

# The Rise of the State-Connected Private Sector in China

Chong-En Bai, Chang-Tai Hsieh, Zheng Michael Song, and Xin Wang (2020). **The Rise of the State-Connected Private Owners in China**. National Bureau of Economic Research (NBER) working paper.

Many observers associate the economic transformation of China over the last few decades with the decline of the state sector and the rise of the private sector. The share of state-owned firms in China's industrial output, for example, fell from 50% to under 30%, leading many to conclude that China's growth was driven in large part by the expansion of the private sector. How distinct are the lines of ownership between the state and private sectors in China today?

**The data.** Researchers analyzed all 37,546,000 firm registration records from the State Administration for Market Regulation in 2013 and 2019. All of China's firms are legally obligated to register with this body and list their immediate owners. This allows researchers to "peel" through layers of ownership to determine the ownership networks of all private registered firms in the country, add up their registered capital, and map their equity ties to state-owned firms and entities.

**China's largest private owners have direct equity ties to the state.** Large "private owners" — i.e., private individuals or private business entities — often own many firms. East Hope Aluminum, for example, owns at least a 10% equity share of 236 companies. Researchers found that as of 2019, 78% of China's largest 1,000 private owners have equity ties with a branch of central or local government or a firm owned by central or local government — i.e., "state owners." Roughly 65% of these 1,000 private owners are "directly connected" to state owners, meaning both the state owner and private owner have at least a 10% equity stake in the same joint venture. The other 13% are "indirectly connected" to the state through a joint venture with a separate private owner that itself has equity ties with a state owner.

The analysis finds that as of 2019, there were more than 100,000 private owners in China that had direct equity ties with state owners. These 100,000 private owners collectively account for more than 15% of all registered capital in China. China's largest private owners also have significant equity stakes in smaller private owners, who themselves invest in other smaller private owners.

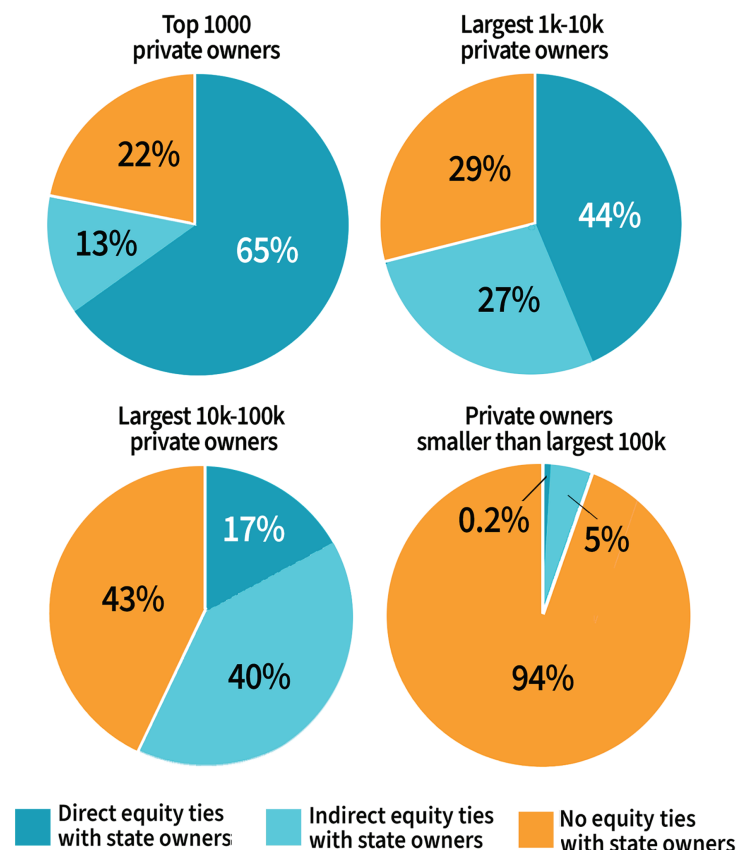
## INSIGHTS

■ Analysis of all 37.5 million registered firms in China reveals that 65% of the largest 1,000 private owners have direct equity ties with state owners. All told, over 100,000 private owners had equity ties to the state, comprising 15% of China's registered capital in 2019.

■ Large private owners also hold significant stakes in smaller firms that themselves invest in other private owners. This results in 3.5 million "indirectly state-connected" private owners, comprising an additional 18% of China's registered capital in 2019.

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Largest private owners by registered capital



■ The number of private owners with direct equity ties with the state almost tripled between 2000 and 2019, and those with indirect equity ties rose 50-fold. The analysis suggests that equity ties to the state may have aided, not constrained, the growth of China's private sector.

In 2019, a total of 3.5 million owners had such “indirect” ties to state owners. These smaller, indirectly state-connected private owners comprised an additional 18% of all registered capital in China. There is a high share of both directly and indirectly state-connected private owners in sectors where the state plays a dominant role, like mineral extraction.

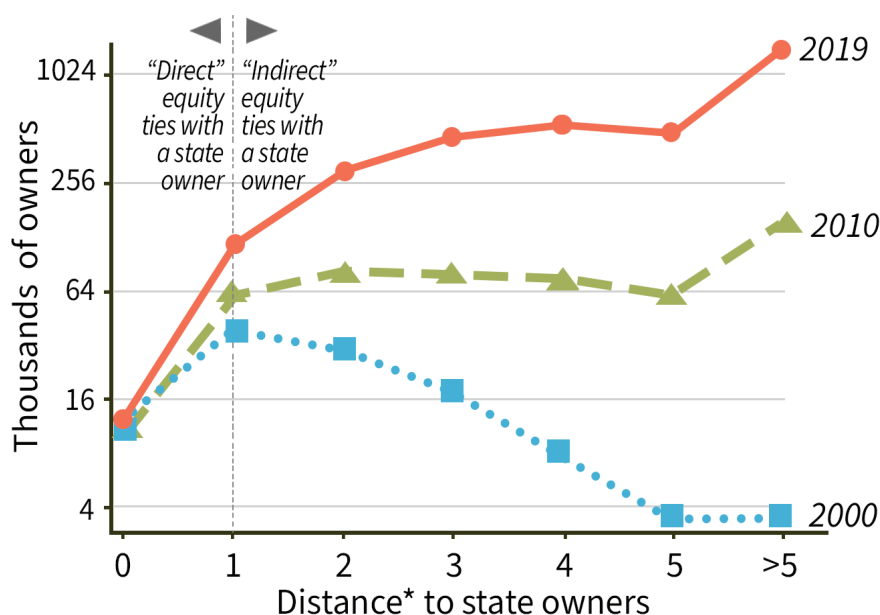
Nevertheless, researchers find that most state-connected private owners' businesses are still fully owned by the private owner. Of the 236 companies partially or wholly owned by East Hope, for example, 210 are wholly owned by the East Hope family and 26 are joint ventures. Fourteen of the joint ventures involve direct equity ties to state owners.

**Smaller private owners less connected to the state.** China's smaller private owners are more likely to be indirectly connected to the state or not connected at all. Specifically, about 40% of owners among China's top 10,000 to 100,000 largest private owners are indirectly connected to the state. Among owners smaller than the top 100,000 largest owners, the vast majority (94%) have no equity connection to the state.

**Proliferation of state-connected private owners.** The network of private owners with equity ties to the state has expanded significantly over the last 20 years. The number of private owners with direct equity ties to the state almost tripled between 2000 and 2019, and those with indirect equity ties rose 50-fold.

During China's period of rapid economic growth, the size of the state sector declined, and the private sector expanded: the share of private owners in total registered capital increased by 22 percentage points between 2000 and 2019. However, this analysis also finds that the share of connected private owners in total registered capital increased by 19.4 percentage points over the same period. In other words, almost all the increase in the share of private owners can be attributed to the expansion of the state-connected private sector. Most of this increase is due to the expansion of private owners who have indirect equity ties to the state versus private owners that have direct equity ties with state owners.

*Increase in the number of private owners with equity ties to state owners 2000-2019*



\* Distance = 0: State owners

Distance = 1: Private owners with direct equity ties to state owners

Distance > 1: Private owners with indirect equity ties to state owners

**Blurry lines between the state and private sector.** Taken together, these findings indicate that a large share of China's economy is neither completely state owned nor completely privately owned but rather in a gray zone of mixed ownership. In contrast to the widely held view that state ties encumber private enterprise, the proliferation of state connected private owners suggests that they benefit from their equity ties to the state. As such, the rise of state-connected private owners may be a significant driver of China's rapid growth.