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Economic Affairs

Saving China's private sector

Deng Xiaoping's reforms let China's entrepreneurs make their country great again. Now they feel embattled, but the trade war is not their only worry.

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For The Straits Times

For China's private sector, this should have been the best of times. It is the engine of growth – 60 per cent of gross domestic product (GDP), 70 per cent of innovation, 80 per cent of urban employment.

Yet, Chinese private entrepreneurs are racked by uncertainty about their future.

The ongoing trade war between the United States and China is clearly a major factor, but not the only one. The home front is troubled too.

It is true that the trade war has been hard on private firms in the export-oriented manufacturing sector, particularly in the Pearl River Delta. It has also posed serious problems for information and communication technology companies that rely on foreign technologies.

Nevertheless, for the majority of private firms, the impact of the trade war is blunted as they operate largely in China's huge domestic market. Domestic consumption now accounts for 65 per cent of China's GDP.

Even if the latest retail figures released last week showed flagging consumer confidence, that is a problem most nimble private companies can manage as a sales challenge. What the private sector find itself powerless to deal with is the looming shadow of the state over its turf.

Indeed, China's private entrepreneurs have much to worry about on the domestic political front.

THE LAW AND IDEOLOGY

Leftist ideology is on the ascendant.

In China, there is always a tension between law and ideology. A tilt in the balance towards the latter makes the private sector uneasy, because it stands to lose whatever protection it has to run businesses without state interference.

The laws and regulations may exist on paper, but China still lacks a strong foundation of rule of law; what the 18th-century French philosopher Montesquieu called "spirit of law" does not exist.

Furthermore, China's private sector had gained much in party standing and legitimacy in the country's Constitution for being the vehicle of Deng Xiaoping's reform drive. A leftward shift puts those gains in jeopardy too.

Two types of leftist ideology are apparent today.

There is the old and deeply rooted leftist anti-capitalism ideology. Its re-emergence is best captured in an online essay last year that raised the question of whether China's private sector should be phased out, having completed its "historic mission" of helping state firms develop.

The article, by hitherto obscure former investment banker Wu Xiaoping, went viral, coming as it did at a time of greater muscle-flexing by the Communist Party.

A few months prior to the posting of the article, the party had announced it was mandating that all listed companies set up party organisations for their employees. Private entrepreneurs feared it signalled the government's intention to go back to Maoist-era policies.

The fear was so widespread that President Xi Jinping had to publicly assure a group of private entrepreneurs that no policy change was afoot, and the government would continue to support the private sector.

There is also the so-called "new left" ideology. While the old left is wholly against capitalism, the new leftist ideology accepts the inevitability of capitalism, but emphasises support for workers' rights.

This thinking underpinned the protests in recent years in pushing for better pay and conditions for factory workers in Shenzhen.

Notably, the protests were organised by students from China's top universities, such as Beijing University and People's University.

PARTY AND STATE INTERVENTION

Ideological swings aside, China's private entrepreneurs are also threatened by a loss of autonomy from a variety of government policies.

One is the unexpected result of a reform initiative aimed at helping the private sector. The private-public partnership started off with noble intentions – the government would give the private sector a boost by injecting state capital into private firms.

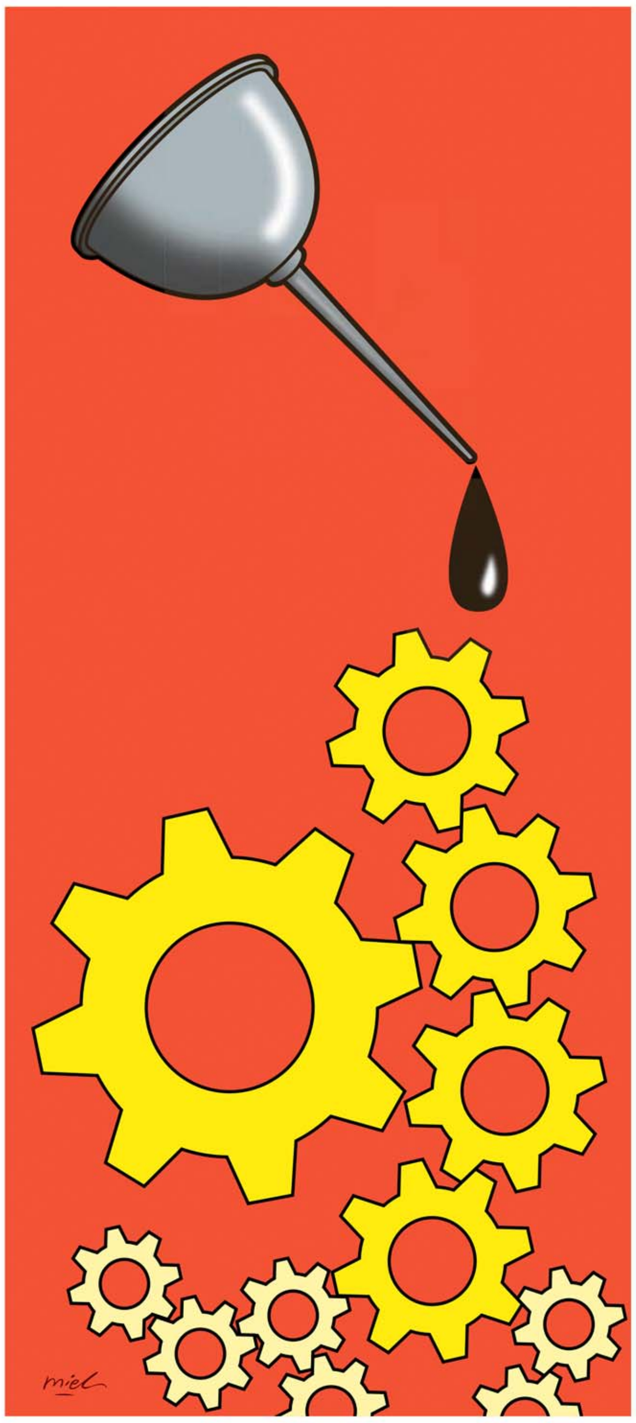
What has happened instead is that the infusion of state capital has changed the power equation in the management of the recipient companies. Once state capital gains control over a private firm, it is no longer private.

Private firms are also increasingly subject to party control. Party cells in the private sector are not new. However, in recent years, bureaucrats and local governments have attempted to reinforce the policy, a move that disturbs many in the private sector as they do not see the purpose of strengthening the party cells.

The sudden and arbitrary nature of government intervention – even if labelled as well-meaning support – can be deeply discomfiting for those in the private sector.

Case in point: a directive issued by the Hangzhou municipal government last month that it would transfer 100 officials to key enterprises such as Alibaba and Geely Holdings.

The directive, which state media said was part of the Hangzhou government's "New Manufacturing Plan" to boost the local economy in Zhejiang province, caused ripples of concern across the country.



Hangzhou is China's tech hub and home to some of its biggest companies, including Alibaba.

The transplanting of government officials is problematic on several counts. If it is meant to boost the local economy, why is it not a universal directive that does not discriminate against smaller companies?

Questions were also raised as to the roles of these officials and the costs to their hosts even if they did not have to pay their salaries.

STRUCTURAL PROBLEMS

The specific symptoms of what ails China's private sector point to bigger structural problems in the economy.

The state sector continues to be too dominant in many industries and regions, to the detriment of both.

China's north-east region is a good example. Despite the central government's efforts to revive the region over many years, it continues to worsen economically. What it needs is perhaps a drastic Zhu Rongji-style privatisation programme to start afresh.

If one compares the north-east with Guangdong and Zhejiang, it is not difficult to see how a strong private sector in these two provinces has developed together with an equally strong state sector.

The competition between the state and private sectors is not necessarily zero-sum, but to avoid such a game, there must be a rational division of labour between the two.

There are structural problems in the financial sector too.

Large and state-owned banks have no incentive to lend money to the private sector as their targets are equally large state-owned enterprises. For years, the government has asked the state banks to lend money to small and medium-sized enterprises (SME), but there is little to show for it.

The private sector is then forced to turn to the informal sector for funds, but this comes with much risk. Whenever the government moves to tighten the informal financial market, the private sector suffers.

WHAT'S TO BE DONE?

What, then, can be done to revamp China's private sector?

First, greater effort must be made to promote the rule of law to safeguard the interests of private enterprises. Without this, it will be hard for them to flourish in the longer term.

Second, in the Chinese context, it would be unrealistic to ignore the role of party ideology even if much of it is often disregarded. But given the anxieties of private companies, it would help if the party were more sensitive to how ideological changes affect them and manage its handling of the messages it sends out.

Third, greater clarity is needed as to the role of party cells. Again, given the Chinese political system, it would be unrealistic to eject the party cells. The issue is not if party cells should stay or leave, but what role they play in private firms. A party cell can play a positive role if it works to foster better relations between the owners and workers.

More important are structural reforms.

While Chinese bureaucrats have been talking about the principle of neutrality of the government in its dealing with the state and private sectors, there is no such thing in reality. If the assumption is that the state will always prevail, it would be hard to expect state and private firms to compete with each other on an equal footing within the same industrial sector.

A more realistic way forward is to have division of labour between the state sector and the private sector. State firms can dominate certain sectors, while private firms dominate other sectors. This need not necessarily lead to a monopoly situation, as there can be many firms within each sector.

The government also needs to establish more small and medium-sized banks, be they state-owned or private-owned, for SMEs. Without the development of this sector, SMEs find it hard to grow for lack of adequate financing.

Finally, the government needs to stop direct state interference in its attempt to regulate the behaviour of the private sector. Far better to use regulatory means such as taxation, fiscal policy and monetary policy.

Regulatory means are transparent and provide a more level playing field for all in the marketplace. As arbitrary government behaviour is reduced, the risks to business are reduced as well.

Chinese entrepreneurs have a long history of overcoming great odds to become huge successes. Given these troubled times and the choppy economic waters ahead, the sensible way forward would be for the government to do all it can to make it easier for them to flourish.

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