An Assessment of the Mixed Ownership Form of Enterprise  
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1. Introduction
State owned enterprises occupy an important place in China's economy. This is not surprising given the aim of building a socialist economy. If China's economy is to continue as a socialist economy, the state owned enterprises must operate effectively.

One proposal to improve the performance of China's State owned enterprises is to convert them to mixed ownership enterprises. That is, private investors would be allowed to buy shares, so that the ownership would become partly state and partly private. To evaluate this proposal, I will consider following:
1) What are the main differences between privately owned enterprises and state owned enterprises and their respective roles in the economy?
2) How is combining private and state ownership in one enterprise likely to work, taking account of two examples from USA.
3) Concluding comments.

2. Privately Owned Enterprises and State Owned Enterprises
The aim of a privately owned enterprise is to gain maximum profit for the owners. Under certain conditions (competitive markets) and certain assumptions (no external costs or benefits, perfect information), Western economic theory claims that pursuit of maximum profit can bring certain good outcomes, such as minimization of costs, responsiveness to consumer wishes, and vigorous innovation. Western economic theory also claims that the income received by workers and owners in a privately owned enterprise will reflect the contribution of each to the production process.

However, the assumptions underlying the above claims about privately owned enterprises typically are not valid in the real economy. As a result, various negative outcomes can result from the pursuit of maximum profit. Profit maximization can result in rapidly rising inequality as enterprises drives down wages to below a living wage while the owners get income that is unrelated to their contribution to production. For example, in the USA the average pay of the CEO of a large corporation rose from 29 times that of average worker in 1978 to 352 times as much in 2007. It is not believable that in 2007 the average CEO was contributing so much more to production than in 1978. Pursuit of maximum profit can also lead to unsafe working conditions, unsafe products, environmental destruction, and waste of innovation effort on new products of negligible social value.

Consider the recently revealed example concerning the pursuit of a vaccine for the deadly disease ebola. In 2003 scientists at the University of Texas in the USA developed a vaccine against ebola that was 100% effective in monkeys. They tried to interest a pharmaceutical company in testing the vaccine in humans so that it could be put to use. However, none of the privately owned US pharmaceutical companies was interested, because they regarded an ebola vaccine as a low-profit product, since at that time ebola was only affecting people in poor countries in Africa. If that vaccine had gone through testing by a company starting in 2003, a fully tested vaccine would probably have been available for use today against the deadly outbreak of ebola. Now that ebola is threatening people in high-income countries due to international travel, the vaccine is being rushed
into use even though the usual testing has not been done to make sure it is safe and effective in humans.

One more problem of the pursuit of profit by privately owned companies should be mentioned. Many privately owned companies today, often under pressure from shareholders for quick profits to boost the share price, tend to seek short-run profit rather than long-run profit over a period of 5 to 10 years. If only short-run profit guides economic decisions, those sectors and products that are not yet profitable but could be efficiently produced in 5 or 10 years will not be pursued. This is a serious problem for a developing country that needs to "move up the economic ladder" to more advanced production.

One way to correct some of the problems of privately owned enterprise is state regulation of business, such as environmental regulation, job safety regulation, and consumer product safety regulation. Another approach is to adopt state policies to compensate for the problems, such as progressive taxation to reduce excessive inequality and state subsidies for research and development in important areas that may not have high profit potential. However, another way to avoid the potential problems of pursuit of only profit is through a large role in the economy for state owned enterprises.

Presumably a state owned enterprise has not just one aim but several. These aims include meeting the needs of consumers, employees, communities, and the general public in an efficient manner. While controlling costs and generating revenues that can cover costs is normally desirable, a state owned enterprise should not cut costs regardless of the consequences. A state owned enterprise should pay a living wage, provide safe working conditions, avoid environmental damage, produce a safe and effective product, and contribute to its local community. A state owned enterprise should not pay unreasonably high salaries to its managers while paying very low wages to its workers.

State owned enterprises can play an essential role in at least three types of sectors of the economy: 1) high technology, high skill sectors that are not yet profitable but will be important to economic development over time; 2) sectors that are of central importance to the economy or to national security such as transportation, communication, power, finance, energy, basic materials, and military equipment; 3) sectors that fulfill essential human needs such as provision of health care, housing, and education. In such sectors, the pursuit of maximum profit is not desirable.

The public invests in the state owned enterprises. When a state owned enterprise makes profits, the gains should go to the public. If it loses money, the losses must be born by the public. If a state owned enterprise has a loss, it should not necessarily go out of business. Some economic activities are unprofitable but essential.

If a product has big external benefits, sales revenues should not be expected to cover costs. For example, rail transportation, both inter-city and within-city, has large external benefits including reducing road traffic, reducing pollution, and reducing energy use. Those who ride the train should not have to pay the full cost of providing rail service since the benefit of someone riding a train extends to others as well. Thus, rail ticket prices should not cover the full cost but instead the service should be subsidized to some extent. The point is not that every state owned enterprise should be subsidized, but that when a state owned enterprise incurs losses, a judgment is needed about whether it deserves a subsidy. A loss does not necessarily indicate bad performance or that the enterprise should go out of business.
3. Combining Private and Public Ownership

It may appear that combining the two types of ownership in one enterprise could get the benefits of both. It might be claimed that allowing and encouraging private investment in state owned enterprises, creating a mixed ownership enterprise, would bring the claimed advantages of privately owned enterprise to currently state owned enterprises. That is, a mixed ownership enterprise might be more efficient, attuned to consumer wishes, innovative, and so forth.

However, the proper aims of privately owned enterprises and state owned enterprises are different. This can create problems if the two are combined in the same enterprise. What aims should the managers follow? The private owners will want a sole focus on profit. The state owner should want several aims to be pursued. How can this be reasonably resolved within a single enterprise? Will the enterprise pay the lowest possible wage or a living wage? Will the enterprise avoid damaging the environment, or save money by damaging it if it can do so? If a mixed ownership enterprise distributes profit to private owners while enjoying state support of some kind, this represents an unjustified subsidy of wealthy shareholders by taxpayers.

I will give two examples from the USA, one that worked well and one that did not.

**General Motors**

In 2008 General Motors, one of the largest corporations in the US and the largest automobile manufacturing company, was heading toward bankruptcy. It was being dragged down by the financial crisis of 2008, which hit the General Motors financial subsidiary. The US government under President George W. Bush extended more than $13 billion in loans to the company in December 2008. Then the US government under President Barack Obama acquired a 61% share of the stock of General Motors and pumped more federal loan funds into the company. Thus, General Motors became a mixed ownership enterprise. It came to be called "Government Motors" by some!

The rationale for this action was to save many well-paying jobs of workers at General Motors and to save the huge network of small business supplier companies and dealer companies associated with General Motors. Also, General Motors is reportedly the sole producer of some key components used by the other auto companies. If General Motors had disappeared, this would have been a big blow to the US auto industry, which is a key industry in the US economy.

What was the result of turning General Motors into a mixed ownership enterprise? The government imposed a successful restructuring on General Motors and financed the restructuring. From 2009-2013 General Motors got profits of $22.6 billion while paying back the loans from the government. By 2014 General Motors was among the 40 most profitable US companies. By end of 2013 the government had sold its shares in General Motors back to private investors. Thus, this was a successful mixed ownership enterprise for a period of 5 years.

**Fannie Mae**

Fannie Mae is the informal name for the Federal National Mortgage Association, which was created by US Government in 1938. It is a financial institution whose aim was to promote home ownership by buying home mortgages from banks and mortgage companies. In 1954 Fannie Mae became a mixed ownership enterprise, with private as well as federal government ownership. However, it retained its public mission of supporting the mortgage market. In 1968 it was fully privatized, but it still had a public mission from the government of promoting home ownership. It was now called a Government Sponsored Enterprise. There was implicit guarantee that the government would not allow its bonds to default, which allowed Fannie Mae to borrow at low
interest rates. In 1992 Fannie Mae's charter was amended to say it must facilitate financing of the building of affordable housing for low and moderate income households.

Thus, while Fannie Mae was technically a mixed ownership enterprise only from 1954 to 1968, even after 1968 it had a mixture of aims similar to the case of a mixed ownership enterprise. The private shareholders of Fannie Mae wanted maximum profit, while the government required Fannie Mae to pursue certain social aims and implicitly guaranteed its bonds. These conflicting pressures on Fannie Mae represented a problem that burst out in the 2000s.

In the 1990s and even more so in the 2000s, the US financial sector became increasingly involved in risky, speculative activities. US financial institutions created trillions of dollars in new financial securities such as subprime mortgage backed securities and other derivative securities. These new types of securities were very profitable for the financial institutions, but some observers realized that they were very risky. Until 2005 Fannie Mae, mindful of its public obligations, largely did not handle subprime mortgages or other risky housing market related securities despite the high profits that could be gained from them. Fannie Mae placed its obligations to the government, to support home ownership, ahead of making maximum profit from financial dealing.

However, in 2005 the big shareholders in Fannie Mae began to demand that Fannie Mae CEO Daniel Mudd start handling the new securities to get the big profits from doing so. Mudd resisted, wary of the dangers. A hedge fund manager with big stake in Fannie Mae said to CEO Mudd, "Are you stupid or blind? Your job is to make me money." Mudd gave in to the pressure from shareholders, ignoring his responsibility to the taxpayers who implicitly backed up Fannie Mae.

From 2005 through 2008 Fannie Mae purchased or guaranteed more than $270 billion in high-risk loans. When the financial crisis hit in 2008, these risky loans drove Fannie Mae into bankruptcy on Sept. 7, requiring a $187 billion bailout of Fannie Mae and its partner government sponsored enterprise Freddie Mac. The Fannie Mae bankruptcy contributed to the severity of the overall financial crisis, which intensified the gathering Great Recession. This crisis was very costly to the taxpayers and caused millions of workers to lose their jobs.

4. Conclusion

One can draw some conclusions about mixed ownership enterprises. First, the mixed ownership form of enterprise as a stable, long-term form of enterprise ownership has serious dangers. It can enable private shareholders to take advantage of state guarantees. This can result in risky activities aimed at profit for private shareholders but backed up by the state in case they go bad. It can result in replacing the several public aims of a state owned enterprise by the sole aim of pursuit of profit. Furthermore, private investors may in some cases be able to unjustly benefit from past public investments and from the special privileges of a state owned enterprise.

Second, mixed ownership enterprise may be desirable as a transitional form under certain circumstances. One such circumstance is to rescue an important privately owned enterprise. Another case can arise if it is determined that, in certain sectors where privately owned enterprise currently predominates, state owned enterprise should start to play a role. In such a case, state investment in privately owned enterprises in the sector, creating mixed ownership enterprises, may be a reasonable step toward introducing state owned enterprises in the sector.

Policy-makers should be wary of inappropriate reasons for promotion of mixed ownership enterprise. One inappropriate reason is a possible desire of private investors to reap the rewards flowing to successful state owned enterprises. The profits of profitable state owned enterprises...
should benefit the public, not private investors. Another inappropriate aim is a possible interest of some investors in entering a sector built up by public investment where profit could be higher if social aims were ignored and only profit maximization by any means were instead pursued. For example, profit might be increased in some sectors by driving down wages, laying off workers and increasing work intensity of those remaining, ignoring workplace safety, ignoring product safety, and/or damaging the environment.

It is important to reform China's state owned enterprises to improve their effectiveness. However, the promotion of mixed ownership by private investment in state owned enterprises should be approached cautiously and carefully so as avoid serious problems.