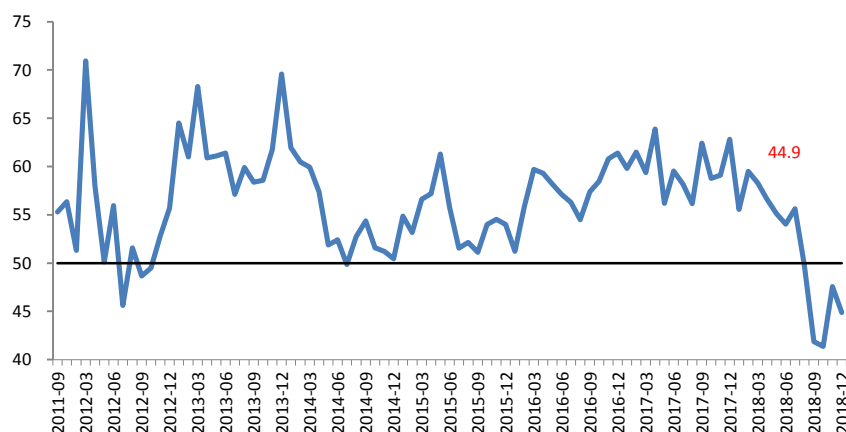


Commentary on the December 2018 CKGSB BCI

Professor Li Wei

In December, the CKGSB Business Conditions Index (BCI) read 44.9, a clear drop from 47.6 in November (Figure 1).

Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

This month's BCI may leave readers a bit frustrated. Aside from the main BCI index, the costs and prices sub-indices have also fallen. The corporate investment index reversed on last month's rebound. Disconcertingly, recruitment confidence continued to drop as well. Although still above 50, this index is now at the lowest since the survey began in 2012. As rumors of layoffs at well-known firms have circulated online, it is well to consider that there is normally no smoke without fire. For specifics, please see this month's BCI report.

Last month, we took stock of new central government policy that was favorable to the development of private business in China. This month marks the 40th anniversary of China's reform and opening up era. On December 18, President Xi Jinping spoke at a celebration, upholding what we know to be true: that this policy marked the start of a great new economic direction for the country. His speech was peppered with confidence for the future. As an economist, one of our key academic topics is economic development. Indeed, reform and opening up was a huge development, no matter how you measure it. Before the industrial revolution, the gap between East and West in terms of economic development was marginal. But since the West took the lead in industrialization, Western economies shot ahead, growing rapidly. Economists call this moment the "Great Divergence." Despite the efforts of the late Qing dynasty's Western Affairs Movement and the modernization efforts during the Republic of China era, China was unable to catch up with advanced countries of the world for a long time. And while the PRC's establishment enabled the Chinese to stand up in politics, diplomacy and culture, the road to economic development would see many more twists and turns. By 1978, China's miserable economy and low living standards were common knowledge. The reform and opening period had felt like a rescue effort when it began, but became a trigger for enormous economic enthusiasm in the country. High speed economic growth ensued, and living standards improved. China was no longer the scene of a great divergence; global economics has finally leveled out.

Reform and opening up has worked for many reasons. There is mostly consensus on the reasons for its success, but still some are debated. We want to explore one of the reasons on which most agree: the role of private business. Why? The reason is very simple. The Chinese economy has recently suffered domestic and international pressures, which have been felt the most by private firms. Some have argued that the economy holds no place for private business and that they should quit the market, or at least be coupled with the state in “new public-private partnerships.” Yet private enterprises have “contributed more than 50% of tax revenue, 60% of GDP, 70% of innovations, 80% of urban employment, and 90% of enterprises,” and the central government has affirmed the positive role of private enterprise in China’s economy and stressed its “unwavering encouragement, support and guidance for the development of the private economy.” In terms of actual economics and policy direction, it appears that private business is recognized as key to growth and prosperity. So why are critical voices still so popular?

To understand this, we need to understand the history of private firms in China, especially since 1978. The founding of the PRC led to an extremely tight restriction on capitalism. After three major transformations in the 1950s, the private economy was by and large eliminated. Given the successive political movements since then, the private economy had little opportunity to establish itself. In 1979, reform and opening up began just as a large number of educated youths who had been sent to the countryside returned to the cities. There were not enough jobs for them. Those who returned were unemployed (known as ‘awaiting employment’ at the time). They were seen as a social problem and became a headache for the government.

According to the National Bureau of Statistics, the number of people awaiting employment in 1979 was 15 million in urban areas. The number of unemployed registered with the Labor Department was 5.68 million. Urban, registered unemployment was 5.4%. In 1980, the Party Central Committee proposed a “three-in-one” employment policy, and adopted a series of policy measures that introduced a combination of jobs recognized by the labor department, ‘voluntarily organized’ work, and self-employment. In other words, the government recognized the legitimacy of self-employed and forms of private economy. In three short years, these policies resolved the employment issues that had built up during the Cultural Revolution. By 1982, the urban registered unemployment rate had fallen to 3.2%, and in 1984 it fell again to 1.9%. In much of the country, urban unemployment had all but disappeared.

From this, we know that at the start of the reform and opening up period, the government recognized the legitimacy of the private economy and allowed its development, and that this was not a strategic decision, but a practical solution. We could even call this the mission of the private economy at the time. However for many years afterwards, the private sector operated in a grey or even illegal area. Small individual businesses and the self-employed needed to expand their business and employ others, but one question loomed - Will this be considered an “exploitation of labor”? As no official statements were made on this, law enforcement varied from place to place. Small business owners and self-employed individuals expressed their worries all the time, and in a quest to provide clarity to this new private economy they alerted the designer of the reform and opening up policy, Deng Xiaoping.

In this context, some very Chinese phenomena emerged, such as the “Red Hats.” These were private entrepreneurs who fear policy would change suddenly and their businesses will be liquidated. Therefore, their own enterprises were linked to public units, and thus became state-owned or collectively owned when ownership was registered. This was like putting a Communist hat on a private company that would act as a shield. This bred other risks. When ownership laws changed, all rights were cemented according to the law. This resulted in property disputes, which lost countless private entrepreneurs their companies.

To this day, China has never been the same. Private entrepreneurs can be upright public citizens, invited to participate in all sorts of political discussions. Their recruiting and investing activities are rewarded, and entrepreneurs are often guests of local government leaders. But problems remain, and the most important of these is the issue of property rights. The Party Central Committee has repeatedly

stressed a construct known as the “two unwaverings”. The Property Law clearly states that “the state implements a socialist market economy and guarantees the equal legal status and development rights of all market entities”, but in operational terms, discrimination on the grounds of ownership keeps coming up. For example, on the issue of bank loans, it is far more difficult for private enterprises to obtain loans than state-owned enterprises.

Property rights are the cornerstone of market economy. Without a strong and stable property rights system, business people will not dare to invest, recruit, or operate enterprises, just as in the 1980s. Therefore, how can the economy of a country achieve growth and prosperity?

Not only are protecting property rights important, another key to a vibrant market economy is fair competition. Let efficiency determine the outcome, not ownership. If state-owned enterprises are low cost and easy to finance and private enterprises hard to finance and high cost to run, this is clearly not a level playing field. The final result may not be the survival of the fittest, but more a case of throwing good money after bad investments. In this kind of competitive system, how can efficiency be improved and economic growth sustained?

For any country, total economic statistics are extremely important, but for ordinary people, employment is the most important statistic. With jobs, people have the income to support their families. From a societal point of view, employment is the biggest stabilizer. When people have jobs, there is little need to make trouble. In fact, the history of the entire reform and opening up period is also a history of employment transfer. In 1978, according to the National Bureau of Statistics, apart from a small percentage of self-employed “getihu,” China’s urban population was 99.8% employed by state-owned and collective units. By 2017, private enterprises and the self-employed accounted for more than half, 31.4% and 22.0% respectively, while the proportion of employed people in public organizations such as state-owned, collective, joint-stock, and solely state-owned enterprises had fallen to 17.4%.

Private businesses are now so important to China’s economy that policy-makers cannot ignore them. Whether it is the idea that private business should quit the market or the theory of the “new public-private partnership,” the essence is to diminish private enterprises in ideological terms, manufacturing an unequal property status and suggesting private enterprises should be coupled with state-owned enterprises. We need not discuss these ideas further, but what lies behind them deserves our vigilance and attention. The “two unwaverings” of equality of the state and private economic rights, opportunities and rules, the Constitution and the Property Law all confirm the state’s support. So why do these arguments threaten the sector? In the early days of reform and opening up, private businesses were often considered “expedient measures.” Does this idea remain so today? It seems that we really need to carefully reassess the status of private enterprises in the Chinese economy from a legal and ideological perspective. Otherwise, whenever the ill winds pick up again, private businesses will be swept up. And if this happens, who will invest, and who will recruit? We should ensure that this month’s lowest ever BCI recruitment index is the lowest it ever gets.

This is the author’s commentary on the CKGSB BCI report for December 2018. Do not hesitate to contact the BCI team by email as shown in the accompanying BCI data report.

CKGSB Professor Li Wei
December 24, 2018