

Informal Privatization Through Internationalization: The Rise of Nomenklatura Capitalism in China's Offshore Businesses

X. L. DING*

China's remarkable business expansion abroad since the mid-1980s cannot be explained simply by applying existing theories, which focus on conventional international businesses from capitalist systems. Many puzzling phenomena in Chinese investments abroad become intelligible only when we introduce a key variable – illicit privatization through internationalization. So far only advantageously-placed *nomenklatura* members and their kin have had access to crossborder ownership, but many of them are accumulating sizeable private wealth at the cost of nationalized property. Contrary to an impression held by many in the West, the Chinese economy under Communist rule experiences spontaneous privatization parallel to what has happened in European postcommunist nations – though with a few Chinese characteristics. An examination of informal privatization in China's multinationals adds a new dimension to our understanding of the shift from state socialism to market capitalism.

The recent years have witnessed an impressive expansion of Chinese businesses overseas; these are not from the ethnic Chinese communities of Hong Kong, Taiwan or Southeast Asia, but from the People's Republic of China. PRC investors are eagerly setting up new companies and taking over existing ones in the United States, 'pumping money into industry, finance, restaurants and, especially, real estate'.¹ A May 1996 report noted that PRC firms occupied more space in New York's World Trade Center than any other foreign country's.² In mid-1996 some 150 PRC companies were operating in Hamburg, Germany, exceeding Japan's 140 firms in this European business centre.³ As early as 1994 China had become the second-largest external investor in Hong Kong, next only to Britain and ahead of the United States.⁴ China has even become a big player in the American Treasury market: in the first half of 1996, it was the third-largest foreign buyer with net purchases of nearly \$12 billion.⁵

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¹ *Asian Wall Street Journal* (AWSJ), 22–3 July 1994, p. 1.

² *Reports on China's Assets* (RCA), 15 October 1996, p. 4.

³ *RCA*, 30 July 1996, p. 4.

⁴ *Hongkong Economic Journal*, 11 September 1995, p. 1.

⁵ *Far Eastern Economic Review* (FEER), 7 November 1996, p. 92.

Why are Chinese businesses so eager to go abroad while everyone outside tries to get a foothold in the Chinese market? Our main findings can be summarized as follows: although some overseas PRC businesses are similar to other countries' transnational corporations (TNCs), many of the international investment projects from China have been made primarily to serve the purpose of informally transferring property from state ownership to *de facto* or *de jure* private possession, or put briefly, informal privatization. It is informal in the sense that such transfers are either plainly forbidden by Chinese law or formally discouraged by the central government, even though a certain degree of tacit consent has sometimes been granted by local authorities. By focusing on this intriguing restructuring of ownership in the offshore part of the Chinese economy, this study strives to shed light on an important yet largely unreported aspect of China's transition from socialism.

THE GROWTH OF PRC BUSINESS ABROAD

China had few companies abroad before the Deng era, and almost all were located in Hong Kong, totalling only 122 in 1979.⁶ Under the direct control of respective ministries in Beijing, these companies did not take part in the Hong Kong economy but acted as the ministries' agents, handling only affairs related to China's international trade and overseas visitors.⁷

The reforms in China and its new relations with the outside world opened a new chapter for its offshore business. Starting in the late 1970s the State Council (the Cabinet) gave permission to selected state institutions to establish new companies abroad, engaging in a wide range of activities. From the late 1970s to the early 1990s China's investment abroad reportedly maintained an annual increase of 35 per cent.⁸ During 1980–84 the yearly average volume of investments was \$52 million, and during 1990–94 it climbed to \$2.4 billion a year.⁹

Although the responsible state offices all believe that offshore PRC business has grown rapidly, no one can tell the size accurately, for many investors, for a variety of reasons, do not expose their outside operations to the higher custodian bodies. Thus, each of the responsible central authorities, on the basis of whatever information it has access to, has to make its own guesstimates. Below I show how considerable the discrepancies are between the official data, a convincing sign of the state's inability to control the movement of large quantities of national assets.

⁶ Interview with a senior PRC official in Hong Kong, *Yazhou Zhoukan*, 8 September 1996, p. 56.

⁷ Lin Congbiao and Jian Zeyuan, 'PRC Companies and the Hongkong Economy', *Asian Studies*, 17 (1996), 130–76, pp. 131–2.

⁸ Zhu Ronglin, ed., *Transnational Operations* (Shanghai: Fareast Press, 1994), p. 34.

⁹ *Reform Times*, 26 September 1996, p. 1.

TABLE 1 *The Growth of Offshore Nontrading PRC Firms, 1979–93*

Year	No. of firms at year end	Cumulative direct investment (\$m.)
1979	4	0.5
1980	17	31.4
1981	30	34.0
1982	43	37.2
1983	61	45.9
1984	108	126.7
1985	185	177.2
1986	277	252.8
1987	401	602.8
1988	570	755.8
1989	689	985.8
1990	846	1,060.5
1991	1,053	1,427.5
1992	1,408	1,662.7
1993	1,703	1,718.7

Source: Duan Yuncheng, *Chinese Firms' Transnational Operations and Strategies* (Beijing: Chinese Development Press, 1995).

According to the Ministry of Foreign Trade and Economic Co-operation (MFTEC), the designated body issuing permits to major PRC projects abroad, by June 1995 China had established 4,739 offshore firms (excluding finance and insurance) with cumulative assets of \$30 billion.¹⁰ Another dataset puts total number of PRC TNCs in mid-1996 around 5,500, with investments of \$40 billion.¹¹ Yet the National Administration of State Assets (NASA), the chief watchdog for public property, which has investigated dubious cases of capital outflow, estimates that by late 1994 China had already founded over 10,000 firms offshore, with assets of almost 2 trillion yuan (\$235 billion).¹² Table 1, based on MFTEC's conservative data (the only statistics with annual details), shows the growth of China's TNCs.

All the official statistics agree that Hong Kong has been the most popular location for China's TNCs and yields most revenues. But when asking how many PRC companies reside there and how much PRC property is there, we again face irreconcilable datasets. MFTEC's figures remain the smallest (Table 2), suggesting that PRC businesses in Hong Kong have tried their best to avoid being looked after by their supervisor.

¹⁰ *Economic Research Reference (ERR)*, no. 7 (1995), pp. 22 and 39; *State Assets Management (SAM)*, no. 8 (1996), p. 20.

¹¹ *RCA*, 15 October 1996, p. 4.

¹² *ERR*, no. 190 (1994), p. 9. These figures perhaps include banks while the others do not.

TABLE 2 *Locational Distribution of Offshore
Nontrading PRC Firms, at the End of
1990*

Location	Number of firms
Hong Kong and Macau	140
United States	109
Thailand	61
Australia	49
Japan	44
Former Soviet Union	34
Canada	20
Germany	18
Malaysia	13
Mauritius	13
Nigeria	11
Bangladesh	10

Source: Duan, *Chinese Firms' Transnational Operations and Strategies*, pp. 66–8.

According to the same source, with 180 trading companies added, 320 PRC firms were reported to MFTEC as located in Hong Kong and Macau in April 1991. But on the 1991 file of the Hongkong Chinese Enterprises Association, Beijing's watchdog, 952 member firms were registered, three times those known by MFTEC.¹³ The Xinhua News Agency's Hongkong Branch (XNAHB) disclosed that in mid-1996 at least 1,800 PRC companies operated there, and these do not include those spontaneously installed by local governments from the mainland. Nicknamed 'underground PRC companies', these are estimated by Hong Kong observers as close to 5,000 in mid 1996.¹⁴ A secret investigation conducted by the PRC's Ministry of Supervision is quoted as stating that in March 1994 there were already 3,200 PRC firms in Hong Kong (excluding branches and subsidiaries), plus 420 firms in Macau, with a total staff of 71,400 from mainland China, and the direct investment stood above \$25 billion.¹⁵ The exact size of PRC investments is unknown even in the tiny territory just next door! More generally, NASA has repeatedly complained: 'The obvious fact is that currently the state has no clear idea at all about the quantity of our country's firms and investments overseas.'¹⁶

Needless to say, not all China's TNCs derive from the public sector. Some private owners, as confirmed by my fieldwork in Guangdong and Zhejiang, have

¹³ Lin and Jian, 'PRC Companies and the Hongkong Economy', p. 137.

¹⁴ *Yazhou Zhoukan*, 8 September 1996, pp. 56–7 and 60.

¹⁵ Lin and Jian, 'PRC Companies and the Hongkong Economy', p. 131; cf. *ERR*, no. 190 (1994), p. 38.

¹⁶ *SAM*, no. 9 (1995), p. 24.

shifted their hard-earned wealth out of China for a range of reasons – fear of political uncertainty, hyperinflation and so on – similar to the motivations driving private firms from other Third World countries to stash assets overseas. But below, I limit my analysis only to the TNCs established by Chinese state institutions; as NASA reports, the great majority of overseas PRC investments have been made by the state sector.¹⁷

RECEIVED THEORIES

Existing theories of overseas investment are primarily concerned with explaining two types of TNCs: those established by Western and Japanese corporations, and those by non-communist Third World countries, mostly from the newly industrializing economies in East Asia and Latin America.

For TNCs of the first type, the reasons for internationalization are quite obvious, as the investments are usually made by technologically advanced and financially mighty corporations which regularly appear in ‘the upper ranks of *Fortune*’s various lists of the world’s leading firms’.¹⁸ The conception of proprietary assets is fundamental: the corporation owns firm-specific assets (‘ownership’), which can be special skills in production, marketing or organization, and which give it monopolistic advantages in competing with rivals. Because of the nature of these assets – intangible, ill-defined, hard to patent and so on – and because of market imperfections, it is more efficient for the owning firm to apply them within subunits under a common administrative control than to sell or rent them to another company (‘internalization’). And after taking into account circumstances such as the prices of production factors and trade barriers, the owning firm decides that the application of its proprietary assets in branches located in selected foreign countries will generate more desirable results than exporting to them goods produced domestically (‘locational advantages’). These three concepts, largely interpreted in the light of transaction-cost economics, point to the necessary conditions for the existence of TNCs.¹⁹

This paradigm was extended to cope with the new TNCs from non-communist developing countries emerging in the 1970s, which ‘are relatively small, produce low-technology undifferentiated goods and direct their investment to poorer and smaller neighbouring states’.²⁰ Theoretical modifications

¹⁷ *SAM*, no. 11 (1994), p. 17.

¹⁸ Raymond Vernon, *Storm Over the Multinationals* (Cambridge, Mass.: Harvard University Press, 1977), p. 19. My purpose here is to summarize the previous analyses generally; detailed examinations would reveal differences among TNCs from different industrial nations, see, for example, K. Kojima, *Direct Foreign Investment: A Japanese Model of Multinational Business Operations* (New York: Praeger, 1975).

¹⁹ John Dunning, *International Production and the Multinational Enterprise* (London: Allen & Unwin, 1981); Richard Caves, *Multinational Enterprise and Economic Analysis* (New York: Cambridge University Press, 1996), pp. 1–23.

²⁰ A. Rugman, ed., *New Theories of the Multinational Enterprise* (London: Croom Helm, 1982), p. 59.

were made in the notion of proprietary assets: Third World firms, though not at the frontiers of research and development, may possess some technologies specially fitting the needs of other developing countries, and their owner-managers are more skilful in dealing with the latter's governments and penetrating their markets. All these give Third World investors certain advantages in competition with developed nations' TNCs and help them to capture market niches in the host territories.²¹

According to this transaction-cost model, the motives of transnational investors can generally be summarized as: preserving existing markets and seeking new markets, as well as seeking resources, efficiency and strategic assets (technology and managerial know-how). Besides, Third World transnational investors have special motives: diversification to reduce the political or economic risks inherent in home countries, shifting the family with its capital to safe destinations, and creating jobs for overseas relatives.²²

The paradigm drawn from developed country TNCs can be extended to explain Third World TNCs because their differences are largely technical. They share, however, the same quality on a more fundamental level: both are *private* enterprises from *capitalist* economies. Because of this common property-rights background the two types of transnational investors have manifested to a great extent comparable motivational and behavioural characteristics, which make it logically legitimate for the classical framework to be stretched out to encompass the latecomers once a few factors specific to the Third World are taken in.

Given this, I will label transnational investments made by both developed and developing countries as 'conventional TNCs' so long as they are from the private sector. They are precisely the focus of attention in the existing literature, which takes the firm as the unit of analysis, as demonstrated in that when 'motivations' and 'behaviour' relating to foreign investment are discussed, all are referred to the firm level.²³ This approach is justified by an unspoken yet crucial institutional context from which conventional TNCs come: the establishment of a clear ownership structure and, in the case of a separation between owner and manager, a well-defined principal-agent relationship. Hence, one can talk about 'the behaviour of the firm as an organizational entity',²⁴ as if there is a union of owner's and management's interests so far as the TNC is concerned. This is reflected in the predominance of the 'proprietary asset' notion in the analyses, commonly referred as the 'ownership' condition

²¹ Louis Wells Jr, *Third World Multinationals* (Cambridge, Mass.: MIT Press, 1983); Sanjaya Lall, *The New Multinationals* (New York: John Wiley, 1983); Krishna Kumar and Maxwell McLeod, eds, *Multinationals from Developing Countries* (Lexington, Mass.: Lexington Books, 1981).

²² John Dunning, 'Re-Evaluating the Benefits of Foreign Direct Investment', *Transnational Corporations*, 1 (1994), 23–51; Wells, *Third World Multinationals*, pp. 67–90; Caves, *Multinational Enterprise and Economic Analysis*, pp. 214–42.

²³ Rugman, *New Theories of the Multinational Enterprise*, pp. 57–9; Lall, *The New Multinationals*, p. 250.

²⁴ United Nations, ed., *Transnational Corporations and World Development* (London: International Thomson Business Press, 1996), p. 32.

for a firm to invest abroad. We must rethink this assumption when analysing outward investments from China's transitional economy.

It has also been noted that among the TNCs of the 1970s–80s some were installed by public-sector firms from Western European and non-communist developing countries.²⁵ A few observers have pointed out that there is a fundamental tension between state ownership and multinationality, that state firms are compelled to behave like their private competitors once situated in the international market, and that sooner or later state-owned multinationals have to undergo privatization or return to strict state control.²⁶ However, this potentially fruitful line of inquiry has not been taken up by many researchers, perhaps because such unconventional multinationals owned by capitalist states were few.

Before the late 1980s the Soviet-bloc countries did operate overseas businesses, but they were limited to import–export trade only,²⁷ similar to China's offshore businesses of the pre-Deng era, and have not been systematically studied. The few works on Third World and state-owned multinationals have all precluded these 'red multinationals' from being examined.²⁸

To recapitulate, the world economy has seen a wide spectrum of TNCs that can be grouped into various categories according to two characteristics: the home country's level of development and the parent firm's ownership type. Thus, we have classic TNCs from the private sector of developed countries; their younger and smaller cousins from the private sector of non-communist developing nations; unconventional TNCs from the public sector of industrialized and industrializing capitalist systems; and the old type of 'red TNCs' from central-planned economies. Those in this study are from the *public* sector of a *developing* country whose economic system is *neither entirely centrally-planned nor market-directed*, but something in between. Therefore, TNCs from the transitional Chinese economy, a new type of 'red TNCs', do not completely fit into any of the previous categorizations. The existing theories, based mainly on the conventional TNCs' experiences, have only partial applicability to our cases.

PUBLIC-SECTOR INVESTORS FROM CHINA AND THE DRIVING FORCES BEHIND THEM

Even a glance at the identities of outward PRC investors reveals a striking difference: these public-sector investors are very heterogeneous, far beyond the

²⁵ Jean-Pierre Anastassopoulos, Georges Balnc and Pierre Dussauge, *State-Owned Multinationals* (New York: John Wiley, 1987); Kumar and McLeod, *Multinationals from Developing Countries*, pp. 187–201.

²⁶ Anastassopoulos *et al.*, *State-Owned Multinationals*, pp. 150–82.

²⁷ *Fortune*, February 1977, pp. 134–48; G. Hamilton, ed., *Red Multinationals or Red Herrings?* (London: Frances Pinter, 1986).

²⁸ See Kumar and McLeod, *Multinationals from Developing Countries*, pp. xv and 13; Anastassopoulos *et al.*, *State-Owned Multinationals*, pp. 25–6.

scope of previous TNCs. This institutional heterogeneity presages a great diversity of motives, objectives and behavioural characteristics.

Since the late 1970s state institutions authorized by the central government to invest abroad can be sorted into six categories.²⁹ Type one are central state bodies of which MFTEC and the Ministry of Communications are of particular weight, sharing 28 per cent and 11 per cent of China's entire overseas investment, respectively.³⁰ Type two are state financial institutions and industry-wide corporations. The China International Trust & Investment Corporation (CITIC), Everbright Industrial Company and China Nonferrous Metals Industry Corporation are well-known examples, whose offshoots are spread over many countries.

The third type are provincial governments and large municipalities. Type four are special economic zones (SEZs), for example, Shenzhen or Zhuhai. The next type are giant state enterprises, the best known being the Capital Iron & Steel Company (Shougang). The last type are those controlled by the army and the police, such as the army's Poly Technologies and China North Industries Corporation.

At the earlier stage of the overseas expansion only a tiny number from these six categories were picked to go overseas, in accordance with the top leadership's national development policy. But once a few examples had been set up on an *ad hoc* basis, others of equal hierarchical status pushed to follow suit. Thus, by the early 1990s not only the few ministries specializing in foreign economic relations but every ministerial body had firms outside China; not only the coastal provincial governments but every province had established offshore 'window firms' (meaning a window for international networking); not only the four SEZ cities but all the major municipalities across China had invested overseas.

In spite of this 'competition among equals', the above public bodies are at the upper ranks of respective hierarchies and small in number, hence relatively easily monitored by the centre, and their transnationalization has obtained some form of central approval. In comparison, far more public-sector investors have gone outside spontaneously, particularly after 1983 when the State Council delegated the right of approval to MFTEC for overseas investments below \$30 million, and to local governments for projects below \$1 million.³¹ Once lower governmental levels had a say in the matter, the whole situation began to get out of control. Spontaneous outward investments range widely: government and party offices, police and army units, branches of state financial institutions, state firms of all sizes, among others. The further they go down the coast, the less effective is Beijing's control over public institutions' outgoing investment

²⁹ Based on fieldwork; cf. Duan, *Chinese Firms' Transnational Operations and Strategies*, pp. 64–6.

³⁰ *SAM*, no. 8 (1996), p. 23. This refers to officially recorded investment.

³¹ Wang Kaiguo, ed., *Complete Manual for State Assets Management* (Beijing: Yuhang Press, 1995), p. 79.

because of the coastal regions' extensive connections with overseas Chinese communities.³² Obviously asking spontaneous offshore ventures to go to the centrally appointed supervisor to register is like asking smugglers to fill out a customs declaration. That is why there are colossal discrepancies among the statistics on TNCs, and why MFTEC's are the smallest.

The central government has attempted to curb this spontaneous internationalization, but with little success. A major effort was made in the wake of the 1989 Tiananmen protests, in which over 1,000 PRC offshoots in Hong Kong were ordered to shut down, but shortly thereafter Hong Kong-based PRC outlets exceeded the previous number of 3,000.³³ The failure of central control over this arena is inevitable as state firm managers and public officials are strongly self-interested, as shall be seen, and operate in a vast country that has evolved economically into a para-federalist arrangement granting localities substantial autonomy.³⁴ Besides, the central government's authorization procedures are technically flawed, and easily exploitable by subordinate bodies. The selection of public entities allowed to invest abroad is largely made on an *ad hoc*, inconsistent basis. This style of issuing permits has a demonstration effect on subnational authorities: 'If you at the centre can pick your favourites, why can't we pick our own?'³⁵ Once the central authorities open a chink for a certain type of national organization to go overseas, organizations of a similar nature at lower ranks sneak through, turning the chink into an open gate. This is a classic case of the size problem – the special difficulty of managing an oversized structure.³⁶

Analytically we can make out three clusters of motives driving PRC public bodies to invest abroad when the rest of the world has been running to China to invest: conventional, special and dubious.³⁷ The conventional motives include collecting trade information, making business connections, consolidating and expanding export markets, competing for business opportunities in industries such as construction and ocean shipping, seeking new technologies and managerial know-how, and obtaining cheaper and better raw materials. These are perfectly legitimate reasons from any standpoint, considering China's status as a rising trading power, its businesses' competitive advantages in

³² Eighteen per cent of China's transnational investment has been made by Guangdong (excluding Shenzhen, which takes the third place) and 4 per cent by Fujian, the runner-up (*SAM*, no. 8 (1996), p. 23).

³³ Cf. Xu Jiatur, *Memoirs of Hong Kong* (Taipei: Linking Publishing Company, 1993), p. 258; *Yazhou Zhoukan*, 8 September 1996, pp. 56–7; Lin and Jian, 'PRC Companies and the Hongkong Economy', p. 133.

³⁴ See Gabriella Montinola, Yingyi Qian and Barry Weingast, 'Federalism, Chinese Style: The Political Basis for Economic Success in China', *World Politics*, 48 (1995), 50–81.

³⁵ Based on interviews.

³⁶ See Oliver Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985), pp. 134 and 149, for discussion on the size dilemma.

³⁷ Based on fieldwork; cf. Duan, *Chinese Firms' Transnational Operations and Strategies*, pp. 143–55.

several spheres, and shortages of some important natural resources in this rapidly developing nation. As far as those activities are concerned, China's TNCs share basic similarities with other nations' conventional TNCs, which are identified by the received theories as preserving markets and seeking new markets, resources, networks and strategic assets.³⁸

Heading the list of the special motives has been Hong Kong's handover. When Beijing picked major financial institutions and corporations to invest there, a concern for national pride was primary: PRC investments in the territory were intended to be stabilizing, demonstrating to the world that China could keep Hong Kong prosperous even when faced by an international plot against the takeover, such as massive withdrawal of Western, especially British, capital from the territory.³⁹ China has another principal political concern – the Taiwan issue – for which it has to run political operations overseas. For these special activities, a line of TNCs are a necessary cover as well as an indispensable source of financing.⁴⁰

Total investment abroad, whether for conventional or special reasons, according to Xu Jiatun, China's ex-representative in Hong Kong, was not particularly large: about \$3 billion in Hong Kong (the largest recipient for such capital) up to 1987–88,⁴¹ a tiny fraction of the total amount known by independent observers, as cited earlier. This huge difference directs our attention to the third cluster of motives behind the overseas business expansion, the dubious ones.

A portion of offshore PRC structures have been erected just to provide an excuse for the parent organizations' officers to travel abroad.⁴² Such duty tours are largely vacations – paid for out of public funds – for officials, who often bring families or lovers with them,⁴³ the companies being set up in scenic and exotic localities or shopping paradises. Their reception, when visiting the overseas venture, is comprehensive, thoughtful, generous and, for the most part, free of charge, covering accommodation, feasts, transport, telecommunications, gifts, entertainment and sometimes even erotic and gambling adventures.⁴⁴

³⁸ For polite discussions on these investments, see James Zhan, 'Transnationalisation and Outward Investment: The Case of Chinese Firms', *Transnational Corporations*, 3 (1995), 67–100; Michael McDermott and Chun Hua Huang, 'Industrial State-Owned Multinationals from China', *Asia Pacific Business Review*, 1 (1996), 1–15.

³⁹ See Lore Basher and Joe Schuknecht, 'Chinese Investments – "Hostages" for Hong Kong'? *Journal of Institutional and Theoretical Economics*, 4 (1992), 645–53.

⁴⁰ See Xu, *Memoirs of Hong Kong*, pp. 52–5, 68, 289–90 and 330 for details.

⁴¹ Xu, *Memoirs of Hong Kong*, pp. 256–7.

⁴² *SAM*, no. 8 (1996), pp. 21–2.

⁴³ The central party-disciplinary office detected 43,144 misuses of public funds by officials, amounting to 260 million yuan, for overseas holidays between July 1992 to December 1993 (Source Book A35, p. 30). Far more such cases seem to have escaped the central office's eyes, see Jilin province's data (*Mingjian*, no. 5 (1994), pp. 16–18).

⁴⁴ *Xinhua News* report, 20 February 1995.

To convert their identity from domestic to 'foreign' corporations is a powerful attraction for many PRC organizations to invest abroad as Chinese laws and administrative decrees give foreign investment within China special favours. Once having a subsidiary registered offshore, a PRC entity can send funds back into China as 'foreign investment' and form 'foreign companies' or 'joint ventures' in China,⁴⁵ enabling them to enjoy tax cuts, to import vehicles and equipment free of tariffs, etc. This is essentially 'rent-seeking' activity, as the effort is to gain the monopolistic advantages created by government for a particular class of businesses.⁴⁶ NASA estimates, based on its investigation in Guangdong in 1994, that of all the foreign companies and joint ventures in China, amounting to 160,000, 20–30 per cent are fakes established by offshore PRC structures.⁴⁷ A World Bank study guesses that, of the \$11 billion of officially recorded investment inflows to China in 1992, 25 per cent were recycled PRC capital.⁴⁸

To some PRC organizations, particularly the police and the army, a further motive for running a company abroad is the convenience gained to import goods that are either prohibited imports or allowed only with high tariffs. These import activities range between plain smuggling and informal market transactions. For instance, a police division ran a trading firm abroad, which had the privilege of importing police equipment tax-free. It often used government funds to buy high-grade household appliances and got them through the Customs as police equipment. These tariff-free appliances then went to a store owned by the division and were sold to yield high profits.⁴⁹

For many PRC officials and managers, investing in foreign territories serves a family goal – emigration. These emigrants are a new subtype among the world's 75 million legal and illegal migrants: they can be said to be motivated 'by the pull of opportunity and attaining an advanced standard of living' but definitely not 'by the push of poverty and economic hardship';⁵⁰ in every sense they are among the privileged in their homeland. Their moves look on the surface like the recent emigration investments made by the new rich from Asia, in that their capital opens the gate for the capitalists and the family business

⁴⁵ *ERR*, no. 7 (1995), pp. 28–9; *Chinese Business Times*, 5 January 1994; *Internal Reform Reference*, no. 4 (1994), pp. 46–7.

⁴⁶ Gordon Tullock, 'Rent Seeking', in J. Eatwell, M. Milgate and P. Newman, eds, *The New Palgrave Dictionary of Economics* (New York: Stockton Press, 1987), IV, pp. 147–9.

⁴⁷ *ERR*, no. 3 (1995), pp. 25–6.

⁴⁸ Peter Harrold and Rajiv Lall, 'China: Reform and Development in 1992–93', Discussion Paper 215 (Washington, DC: World Bank, 1993), p. 24.

⁴⁹ I shall present a real case with necessary details in illustration of each of the typical patterns of informal privatization, which is useful in examining a new terrain full of elusive phenomena. See discussions on this in Alejandro Portes, Manuel Castells and Lauren Benton, eds, *The Informal Economy* (Baltimore, Md.: Johns Hopkins University Press, 1989), pp. 1–7. More information on these cases' specific sources is available upon request.

⁵⁰ Karl Sauvart, Padma Mallampally and Persephone Economou, 'Foreign Direct Investment and International Migration', *Transnational Corporations*, 1 (1993), 33–69, p. 54.

emigrates with the family.⁵¹ But a closer check reveals a crucial difference: those who are not from the PRC qualify as investment emigrants by means of their family capital, but the PRC officials and managers do so through public property under their control. And as we shall see, their emigration is often associated with the vanishing of large sums of China's public assets.

Property transfer, the shadiest motivation for investments abroad, involves changes in the *de facto* ownership of public assets in several forms. Organizations, legal or criminal, and *nomenklatura* members shift abroad money illegally gained in China through the establishment of transnational structures, a classic form of money laundering.⁵² For example, in the Xinxing Company case – leading to the exposure of the mayor of Beijing, Chen Xitong, and his associates – the managers, in order to cover up the illegally raised funds, sent more than \$11 million to two Hong Kong affiliates and then had the money returned to China as 'foreign capital', opening up twenty-eight joint ventures.

Other forms of property transfer include state firms relocating their domestic earnings overseas in order to cut taxes; subdivisions of giant organizations hiding income from their superiors by sending money far away; offshore PRC firms avoiding the remission of revenues back home by investing in foreign lands; or managers and officials trying to turn public wealth into private via overseas channels. Thus, the outgoing money may be clean, but the transnational movement is to switch it from state to private hands.⁵³

In a concrete transnational investment, to be sure, the motives are often mixed, and what differentiates one project from another is the relative weight of legitimate against illegitimate considerations. Generally speaking, formally approved projects are driven by less suspicious motives than spontaneous investments, and those that are centrally approved are driven by less illicit reasons than those approved by grass-roots leaderships. Opportunism is also an important factor: some investments have gained approval from the top government level and served national goals; but over time the managers become self-serving, thanks to the behaviour of those running dubious Chinese TNCs and the encouragement of the barely fettered business environment abroad.

The whole range of dubious motives appears strange and abnormal when viewed from the earlier theoretical perspective drawn from developed nations' TNCs. Even the Third World-specific motivational variables, i.e., diversification of risks, etc., provide little help in telling the PRC story. Large numbers of investments from China become fully rational and predictable

⁵¹ Sauvart *et al.*, 'Foreign Direct Investment and International Migration', pp. 33–65; K. Yoshihara, *Foreign Investment and Domestic Response* (Singapore: Eastern Universities Press, 1976).

⁵² Cf. Lin and Jian, 'PRC Companies and the Hongkong Economy', pp. 141–2 and 147.

⁵³ This seems the case in the flow of \$39 million, which came from the army's Hui Tong Corp. in Beijing, and was channelled to the United States, Switzerland, Japan and Hong Kong in 1993 through Australian bank accounts held by two Chinese, one having prepared this by registering a trading company in Sydney (fieldwork; also *The Australian*, 3–4 August 1996, p. 7).

only when we put them in a crucial, property-rights centred context – the *nomenklatura*'s seizing opportunities in the transitional Chinese economy.

PROBLEMS OF CORPORATE GOVERNANCE

Problems start from the very beginning: numerous PRC investors pour out capital without conducting even a preliminary feasibility study, because for the decision makers going overseas is the overriding purpose, and therefore they do not care if their business has a competitive advantage in the chosen area. Even in a semi-official questionnaire survey, 'going overseas in order to demonstrate the firm's advantage on international markets' received the lowest rating among the stated motives.⁵⁴

The jurisdictional separation between the home and the host territories naturally makes the control of TNCs a headache for the Chinese state. The higher the government level, the greater is the frustration with the situation.⁵⁵ There is a problem of supervision. In theory, five central government departments are in charge of the offshore sector, screening and approving proposals and conducting post-investment checkups: the Economic Planning Commission, MFTEC, the Administration of Exchange Control, the Ministry of Finance and NASA. This supervisory structure also applies to subnational levels for investment below certain thresholds. But the division of labour among the five is unclear, there is no co-ordination at major administrative levels, and guidelines and instructions sent out by them often contradict each other.⁵⁶

More worrisome is that many PRC public entities, as mentioned earlier, for fear of their real objectives being exposed, deliberately keep their external business closed to the supervisory agencies, and this alone renders monitoring untenable. This is the case not only at the national level, which is understandable in a country of China's size, but also at local levels.⁵⁷ It is the case not only for prosperous coastal regions, which may have too many offshore establishments to take care of, but also for poor peripheral regions.⁵⁸ Sometimes the outward investments were made secretly by one official alone, who maintains single-line control over the operation.⁵⁹ Under this circumstance both the parent entity and the higher government levels are kept in the dark.

The next problem lies in managerial appointments. Those who make decisions about investment want to be sure that the right person heads the

⁵⁴ Duan, *Chinese Firms' Transnational Operations and Strategies*, pp. 146–7; cf. Zhu, *Transnational Operations*, p. 190.

⁵⁵ Primarily based on fieldwork and two investigating summaries by central Chinese government bodies (*Exploration & Decision*, no. 6 (1995), pp. 8–11; *ERR*, no. 190 (1994), pp. 1–40). Specific references will be given where other sources are used.

⁵⁶ *Almanac of China's State Assets (ACSA)* (Beijing: Economic Science Press, 1994), pp. 150–1; *SAM*, no. 8 (1996), p. 21.

⁵⁷ For example, Changshu, a medium-sized city in Jiangsu province (*SAM*, no. 11 (1995), p. 47).

⁵⁸ Such as Gansu, the second-poorest province (*SAM*, no. 7 (1994), p. 50).

⁵⁹ *SAM*, no. 8 (1996), p. 8; *ACSA*, p. 151.

offshore subsidiary so that their special concerns will be served well all the time. As heading a company abroad guarantees a variety of benefits, privileges and freedom, only those most trusted by the parent organizations' bosses are likely to be assigned to overseas management. It is not unusual for some offshore businesses to be created by the powerful chiefly to employ their loved ones. Thus, a remarkably high proportion of the managers of major Chinese TNCs are relatives of senior government officials.⁶⁰ This pattern runs from the top down: relatives of national leaders are most likely to control offshore businesses attached to national institutions, and relatives of subnational leaders control offshore businesses attached to subnational bodies.⁶¹ As nepotism and cronyism predominate in staffing processes, a TNC may be run by several people from the same extended family, and financial papers be signed by a husband and wife team.

Here we see a close parallel between transitional China and the ethnic Chinese family-run businesses in South-east Asia, where only family members are sent out to hold key positions in the subsidiaries abroad to ensure effective family control and supervision.⁶² This resemblance says a great deal about the real situation of control within large numbers of so-called 'publicly-owned' PRC multinationals.

Here, family-based personnel arrangements make good sense. Many senior Chinese officials have prepared for the worst since the sudden collapse of European Communist regimes in the late 1980s, in particular the summary executions of the Romanian dictator Ceausescu and his wife. Chinese officials have been diversifying and sending their kin into different sectors and territories, a key part of their contingency plans.

⁶⁰ The total number of the PRC's blue blood in Hong Kong known to Xu Jiatun (*Memoirs of Hong Kong*, pp. 261–2 and 74) was about 200 in the late 1980s, which apparently referred only to those whose parents were at the ministerial rank or above. To identify these red capitalists, nicknamed 'princelings', is the tireless endeavour of China-concerned publications, and one can find lists of names, albeit incomplete and not entirely accurate, in Ho Pin and Gao Xin, *CPC Princes* (Ontario: Mirror Books, 1994); *Open Magazine*, no. 4 (1995), pp. 50–2; *FEER*, 6 March 1997, pp. 60–1; *Hongkong United Daily*, 25 February 1995, p. 2; Murray Tanner with Michael Feder, 'Family Politics, Elite Recruitment, and Succession in Post-Mao China', *Australian Journal of Chinese Affairs*, 30 (1993), 89–119; *Contending*, no. 2 (1986), pp. 6–11. These lists of names, like Xu's figure, contain little information on families of sub-ministerial rank in the central government and sub-governor rank in local governments, the latter being of particular weight in large numbers of TNCs installed by China's subnational public bodies.

⁶¹ Two cases illustrate this. The late Chinese vice-president Wang Zhen, in spite of his senility, refused to hand over his post in 1993 to Rong Yiren until the latter agreed to give up his chairmanship of CITIC to Wang Jun, his son (interviews). A top bureaucrat of Shandong province, against the advice of the bureaux in charge, appointed his son, a young man without business experience, to reinforce the management of a financially troubled government company in the United States. Upon arriving, however, the son used the province's \$170,000 to open a self-run business instead of helping the existing one, as instructed. Up to late 1996 the father had obstructed all official efforts to discipline his son, who remained at large (fieldwork).

⁶² Wells, *Third World Multinationals*, pp. 81–2.

The most bizarre thing about TNC governance is that many investments made by PRC state entities are registered abroad under their managers' private title because, it is claimed, this helps the business pay less tax, raise funds more easily and make additional investment more conveniently.⁶³ Public funds of offshore PRC structures are often deposited under their officers' private savings accounts.⁶⁴ This 'public property with private title' practice is particularly widespread in Hong Kong and Macau where China's offshore business is concentrated, and the central government was not aware of the problem's scale until the spring of 1989,⁶⁵ when the Tiananmen movement's anti-corruption pressure motivated the government to start investigating bureaucrat-run companies.

Although situated in capitalist systems, most offshore PRC establishments, at least until the mid-1990s, had not been able to adopt the host countries' pay schemes for employees. For the expatriate PRC personnel, the firm had to stick to the scheme of 'low salaries, high benefits' prevalent in the Chinese state sector. As members of the *nomenklatura*, they all had bureaucratic ranks to determine the material benefits allocated to them. Their wages were not allowed to be too high in comparison with government officials in the same ranks back home, and the offshore establishment, like all state entities in China, had to provide them with free housing, medical care, transport, food subsidies, health insurance and so on. When a TNC was too large to rely solely on PRC expatriates and local employees had to be taken on, the firm implemented a 'one company, two systems' policy: to those sent by the parent organization from China, a PRC-style scheme applied; to those recruited locally, a local scheme applied. Thus, it was not unusual in many PRC firms in Hong Kong that the China-assigned manager's nominal salary was lower than that of his locally recruited clerk. This, of course, has created a burning sense of humiliation and unfairness among the management.⁶⁶

Another major governance problem for Chinese TNCs is that their systems of accounting are rarely methodical. An investigation found that in one province's TNCs, only half employed accountants, and of those 20 per cent were not qualified.⁶⁷ Many firms keep multiple accounts, with the accurate one left for their managers and the falsified ones sent to external authorities, and many do not even bother about recording transactions,⁶⁸ for these structures

⁶³ ACSA, p. 151.

⁶⁴ Wang, *Complete Manual for State Assets Management*, p. 1105.

⁶⁵ Wang, *Complete Manual for State Assets Management*, p. 596.

⁶⁶ Based on interviews. The reader may wonder why, if that is the case, overseas assignment is still eagerly pursued in China? The rates of pay appear low in comparison with those provided by TNCs from capitalist countries, but several times higher than those provided in China. If one takes into account other grey or black income and freedom available abroad, an overseas job is irresistibly appealing to most Chinese cadres. This is why many expatriate PRC personnel try every possible way to stay on when their terms end.

⁶⁷ ACSA, p. 151.

⁶⁸ SAM, no. 11 (1995), p. 47.

primarily perform functions such as ‘hospitality’, money-laundering, etc.; thus, it is better to keep everything off the record. Until the early 1990s the multiple-account practice was permitted or at least tolerated by the parent organizations back in China, for they liked their subsidiaries to beat the host countries’ tax systems and retain maximum earnings. But gradually the parents too fell victim to their subsidiaries’ manipulatory accounting. Higher levels of Chinese government, theoretically looking after the public purse, even fail to acquire accounting records from numerous TNCs. NASA, for example, could only get replies from major PRC firms in Hong Kong to about 40 per cent of its requests.⁶⁹ A large coastal province had some 150 government-owned firms abroad, but most refused to send back financial reports, and the reasons given appear absurd.⁷⁰

STRATEGIES FOR INFORMAL PRIVATIZATION

Given what is shown in this sketch of the Chinese TNCs’ chaotic governance, it is logical to expect that a high frequency of property appropriation will be found in this arena. Below I present four main strategies employed by PRC officials and managers to carry out informal privatization.

The simplest and also the funniest method – though that depends on how you see it – of turning a state-owned TNC into a private concern is that the nominal owner claims what he is entitled to on paper. As mentioned, a great number of the foreign investments made by Chinese public bodies are registered as private property; thus, the actual owner can do little when the nominal owner turns his paper title to the property into reality and manages to emigrate.⁷¹ Such incidents have happened, as when a nominal owner died and his offspring in Hong Kong just took the company as an inheritance; or when a co-nominal owner of a Macau-based firm ran away with most of its assets, while the Zhuhai government, the real owner, could not ask the local court for help; or when a district government of Guangzhou sent a man to Hong Kong to open a transport business and later he refused to give it back. But the most dramatic case of this type up to 1997 was that of Yu Zhian, head of the Changjiang Motive Power Corporation in Wuhan (among the top 500 Chinese firms), who had been granted several national awards, such as that of Model Communist Party Member. In January 1994 the corporation opened an electrical engineering company in the Philippines and the project was very

⁶⁹ *ERR*, no. 190 (1994), pp. 15 and 35.

⁷⁰ Frequently used excuses include: ‘The documents were written in a foreign language, and we have no time to make a Chinese translation’; ‘If we make reports to the provincial government, lots of tax-evading information could leak out to the host country’; or ‘Our financial documents contain business secrets, so it is very risky to send them by mail or fax, and it is too costly to use registered mail service’ (fieldwork).

⁷¹ *SAM*, no. 8 (1996), p. 23.

successful, generating a yearly gross revenue of \$10 million. In May 1995 Yu suddenly disappeared from Wuhan, and soon afterwards the Chinese Embassy in Manila discovered that he was there running the company. The Wuhan Municipality sent a group in September to Manila to try to take back the business, of which it claimed to be the sole owner, but those familiar with local laws doubted if the Wuhan side could win the case, for all the legal papers stated Yu's private ownership of the business.

Another common method for the expatriate PRC management to turn public property into private is to siphon off some funds from the TNC under their control, a strategy that invites less publicity and is less risky than taking over an entire firm, especially when the manager still travels on a PRC passport or his family still remains within China's borders. In both cases, their personal freedom could be jeopardized. But once the company funds are swallowed up and the migration paperwork is done, no matter by what means, then is the time for the manager to flee.⁷²

The majority of the cases in this category are characterized by insider-outsider conspiracy, leaving little hard evidence for the parent organization to detect. A typical technique is as follows: a PRC manager offers an attractive deal to an outside business under the condition that the outsider issues an invoice with an exaggerated subtotal if the PRC firm is the buyer, or a bill of payment with an underpriced rate if the PRC firm is the seller. The difference between the stated sum and the actual amount of the transaction will be returned to the PRC manager or deposited in his family's account. This technique has been widely employed by managers of China's TNCs in trade, service, construction and engineering projects.⁷³ In business between the Chinese mainland and Hong Kong such practices are so commonplace that a Hong Kong trader, having made tremendous profits from assisting these transactions, confessed in private: 'For years, together with the mainland officials, we have been sucking the nation's blood.'⁷⁴

Siphoning off company funds is rarely performed individually if the TNC is run by a group of people. Synergism among the expatriate managers is easily achieved as they are under the same PRC-style pay scheme and all have a limited time horizon – normally after four years of overseas service

⁷² The Guangdong manager of a firm owned by Foshan city floated a subsidiary in Hong Kong by diverting the parent company's funds without the government's permission. When the authorities were about to punish him, he ran away and the government lost \$9 million (fieldwork). More shocking still is that the head of Shaanxi province's Hong Kong company managed to escape with HK\$100 million belonging to that relatively poor province, perhaps the largest embezzlement case involving Chinese TNCs before mid-1995 (fieldwork).

⁷³ Shao Jun's case is a good example. As head of the Shougang Shipping Company, he was found in 1992 to have taken \$160,000 from such dealings with his Hong Kong affiliates' help, most of the funds being hidden in overseas banks (fieldwork).

⁷⁴ Interviews in Hong Kong.

they are required to return to China.⁷⁵ When a firm's management is made up of kin, synergism in the illegal property transfer is a natural outcome.⁷⁶

Structural multiplication is the third main strategy in informal privatization. Its basic form is 'twin businesses', in that the management controlling a state-owned TNC simultaneously operates a private concern, normally in the same or a similar line of business. It is not surprising that assets and profits are transmitted from the former to the latter without proper compensation for the former.⁷⁷

A more artful form of structural multiplication is that once a parent organization in China is permitted to invest abroad, the overseas subsidiary quickly becomes a parent of multiple offshoots, which in turn are made parents of new offshoots, and so on.⁷⁸ Legally these offshoots are seldom wholly owned by the original state-owned parent firm, which would make their property title clear, but interbred with other property forms and organizations. With the birth of each new generation of offshoots, the asset flows between them become increasingly difficult to trace, and even harder to trace is the income from these asset movements. Offshoots that are geographically and legally distant from the original parent in China are apt to become the private concerns of their managers.⁷⁹

⁷⁵ For instance, Liu Guoxiu oversaw three subsidiaries set up in Thailand by Civil Engineering Construction Corp. of China, which gave him, in addition to a comprehensive benefit package, only \$100 pocket-money a month. Between 1986 and mid-1989 Liu stole \$270,000 from the subsidiaries. To ensure no report on his deeds was made to the parent company, he introduced each of his three assistants to brothels, for which they had to steal company funds (fieldwork).

⁷⁶ Ex-diplomat Hu Zhengguang was hired by the Fujian Foreign Trade Corp. to direct its subsidiary Jianhua Company in Togo. His wife served as his deputy. As a measure of precaution the parent corporation made Yang Yuanchen, its future director, Jianhua's chief accountant. The couple started siphoning the company's money soon after taking up duty, and later set a trap for Yang by giving him extra 'living-expense subsidies' when he was about to tighten financial discipline. The three then co-operated, switching over \$3 million of company funds to their private accounts in Swiss and Togo banks between 1984 and 1988. They intended to use these to open their own business in Canada and to emigrate there (fieldwork).

⁷⁷ Xu Jiatun disclosed two such incidents within his jurisdiction (*Memoirs of Hong Kong*, pp. 238 and 262). One is that Mr Xue, head of a large company belonging to XNAHB, formed a trading firm with a Singapore business man. Xue paid \$2 million to the partner for a bulk purchase, later reporting to XNAHB that the goods had never been delivered. Later still it became known that a co-owner of the trading company was Xue's crony. Another incident is far more significant: MFTEC etc. bought Kangli Company in Hong Kong and appointed as manager Ke Junwen, who registered another firm and kept moving Kangli's assets to it. Once his private firm was well supplied, Ke went away from Hong Kong and left Kangli a loss of \$35 million.

⁷⁸ A report states: 'Continental Mariner, the Hong Kong-listed arm of Poly, has 36 subsidiaries and associated companies, 15 of which are listed in the British Virgin Islands or Bermuda; many are dormant shell companies with registered capital of \$1 and fanciful names like Silver Point Assets and California Hero Property'. Poly's spokesman says 'this is primarily for tax purposes', but independent observers believe that it has to do with the illegal diversion of company assets (*Institutional Investor*, July 1996, p. 53).

⁷⁹ *SAM*, no. 11 (1994), p. 18; *ERR*, no. 190 (1994), p. 16.

An elaborated variant of structural multiplication is the use of shell companies. State institutions in China are required to obtain several levels of formal approval for the establishment of overseas structures, but until the late 1990s no clear regulations had been established regarding the acquisition of an existing company abroad. Some PRC organisations found it convenient to buy a shell company registered in a loosely regulated territory (like Hong Kong) and then secretly inject capital funds into it.⁸⁰ The dialectics about shell companies is that once a state institution from China puts a shell on itself by acquiring a foreign company, the shell company, which is not registered as wholly state-owned, will soon become full of fresh blood thanks to financial inputs from the state-owned parent, which in its turn becomes an empty structure 'like a shell without meat'.⁸¹

The fourth main strategy for informal privatization is the free use of public funds as private capital. The main playgrounds for these funds are the real estate, equity and currency markets, which are known for being volatile. The secret of the strategy is an asymmetrical distribution of costs, risks and gains. Despite the Chinese government's prohibition against attempting highly risky speculations in outside markets, it is customary among many Hong Kong-based PRC establishments for the manager to hand over large amounts of funds to brokers and to ask that a portion of any gains, normally 20 per cent, be put aside secretly for him. When a loss occurs, the manager averts any personal financial responsibility.⁸² It shocked the Chinese public when the media reported in February 1991 that the officers of Hong Kong-based Plymouth (Baifu), a company linked to MFTEC, had misappropriated public funds between early 1986 to August 1989 by speculating in foreign exchange, and the government had incurred a loss of \$18.7 million (actually over \$40 million). The public were outraged because the punishment meted out was minor in view of the financial consequences to the nation, whose per capita income was \$270. They could not believe that the officers were as naive as they claimed, simply handing over millions of dollars to the broker, an American citizen of Chinese origin, and that they did not even ask for a contract, supposedly never taking a penny for themselves.⁸³ Such transactions, though involving large sums, had been conducted secretly and were exposed only after the public funds became uncollectable. Communist speculators from China have thus enjoyed a luxury which may be the envy of their capitalist counterparts: they are guaranteed a big share of the profits while the state is guaranteed all the costs and risks.⁸⁴

⁸⁰ *Banking Communications*, no. 26 (1995), pp. 3–5.

⁸¹ *ERR*, no. 190 (1994), pp. 16 and 36.

⁸² Interviews in Hong Kong.

⁸³ There are many similar incidences: Fujian's Huafu, involving HK\$159 million; Jianxi's IIC, ¥2 billion plus \$931,000; and Guangdong's Huacai, HK\$140 million (fieldwork).

⁸⁴ The vice-president of Yifeng (Hongkong) Company of Hubei province mobilized huge amounts of capital in currency speculation and then vanished, at the same time as \$14 million of government funds disappeared (fieldwork). The Guangzhou municipality owned Yuexiu Company in Hong Kong and its chief executive was busy in the stock market. When he made profits he pulled

In this and similar occurrences, a 'foreign citizen' identity, real or not, is all too often a smoke-screen for the agent's illicit switching of national wealth out of China. Many of these foreign passport-holders are related to the Chinese Communist elite; they act on behalf of the family and perform functions that are otherwise too inconvenient to carry on.⁸⁵

An even more volatile marketplace for PRC personnel on overseas duty is gambling, for which Macau casinos are convenient. Casino managers there have observed that recently about one third of their customers were from China, and that these often surprised those from the capitalist world by placing relatively large bets. There are good reasons to suspect that many of these big players played with public funds, for between 1988 and 1993 the Macau casino and tourism industry's revenue increased on average by 40 per cent a year, while regulations on PRC-Macau tourism were streamlined. This rate declined to 20 per cent in 1994 as the Chinese government from mid-1993 tightened budgetary control and restricted overseas travel on government money.⁸⁶ Numerous documented cases suggest that the Chinese state is often the ultimate loser when its employees carry public funds into gambling dens, for it can claim nothing when they lose and never shares the gains when they win. (In this trade Macau lenders normally set the interest rate at 1 per cent per day to cover the financial risk.) Thirteen officials and managers, unrelated to each other, in documented cases occurring between 1987 and 1994 lost over \$10 million of public funds to casinos.⁸⁷

(*F'note continued*)

for himself, and when he made losses he pushed to Yuexiu, forfeiting HK\$15 million as a result (fieldwork).

⁸⁵ During the late 1980s a young Chinese named Zhang Shaohuang showed up in Hong Kong, declaring himself a wealthy South American business man. He floated his private company with only HK\$2 but speculated daringly in the property market – his HK\$200 million working capital was taken from a Liaoning province's Hong Kong firm. He could do this by virtue of his connections with a Beijing foundation headed by the late Marshall Zhu De's widow and a deputy director of the Party Central Committee's general staff. After Hong Kong unexpectedly lost sight of Zhang, it became known that he was actually a relative of Wang Guangying, vice-chairman of the National Political Consultative Conference, China's Upper House (Xu, *Memoirs of Hong Kong*, pp. 260–1). This pattern is frequently observed on subnational levels too: the party boss of Guizhou province Liu Zhengwei and his wife Yan Jianhong, the finance boss, first sent two sons to the United States, and then arranged for them to return to China as 'American business men' to make money. Together they siphoned out 2.75 million yuan and \$214,000 from this poorest Chinese province (fieldwork). Ouyang De, party chief of Dongguan city, Guangdong, organized the dispatch of his eight children to Hong Kong through the back door. His eldest son quickly returned to Dongguan as a 'Hong Kong investor' but took \$6 million from a state bank as investment capital and eventually transformed all this into his personal shares (fieldwork).

⁸⁶ *Yazhou Zhoukan*, 23 July 1995, p. 63.

⁸⁷ A controversial figure in this connection is Larry Yung, son of former Chinese vice-president Rong Yiren and head of Citic Pacific, the Hong Kong flagship of CITIC. The Hong Kong press often carries articles about how he routinely stakes hundreds of thousands of Hong Kong dollars on a horse race or a million on a golf competition. Furthermore, he purchased a 335 hectare English estate, the old home of the former British Prime Minister Harold Macmillan, and possesses the most expensive

How much by way of public assets have been informally privatized through overseas PRC businesses? To measure the amount is at least as hard as measuring a country's underground economy.⁸⁸ But the individual cases presented so far suggest that the size cannot be insignificant, particularly when viewed against the average Chinese income per head. Several statistics, despite their patchiness, indirectly indicate the extent to which public assets have been siphoned off by those controlling China's offshore operations. NASA reports that by late 1992, as much as 830 million yuan (\$120 million) of state funds had been embezzled within the offshore subsidiaries run by thirteen large state firms from Guangdong, Fijian, Shaanxi and elsewhere.⁸⁹ According to an internal report from Beijing, government and company staff in nearly a hundred cases documented up to the mid-1990s had taken \$12 million to gamble in Macau.⁹⁰

Several figures can help us to guess PRC management's private gains from property speculation in Hong Kong: the aggregate PRC investment in the property market (HK\$13.2 billion by May 1993); the average rates of return (about 20 per cent for the residential sector in 1992–93 and over 30 per cent for office building in 1993–94); and the customary ratio for illicit managerial sharing of the gains (20 per cent).⁹¹ This would yield around \$85 million a year to PRC officials in the early 1990s.

The data of the PRC Administration of Exchange Control show that prior to 1987 more than 90 per cent of the export earnings were handed back to China, and this percentage has declined since, to 75.5 per cent in 1992 and 63 per cent the next year. Between 1987 to 1993 the export earnings that were not sent back to China accumulated to 60 billion yuan and the sum for 1991 to July 1995 was \$98 billion.⁹² Business analysts in Hong Kong calculate that over 1990–92 as

(Footnote continued)

mansion (worth C\$10 million) in the Point Grey area of Vancouver, plus luxury sedans and boats. Such reports were sometimes sent to Beijing, and Yung was suspected of using public funds for these expenditures. But up to the present time he seems to be well protected by his family background, albeit there is much controversy about him within Chinese officialdom (see Xu, *Memoirs of Hong Kong*, pp. 56 and 262; *Yizhoukan*, 10 December 1993, pp. 68–78; *South China Morning Post (SCMP)*, 5 July 1993, p. 15).

⁸⁸ What students of underground economies have said of their inquiry can basically be applied here: 'Any attempt to measure a social phenomenon whose *raison d'être* is to defy observation is fraught with complex conceptual and empirical difficulties. All estimates of the size and growth of the unobserved sector are likely to contain substantial errors ... Given the difficulties inherent in any effort to quantify the unobserved sector, the various approaches to measurement are best viewed as complementary, yielding insights into different aspects of the issue' (Edgar Feige, ed., *The Underground Economies* (New York: Cambridge University Press, 1989), pp. 26 and 28).

⁸⁹ *ERR*, no. 117 (1995), p. 63.

⁹⁰ *Yazhou Zhoukan*, 23 July 1995, p. 63.

⁹¹ Lin and Jian, 'PRC Companies and the Hong Kong Economy', p. 170; *Hong Kong Property Review 1994* (Hong Kong: Government Printer, 1994), Table 15; *Open Magazine*, July 1994, p. 64.

⁹² *Briefs of State Assets Management*, no. 3 (1995), p. 29; and *Workers' Daily*, 23 October 1996, p. 8. These seem underestimates; an *Associated Press* report of 16 December 1991 put the cumulative figure by that time as \$14 billion (85 billion yuan).

much as \$30–40 billion was shifted out of China, making it ‘the source of the most dramatic capital flight at least since that from Latin America circa 1980, and perhaps since the 1930s’.⁹³ This observation seems to be backed by Chinese finance staff research, according to which, capital outflow from China in 1982–94 reached \$245 billion and 20–50 per cent of this may have been capital flight.⁹⁴ These large sums are the main resources that PRC officials and managers have to play with and spend on outside markets. It would be an enormous amount if even a fraction of these publicly-owned funds, plus the income they generated, fell into private hands.

DISCUSSION AND IMPLICATIONS

That private takeovers of public assets have been so vigorously and successfully carried out in offshore PRC businesses raises interesting questions. We see, first of all, that a basic impulse for numerous PRC institutions to go international is not for the better application of existing ‘ownership-specific assets’ as the received theories would predict, but for the *illicit creation of private ownership*. Creation implies destruction; the first step in creating the new is to make the existing one less clear and hence less enforceable. As state ownership becomes less clear, the business abroad is more subject to private control. Thus, in the Chinese style of market transition, *muddling property relations is a necessary condition for clarifying them later*.

As this sort of ownership transformation is illicit, the transaction cost is high, but the decision maker-manager knows that it is borne by the owner-state rather than by himself. This goes a long way to explaining many Chinese puzzles; why is the search for efficiency, the key to conventional foreign investments from other market systems, hardly observable in the PRC case? The answer is that though many PRC firms have been situated in territories where most of the production factors cost much more than in China,⁹⁵ in the light of seeking outlets for ownership transformation, ‘abnormal’ acts become rational choices.

Here we confront the classic principal–agent problem, which has been evident in state-socialist economies⁹⁶ but gets exacerbated when their firms go international. Once beyond Chinese territory most of the coercive means of control – the last resort for the Chinese state in coping with domestic economic wrongdoings – are no longer employable. Thus, for example, public funds freely get used as private capital, and managers take over public investments registered under their private title.

⁹³ SCMP, 5 July 1993, p. 15; cf. The World Bank, *China: Macroeconomic Stability in a Decentralized Economy* (Washington, DC: World Bank, 1994), p. 14.

⁹⁴ *Journal of Reform*, no 5 (1996), pp. 91–3. Cf. Nicholas Lardy, ‘The Role of Foreign Trade and Investment in China’s Economic Transformation’, *China Quarterly*, 144 (1995), 1065–73.

⁹⁵ Zhan, ‘Transnationalisation and Outward Investment’, p. 88.

⁹⁶ See Frederic Pryor, *Property and Industrial Organization in Communist and Capitalist Nations* (Bloomington: Indiana University Press, 1973); Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton, NJ: Princeton University Press, 1992).

The Chinese government is not entirely blind to the peculiar risks its overseas property is exposed to, and one of the key preventive measures is to ban staff from bringing their families with them when working abroad, save the few whose cadre ranks are equal to or above the head of *si* (one step below ministers and provincial governors).⁹⁷ Taking families hostage in this way works in some circumstances, as the illicit transfer of public assets is incomplete until the beneficiaries are in a safe place. For example, Zhou Beifang, chairman of Shougang's joint venture in Hong Kong, was caught by PRC investigators mainly because he was found to have paid HK\$1.2 million to Beijing police officers to let his wife and daughter migrate to Hong Kong, which eventually led to his conviction for embezzlement of HK\$10 million.

But this family-as-bond measure does not always help the Chinese government protect its overseas property as wished; often it leads to the opposite. Long-term separation from their wives makes expatriate PRC staff particularly vulnerable to prostitution, a service that few can afford to buy with their legal income and for which many have used public funds. Once a manager's hiring of prostitutes is known to colleagues, it can be used as blackmail to trap him into collusion to embezzle larger sums of public funds.

Thus, there is a host of peculiar control problems once state-owned firms cross the state's boundaries,⁹⁸ given the poor monitoring mechanisms at the socialist state-firm level. Considering this, it is questionable to apply the basic assumption of the received theories, the firm as the unit of analysis, to our subjects. The Chinese TNC is not a unity of shared interest between owner and manager which enables us to talk about *its* motive and behaviour, as in: 'It goes wherever profits take it ...' and so on; quite the contrary, too often the firm's profitability or even survival is sacrificed for the maximization of its manager's utility.⁹⁹

The magnitude of the agency problem in China's TNCs today cannot be compared to the old 'red TNCs', which were small in number and extremely restricted in their scope of activities. The new TNCs are too many, too widely distributed, and spun off from a domestic economic system that is itself in a chaotic state of governance caused by the shift from command to market co-ordination.¹⁰⁰

In so far as the tension between transnationalization and state ownership is concerned, China's TNCs bear discernible similarities to state-owned TNCs

⁹⁷ But most princelings seem to be above this rule. Besides, there are other avenues for expatriate PRC staff to ship families out of China, like arranging for children to attend foreign schools or organizing spouses to work for foreign companies.

⁹⁸ To the nation-state, the implications of internationalizing state-owned capital differs fundamentally from internationalizing private capital; cf. John Dunning, ed., *The Multinational Enterprise* (London: Allen & Unwin, 1971), pp. 265–88.

⁹⁹ See rich evidence in AWSJ, 22–3 July 1994, pp. 1 and 6.

¹⁰⁰ For more on the domestic problem, see *World Development Report 1996: From Plan to Market* (Washington, DC: World Bank, 1996); Masahiko Aoki and Hyung-Ki Kim, eds, *Corporate Governance in Transitional Economies* (Washington, DC: World Bank, 1995).

from capitalist nations: the management enjoys greater autonomy once the company goes transnational and government-set objectives get sabotaged from within the TNC. This means the TNC is progressing toward quasi-privatization.¹⁰¹

But the parallel cannot be drawn further. First, in capitalist systems state firms are in a minority and the larger institutional environment differs fundamentally from transitional socialist systems in respect to laws, property rights enforcement, product-market discipline on the state firm and job-market discipline on the manager, and checks and balances on government. All these help to keep managerial misconduct in capitalist state-owned TNCs at a reasonable level. Secondly, privatization of these TNCs is not legally prohibited by their home countries, where institutionalized market channels for change of ownership exist. Therefore, when these capitalist state-owned TNCs under market pressure progress toward quasi-privatization, the home government can make it into a legal transaction by selling shares, etc.¹⁰² This would make free takeovers of state assets much less likely to happen.

In China's TNCs, however, there has been a *paradoxical combination* of the fragile enforcement of state ownership and a government ban on formal privatization. Thus, for the most part informal privatization in PRC multinationals is carried out piecemeal, in that the property-rights 'bundle', i.e. the right of utilization, the right to income and the right of alienation,¹⁰³ is skilfully taken apart and put into the service to those controlling the business. A main characteristic of informal privatization in the transitional Chinese economy, both the overseas and domestic sections, is the *nomenklatura's* greater reliance on the dubious exercise of the first two rights relative to the third one.¹⁰⁴

This empirical study suggests a political-economic ecology of postcommunist capitalism in China: the most successful capitalists most often spring from the *nomenklatura*, who have been in control of key nationalized resources under state socialism. The transition from command to market economies offers *some segments* of them particularly favourable opportunities to make a fortune quickly and easily by pocketing state assets. Those who run China's TNCs are clearly among these segments, and they predominantly come from key units of the economic and political bureaucracies and resourceful state firms or from the ruling-elite families, providing many of them with political protection.

The Chinese informal privatization phenomenon has its parallel in other postcommunist societies under marketization, widely known as 'spontaneous privatization' and '*nomenklatura* privatization', in which members of the ex-communist managerial and political establishment smoothly turn themselves

¹⁰¹ Anastassopoulos *et al.*, *State-Owned Multinationals*, pp. 176–82.

¹⁰² Anastassopoulos *et al.*, *State-Owned Multinationals*, pp. 171–80.

¹⁰³ For this complex definition, see Eirik Furubotn and Svetozar Pejovich, 'Property Rights and Economic Theory', *Journal of Economic Literature*, 10 (1972), 1137–62; Louis De Alessi, 'Property Rights, Transaction Costs, and X-Efficiency', *American Economic Review*, 1 (1983), 64–81; Williamson, *The Economic Institutions of Capitalism*, pp. 26–9.

¹⁰⁴ Our observation of the domestic sector will be reported separately.

into a business elite in the new-born capitalism.¹⁰⁵ This trend contradicts an earlier hypothesis that the introduction of market mechanisms into socialist systems increases the direct producers' gains and reduces proportionately the cadres' power and privileges, in the belief that the market rather than the state redistributive system increasingly determines rewards.¹⁰⁶ This proposition does not account for the rise of *nomenklatura* capitalism because it overlooks numerous possibilities for redistributive power to capture market opportunities, an essential feature of real life in transitional societies though contradictory to pure logical reasoning. The state cadre will be *better off* as marketization progresses if he controls resources that are indispensable in the new arenas of the market.¹⁰⁷ The scarcer the resource, the less egalitarian is the outcome the market transition will produce. Overseas PRC businesses are the most internationalized, market-oriented section of the Chinese economy, yet those succeeding in the formation of private capital are almost exclusively state cadres and their children, because two key resources for entering this section, the permission to work abroad and the investment capital, are monopolized by the state.

What might the consequences of this informal privatization be? Given continuity in the Chinese political structure, given the growing economic autonomy enjoyed by local public authorities and state firms, given the fragile control over the TNCs and deficient monitoring system, plus Hong Kong's return to Chinese rule, making it an even more convenient outlet for public assets to be illegally shipped out of China, internationalization will continue to be an effective channel for advantageously-placed cadres to convert publicly-owned productive and financial assets into private property, and we can expect to see the rise of large numbers of exceptionally successful capitalists from that sector.

Under the increasing pressure of informal privatization, the central government may have to make two efforts: one is to restrict transnationalization and improve the governance of TNCs, an effort in fact periodically attempted

¹⁰⁵ Publications mentioning this are countless, concrete accounts can be found in Elmer Hankiss, *East European Alternatives* (Oxford: Clarendon Press, 1990); Jadwiga Staniszkis, *The Dynamics of the Breakthrough in East Europe* (Berkeley and Los Angeles: University of California Press, 1991); Simon Johnson and Heidi Kroll, 'Managerial Strategies for Spontaneous Privatization', *Soviet Economy*, 4 (1991), 281–316; Roman Frydman and Andrzej Rapaczynski, 'Insiders and the State', *Economics of Transition*, 1 (1993), 39–59; Akos Rona-Tas, 'The First Shall Be Last?' *American Journal of Sociology*, 100 (1994), 40–69; Egor Gaidar, 'How the Nomenklatura "Privatised" Its Own Power', *Russian Politics and Law* (January–February 1996), 26–37; Svetlana Glinkina, 'The Shadow Economy in Contemporary Russia', *Russian Politics and Law* (March–April 1996), 46–70; and Leonid Khotin, 'Old and New Entrepreneurs in Today's Russia', *Problems of Post-Communism* (January–February 1996), 49–57.

¹⁰⁶ Victor Nee, 'A Theory of Market Transition', *American Sociological Review*, 54 (1989), 663–81; and 'Social Inequalities in Reforming State Socialism', *American Sociological Review*, 56 (1991), 267–82.

¹⁰⁷ See Ivan Szelenyi and Erie Kostello, 'The Market Transition Debate', *American Journal of Sociology*, 101 (1996), 1082–96.

since 1993.¹⁰⁸ with little success for all the reasons mentioned above; the other is to permit *ad hoc* management buyouts at discount prices when the TNC is so autonomous and the management is so powerful politically that the government sees little hope of resuming effective control; namely, *prerogative privatization*. This scenario is demonstrated forcefully by a recent event, the \$1.4 billion purchase of Citic Pacific's shares by its senior managers from the parent CITIC. The unusual 24 per cent markdown of the shares means that 'the Chinese state ... handed Larry Yung and his associates a paper profit of around HK\$3.5 billion'.¹⁰⁹ There are no grounds for viewing this as an anomalous case; top managers of many large Chinese TNCs share essential features with Yung: family background, connections, managerial autonomy, crossborder mobility, etc. It is hard to think that other powerful cadres controlling China's TNCs will not push for similarly sweet deals from the government. From informal privatization to prerogative privatization, the overseas section of the Chinese state economy is highly likely to be a fertile field for the emergence of the postsocialist grand bourgeoisie.

¹⁰⁸ These moves were reported in *SAM*, no. 2 (1994), pp. 50–2.

¹⁰⁹ *FEER*, 9 January 1997, p. 92.