and color television manufacturing industries as case studies.

II. BACKGROUND

1. Historical background

(1) “The private sector advances, the state retreats” 民进国退

After its foundation, the People’s Republic of China (PRC) introduced a socialist economy in which state-run enterprises dominated the industrial field and people’s communes dominated the agricultural field.

With the introduction of the “Reform and Openness” policy in 1978, China changed its socialist economy to a market economy. After the Southern Trip Announcement by Deng Xiaoping (邓小平) in 1992, this reform was extended to the whole country, following which the CCP’s 14th National Party Congress set the goal of a “Socialist Market Economy”. In 1993, through the amendment of the national constitution, state-run enterprises were renamed state-owned enterprises. In 1998, premier Zhu Rongji launched three major reforms including reform of SOEs under the principle of “Zhuadafangxiao” (抓大放小 = Invigorate large enterprises while relaxing control over small ones.) At the same time, market penetration of private enterprises was promoted by the Chinese government. The report of the CCP’s 15th National Party Congress in 1997 identified “individual and private economy as important components”.

The accession of China to the WTO in December 2012 accelerated the reform of SOEs. In April 2003, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) (国有资产监督管理委员会) was founded to undertake integrated management of the ownership of SOEs. In March 2004, the national constitution was amended to incorporate the concept of the “non-public economy”. In February 2005, the State Council adopted “36 non-public articles” (非公有36条) which declared “equal treatment of the public and private sectors” and defined more clearly the operational field and conditions for the private sector.
In December 2006, SASAC Chairman Li Rongrong (李荣融) announced the specific fields which the public sector must control as set out below.

<table>
<thead>
<tr>
<th>Absolute control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Military industry, delivery of electric power, petroleum and petrochemistry, telecommunication, coal, air transportation, marine transportation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Relatively strong control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production facilities, automobiles, electronics and information, steel, nonferrous metals, chemicals, resource mapping/design, science and technology</td>
</tr>
</tbody>
</table>

The Anti-monopoly Law of China (反垄断法) was enacted in August 2007 and came into force in August 2008. In this process, the proportion of SOEs in the Chinese national economy decreased (“private-sector advance, state retreat” 民进国退)

Figure 1 Share of SOEs

Source: Guan [2010]
As a result of closures, buyouts and bankruptcies among SOEs, the profit rate of SOEs recovered after 1998 and reformed SOEs grew into large global businesses.
The world financial crisis of 2008 affected China negatively, not through the financial market but through the decrease in exports. To recover from this recession, the Chinese government has implemented economic stimulus measures worth 4 trillion RMB since November 2008.

The number of Chinese SOEs ranked in the *Fortune 500* has increased and is higher than the number of Japanese firms. Overall, the proportion of SOEs in the Chinese national economy has decreased but the average size of SOEs (or SOE groups) has grown.

<table>
<thead>
<tr>
<th>Year</th>
<th>US</th>
<th>Japan</th>
<th>China (HK)</th>
<th>Germany</th>
<th>Korea</th>
<th>Taiwan</th>
<th>India</th>
<th>Russia</th>
<th>Brazil</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>132</td>
<td>68</td>
<td>69 (4)</td>
<td>32</td>
<td>13</td>
<td>6</td>
<td>8</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>2011</td>
<td>133</td>
<td>68</td>
<td>58 (4)</td>
<td>34</td>
<td>14</td>
<td>8</td>
<td>8</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>2010</td>
<td>139</td>
<td>71</td>
<td>43 (4)</td>
<td>37</td>
<td>10</td>
<td>8</td>
<td>8</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>2009</td>
<td>140</td>
<td>68</td>
<td>34 (3)</td>
<td>39</td>
<td>14</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>2008</td>
<td>153</td>
<td>64</td>
<td>26 (3)</td>
<td>37</td>
<td>15</td>
<td>6</td>
<td>7</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>2007</td>
<td>162</td>
<td>67</td>
<td>22 (2)</td>
<td>37</td>
<td>14</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2006</td>
<td>170</td>
<td>70</td>
<td>19 (1)</td>
<td>35</td>
<td>12</td>
<td>3</td>
<td>6</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>2005</td>
<td>175</td>
<td>81</td>
<td>15 (1)</td>
<td>37</td>
<td>11</td>
<td>2</td>
<td>5</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Jin [2013]

(2) “The state advances, the private sector retreats” (国退民进)

The world financial crisis of 2008 affected China negatively, not through the financial market but through the decrease in exports. To recover from this recession, the Chinese government has implemented economic stimulus measures worth 4 trillion RMB since November 2008. The
government itself invested mainly in infrastructure sectors and supplied preferential loans to SOEs to increase investment.

Moreover, there were some typical cases.

China utilizes mainly energy from coal (about 70%), and therefore many small mineral companies entered this market. In the recession, however, the Chinese government decided to close small, dangerous and environmentally destructive coal mines, mainly in Shanxi province, most of which were privately operated.

In the 1960s, for reasons of transportation and national security, the Chinese steel industry had a dispersed structure. With the explosive increase in demand for steel caused by the construction boom from 2001, many steel companies increased production capacity, which caused over-capacity afterwards. The Chinese government closed some private steel companies, e.g. Jiangsu Tieben (江苏铁本公司).

After 2003, the Chinese government promoted market penetration by private passenger airlines. The private airline Spring Airlines Co., LTD. (春秋航空公司) was set up in 2004. Following Spring Airlines, 13 other private airlines were established and entered the market. But the Chinese government reorganized the airlines into three major state-owned airline groups and gave them preferential treatment. As a result, only four airlines survived as of 2013.
III. Precedence Research and Research Questions of this Presentation

1. Precedence theories and opinions in China, the US and Japan

(1) China
The government policy of giving SOEs preferential status evoked criticism from the private sector and neo-classical economists. They named this phenomenon “state advance, private-sector retreat”.

Wu Xiaobo (Wu, 2010) criticized the dominance of SOEs under three points. ① Monopoly of resources and government contracts ② Private enterprises are prohibited to enter upstream industries ③ Not formal but de facto barriers to entry (“glass door”).

The famous Chinese economist Hu Angang rejected the criticism and asserted that there was no statistical evidence to support the theory of “state advance, private-sector retreat”.

Other left-wing scholars said that because the efficiency of SOEs is not lower than that of the private sector in China and because western countries also have public corporations, the criticism was invalid.

SASAC undertakes management by classification but Zhang Huiming of Fudan University criticized the ambiguity of the classification (based on interview).

(2) US
Ian Bremmer, representative of the Eurasia Group, published an influential book titled The End of the Free Market in 2010 and called for a cautious approach to State Capitalism as in Russia, China and elsewhere. The U.S.-China Economic and Security Review Commission (Andrew Szamosszegi and Cole Kyle) issued a report titled An Analysis of State-owned Enterprises and State Capitalism in China and asserted that the proportion of SOEs including subsidiaries and sub-subsidiaries in the national economy was greater than half.

(3) Japan
Miura [2012] recalculated the proportion of SOEs on an effective basis and supported Bremmer and the U.S.-China Economic and Security Review Commission.
Mariko Watanabe of Gakushuin University, a leading scholar of this field in Japan, divides Chinese industry into three fields, public monopoly, mixed and competitive, and regards the characteristics of the Chinese industries which promoted the country’s rapid economic growth as “active market penetration, dispersed market share and low price”. She also claims that the “public” corporations lack public character.

Hiroyuki Kato of Kobe University, another leading scholar of this field in Japan, characterized Chinese “capitalism” as an “ambiguous institution” (neither public nor private) which contributed to China’s rapid economic growth.

(3) Limits of precedence research

Static

Even in Western countries, the relationship between the public and private sectors fluctuates in response to the short-term business cycle and the long-term transformation of the economy. Why is this not the case in China?

Lack of classification (other than Watanabe)

The conditions of competition are different from sector to sector and from industry to industry.

One-dimensional

Bremmer [2010] proposed a market spectrum with the utopia of communism at one end and the utopia of libertarianism at the other, and state capitalism and free market capitalism situated in the middle. This is a very useful idea which avoids all-or-nothing selection. However, it is still a kind of zero sum game.

Figure 4  Market Spectrum by Ian Bremmer

![Market Spectrum by Ian Bremmer](https://example.com/figure4)

Source: Bremmer [2010]
(4) My approach to this theme

My viewpoints are as follows: A *dynamic viewpoint* which takes the fluctuating process of industrial development into account; a *classified viewpoint* in which the issues are classified according to the differences between industries; and a *two-dimensional viewpoint* in which the issues are analyzed from both the ownership axis and the market governance structure axis. This paper focuses on the last viewpoint.

![Figure 5](image)

**Figure 5**

*Market-oriented governance (X) and importance of public sector (Y) in transit economy*

Source: Original

The telecommunications industry and the color television industry are analyzed from the above-mentioned dynamic, classified and two-dimensional viewpoints.

II. Analysis of the History of Chinese Telecom Common Carriers and Color Television Manufacturers

1. Telecommunications industry

(1) Development of telecommunications market in China

In the 21st century, the Chinese telecommunications market, especially the mobile phone market, has attained astonishing levels of development. An important factor in this success is competition among telecommunications common carriers.
(2) Reorganization of telecom common carriers in China

Before 1993, the Ministry of Post and Telecommunication (MPT) monopolized the Chinese telecom market. In 1993, the Chinese government divided MPT and set up China Telecom as an operational department. At the same time, the government decided to open the telecom market to other domestic sectors. The Ministry of Electronics Industry and other bodies set up China Unicom in 1994 and the Ministry of Railways set up China Tietong in 2000. In 2000, China Telecom was divided into China Satcom, China Mobile and China Telecom, and in 2002, China Telecom was further divided into China Telecom and China Netcom. In spite of the increase in market actors, the competition was not effective other than in the mobile phone sector. In 2009, to promote effective competition among carriers, they were reorganized into three major carriers allowed to supply full-line
telecommunication services and these three carriers were allowed to start third generation mobile telecommunications services.

In spite of the frequent reorganization, by 2013 all of the telecom common carriers were SOEs governed by central government. (In December 2013, the Chinese government issued MVNO licenses to 11 companies including Alibaba, the biggest private e-commerce company. In the near future, China will therefore have private-sector mobile phone common carriers.)

(2) Control by public sector and competition

As all three carriers are SOEs managed by central government (SASAC), it is fair to say that the Chinese telecom market is completely controlled by SOEs, but that does not mean that there is no competition. Although the CCP and State Council control the appointment of the top management of the three carriers and services are regulated by the Ministry of Industry and Information Technology (MIIT), the carriers compete fiercely. In Nakagawa [2000] I name this the “State-State Competition System”.

Figure 7

Market-oriented governance (X) and importance of public sector (Y) in Chinese telecom industry

Source: Original
1. Color television manufacturing industry

(1) Black and white CRT televisions

In 1958, China succeeded in producing television broadcasting and receiver equipment and began broadcasting. In the 1950s and 1960s, however, the buying power of Chinese consumers was limited and the government gave priority to military utilization of electronics. The development of the television manufacturing industry was therefore limited.

In the 1970s, electronics manufacturers, which had been dispersed as a result of war preparations, entered the television manufacturing market. Most of them were SOEs managed by local government.

In the 1980s, price control and production control by government were abolished and in 1991 control of the supply of CRTs was also abolished.

(2) Color CRT televisions

China succeeded in producing color television in 1971, but had fallen behind western countries in technology. The Chinese government decided to introduce color CRT technology from western countries, mainly Japan, and to try to control color television production through the supply of color CRTs.

The government set up Rainbow Electronics based on the technology of Japan’s Hitachi and Asahi Glass, and required three local SOEs (Beijing-Matsushita, Shanghai Yongxin and Nanjinghuafei) to introduce color CRT production lines from Japanese companies. Other television set manufacturers bought CRTs from these companies and assembled the television sets.

Marukawa of Tokyo University characterized this system as “vertical disintegration”. Contrary to its original intent, the government failed to concentrate the production of color television sets. At the time, color television sets were a profitable product whose price was decided by central government. The above-mentioned CRT supply system lowered the entry barrier, so that most local governments wanted to enter the color television industry and central government had to take their requests into account. Moreover, the increase in CRT production and import made government control of CRT supply ineffective. Local SOEs invested aggressively and color television production increased rapidly. In 1992, the price of color television sets was deregulated and in the following year government control
of CRT supply collapsed.

Ironically, the concentration of production was realized not through government control but through market competition. The market share of the top ten manufacturers rose from 56.5% in 1993 to 80.5% in 1997 and 80.6% in 2004.

(3) FDP (mainly LCD) televisions

Table 2  Share of chinese flat-screen television market by company(2008,2012 1st Q)

<table>
<thead>
<tr>
<th>Brand</th>
<th>2008</th>
<th>2012 1stQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hisense</td>
<td>1 14.10%</td>
<td>1 17.90%</td>
</tr>
<tr>
<td>Skyworth</td>
<td>2 13.60%</td>
<td>3 14.10%</td>
</tr>
<tr>
<td>TCL</td>
<td>3 9.60%</td>
<td>2 17.00%</td>
</tr>
<tr>
<td>Konka</td>
<td>4 9.60%</td>
<td>5 10.30%</td>
</tr>
<tr>
<td>Changhong</td>
<td>5 9.50%</td>
<td>4 11.10%</td>
</tr>
<tr>
<td>Samsung</td>
<td>6 6.60%</td>
<td>8 4.00%</td>
</tr>
<tr>
<td>Sharp</td>
<td>7 6.00%</td>
<td>7 4.30%</td>
</tr>
<tr>
<td>Sony</td>
<td>8 5.50%</td>
<td>9 3.90%</td>
</tr>
<tr>
<td>Haier</td>
<td>9 4.60%</td>
<td>6 6.30%</td>
</tr>
<tr>
<td>others</td>
<td>20.90%</td>
<td>11.10%</td>
</tr>
</tbody>
</table>

Source: Display Search

![Figure 8  Television set production and trade in China](image)
Sales of FDP (plasma and LCD) television sets surpassed those of CRT televisions in urban areas in 2005 and in the whole Chinese market in 2009. The vertical disintegration system for CRT television sets has been extended to LCD television sets. The key components of LCD television sets are LCDs and image-processing engines (image-processing LSI). Chinese LCD television manufacturers procure the two key components and assemble the television sets.

The LSD system differs in two points from the vertical disintegration system for CRT television sets.

The first is that in the case of CRT, Chinese set manufacturers procure CRTs from Chinese CRT manufacturers that have introduced production lines from Japanese companies, whereas in the case of LCDs, Chinese set manufacturers import or procure mainly from subsidiaries of Korean companies in China. (Recently, however, Chinese LCD manufacturers are developing.)

The second is that because the LCD market is now dominated by Korean and Taiwanese companies, some major Japanese set manufacturers which previously produced CRTs in-house (such as Toshiba and Sony) have also started to procure LCDs from other companies. These Japanese television set manufacturers have adopted the strategy of differentiating their products by using image-processing engines produced in-house.

In the early stages, Panasonic, Hitachi and Sharp led the FDP television market in China. The Chinese companies Hisense and Prima entered at a relatively early date. Panasonic and Hitachi, which both invested mainly in plasma, suffered a decreased market share as the plasma market grew sluggishly. Sony and Sharp offered a price reduction and recovered market share in 2007 and 2008. After 2009, Taiwanese LCD makers offered LCDs to Chinese television set makers (LCDs account for about 65% of the production costs of LCD television sets). Moreover, in 2007 (-Jan. 2013) the Chinese government introduced a policy of “Electric Appliances in Rural Areas” (家电下乡) which subsidized residents of rural districts to buy electric appliances. As foreign companies do not have marketing channels in rural areas, this subsidy effectively promoted Chinese brands. In 2012, the government began to subsidize energy-saving electric appliances including LCD television sets with LED backlights. In reaction, the Korean manufacturers Samsung and LG changed from a market share-oriented to a profit-oriented strategy. In 2012, Chinese companies
achieved a market share of about 80%.

Among the Chinese companies, TCL, Hisense, Skyworth, Konka, Changhong and Haier are the six major brands. Of these, the development of TCL since 2011 has been spectacular. According to Display Search, TCL ranked fifth in the world in the first quarter of 2012 with a 6.5% share of the world market and ranked third in the world in 2013. Other than the central government, the Shenzhen (深圳) city government also heavily supported TCL. To reduce production costs, TCL and Samsung set up a joint venture which produces LCDs in Shenzhen, but without the investment of the Shenzhen government, TCL could not have raised the required funds.

(3) Ownership of six major television set manufacturers and their significance

Nominally, of the six major television set manufacturers, only Skyworth is a private company. Konka is a subsidiary of the central SOE Huaqiaocheng (华侨城), while TCL, Changhong and Hisense are SOEs managed by the city governments of Huizhou, Mianyang and Qingdao, respectively. Haier is nominally collective.

Judging from the nominal ownership of the six major companies, it is fair to say that the Chinese color television industry is almost completely dominated by the public sector. In effect, however, the five “public corporations” are near to being private. TCL started as a joint venture between Hong Kong (香港) and Huizhou (惠州) city, which subsequently fell under the effective control of top management, including CEO Li Dongsheng (李东生) under the contraction. Changhong (长虹) originally produced military goods as a central SOE but moved on to producing goods for private use and became an SOE managed by the small city of Mianyang (绵阳) in Sichuan Province (四川省).

Changhong was not appointed as a selected color television manufacturer by central government and therefore often ignored central government policy. Changhong often leads low-priced competition in defiance of the price arrangements ordered by central government. Changhong also bought up CRTs to avoid control by central government. Konka also started as a joint venture between a Hong Kong company and a public firm in Guangdong Province and for long years was regarded as a foreign company. As a result of the integration of the Chinese parent company as a cen-
Central SOE and buy-back of the shares held by the Hong Kong company, Konka became a subsidiary of a central SOE. Haier was originally a small refrigerator manufacturer, developed under the leadership of Zhang Ruiming (张瑞敏), China’s most famous entrepreneur.

In the case of the telecommunications industry, all three major carriers are central SOEs and were reorganized by government decision. In the color television industry, on the other hand, the major companies are not central SOEs and have grown and attained leading positions through competition. Central government failed to concentrate the industry and attempts at price regulation and production control through CRT supply collapsed. At the same time, television manufacturers were supported by central government on the consumption side and by local government on the investment side. Conditions are thus different from those in other competitive industries such as the apparel industry.

**Figure 9**

*Market-oriented governance (X) and importance of public sector (Y) in Chinese color television industry*

Source: Original

**CONCLUSION**

Judging from their nominal ownership, it is fair to say that the telecommunications industry is completely, and the color television industry almost completely, dominated by SOEs. However, judgments of this kind are inappropriate when analyzing the effectiveness of the market and suggesting useful policies. Sectors must rather be analyzed from the dynamic,
classified and two-dimensional viewpoints. The case studies of the telecommunications and color television industries suggest that in spite of the domination by state-owned companies, a competitive market structure can develop and bring results.

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