

A Discussion on the Unconventional Aspects of China's Property Exchanges (CPEs)

Heping Cao

Peking University School of Economics

Beginning in 1990s, an economic naissance, called property exchanges (PEs), has been thriving over 250 in China's capital market. Baffled by its nascent stage while, by expert's thought, promising potential for an OTC-type market, these exchanges, more than occasionally, trade a capital good yet to be identified as partially private and partially public, a mutated good variant missed in mainstream frameworks. While their related efficiency and distribution issues are waiting for exploration, CPEs are seemingly forging operations that do not fit into existing patterns and signify a path challenging current understandings over what a unanimous capital market should be. Reporting the current status of CPEs, comprehensively, challenges our further explorations. This discussion is set to introduce the unconventional aspects of CPEs.

The conventional thought is that regulation distorts market forces and brings larger magnitude of failures. As mentioned in "Government Failure vs. Market Failure" (Stiglitz), this faith is by and large congruous with badly designed regulations, especially, the cases in the early 20th century. Nonetheless, there is no proof of a general proposition beyond Arrow-Debreu narrow specification. With information asymmetry explorations, we now comprehend that such a perception is rooted in a dichotomy that the two types of failures, government failure and market one, should be rival "good" if considering social consumption over regulation. Our team has some observations show that the two types of failure are always co-existed, a correction over the theoretic dichotomy could be done if considering a market where a specifically blended good, partially private and partially public, in some way, could be traded.

Last December, Professor Brian Wright (Berkeley) and I observed a group of cases where equity (capital good) was sold in an unconventional way when five regional property exchange centers in China were surveyed. We noticed, for example, for selling a non-listed company with business potential, if trade was arranged in a conventional way, *i.e.*, by private equity operations in OTC market, the cost was very high (PE investment has flourished into a trend during the past quarter century though). In the fields such as intellectual Property (IP) transactions, PE firm's cost may reach a level of prohibiting competitive market to be materialized. Consequently, institutional arrangements for IP transactions tend to grant inventors monopoly power for cost reimbursement. Such a tendency generates an expansionary path for patent regime. That's what we have accumulated in real economy up today.

The trade in China's PE centers like this: (1) If an IP goes to a PE center for sale, after a serial of evaluations, the center may reach a conclusion that the invention has a market potential; (2) would register an company for this inventor and, if needed, reallocate his wife and kids to the place where the center is located; then, (3) put the IP evaluation on its internal board, aimed at not seeking bids for buying the IP, but asking venture capital to match the rest of the required fund for the establishment of the newly registered company and finally, (4) sell the inventor's share if he want retreat after a while of the venture business.

The unconventional way lies that the center does not sell a single IP product (or a patent), but the IP plus a bunch of public services: a good blended a private IP with public services. Such a trading ends up a market selling an ingrained type of product, partially private, partially public. This is quite different from the conventional equity financing and the listed board trading. Actually, this type of market exists in real economy everywhere. In China, Yaoming is worth a little. However, he is worth a lot in NBA club. For a 30 years old guy, he may not have a good chance in job market. However, he will if he is a laurel League's Ph. D. As a Peking Opera singer, in US, she may worthless while, in Beijing, somebody.

The traditional delineation of a public good, such as defense and street light, is not enough here. And the traditional definition of public good excluding trade is incorrect. Actually, only is it not tradable in the narrow specified competitive market. We need a new theory of good and market that can accommodate such cases. If theoretical framework follows Arrow-Debreu direction, even with information asymmetry enhancement, these type of good and market would be missed