

The State-Owned Enterprises of China: Reform Process

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Abstract: In 1978 China promulgated national policy, Reform and Opening. Chinese economy began transformation. Social market economy with Chinese characteristics was established replacing plan economy and had been improved continuously in 40 years. During the process of Reform and Opening, the State-Owned Enterprises as backbone of Chinese economy had also experienced a lot of changes. After the establishment of market, some SOEs was granted autonomy, and some SOEs experienced privatization or merger and acquisition. Now Chinese SOEs are divided into commercial SOEs and strategical SOEs. Their size is getting bigger and financial performance is improved continuously. However, SOEs are still facing many problems. The reform of SOEs still has a long way to go. Therefore, this article mainly describes the reform process of China's state-owned enterprises, the problems faced at each stage, and the current reform direction.

1. Introduction

From the Reform and Opening in 1978, the economy saw an unprecedented growth. The plan economy has been gradually replaced by the socialist market economy with Chinese characteristics. Under the initiatives of Chinese government for private enterprise, the more and more private corporations were established after implementation of Reform and Opening. In the meantime, the new corporate laws were issued continuously and financial system had been improved a lot. As the private enterprises emerged and matured, the State-Owned Enterprises (SOEs) as backbone of Chinese economy had also experienced a lot of changes during the process of Reform and Opening. One of the essential parts of reform is the reform of SOEs.

Unlike rapid transformation of other socialist countries, after consider social stability and feature of Chinese economy, Chinese leader decided to reform SOEs gradually. Therefore, the reform of SOEs proceed gradually and it started from 1978 and can be divided four phases. The criteria of division can be seen that is the proposal of important policy on National Congress of the CPC. Every phase has different main tasks and different issues occurring. The first phase is from 1978 to 1992, and it characterized with granted autonomy of SOEs and introduction of market mechanism. Many barriers of different industries were removed. Private enterprises and foreign joint venture were encouraged and emerging. The second phase starts in 1992 until 2003. The characteristic of this phase is “grasping the large and let the small go”. During this period, many important laws and policies had been issued and market system began to be improved. The reform of SOEs concentrated on ownership transformation. Many small SOEs were bankrupt and sold. The number of SOEs decreased dramatically. Only some large SOEs survived and state-controlled holding enterprise merged. The third phase is from 2003 to 2013. In 2013 a very important institution, State-owned Assets

Supervision and Administration Commission (SASAC), was established. The reform of this stage was characterized by expansion of size of SOEs. Under the supervision of SASAC toward SOEs, many SOEs began Merger and Acquisition. In the meantime, the strategical function of SOEs was put forward.

The new stage of SOEs begin from 2013, and it can be regarded as the forth phase of SOEs reform. The new stage of reform mainly concentrates on the remaining problems and strengthening mixed-ownership reform of SOEs. The main problem nowadays are “Zombie Company”, corruption, complex identification of SOEs.

2. The identification of SOEs in China

Before we discuss the SOEs, we should understand what SOEs is. Its definition is that SOEs are enterprises where governments have full, majority or minority ownership [1]. However, it is just a broad definition, SOEs in different countries have different function and play different role in society. Thus, I think than understanding the classification of SOEs and their practical function and role in Chinese society can help us better understand the SOEs in China.

In China, it is a difficult thing to identify if the enterprise is SOE. Because it may be fully controlled by state, or maybe it is merely partial controlled by state as a shareholder in this enterprise. Moreover, some large Chinese SOEs usually have their subsidiaries. The relationship between state and these subsidiaries further obscure classification of SOEs. This subsection will predominantly introduce the identification in accordance with the criteria of State-owned Assets Supervision and Administration Commission (SASAC) in June 2016.

SASAC divides SOEs into four categories:

Enterprises that are wholly funded by individual government units, e.g. SASAC, and those that are 100% owned by these units, directly or indirectly;

(1) Enterprises jointly owned by two or more governmental units with a total share of more than 50%, and where one of these units is the largest shareholder;

(2) Subsidiary enterprises funded by the above two types of enterprises and in which they hold more than 50% of shares;

(3) Enterprises in which the state is largest shareholder, and though it owns less than 50% of shares actually controls the enterprise through explicit agreement or other arrangements [2].

SASAC’s classification predominantly refers to degree of state’ control. In China SOEs are intervened by state through appointment of main manager or executive from government. Sometime government can issue particular regulation or laws for SOEs. These measures all can help state to intervene and control SOEs. For instance, if a SOE is related to strategical industries which are lifeline of Chinese economy. Government will promulgate some law to make a barrier obstruct the entering of private enterprises. In addition, there is a position, communist organization secretaries, which usually can be appointed to SOEs. Maybe state is not the biggest shareholder, but organization secretaries can monitor the operation of enterprises. Therefore, these SOEs can also be under monitor.

As discussed above, the criteria of SASAC’s classification is just one kinds of different standards. For example, Organization for Economic Cooperation and Development (OECD) have their standard to identify if a SOE is under control of state. Their standard is that if state direct ownership of SOE is over 50%. This indicates the state will be the largest shareholder if state has more than 50% share. Then, state will have dominant voting right on the board of director, and state can manage and control this enterprise. I think this standard of classification will be more convenient to statistic enterprises. It is similar that the NBS (the National Bureau of Statistics of the People’s Republic) definition is convenient for statistical purposes.

Meanwhile the SOEs can also be classified in accordance with the standard of region, the central

SOEs and local SOEs. Central SOEs are also called Yangqi and most of central SOEs are distributed in strategic industries, for example petroleum, defense, telecommunication and so on. Compared with central SOEs, local SOEs tend to be much smaller and less strategically important. As local SOEs are more commercially oriented, they act more like private enterprises and are spread over a variety of different industries [2].

We mention the strategic and commercial orientation above. This is classification according to function of SOEs during the latest phase of SOEs' reform. Actually, there is another classification where state-holding enterprises is divided into state-owned enterprises which are absolutely controlled by state, state-controlled holding enterprises which are partial controlled by state.

3. The reform process of the SOEs in China

The year, 1978, can be regarded as the most important year for China. It is a turning point of growth of China's economy. In the 3rd Plenary Session of the 11th Central Committee of the Communist organization of China, 1978, the policy, Reform and Opening, was proposed by Deng Xiaoping, the leader of China. Many new economic systems and entities began to be implemented, such as Household Responsibility System, Township and Village Enterprises and Special Economic Zone. The mechanism of market was introduced gradually. In summary, the primary goal of Reform and Opening is establishing the socialist market-oriented economy with Chinese characteristics replacing the central plan economy.

One of the essential parts of reform is the reform of State-Owned Enterprises (SOEs). The previous situation of SOEs is that the input, output and price are all under the control of government. However, after the introduction of mechanism of market and the allowance of privatization, China's SOEs were gradually privatized and entering market competing with private enterprises. In the meantime, the related laws were issued and organizational institutions were established. There are two main contributions of these measures: firstly, after the shrinking of SOEs, there would be more room for emerging private enterprises, which is a encourage for private sectors; secondly, Chinese government aimed to increase efficiency and competitiveness of SOEs in market and remain a substantial share in economy. Nowadays China's State-Owned Enterprises not only have their specific duties in the key industries to achieve their political goal but also pursue the commercial targets, and the new generation of SOEs has various ownership types and a significant level of internationalization.

Unlike rapid transformation of other socialist countries, after consider social stability and feature of Chinese economy, Chinese leader decided to reform SOEs gradually. Therefore, the reform of SOEs proceed gradually and it started from 1978 and can be divided four phases. The criteria of division can be seen that is the proposal of important policy on National Congress of the CPC. Every phase has different main tasks and different issues occurring.

3.1 First phase 1978-1992: the autonomy of SOEs and emergence of private enterprises

The first phase is from 1978 to 1992, and it characterized with granted autonomy of SOEs and introduction of market mechanism. During the period of planning economy system, the government played a crucial role in planning, coordination and resource allocation, while SOEs had little autonomy in determining what and how much to produce, adjusting the workforce or deciding on the use of surpluses or profits [3]. The primary goal of SOEs is fulfilling the quota that government commanded. Therefore, there was not incentives for enterprises to produce more goods. Facing these problems, government decided to reform SOEs.

This is the beginning stage of Reform and Opening, and many policies are attempt for China. On the aspect of reform of SOEs, there are two main measures: the first is giving autonomy to SOEs and introducing market mechanism among SOEs; the second is that the government would remove the

entry barriers and encourage the emergence and development of private enterprises, which was also needed for the market mechanism of SOEs.

However, after implement of these measures, the problems also raised. SOEs have a certain level of increasing of number of SOEs and its output growth. However, there was still a significant lag of increasing between state and nonstate enterprises. In the meantime, because of the instance competition in market, the burden of social duty of safety and the monitor problem, the financial performance deteriorated dramatically. These problems would need to be addressed in the subsequent phases of reform.

3.2 The second phase 1992-2003: grasping the large, letting small go

Through the first stage of reform of SOEs, it encouraged both state and nonstate enterprises develop, and diversified ownership type of enterprises appeared in market. The mounting loss of SOEs after mid-1980s drive further reforms. The second phase of reform began after Deng Xiaoping's south tour in China in 1992 and it characterizes with ownership transformation of SOEs which also was an essential policy proposed on the fourteenth National Congress of the CPC.

The second phase starts in 1992 until 2003. The characteristic of this phase is "grasping the large and let the small go". During this period, many important laws and policies had been issued and market system began to be improved. The reform of SOEs concentrated on ownership transformation. Many small SOEs were bankrupt and sold. The number of SOEs decreased dramatically. Only some large SOEs survived and state-controlled holding enterprise merged.

The financial performance of SOEs was successful to be improved, but it still had a lag with private enterprises. Moreover, we can find that there was still a high percentage of lossmaking of SOEs, 39% to 35% between 1999 to 2003. Therefore, the problem of bad debt of SOEs need to be addressed. It was also the main source of banks' nonperforming loans (NPLs). Because at that time Chinese bank system was dominated by stated-owned banks, they provided subsidies for SOEs which was the main source of SOEs' losses.

3.3 The third phase 2003-2013: the expansion of SOEs

During the second phase of SOE's reform, the financial performance of state enterprises indeed could be seen a growth in terms of ROA. The number of SOEs decreased by bankrupt, open sale and same other way. The privatization of SOEs had a little achievement, but SOEs still faced many challenges. During the third phase the Chinese government would have new target for SOEs which are enlarging the size of SOEs by consolidation of public economy and control of key industries. The main characteristic of beginning of the third stage of reform was establishment of the State-owned Assets Supervision and Administration Commission (SASAC) in March 2003. SASAC is under the state council (central government). It will directly supervise central SOEs and indirectly supervise local SOEs. The establishment of SASAC would have a significant impact for the further reform of SOEs. SASAC's focus was on the preservation and increase of the state-owned assets of SOEs, while continuing ownership reform to consolidate SOEs [4].

The first objective of reform was the control of strategical industries. In May 2006, state council release the detail list of strategical industries and it below shows in table 1:

Category description	Industries included	Ownership goal	Approximate number of companies
<i>Strategic and key industries</i>	Defence, power generation and distribution, oil & petrochem, telecom, coal, civil aviation, shipping.	Maintaining 100% state ownership or absolute control; increasing state-owned assets in these industries.	40
<i>Basic and pillar industries</i>	Machinery, auto, IT, construction, steel, base metals, chemicals, land surveying, R&D.	Absolute or conditional relative controlling stake; enhancing the influence of state ownership even as the ownership share is reduced where appropriate.	70
<i>Other industries</i>	Trading, investment, medicine, construction materials, agriculture, geological exploration.	Maintaining necessary influence by controlling stakes in key companies; in non-key companies state ownership will be clearly reduced.	50

Source: [5]

Table 1 The Chinese government's new policy goals on state ownership in key industries

The government had a variety of measures to maintain the control of strategical and pillar industries including using technical barriers and financial measures. The bank system of China is dominated by state-owned banks. Therefore, government can give some preferential access for strategical SOEs to gain loans from banks. In terms of land, because the resource of land is public-owned, government also can offer strategical SOEs the preferential access to lease better lands.

The second objective was the expansion of SOEs. Government used two main ways to support SOEs' expansion, public listing on domestic and international stock exchanges and Merger and Acquisition (M&A). What we should pay attention to is the M&A, which contain the domestic and international M&A. In line with the policy "go global" put forward by Chinese government in early 2000s, the target of international M&A is not only enhancing competitiveness and influence but also gaining critical raw material and energy. This measure, domestic and international M&A, is very useful for expanding the size of SOEs which contributed to an important future policy, One Belt One Road. As the result of M&A, in 2014, some 98 SOEs were on the Fortune Global 500 list, with their sales concentrated in energy, finance, telecommunication, engineering and construction and motor vehicle and parts industries.[6]

3.4 The problem and measures of SOEs nowadays

In the light of objectives of the last stage of reform, SOEs succeeded to expand their size and the financial performances, ROA and ROE, were also improved. However, the problem remaining are also server. The supervision problem was emerging slowly along with increasingly large SOEs. Moreover, more and more Zombie Companies appeared in SOEs because of massive investment and soft constraint budget from local government and bank. "Zombie Company" was the main problem in the new stage of SOEs.

In the meantime, the problem of SOEs' corruption is also serious. Some decision and measures were issued in Third Plenary Session of the 18th Central Committee of the CCP in 2013. The decision, strengthening mixed-ownership reform, not only is very useful to avoid corruption but also marked the new wave of SOE reforms. In the same session, another important decision is redefining the function of SOEs. SOEs were divided into two categories, commercial SOEs and strategical SOEs,

in accordance with different function. Moreover, according to these two kinds of SOEs, there is a dual-track assessment system. This division is used to address complex identification of SOEs. In 2013 China's international strategy, "One Belt One Road", was put forward by China's leader Xi and in 2015 it was officially issued. Currently more Chinese Enterprises began to enter international market, of course, SOEs are main force in this international course.

4. Conclusion

Over the past 40 years of Reform and Opening, Chinese economic system experienced dramatic change. Social market economy with Chinese characteristic is improved continuously. Chinese economy has a compelling growth, and undoubtedly China's SOEs are indispensable contributors.

During the four phases of reform, SOEs can be observed a significant transformation. In the first phase, market mechanism was firstly introduced. Because SOEs was no familiar it and market mechanism was also not perfect, SOEs didn't have good performance when they competed with emerging and active private enterprises. However, corporate law and competition law were promulgated in the second phase of reform, and governments implemented trade policy and fiscal policy. The market economy was improved continuously, and under the policy, "grasping the big letting small go", the number of SOEs declined sharply. On the contrary, the financial performance of SOEs increased significantly. Then, in the third phase of reform, SASAC was established and SOEs began to be supervised by SASAC. The strategical function was mentioned, but the accurate definition was not put forward. In the same time, a large scale of domestic and international M&A happened in SOEs for the target of expansion. The larger size of SOEs is beneficial for the competition in domestic and international market and for the dominance in the strategical industries. However, the expansion concurrently incurred supervision problem and contributed to "Zombie Company" problem. In the meantime, China was trying to address these problems by Supply-side reform and so on.

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