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Is Big Beautiful?—Restructuring China's State Sector under the *Zhuada* Policy*

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In 1995 the Chinese government further elaborated its strategy for reforming the state sector. Termed "zhuada, fangxiao" *(to take command of big enterprises and to let go small ones), this policy seeks to split the state sector into two camps: enterprises that are relatively small and over which the state is willing to give up control (*fangxiao*); and large enterprises that are the object of the government's efforts to restructure the state sector (*zhuada*).*

Since it is the policy of zhuada *that will decide in large measure the fate of China's state sector, this article analyzes* zhuada's *implementation strategy in China's largest industrial city—Shanghai. The article elabo-*

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rates that zhuada's *implementation strategy is based on two separate aspects: first, the establishment of large state-owned conglomerates to attain economies of scale and better resource allocations; and second, the reform of the state's ownership institutions. These reforms, especially the latter, involve the establishment of a new structure for the management of state assets. However, as the article argues, the restructuring of China's state asset management system is heavily circumscribed by the institutional origins of the ownership structures in China's state sector. Moreover,* zhuada's *emphasis on establishing large state-owned conglomerates runs the danger of creating unwieldy and monopolistic conglomerates that are dependent on the state for various subsidies and policy benefits.*

Keywords: state-owned enterprise reform; property rights institutions; conglomerates; corporate governance; state-owned asset administration

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At the Fifth Plenum of the Chinese Communist Party's (CCP's) Fourteenth Central Committee in September 1995, the CCP leadership officially proclaimed a new policy initiative to deal with the seemingly intractable problems of China's state-owned enterprises (SOEs).[1] Abbreviated as "*zhuada, fangxiao*" (to take command of big enterprises and to let go small ones), this policy expresses both a recognition of the severity of the SOE sector's problems and a last-ditch effort to save it from passing into oblivion.[2] *Fangxiao* represents the reluctant admission by the leadership that there is no way to rejuvenate all SOEs in the Chinese economy. Small and medium-sized SOEs, especially those controlled below the provincial level, can thus be "let go," meaning: sold or leased to their workers, management, or private investors; closed; merged; or even bankrupted. Conversely, the slogan of *zhuada* captures the ongoing efforts of the Chinese

[1]For the full text of the Fifth Plenum communiqué see *Renmin ribao* (People's Daily), September 29, 1995, 1; for English excerpts, see *China Daily*, October 6, 1995, 1.

[2]The state sector is, indeed, in dire straits. One senior economist with China's State Statistical Bureau described "the state sector as being in a parlous state" and noted that almost half of the workers in state firms survived on low pay or had been laid off. See *South China Morning Post*, May 31, 1997, B3. Moreover, an increasing share of the firms in the state sector are losing money. In 1996 about 50 percent of SOEs were incurring net losses. See the World Bank, *China's Management of Enterprise Assets: The State as Shareholder* (Washington, D.C.: World Bank, 1997), 1.

government to select a number of large SOEs and concentrate efforts at restructuring management patterns.

The rationale behind "*zhuada, fangxiao*" is simple. According to data analyzed by the World Bank, it is mainly small and medium-sized SOEs that are bleeding red ink. Most of these enterprises are below optimal scale and are responsible for the duplication of industrial activities among provinces and counties.[3] Larger SOEs, on the other hand, are mostly profitable.[4] They were even able to generate a return of 10 percent on assets in 1995.[5] In addition, the 15,668 large and medium-sized SOEs account for about 80 percent of all SOE industrial output.[6] Hence, if the burden of small SOEs could be "released" and efforts regarding the restructuring of the state sector concentrated on the largest and most profitable SOEs, state sector reforms should be able to succeed.[7]

The success of *zhuada* will depend, however, on the degree to which the policy can establish modern corporate governance institutions for China's largest SOEs.[8] As Chinese policymakers and academics have repeatedly argued, the key to *zhuada's* success is the utilization of property

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[3]The World Bank, *The Chinese Economy: Fighting Inflation, Deepening Reforms*, 2 vols. (Washington D. C.: World Bank, 1996), 1:13.

[4]Clearly this is also due to the fact that many large SOEs are still in a monopolistic or oligopolistic position in their industries. They also tend to receive more government benefits. As the conclusion of this article will point out, one of the major problems of the *zhuada* policy is that it might easily lead to an amplification of these problems.

[5]Of the 118,000 industrial SOEs in China, 87,905 were classified as "independent accounting units" in 1996. These are the industrial SOEs on which the Chinese government systematically gathers data. Of these, 15,668 were classified as "large and medium-sized" (according to the size of their work force and assets) and 72,237 as "small" industrial SOEs. See the World Bank, *China's Management of Enterprise Assets*, 17.

[6]Ibid.

[7]In this respect the rationale underlying the *zhuada* policy is also clearly the revenue-maximizing imperative of state leaders. In 1996 the Chinese state relied on the state sector for more than 70 percent of its tax income. See State Statistical Bureau, *Zhongguo tongji nianjian* (Statistical yearbook of China) (Beijing: Zhongguo tongji chubanshe, 1997), 238. Since the largest SOEs tend to be the most profitable and thus contribute most to the state's coffers, to expend the state's limited resources on the restructuring of large SOEs makes obvious sense as seen from a revenue-maximizing point of view. See Margaret Levi, *Of Rule and Revenue* (Berkeley: University of California Press, 1988).

[8]Corporate governance institutions generally refer to the set of institutional relationships that link the ownership and control of an enterprise to each other. This includes the nature of risks, incentives, and control structures expressed in these institutional relationships, as well as the type of enterprise management behavior which they generate.

rights relations rather than administrative commands to attain optimal resource allocations and economies of scale.[9] Yet, the establishment of state-enterprise relations that are based on modern principles of corporate governance also promises to be the most difficult and politically-sensitive of all reforms.

This article will investigate to which extent the policy of *zhuada* has been able to overcome the problems facing these politically most sensitive reforms. It will ask which policy initiatives have been contained in China's latest effort to restructure state-enterprise relations, how these policies have been implemented in practice, and what the initial results of these efforts have been. Inferences regarding the continuing problems facing the effective restructuring of China's state sector will be made from a series of interviews conducted by one of the authors in Shanghai between 1995 and 1997. The case study of Shanghai is particularly relevant as the "Shanghai model" is the basis for the reforms in most other cities and serves with certain modifications as the blueprint for reforms at the central level.[10]

The article argues that the policy of *zhuada* is a double-edged sword. On the one hand, an emphasis on clarifying property rights and implementing modern forms of corporate governance to restructure large SOEs represents a considerable advance over earlier policies of industrial reorganization. On the other hand, the policy of *zhuada* in Shanghai shows major weaknesses at its early stages of implementation. Government and enterprises are not separated sufficiently, and the CCP continues to make personnel decisions and thus maintains control of the most important levers over management. Restructuring is mainly driven according to political criteria and revolves around administrative fiats rather than market-driven exchanges. Finally, the greatest danger of *zhuada* is that it might encounter

[9]See, for example, Jiang Zemin, "Accelerate the Reform, Opening-Up, and Modernization, Score Greater Victory of Socialist Mission with Chinese Characteristics," in *Shisida yilai zhongyao wenxian xuanbian* (Selected important documents since the [CCP's] Fourteenth Congress) (Beijing: Renmin chubanshe, 1996), 1-47; and *Tequ jingji* (Special Economic Zone Economics), September 1996, 15-17.

[10]The World Bank, *China's Management of Enterprise Assets*, 35. The influence of the Shanghai reforms is especially evident in some of the restructuring moves announced at the National People's Congress in March 1998.

the same debilitating problems faced by its major role model, the Korean *chaebol*. Chinese leaders, SOE managers, and local government officials have repeatedly stressed that the goal of *zhuada* is to form large state-owned enterprise groups that can enter the *Fortune* 500. While this emphasis on size and imitating the Korean *chaebol* has been tuned down after the Asian financial crisis, government officials are still continuing to implement this policy. *Zhuada* thus runs the danger of creating and fostering large, unwieldy, and monopolistic conglomerates that exhibit the severe problems inherent in state ownership regimes throughout the world.

The Origins and Policy Contents of *Zhuada*

The idea of *zhuada* is certainly not new in China. Past policies of industrial restructuring have focused on the selection of a key number of enterprises to attain economies of scale and optimal resource allocations, although these efforts have tended to rely on heavy-handed administrative intervention.[11] Historically, Chinese industrial reorganization has had two dimensions: first, the formation of functional ties and inter-enterprise coordination; and second, the "closure, stoppage, merger, and transfer" of enterprise units as well as the formation of large industrial conglomerates and "socialist trusts" as exemplified during both the post-Leap period (1961-66) and the mid-1980s.[12]

The restoration of organizational forms resembling the "socialist trusts" of the post-Leap period in the salt, tobacco, and machine building industries in the mid-1980s is one of the important antecedents to the present *zhuada* policy.[13] Moreover, a series of policy experiments at the local level—such as bankruptcies, enterprise takeovers, shareholding systems, and property rights markets—laid the foundations for the new phase of

[11] See Peter Nan-shong Lee, *Industrial Management and Economic Reform in China, 1949-1984* (Hong Kong, New York, and London: Oxford University Press, 1987), 75-78, 149-69.

[12] Ibid., 73, for the definition of "industrial reorganization" in the Chinese context.

[13] Ibid., 149-69.

market reforms ushered in during the early 1990s.[14]

The beginning of this new phase of reforms can be dated to early 1992 as Deng Xiaoping conducted his last inspection of the provinces (known as his "tour to the south" or *nanxun* in Chinese). This bold move by the aging patriarch rekindled the Chinese government's intentions to restructure its economy and led to a fundamental departure from earlier reform efforts. Officially proclaimed at the CCP's Fourteenth Congress in October 1992, the idea of a "socialist market economy" established for the first time in the history of China's economic reforms the goal of relegating the centrally planned economy (CPE) to a secondary place and creating a full-fledged market economic system.[15]

This new phase of economic reforms led to a redirection of efforts at restructuring the state sector. Throughout the 1980s and early 1990s, most initiatives at reforming SOEs had focused on delegating greater degrees of autonomy to their management. Yet, the administrative framework based on bureaus to exercise the state's ownership rights established under the CPE was not altered.[16] The hope at the time was that by assuring the auton-

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[14]See Dorothy J. Solinger, *From Lathes to Looms: China's Industrial Policy in Comparative Perspective, 1979-1982* (Stanford, Calif.: Stanford University Press, 1991); idem, "Capitalist Measures with Chinese Characteristics," *Problems of Communism*, January-February 1989, 19-33.

[15]At this time the actual definition of public ownership was broadened to include the burgeoning collective sector. This sector is generally under the control of local governments, although in many ways its operational structure resembles that of privately-run enterprises. Broadening the definition of public ownership obviously has given the CCP more leeway in ascertaining what is "socialist" and what not.

[16]This above statement represents somewhat of a simplification of the process of SOE reforms during the 1980s and early 1990s. For detailed analyses of SOE reforms during the 1980s and early 1990s, see Donald A. Hay et al., *Economic Reform and State-Owned Enterprises in China: 1979-1987* (Oxford: Clarendon Press, 1994); Barry Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1990* (Cambridge: Cambridge University Press, 1995); and Gary H. Jefferson and Thomas G. Rawski, "Enterprise Reform in Chinese Industry," *Journal of Economic Perspectives* 8, no. 2 (1994): 47-70. Susan L. Shirk, *The Political Logic of Economic Reform in China* (Los Angeles: University of California Press, 1993), provides an overview of the policy debates regarding SOE reforms during the 1980s. More sociologically-based analyses of state-enterprise relations during this era are provided by Andrew G. Walder, "Factory and Manager in an Era of Reform," *The China Quarterly*, no. 118 (June 1989): 242-64; idem, "Local Bargaining Relationships and Urban Industrial Finance," in *Bureaucracy, Politics, and Decision Making in Post-Mao China*, ed. Kenneth G. Lieberthal and David M. Lampton (Berkeley: University of California Press, 1992), 308-33; and Huang Yasheng, "Web of Interests and Patterns of Behavior

omy of SOE management state enterprises could function independently of the state bureaucracy and redirect their efforts toward purely commercial objectives. This granting of operational spheres of autonomy to SOE management culminated in the promulgation of the Enterprise Law in 1988 and the introduction of the "new operating mechanism" (NOM) in mid-1992.[17] The NOM conferred on SOE management a broad range of autonomous rights, including the right to make investments independently, dispose of assets, and refuse any unwarranted interference from government organs.

By early 1993, however, Chinese reformers had become acutely aware of the repeated failings of their past efforts at delegating spheres of operational autonomy to SOE management. Local governments, bureaucrats, and SOE managers had often become a law onto themselves leading to massive, yet unproductive overinvestments in fixed assets.[18] Moreover, in the early 1990s many SOE managers illegally converted their enterprises into joint stock corporations, diverted profits into their own pockets, or simply stripped SOEs of their state assets.[19] The growing awareness of these problems gave the impetus to the establishment of the modern enterprise system (MES).

Officially put forth at the Third Plenum of the CCP's Fourteenth Cen-

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of Chinese Local Economic Bureaucracies and Enterprises during Reforms," *The China Quarterly*, no. 123 (September 1990): 431-58.

[17]Formally the NOM was known as the "Regulations on Transforming the Management Mechanism of State-Owned Industrial Enterprises" (issued on July 25, 1992). These regulations focus on stipulating fourteen autonomous rights for SOEs in order to enhance their operational independence from the industrial bureau in charge, although SOEs are still taken as an integral part of the state bureaucracy. For a detailed description of the fourteen autonomous rights, see Harry G. Broadman, *Meeting the Challenges of Enterprise Reform* (Washington, D.C.: World Bank, 1995), 23.

[18]This phenomenon is by no means a new one. Repeated cycles of massive but unproductive investments in China can be traced back to the revenue-maximizing tendency embedded in the CPE. For further discussion, see Peter Nan-shong Lee, "Enterprise Autonomy Policy in Post-Mao China: A Case Study of Policy Making, 1978-1983," *The China Quarterly*, no. 105 (March 1986): 45-71.

[19]For an in-depth analysis of these phenomena, see Li Hanlin, *Guoyou zichan daliushi: Zhongguo guoyou zichan liushi qudao luetan* (The big loss of state-owned assets: A discussion on the ways by which China's state-owned assets are lost) (Lanzhou: Lanzhou daxue chubanshe, 1994). You Ji, "Corporatization, Privatization, and the New Trend in Mainland China's New Economic Reform," *Issues & Studies* 31, no. 2 (April 1995): 54-59, offers an analysis regarding the loss of state assets during the conversion of SOEs into joint stock corporations.

tral Committee in November 1993, the objective of the MES is to implement a broad program of corporatization for all of China's SOEs. The Chinese government hopes that the MES can establish corporate governance structures that confine the state to the effective exercise of its ownership rights while vesting with SOE management legally defined rights that can terminate the arbitrary and subordinate position of SOEs to the state bureaucracy. The Third Plenum also announced a wide array of reforms that must accompany the MES in order to make it effective. These reforms include aspects of labor management, welfare provisions, banking, finance, foreign trade, and macroeconomic regulation.[20] If implemented, this bundle of reforms should allow the Chinese leadership to establish a well-working market economy.

The MES holds an especially crucial position in this reform package because it attempts to tackle an issue that is fraught with political risk: how to effectively part the party-state from SOE governance. From 1993 up until early 1998 the implementation of the MES was undertaken by conducting a number of extended experiments. The following will briefly describe what has been officially portrayed as the goals and contents of these various reform experiments.[21]

Corporatization: The core experiment regarding the implementation of the MES is the selection of one hundred large and medium-sized SOEs

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[20]This unprecedented array of reforms is contained in the "Decision on Issues Concerning the Establishment of a Socialist Market Economic Structure," which outlines a fifty-point agenda for economic reform to be attained by the end of the century. For the full text see *China Daily*, November 17, 1993, supplement. See also *Beijing Review* 38, no. 2 (January 9-15, 1995): 7-14, for an introduction to the various reforms and their initial implementation contained in the "Decision."

[21]The SOE reform strategy under the MES is also known as the "10,000-1,000-100-10 enterprise reform experiment." Under this policy ten thousand large and medium-sized SOEs are to adopt new accounting standards, utilize new asset valuation techniques, and implement the NOM. One thousand large SOEs are to adopt the new state asset administration regulations issued in 1994 and then proceed to clarify their property rights. One hundred SOEs are to proceed with full corporatization. And ten municipalities (actually eighteen at the outset and now one hundred ten) are to undergo comprehensive reforms. The following builds on Xu Dong and Yuan Xilu, "The Reform of State-Owned Enterprises in 1995 and the Outlook for 1996," *Jingji yanjiu cankao* (Economic Research References), no. 803 (January 4, 1996): 2-13; and Zhang Chunlin, "The Reform of State-Owned Enterprises: A Perspective from the One Hundred Experimental Enterprises," *Gaige* (Reform), 1996, no. 5:15-20. The article by Li Tieying in *Jingji ribao* (Economic Daily) (Beijing), October 10, 1996, 1, provides a concise official portrayal of the reforms.

in mid-1994 to proceed with a program of corporatization.[22] These one hundred SOEs are mainly being restructured along three fronts. First, they are establishing corporate governance systems according to the Chinese Corporate Law promulgated in December 1993. This involves the setting up of a board of directors, a board of supervisors, and the parting of the functions of the management team from the representatives of the owner(s) (i.e., the directors). Second, the one hundred SOEs are clarifying their property rights by defining which enterprises or government bodies are to hold the property rights to the state assets controlled by each SOE. Finally, all of these enterprises are proceeding with the restructuring of their internal operations by, for example, lowering the number of internal departments, shrinking their work forces, and alleviating their debts by bringing new investors on board. In addition to these restructuring moves, the government has also extended a series of preferential policies to these enterprises, such as corporate income tax relief and the limited conversion of outstanding loan payments to the state banks into state-held equity.

Enterprise groups: The second major trial program relating to the implementation of the MES is the selection of what was originally fifty-five (but by March 1997 has increased to one hundred twenty) large enterprise groups (*qiye jituan*).[23] As noted above, China had in the mid-1980s already revived the establishment of large enterprise conglomerates in various sectors. Building on this, the first official policy on the establishment of state-owned conglomerates was promulgated in 1987, leading to the later formulation of State Council Document #71. This document gave explicit legal recognition to enterprise groups and set out a legal framework for their establishment.[24] Under the MES reforms from 1994 onwards the enterprise groups are to restructure their corporate governance systems according to the Corporate Law. Central to this effort is the formation of

[22]In March 1997 this number has been increased to two hundred. Moreover, since 1994 about another two thousand SOEs under provincial governments have been selected for similar reforms.

[23]In the following the terms "enterprise group" and "conglomerate" will be used interchangeably. Both refer to the Chinese term *qiye jituan*.

[24]*Zhongguo jingji tizhi gaige nianjian 1993* (Yearbook of China's restructuring of the economy 1993) (Beijing: State Commission for Restructuring of the Economy, 1994), 232-35.

internal corporate governance structures that link mother and daughter corporations via boards of directors rather than bureaucratic hierarchies. However, up to 1997 only eight of the selected enterprise groups have proceeded with the formation of these internal governance structures based on property rights relations.[25] The conglomerates are also attaining in a step-by-step manner various preferential rights to increase their operational freedoms. These include the coveted rights to set up finance companies, to conduct initial public offerings, and to directly engage in foreign trade.

City-level reforms: Another pilot program directly linked to the implementation of the MES is the initial selection of eighteen large cities (expanded to fifty-eight in 1996 and one hundred ten in March 1997) to proceed with comprehensive reforms of their state industrial structure. These reforms include moves to part the social obligations of SOEs from their productive functions by establishing labor exchange institutions, social insurance systems, and private housing markets. These cities are also further expanding experiments in SOE bankruptcies, mergers, and the diversification of SOE ownership. Furthermore, these cities have been the first to undertake initial experiments converting outstanding policy loans to the state banks into state equity shares.

SOE sector formation: While the three above pilot programs have had relatively clear objectives and a limited scope, the last program is much larger and more diffuse in nature. In 1994 the PRC State Council decided to select close to one thousand large SOEs to form the core of the state industrial sector. Yet, as of early 1998 no final list of these one thousand enterprises has been established. Line ministries, provincial governments, and SOE managers all have been scrambling to get on the list, leading to protracted wrangling and thus a lack of final decision. Consequently, the State Council has moved in a step-by-step manner, initially selecting 300 large SOEs in 1995 and then expanding this number to 511 in March 1997. These selected enterprises have been subjected to the closer scrutiny of the State Council through the implementation of the "Regulations on the Supervision and Management of the Property of State-Owned Enterprises"

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[25]For a closer analysis of what this process involves, see section two of this article.

promulgated in July 1994. They have also been made eligible for priority access to bank loans (especially for working capital) and have been given the rights to set up finance companies, to directly engage in foreign trade, and to issue corporate stocks and bonds.[26]

The policy of *zhuada* to be investigated in this article runs across all four of these experiments. In essence, *zhuada* refers to the formation and restructuring of a selected number of large state-owned enterprise groups by giving them policy preferences and corporatizing them along the lines of the Chinese Corporate Law.[27] These large enterprise groups should then become the driving force for restructuring their subsidiary SOEs along the lines of the MES reforms and allowing the state sector to effectively compete in the emerging market economy.

This policy has recently been reaffirmed by the CCP's Fifteenth Congress convened in the autumn of 1997. Despite the Congress' emphasis on allowing for "diversified forms" of ownership in the state sector, the Chinese government is intent on using the *zhuada* policy to retain majority state ownership in those sectors that form the commanding heights of the economy. How many SOEs will be subsumed under the *zhuada* policy is still unclear; the lowest figure is one thousand, with three thousand a more probable figure.[28] Even if only the one thousand largest SOEs fall under *zhuada*, these enterprises reportedly account for two-thirds of the assets in all industrial SOEs and for more than 70 percent of sales revenue, profits, and tax receipts in the whole state sector.[29]

Hence, *zhuada* aims to restructure China's largest and by far most important state enterprises. Certainly, in the eyes of the Chinese leadership the country is not embarking on the road to capitalism, but is rather attempt-

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[26]See *Zhongguo zhengjuan bao* (China Securities News), October 10, 1995, 1.

[27]See *Guangming ribao* (Bright Daily) (Beijing), November 22, 1995, 5 and *Renmin ribao*, November 7, 1995, 9.

[28]How many enterprises will be "taken command of" under *zhuada* is actually not particularly relevant since *zhuada* mainly refers to large enterprise groups. Hence, what were formerly regarded as individual enterprises can be easily subsumed under an enterprise group. Overall the number will probably include close to all of the more than fifteen thousand large and medium-sized SOEs in China, especially when the replication of the central government's *zhuada* policy at the provincial level is included.

[29]The World Bank, *China's Management of Enterprise Assets*, 5.

ing to find a viable means to create a mixed economy where the state continues to control the lifelines of the economy through direct ownership over the means of production.

Establishing the State Ownership Regime

The success of *zhuada* relies on the full implementation of the program of corporatization under the MES. Since corporatization necessitates an institutional structure where the state's ownership rights are clearly located and effectively exercised, the Chinese government has moved ahead with the design and construction of a three-tiered state-owned asset management structure.[30] It is the establishment of this structure that constitutes the most comprehensive and visible aspect in China's new era of SOE reforms.

Traditionally, SOEs were factories that fell under the direct supervision of a ministry (at the central level) or a sectoral bureau (at the level of the province or provincial-status city).[31] SOEs thus functioned as an extension to the state bureaucracy and did not possess any independent legal status. During the process of economic reforms in the 1980s and early 1990s SOE management did gain a wide range of operational freedoms, yet state enterprises continued to be regarded as an appendage to the state bureaucracy. In this system the murky status of SOEs vis-à-vis the state bureaucracy gave rise to continued government interference in enterprise affairs, excessive reliance of SOEs on the state for grants and financial sub-

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[30]See Ju Baoyuan, "On the Concentration of the Property Rights to State-Owned Assets in One Body," *Guoyou zichan guanli* (State-Owned Asset Administration), 1995, no. 9:17-19. Regarding the Shanghai reforms see Hu Xiongfei, "To Increase Economic Efficiency by Adjusting the Institutional Structure of the Economic System," *Jingji yanjiu cankao*, no. 1013 (February 7, 1997): 18-28, and Christopher A. McNally, "Shanghai's Way Forward: A Prelude to China's Next Stage of Enterprise Reforms," *China Perspectives*, no. 14 (November/December 1997): 33-39.

[31]Since the mid-1980s there often has been an intermediary level between the bureau and the SOE composed of a sector's or subsector's "trade general corporations" (*hangye zonggongsi*). However, these corporations tend to merely function as administrative extensions of the bureau rather than independent corporate entities. Some of these controlling corporations at the national level are now being restructured into state holding corporations (SHCs).

sidies, and unclear responsibilities for protecting and increasing state-owned assets.[32]

The formation of the new three-tiered state-owned asset management structure seeks to ameliorate the deficiencies of the traditional management system.[33] It intends to establish a structure that allows for a clear division of duties and rights between enterprise managers and owners. The first tier is constituted of state-owned asset administration committees (*guoyou zichan guanli weiyuanhui*, SOAACs) and their attached offices (*guoyou zichan guanli bangongshi*, SOAAOs).[34] These bodies should ultimately constitute the only bureaucratic entities able to represent the state's property rights regarding all forms of state-owned assets (e.g., in corporations, in administrative units, or regarding natural resources). As of this writing, however, most of these bodies have focused on establishing a system to account for and control the flow of state-owned assets.[35] Little progress has been made regarding the actual exercise of ownership functions by these

[32]For introductions to China's system of public administration and how it relates to SOE-government relations, see the contributions by Barry Naughton, David M. Lampton, and Andrew G. Walder in Lieberthal and Lampton, *Bureaucracy, Politics, and Decision Making in Post-Mao China*. For more recent analyses on the property rights institutions of SOEs, see Louis Putterman, "The Role of Ownership and Property Rights in China's Economic Transition," *The China Quarterly*, no. 144 (December 1995): 1047-64; and Harry G. Broadman, ed., *Policy Options for Reform in Chinese State-Owned Enterprises* (Washington, D.C.: World Bank, 1996).

[33]What follows is with a basic reference to what the reforms have encompassed in Shanghai. Ultimately, the formation of a three-tiered state-owned asset oversight structure is the basic goal for all of China, both at the central and provincial levels. See *South China Morning Post*, August 11, 1997, B3.

[34]By 1996 these reforms had already spread to a number of cities, including Tianjin, Deyang in Sichuan, Quanzhou in Fujian, as well as Shanghai and Shenzhen. However, most provinces and cities, as well as the central government still have state-owned asset administrative departments which fall under the supervision of the financial system. The intention is for all governments to move in the direction of Shanghai and Shenzhen with independent SOAACs and SOAAOs.

[35]The elements of this system are, first, *qingchan hezi* (to clarify and investigate the assets and to assess the state's investment capital). After *qingchan hezi*, the property rights of an SOE are established (i.e., which other SOE or statal body actually holds them) and registered with the state-owned asset administrative bureaucracies' asset registration system. This system then should allow the state-owned asset administrative bureaucracies to build up a statistical database that can keep track of changes in state-owned assets. Ultimately, the system should also allow the state to establish a separate budget for state-owned assets that can effectively part government and SOE finances. However, so far not much progress has been made on this last point.

bodies, and their role in improving SOE management behavior has remained very limited.

Nonetheless, in Shanghai, as in other cities that have proceeded furthest with the MES reforms, the SOAAC and SOAAO have played an important role in establishing state holding corporations (SHCs).[36] These constitute the second tier of the three-tiered management structure. The intention for SHCs is to form a screen that parts the state's bureaucracy from SOE management. They are to take over the state's ownership rights and function like specialized and market-oriented state asset management corporations. Their mission is to establish what the Chinese term a personalized (*rengehua*) system that can take the responsibility for the protection and increase of state-owned assets. As one author put it, the managers of SHCs should act like true "red capitalists."[37] SHCs also stand at the center of *zhuada*; they and their direct subsidiaries constitute the commanding heights of the economy. Indeed, SHCs are to make the state's exercise of its ownership rights more effective, and by this strengthen the party-state's control over the state sector.

From a legal point of view, SHCs are corporations with the status of an independent legal person. Their internal governance systems are structured according to the stipulations in China's Corporate Law. However, they are by definition solely owned by the state. Hence, they are regarded as a special type of enterprise legal person and possess certain powers and obligations not stipulated in the Corporate Law.[38]

Finally, in China's new state-owned asset management structure the lowest tier is constituted of former SOEs that have been converted into limited liability or limited liability stock corporations. All of these are

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[36]SHCs are generally termed *guoyou konggu gongsi* in Chinese.

[37]Liu Yishun, "On the Establishment of State Holding Corporations in Theory and Practice," *Jingji yanjiu cankao*, no. 931 (August 26, 1996): 18.

[38]What exactly the legal powers and obligations of SHCs are will be established in the PRC's State-Owned Asset Law. Some of the special characteristics of SHCs are still being debated and, indeed, the controversial nature of many of the stipulations in the law have caused its promulgation to be continuously delayed. See *South China Morning Post*, August 3, 1998, B3. On the special legal status of SHCs, see Liu Yishun, "The Special Characteristics of State Holding Corporations," *Jingji yanjiu cankao*, nos. 998/999 (December 28, 1996): 25.

owned in full or in part by the SHCs or by other state-owned corporations.[39] The corporatization of SOEs should ideally rely on increasing investments from outside sources.[40] This can include the listing of SOEs on local or overseas stock markets, issuing a limited amount of stocks internally to employees, or directly selling stakes to foreign or domestic investors.

As the initial corporatization of one hundred SOEs under the MES reforms has shown, however, this is no easy task. Indeed, by 1996 a total of seventy-seven of the one hundred enterprises had opted to become solely state-owned limited liability corporations.[41] As some observers have noted, these enterprises have just moved to set up superficially the corporate governance structures as stipulated in the Corporate Law, while actually changing very little in their relationship to the government.[42] Ultimately, the efforts of individual SOEs to establish effective corporate governance structures depend on the extent to which their owners—the SHCs—are able to act as real owners.

In sum, the formation of a three-tiered state-owned asset management structure is directly linked to the implementation strategy of *zhuada*. SHCs can act to group large numbers of SOEs under one hat and, by obtaining the ownership rights to their state assets, function to more effectively merge, corporatize, restructure, and bankrupt these SOEs. SHCs are also the direct counterpart of the government and receive policy benefits in the form of low interest rate bank loans, state grants, regulatory benefits, and greater operational freedoms. These corporations also carry out the responsibility of implementing the government's industrial policy and strengthen the position of the state sector in the economy. How SHCs have been created in China's largest industrial city—Shanghai—and what have been some of the resulting problems will be illustrated in the following section.

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[39]There can be a large number of tiers of SOE subsidiaries under one SHC. On average there are about four to five generations of SOEs below an SHC, although the highest number I have heard off in Shanghai was eleven generations of SOEs under one SHC (Interview 33, Shanghai).

[40]In most cases the state will tend to keep a majority stake, although how much this will be depends on the sector and size of the respective SOE.

[41]Zhang, "The Reform of State-Owned Enterprises," 16.

[42]Various interviews Shanghai, 22, 38, 80, 107, and Beijing, 57.

Zhuada in Shanghai: The Formation of State Holding Corporations

The formation of SHCs in Shanghai has proceeded farther than in most other large Chinese cities. By mid-1996 more than 60 percent of the city's state-owned assets had been in one form or another attached to a total of thirty-one SHCs.[43] The formation of these thirty-one SHCs has allowed the city government to transform a total of fourteen sectoral bureaus (in industry, construction, commerce, and agriculture) into corporate entities.[44] According to a government official, Shanghai's intention is to let the number of SHCs rise to approximately seventy and then diminish it via mergers and consolidations to about twenty by the year 2000.[45]

The process of establishing SHCs and the three-tiered state-owned asset management structure in Shanghai began on July 16, 1993, when the city created the Shanghai State-Owned Asset Administration Committee and its attached office.[46] Following this move the city selected on December 12, 1993 three units to implement the first experiment in establishing SHCs. These were the city's Textile Bureau, the Instrumentation and Electronics Bureau, and the Shanghai United Electric (Group) Corporation.

The essence in establishing an SHC is what the Chinese have termed *shouquan* (to vest powers). *Shouquan* is the central aspect of corporatization and denotes the process whereby the state vests the asset property rights in an SOE. In the case of the SHCs this means that they become the "legal person" to act on behalf of the state to manage the assets contained in the SOEs under their control. SHCs thus exercise, on behalf of the state,

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[43] *Jiefang ribao* (Liberation Daily), May 20, 1996, 1. Another two SHCs have been formed at the level of two districts (Minhang and Huangpu) to take over the management of all productive state assets under the supervision of these districts.

[44] *Shanghai nianjian* (Shanghai almanac) (Shanghai: Shanghai renmin chubanshe, 1996), 222.

[45] Interview 51, Shanghai.

[46] Originally, Shanghai followed the lead of the central government and established its State-Owned Asset Administrative Division (*Guoyou zichan guanli chu*) within the city's Finance Department. The formation of the Shanghai SOAAC and SOAAO allowed the city government to part the administration of state-owned assets from the finance bureaucracy and to establish a commission that could group together the powerful interests needed to

the ownership rights over a group of SOEs and are in effect responsible for how the state's assets are managed, allocated, and restructured.[47] A variety of SHCs have been formed throughout China by restructuring sectoral bureaus, ministries, "trade [sectoral] general corporations" (*hangye zong-gongsi*), state asset management corporations, and the core enterprises of large conglomerates. Four major methods have been used to create Shanghai's thirty-one SHCs.[48]

First, the core enterprises of relatively small, new, and dynamic corporations have been vested with the state's property rights to their subsidiaries. The prototype in this category is the Lansheng Group Corporation, the first SOE in China to be named after the chair of its board of directors, Zhang Lansheng. Lansheng is formed around one major limited liability stock corporation listed on the Shanghai stock market. This group's young age, flexible operations, and the charismatic character of its chair have propelled the Lansheng Group to become one of the largest corporations in China and a major export earner.[49] In this respect Lansheng is one of the most successful of Shanghai's SHCs, although government officials also complain that it tends to operate like a private corporation outside of the state's purview.[50]

A second type of SHC has been established by assembling a number of SOEs within the same industrial/commercial sector under a new conglomerate. However, at least one SHC under this category has encountered severe problems. Its subsidiary SOEs are not willing to give up their autonomy to their new owner and dread the added financial burden that the new

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[47]This process helps clarify the property rights of subsidiary SOEs. However, despite the SOAAC and SOAAO's oversight functions over the SHCs, the actual property rights of the SHCs remain quite muddled. Especially the party bureaucracy, as well as various government agencies (the Planning Commission, the Economic Commission, the Labor Bureau, etc.) continue to influence the corporate governance of the SHCs.

[48]The following builds on approximately ninety interviews conducted with government officials, enterprise managers, professionals, and academics regarding the restructuring of Shanghai's state sector between August 1995 and January 1997.

[49]Lansheng also has been one of the first three state-owned corporations chosen to form a foreign trade joint venture with a foreign partner. See *South China Morning Post*, July 12, 1997, B3.

[50]Interview 1, Shanghai.

SHC constitutes.[51] Indeed, in this case the administrative fees that the SOEs needed to pay to their supervisory body were doubled after their ownership was vested with an SHC.

The third type is numerically the most common in Shanghai. These are former enterprise groups whose core enterprises have now been vested with the property rights to their subsidiaries.[52] One of the most prominent examples in this category is the Shanghai Automobile Industrial Conglomerate (SAIC). In September 1994 SAIC was selected in the second batch of SHCs to be created. It set up a new institutional framework by forming a small corporation staffed by approximately twenty-five people which acts as the core enterprise of the group. This core enterprise is chiefly responsible for the development of corporate strategy, the personnel management of the directors and managers one step down the corporate ladder, and the administration of the state assets contained in its subsidiaries (the institutional setup and functions of the state asset management department in SAIC basically follow that of the SOAAO at the city level). In addition to the administrative departments in charge of these above functions, SAIC also has three specialized corporations (involved in quality control, training, and technology development) and one design institute directly attached to it. In this manner SAIC has actually attained more autonomy, because certain functions formerly performed by the government (i.e., corporate development and the administration of state assets) are now with SAIC.

In theory, SAIC's small group corporation should basically be structured according to the stipulations of the Corporate Law. However, in mid-1996 the board of directors and supervisors still had not been definitively established. As is common in most of Shanghai's SHCs, the leadership in

[51]Interview 39, Shanghai. According to this informant, one major failing of an SHC under this category has also been due to the appointment of unqualified managers and directors to the new SHC: "The city government was just looking for a plush retirement position for some of its former secretaries."

[52]For quite a number of group corporations this has given a considerable boost to their status. While they formerly were considered as *fuju ji* (vice-bureau level), their transformation into SHCs has put them on an equal footing with former *ju ji* (bureau-level) corporations. Naturally, the reforms should theoretically have abolished the status designations of SOEs within the government bureaucratic hierarchy. However, old ways die hard and most managers of SHCs and SOEs interviewed were keenly aware of their status in the government administrative hierarchy and intent on improving it.

SAIC is the same as before its conversion into an SHC. Moreover, the city government and its party apparatus decide on the setup of SAIC's board of directors. Furthermore, SAIC's group leadership also holds most of the leading positions on the board of directors of the Shanghai Automobile Limited Corporation, the main subsidiary of SAIC.

SAIC's position in the politics and economy of Shanghai is pivotal. Many of Shanghai's government leaders have had stints at SAIC, and its leadership is closely fused with the city government's economic leadership. As one company official remarked, SAIC does not need to fear much for its autonomy, but is rather often in the position to influence the government.[53] This situation has also caused SAIC to play a strategic role in Shanghai's *zhuada*. In late 1996 and early 1997 SAIC took over the property rights in a number of large SOEs in Shanghai. These include the Shanghai Video & Audio Electric and the Shanghai Vacuum Electronic Devices corporations. Both of these SOEs are in the red. It also includes the highly profitable Dazhong Taxi Corporation, in which SAIC will take over a 20 percent stake by being vested with part of this listed company's state shares.[54] Overall, it seems that the city government trusts the ability and loyalty of SAIC's management more than that of many other SHCs, and is thus intent on investing a wide plethora of state assets to its control. While some of these assets are complementary to its core business, however, others are totally unrelated and probably represent the hope of the city government that SAIC's management acumen can prop up these ailing businesses. Indeed, most of the takeovers seem politically directed and only increase the overall assets of SAIC, while adding little to its efficiency.

The final mode of establishing SHCs in Shanghai is certainly the most far-reaching, yet also the most controversial. As mentioned above, a total of fourteen sectoral bureaus have been abolished. In the industrial sector seven bureaus have been converted into six SHCs. Except for the First and Second Light Industrial Bureau which have been merged, the other five industrial bureaus have been directly transformed into SHCs. The newly

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[53]Interviews 43 & 44, Shanghai.

[54]*South China Morning Post*, April 4, 1997, B4.

established SHCs have shed about half of their employees (from 2,004 in the seven bureaus to approximately 1,000 in the six SHCs) and diminished the number of internal departments from 198 to 74.[55] Moreover, the staff of the new SHCs has been taken off the government's payroll and, at least in theory, their administrative ranks have been abolished. This has allowed the city of Shanghai to shed a large part of its government bureaucracy in one swoop.

The six new industrial SHCs have also initially moved to part their government and social functions from their state asset administrative functions. As in the case of SAIC, a small number of departments mainly in charge of corporate development and various aspects of state asset management have been formed. To take over the sectoral administrative functions of the former bureaus the city's Economic Commission has established several new administrative divisions. Hence, sector-based administration of industries has not been abolished, but simply moved one step up the bureaucratic ladder.

Similar to the case of industrial bureaus, the city of Shanghai has also restructured its commercial bureaucracy. Most noteworthy here is the fate of the First Commercial Bureau. Originally in charge of all large retail and wholesale operations in the city, this bureau has been transformed into three conglomerates.[56] At first the intention was to establish one conglomerate, since a major objective of the reforms was to create enterprises with sufficient market power to compete. However, government officials feared that with one large corporation the administrative influence of the old system would be difficult to abolish. Discussions then moved to consider two large or even four or five smaller groups. Naturally, it was in the interest of most SOE retailers to be upgraded into an SHC and so the number tended to expand. The First Commercial Bureau, on the other hand, wanted to keep the number small. Finally, after more than one year of wrangling it

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[55] Interview 3, Shanghai.

[56] In addition to the retail operations under the First Commercial Bureau, there are also a number of retailers under the city's district governments. These are being restructured as well, mainly by listing on the city's stock market. Moreover, the city's Second Commercial Bureau and its Maritime Products Bureau have also been converted into four SHCs.

was decided that the two existing large conglomerates under the bureau—the First Department Store Conglomerate and the Hualian Conglomerate—would be transformed into SHCs. Moreover, the Friendship Store Conglomerate was able to effectively argue that its business nature differed sufficiently from the other two retailers and that it had to be run independently. Hence, it became the third SHC to be formed out of the First Commercial Bureau.

In addition to the three large retailers, the First Commercial Bureau was also in charge of various large wholesale operations in the city. While at first there was the idea to create one large wholesaling group, this idea was rapidly discarded since it harked back to the functional division of labor under the CPE. Instead, as one observer remarked, without any apparent logic the wholesalers were distributed to the three new SHCs.[57]

Actually, all of the wholesalers are large money losers and in some cases their losses by far exceed the profits of the retailers.[58] The official explanation for injecting the wholesalers into the new SHCs is that the wholesalers possess greater technical knowledge than the retailers and there are sufficient complementarities between the wholesalers and retailers to warrant their fusion. In reality, the leaders of the new SHCs (all of them the former leaders of the First Commercial Bureau) bargained intensively to attain the wholesalers' property rights. While the wholesalers are all big money losers, they sit on large tracks of potentially extremely valuable real estate in Shanghai. Hence, the First Commercial Bureau's wholesale empire was distributed in bits and pieces according to the size and political influence of the three new SHCs.

In this restructuring process the First Commercial Bureau was abolished and its former employees reallocated by the party's personnel apparatus to different units. While some technically knowledgeable administrators went to the newly restructured Commercial Commission of Shanghai, all of the top leaders chose to go to the new SHCs. The former director of

[57] Interview 81, Shanghai.

[58] One observer (Interview 38, Shanghai) noted that the First Department Store Group was of negative net asset worth. This, however, excludes the all-important real estate assets which are now in a step-by-step process being vested with the SHCs.

the bureau became the chair of the First Department Store Conglomerate. The two most powerful vice-directors became the chairs of the Hualian and Friendship Store conglomerates. In this manner political resistance to the restructuring could be kept at a minimum. However, the fact that personnel arrangements have been conducted in a closed and noncompetitive environment points to some of the deep-rooted problems of the SHCs.

Personnel appointments at the top of the SHCs are closely controlled by the city's party apparatus. Managers are not appointed according to a competitive process but rather rely on their loyalty and status in the party hierarchy to clinch good jobs. This nonmarket-based allocation of managerial personnel closely circumscribes the effectiveness of the SHCs and their autonomy vis-à-vis the government. Indeed, the SHCs must be seen as being exposed to both political and economic pressures.

SHC managers are fundamentally driven by the incentives that emanate from the city's party apparatus. These incentives do incorporate economic efficiency measures. In Shanghai great emphasis has been put on two measures of economic efficiency: profitability and the returns on net assets of the whole SHC. This represents a considerable step away from the bureaucratic management of the former bureaus toward the asset management envisaged by the reforms. Nonetheless, there remain considerable problems with how performance indicators are to be established and measured.

Some performance indicators are still arrived at by looking at the SHCs' historical track record and are thus open to negotiations with the government. Moreover, the poor financial and accounting standards in most Chinese SOEs make it very difficult to exactly assess the worth of their net assets. The establishment and assessment of the indicators are thus open to creative accounting and continued bargaining with the government. Ultimately, it is the degree to which the top personnel of the SHCs fulfill the demands of the city's government and party apparatus that will determine their career. Obviously, these demands are mainly of a political/ administrative nature.

Another noteworthy shift in the incentives of the bureaucrats-turned SHC managers is that the SHCs have attained the rights to all the profit streams emanating from their subsidiaries. This creates stronger profit maximization incentives than those that existed for the administrators in the former bureaus. However, it also pits the new SHC managers against the managers of their subsidiary SOEs. The latter have become used to the right to retain a considerable share of profits. Wrangling over how profits are to be distributed and the illegal diversion of a subsidiary's profits to other uses are thus serious problems confronting the relations between the SHCs and their subsidiaries.

In sum, the implementation of the MES reforms in Shanghai and the establishment of a large number of SHCs have rationalized and lent transparency to the city's state asset management structure. These reforms have initially moved the ownership structures of SOEs away from the sector-based fine functional division of labor practiced under the CPE toward a more market-oriented management of state assets. Nonetheless, the reforms, though radical in intent, have in practice only moved a small step forward. Many of the SHCs, especially those formed out of former bureaucracies, still exhibit several features of their former roles. Corporate governance structures still rely on extensive administrative links. Mergers and acquisitions are primarily conducted within the boundaries of each SHC, and where they are not they often follow the directions of the city government. Indeed, some observers have even argued that the reforms are a step backwards since they may tend to reduce the flexibility and performance of subsidiary SOEs.

The reforms are also inhibited by a glaring lack of factor markets. Personnel appointments of the directors and managers are still closely controlled by the party apparatus and there is no open competitive process of selection. The performance of the SHCs is very difficult to assess due to a lack of capital markets (SHCs are not to be listed on stock markets) and effective independent accounting and financial services institutions. Finally, the SHCs are also often in charge of a plethora of SOEs (in some cases as many as a few thousand). It is difficult to imagine how the SHCs can effectively oversee and optimize the allocation of resources when confronted with such a large number of subsidiaries.[59]

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[59] One SHC interviewed (the Shanghai Textile Holding [Group] Corporation) praised itself

Conclusions

The basic thrust of "*zhuada, fangxiao*" is to split the state sector into two camps: enterprises that are relatively small and in which majority stakes can be sold to non-state investors (*fangxiao*); and enterprises that are large or medium-sized and in which a majority stake has to be retained by the state (*zhuada*). This thrust of the "*zhuada, fangxiao*" policy has been reaffirmed by the CCP's Fifteenth Congress in September 1997. Yet, the Party Congress has failed to spell out how *zhuada* is to be put into effect. This article has utilized data from the implementation of the *zhuada* policy in Shanghai to shed more light on the future course of China's state sector reforms.

The example of Shanghai shows that the implementation strategy of *zhuada* is to attain economies of scale and ameliorate the allocation of resources in the state sector by forming large enterprise conglomerates. As such, this idea represents nothing new and has been tried in a number of socialist economies, generally with poor outcomes. In Shanghai, *zhuada's* saving grace is that the formation of the three-tiered state-owned asset management structure and SHCs opens the door further to the diversification of state ownership. Theoretically, the participation of investors from different backgrounds should be conducive to the emergence of corporate governance structures that allow the state sector to adjust to a market economy. In Shanghai the diversification of state assets under SHCs has taken several forms.

First, the core holding of many SHCs in Shanghai is a listed limited liability stock corporation, as is the case with Lansheng. Second, most SHCs interviewed have subsidiaries that have entered or are in the process of entering large joint ventures with foreign multinationals. Third, the corporatization of all of the SHCs' subsidiaries encourages investments by

for being able to lower the number of old SOEs under it from around 300 to 180 in three years. However, the subsidiaries of the SHC formed in the same time period 240 joint ventures with foreign investors, 230 with domestic investors, and more than 1,200 tertiary industries. Certainly, the number of subsidiaries has thus increased rapidly. Interview 11, Shanghai.

non-state owners. And finally, the SHCs of Shanghai are also themselves conducting extensive *fangxiao*. They are transferring their smaller subsidiaries to district governments which then sell these enterprises off, redevelop their real estate, or allow management/worker buyouts to be conducted.

Zhuada in Shanghai thus attempts to solve the most difficult conundrum facing China's economic reforms: how to find an effective means by which large SOEs can be revitalized without letting the state's control over these enterprises slip. As the material presented in this article shows, Shanghai's *zhuada* reforms have not yet found an adequate solution to this conundrum.[60] Although the policy of *zhuada* furthers the diversification of state assets, it has nonetheless relied heavily on state intervention. This highlights a distinctive feature of China's transitional economy: corporate governance structures evolve from and are nurtured by the state hierarchy. Consequently, state sector reform is conditioned and inhibited by its institutional origins, and SOEs continue to exhibit most of the classic problems found in public enterprise regimes throughout the world.[61]

Perhaps the greatest danger of *zhuada* is that it can easily serve as a means for politically powerful SHCs to amass ever greater amounts of state assets. This can easily lead to powerful regional and local monopolies that will be difficult to unseat in the future. Moreover, state asset exchanges are not taking place via markets, but by administrative dictates under the close

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[60]Naturally, accompanying the *zhuada* reforms are also a number of other reforms seeking to ameliorate the corporate governance structures of China's SOEs. These reforms include aspects of the SOEs' labor management, the reform of the financial system as well as increasing competition in commodity markets. Except for the last point the impact of these reforms can be considered as having been limited so far.

[61]For classical statements on the peculiar problems of corporate governance in public enterprise regimes, see the theoretically-oriented arguments of John Vickers and George Yarrow, *Privatization: An Economic Analysis* (Cambridge, Mass.: MIT Press, 1988) and Joseph E. Stiglitz, *Whither Socialism* (Cambridge, Mass.: MIT Press, 1994), as well as the more empirically-based arguments of John Waterbury, *Exposed to Innumerable Delusions: Public Enterprise and State Power in Egypt, India, Mexico, and Turkey* (New York: Cambridge University Press, 1993). A more detailed analysis of what the exact effects of Shanghai's state sector reforms are is given in Christopher A. McNally, "Dynamos, Dinosaurs, and Dragons: Property Rights and State Power in Shanghai's State Sector Reforms, 1992-1997" (Ph.D. dissertation, Department of Political Science, University of Washington, Seattle, in progress).

surveillance of local governments. Indeed, as the example of Shanghai's commercial sector has shown, SHCs themselves are formed by purely administrative means, often paying greater attention to political expediency rather than economic rationality.

Viewed from this perspective, the implementation of *zhuada* is problematic at best. When asked what the primary goal of their corporation was, most SHC officials answered: "To become an even larger, more diversified conglomerate that can become one of the world's top 500 corporations." Since the career paths of the SHCs' top personnel are still determined by the politics of the CCP, it is no wonder that they primarily seek to increase their status in the political hierarchy. And this status is directly dependent on the size of their enterprise. Naturally, SHC directors and managers can also heighten their standing by increasing the efficiency of their company, as does often happen. Nonetheless, it often proves easier and more expedient to enlarge the asset base of a corporation by seeking the government's help in taking over a variety of state assets or receiving other types of policy supports.

Hence, the Achilles heel of *zhuada* is that this policy can easily lead to the formation of large, unmanageable, and monopolistic corporate empires that are closely tied to the state. It is exactly this type of "incestuous" government-enterprise relations that are held responsible for the Asian financial crisis. While the Chinese government has taken the lessons of this crisis to heart, especially those regarding the downfall of the Korean model, it is doubtful whether the policy of *zhuada* will be trimmed back or reversed. It is in the very interest of China's economic bureaucrats, party cadres, and SOE managers to oversee vast industrial and commercial empires. As one observer put Chinese thinking: "Claiming that Chinese conglomerates are superior to the *chaebols* thanks to tighter supervision, State Council bureaucrats have pressed ahead with the program of mega-mergers."[62]

Ultimately, *zhuada's* main contribution is that it puts emphasis on

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[62]Willy Wo-lap Lam, "Radical Surgery Spurned by Beijing," *South China Morning Post International Weekly*, February 14, 1998, 9.

property rights-oriented restructuring. With the implementation of the MES the ownership institutions of SOEs are finally moving away from the bureau-centered mode of administration under the CPE. In its place a more rational and market-oriented mode of managing state assets is emerging. Yet, as long as there are considerable political and administrative barriers to the market-based exchange of state assets throughout the country, the effectiveness of *zhuada* has to be doubted. Despite its good intentions, *zhuada* easily serves as a convenient excuse to build ever bigger and more unwieldy enterprise groups that will only retard the restructuring of China's large SOEs.