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Reform of State-Owned Enterprises in Mainland China Since the CCP's Fifteenth Congress

YEH CHANG-MEI

In September 1997, the CCP's Fifteenth National Congress devised a new orientation for the reform of state-owned enterprises (SOEs), with an emphasis on boosting productivity, using the joint stock system to clarify ownership, and improving the performance of state-owned economic entities. Since then, invigorating small SOEs has been replaced with successfully managing and internationalizing large ones as the most important long-range objective.

In this article, the author analyzes why Beijing has been reforming SOEs since the 1970s, and why the CCP's Fifteenth Congress and the Central Economic Work Conference have both made SOE reform the core of economic reforms. Special attention will be paid to the following issues: (1) the management difficulties which SOEs face; (2) the strategy for reforming SOEs adopted by the CCP's Fifteenth Congress; (3) problems arising in the course of reform; and (4) essential reform difficulties.

Keywords: modern enterprise systems; the joint stock system; enterprise groups; enterprise mergers

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Under the planned economic system, state-owned enterprises (SOEs) in mainland China followed state plans and did not have management autonomy. As they were not held responsible for their economic perfor-

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mance, they lacked profit-seeking initiatives, thus resulting in slow development and inefficiency. With the implementation of reform and opening-up policies in 1979, SOE reform began to receive serious attention. The non-state-owned economy, particularly the town and township enterprises, was encouraged to develop so as to force SOEs to improve efficiency. More decision-making powers were also delegated to enterprises to link responsibilities and powers with profits so as to boost productivity and lower costs.

The delegation of greater management autonomy to enterprises in Sichuan Province in 1979 raised the curtain for mainland China's reform of SOEs, as their production and management system began to shift from being owned and managed by the state to being "owned by the state but managed by enterprises." In the 1980s, "delegating managerial power and conceding profits to SOEs" became the mainstream policy, the theoretical basis of which was separating the ownership of production means from the production and management authorities of enterprises.

Before the CCP's Fourteenth National Congress in October 1992, reform experiments in SOEs included greater management autonomy for enterprises, a tax contract system, substitution of taxes for profits, separation of taxes from profits, a joint stock system, and enterprise groups. Of these, only the first two were popularized throughout mainland China after trial experiments.

To clearly separate the ownership of the state from the management rights of enterprise managers, the Third Plenum of the CCP's Fourteenth Central Committee in 1993 proposed to establish a modern enterprise system with public ownership as the principal element. The promulgation of the Enterprise Law in 1993 provided an operational formula for reform of the enterprise system, thus ushering in a period of system renovation for SOEs. In September 1997, the CCP's Fifteenth Congress further devised a new orientation for SOE reform, with an emphasis on boosting productivity, using the joint stock system to clarify ownership, and improving the performance of state-owned economic entities. During the Central Economic Work Conference at the end of 1997, the textile industry was singled out as a "breakthrough" area for SOE reform in 1998; enterprises with current deficits are required to overcome their predicament and become profitable before the end of 2000. Therefore, mainland China's fundamental challenge in enterprise reform is how to revitalize SOEs and enable them to adapt to an open market economy.[1]

In this article, the author analyzes why Beijing has been reforming SOEs since the 1970s, and why the CCP's Fifteenth Congress and the Central Economic Work Conference have both made SOE reform the core of economic reforms. Special attention will be paid to the following issues: (1) the management difficulties which SOEs face; (2) the strategy for reforming SOEs adopted by the CCP's Fifteenth Congress; (3) problems arising in the course of reform; and (4) essential reform difficulties.

Management Difficulties of SOEs

In a typical market economy, enterprises decide their production according to contracts with their customers, seek the lowest prices for purchases of raw materials, and sell their ultimate products at competitive market prices, with strong motives to obtain the highest economic results by lowering their costs. One of the results of the market economy is that enterprise managers have full decision-making powers. As enterprises are forced by market competition to focus on changes in their profit indices, they need management and technical experts to improve their production efficiency and must encourage them to work hard by remunerating them according to their ability.

By contrast, typical socialist enterprises do not produce for profits; their production objective is to satisfy the needs of society. In pre-enterprise reform mainland China, the production objectives of all SOEs were decided by a Central Planning Commission. These enterprises were actually an appendage to the state administration, and did not have the power to decide their production; they had to produce according to the mandatory plans assigned to them by the state. This industrial production

[1]Mitsuo Morimoto, "Managerial Reform of Chinese SOEs: A Shift to Joint Stock Corporation," in *China in the Twenty-first Century: Politics, Economy, and Society*, ed. Fumio Itoh (Tokyo: United Nations University, 1997), 135.

mode caused the following problems in SOEs:

1. Because of such practices as employment protection and average wages, workers had little motive to compete with each other, thus leading to low labor efficiency.

2. Product prices were unrelated to profits, and profits were also unrelated to efforts of enterprises. The state treated deficit SOEs with tolerance; thus, their budget control became increasingly lax.[2]

3. The central planning system led to a trend of overheated investment. As output growth depended on investment increases, SOEs were inclined to consolidate themselves by obtaining more state investment, without considering recovery of the investment, as they would not be punished for losses.

Before enterprise reform, SOEs survived on planned needs and distorted prices. The planned needs of the market emphasized heavy industry and the processing industry; thus, large and medium-sized SOEs that monopolized the mainland market could easily earn high profits. However, market-oriented reform has replaced planned guidance and market prices have substituted for planned prices. The needs of the market have thus shifted toward consumer goods and market prices have differed from the distorted planned prices. In a new market environment, many SOEs that performed well in the past have had difficulties in adapting to the changing market demands, and many of them face poor sales and declining profits.[3]

The market economic system also allows the non-state-owned sector to participate in competitions; consequently, SOEs have had difficulty in obtaining high profits as before. In 1997, SOEs lagged far behind private enterprises in terms of added value creation and profit and tax creation per one *yuan* of wages (see table 1). Moreover, since economic reforms began, the two economic systems have coexisted both within and without enterprises. SOEs have especially been affected because they operate under

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[2] Jiang Ruiping and Zou Jianhua, *Guoyou qiye de gaige he Zhongguo de jueze* (The SOE reform and China's choice) (Shaoguan City: Guangdong renmin chubanshe, 1996), 413.

[3] Zhou Zhenhua, *Bulü weijian de zhuanhuan—Zhongguo maixiang xiandai jiye zhidu de sisuo* (A difficult transition—Thoughts on China's approach to a modern enterprise system) (Shanghai: Yiwen chubanshe, 1994), 41.

Table 1
Value Creation Per One *Yuan* of Wages Among Mainland Chinese Enterprises

Unit: *Yuan*

	Value-added creation per one *yuan* of wages	Profit and tax creation per one *yuan* of wages
Private enterprises	5.97	2.43
Foreign-invested enterprises	5.72	1.99
Joint stock enterprises	4.45	2.10
Hong Kong, Macao, and Taiwan-invested enterprises	4.08	1.99
State-owned enterprises	3.35	1.16
Collective enterprises	3.28	0.88
Joint ventures	2.43	1.01

Source: "Private Enterprises Have Achieved High Value Creations," *Xinbao caijing xinwen* (Hong Kong Economic Journal), November 7, 1997, 10.

both systems in production, procurement of raw and semi-finished materials, marketing, investing, financing, distribution of retained profits, and utilization of the labor force.[4] Without clear operational standards to follow, they have been plagued by confused management, wasted resources, and low efficiency and performance.

Due to unsound management and other factors, most SOEs have suffered losses. In 1986, only 8.66 percent of them were in the red; however, in 1996, more than one-third of them were obviously operating at a deficit; and others were listed as profit-makers on account but were actually incurring losses. Combined, this accounted for 63 percent of all SOEs. Moreover, the net accounts receivable of industrial enterprises alone increased by nearly 120 billion *yuan* over the same time span. The triangular debts among enterprises have been so serious that the functions of commodities, money, and banks have become distorted, leading enterprises to mutually

[4]Dong Fureng, "The Behavior of China's SOEs Under a Dual System," in *Gongying qiye gaige—Haixia liang'an de gongtong keti* (Reform of SOEs—A common theme for both sides of the Taiwan Strait) (Harbin: Heilongjiang jiaoyu chubanshe, 1995), 4-19.

Table 2
Major Financial Indices of Independent Accounting, State-Owned Industrial Enterprises in Mainland China

Unit: Billion *yuan*

Year	Original value of fixed assets	Net value of fixed assets	Total losses of deficit enterprises	Total profits	Total profits and taxes
1986	674.48	454.38	5.45	68.99	134.14
1987	767.79	524.24	6.10	78.70	151.41
1988	879.52	604.04	8.19	89.19	177.49
1989	1,016.08	703.32	18.02	74.30	177.31
1990	1,161.03	808.83	34.88	38.81	150.31
1991	1,355.68	950.72	36.70	40.22	166.12
1992	1,566.98	1,098.27	36.93	53.51	194.41
1993	1,906.64	1,330.44	45.27	81.73	245.47
1994	2,310.20	1,567.75	48.26	82.90	287.63
1995	3,093.57	1,747.41	63.96	66.56	287.42
1996	3,476.50	2,214.08	79.07	41.26	273.71

Source: *Zhongguo tongji nianjian 1997* (Statistical yearbook of China 1997) (Beijing: Zhongguo tongji chubanshe, 1997), 439.

mortgage or exchange their goods.[5] In 1996, the total losses of state-owned industrial enterprises operating at a deficit accounted for as much as 28.9 percent of the profits and taxes realized by all state-owned industrial enterprises (see table 2). It has also been learned that despite long-term state subsidies, about 12,000 SOEs have been losing money since the Great Leap Forward in 1958.[6]

From January to November 1997, as much as 30 percent of the 87,000 industrial SOEs were losing money, with their losses totalling 70.5 billion *yuan*.[7] Of these enterprises, the textile industry, which had the greatest number of staff and workers, incurred the largest losses. At present, there are 4,031 state-owned textile enterprises employing more than 4 million

[5]Wang Xiaoming, *Zhongguo jingji redian wenti toushi* (China's economic hot issues) (Beijing: Qiye guanli chubanshe, 1997), 480-81.

[6]Cao Xiao, "Zhu Rongji Talks About the Economic Situation with Both Joy and Apprehension," *Jingbao yuekan* (Mirror Monthly) (Hong Kong), 1997, no. 10:35.

[7]Ye Hongyan, "Reflections on the Policy of Managing Large SOEs Well," *Ta Kung Pao* (Hong Kong), January 8, 1998, C5.

people, accounting for about 10 percent of the total employees of mainland China's industrial enterprises. The total losses of the textile industry increased rapidly from 1.9 billion *yuan* in 1993 to 8 billion *yuan* in 1997, and it should be noted that the whole industry has lost money in the last three years.[8] In 1996, a total of 1,031 large and medium-sized state-owned textile enterprises were in the red, accounting for 17.5 percent of all large and medium-sized deficit SOEs. Their losses totalled 9.63 billion *yuan*, or 19.2 percent of the total deficits of large and medium-sized deficit SOEs, and involved 1.8 million employees, or about 19.6 percent of the total number of employees of large and medium-sized deficit SOEs. These percentages were all the highest in comparison with the other sectors of the national economy.[9] In fact, with 41.71 million spindles for cotton spinning, the production capacity of the textile industry far exceeds both domestic and international demand.[10]

Despite continuous state support in the form of financial inputs and bank loans, the performance of SOEs has continued to decline. At present, mainland China has 305,000 SOEs in various sectors; their total assets in 1997 amounted to 9.6 trillion *yuan*, but their liabilities were as high as 5.8 trillion *yuan*, while their net assets amounted to less than 4 trillion *yuan*.[11]

Bank loans have been the major source of funds for SOEs. However, because of undesirable economic results, these enterprises have depended too heavily on bank loans, leading to banks being trapped in a vicious circle of financial input→fund stagnancy→financial input again→fund stagnancy again. At present, mainland banks have a total of more than 1 trillion *yuan* in bad debts, accounting for 20 percent of their total credit assets.[12] As of the end of June 1997, uncollected due interests on loans to SOEs by the four specialized banks that had been overdue for less than two years

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[8]Ibid., December 27, 1997, B6.

[9]"The Textile Industry Will Be a Breakthrough Point in the Reform of SOEs," *Wen Wei Po* (Hong Kong), December 18, 1997, A7.

[10]"Enterprises After the Congress," *China News Analysis* (Taipei Hsien: Socio-Cultural Research Center, Fu Jen University), December 1, 1997, 4.

[11]"The Leading Role of SOEs Is Manifested in Controlling Force," *Gongren ribao* (Workers' Daily) (Beijing), November 13, 1997, 7.

[12]*Ta Kung Pao*, January 1, 1998, C4.

totalled 143.1 billion *yuan*, for a 20 percent increase over the end of 1996.[13] Serious defaults by SOEs of loan repayments and interest payments as well as the huge amount of bad debts caused by enterprise bankruptcies have affected normal bank operations and increased potential financial risks, jeopardizing mainland China's overall economic stability.

Large and medium-sized SOEs have not only been burdened by debts, but must also have to shoulder a heavy responsibility of *qiye ban shehui* left over by the old planned economic system, i.e., establishing and running certain nonproductive organizations or facilities, such as hospitals, elementary and secondary schools, kindergartens, employee canteens, bath houses, housing, and cultural and recreational facilities. The nonproductive assets of SOEs related to welfare of staff and workers have amounted to more than 100 billion *yuan*, accounting for over 10 percent of their total assets.[14] In addition, their investments in housing for staff and workers, medical facilities, and schools account for another 15-20 percent of their total investments.[15] In other words, SOEs also perform service-oriented social functions, which has made enterprise reform and redundant personnel reduction among them much more difficult.

The Strategy for Reforming SOEs Adopted by the CCP's Fifteenth Congress

For more than a decade, Beijing's major policy toward SOEs was to introduce reforms gradually. The reform measures included: (1) upholding the essence of state ownership while opposing privatization of SOEs; (2) recognizing SOEs as independent commodity producers capable of merging with the market economy; and (3) separating the ownership of production means from the production and management authorities of enterprises

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[13]*Xianggang jingji ribao* (Hong Kong Economic Times), October 14, 1997, A33.

[14]Li Shuguang, Ge Ming, and Li Qi, *Zhongguo qiye pochan yü chongzu* (Bankruptcy and reorganization of China's enterprises) (Beijing: Renmin ribao chubanshe, 1996), 6.

[15]Zhan Guoshu, "How to Observe the Reform of SOEs," *Jingji ribao* (Economic Daily) (Beijing), June 2, 1997, 1.

as a basic objective to free enterprises from state administrative control and enable them to become independent commodity producers responsible for their own losses and profits. The CCP's Fifteenth Congress in 1997 achieved an important breakthrough in ownership theories, emphasizing that public ownership can take diversified forms and that the public sector includes not only the state- and collectively-owned sectors, but also state- and collectively-owned elements in the sector of mixed ownership.[16] The Congress reinterpreted the dominant position of public ownership as well as its leading role, pointing out: (1) public assets dominate in the total assets in society while the state-owned sector controls the life-blood of the national economy and plays a leading role in economic development; and (2) based on the premise that the state-owned sector has stronger control power and is more competitive, even if the state-owned sector accounts for a smaller proportion of the economy, the socialist nature of mainland China will not be affected.[17]

Irrational economic, industrial, enterprise organization, and output structures, which have incurred losses and serious equipment idling, have been the major obstacles to SOEs' adaptation to the market economy. Therefore, to achieve successful SOE reform, Beijing must readjust all of the above across important areas and trades according to its industrial policies.[18] This theoretical basis was manifested in the Fifteenth Congress' emphasis on boosting productivity, implementing the joint stock system, improving state-owned economic entities, and combining the SOE reform with the readjustment of the industrial structure and government institutions, as well as urban economic reforms.

Since SOEs are the pillar of the mainland economy, the Chinese Communists believe that reform of these enterprises is of vital importance to establishing a socialist market economy as well as consolidating the socialist

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[16]"A Tremendous Breakthrough in the Realm of Ownership Theories," *Zhongguo shuiwu* (China Taxation) (Beijing), 1997, no. 11:1.

[17]Ye Tan, "General Secretary Jiang Advocates the Third Great Ideological Liberation, the [CCP's] Fifteenth National Congress Adopts Drastic Economic Reform Measures," *Jingbao yuekan*, 1997, no. 10:29.

[18]"Reorganization as Prerequisite to Reform of the System," *Gongren ribao*, December 4, 1997, 7.

system. Therefore, a strategic reorganization of the state-owned sector has become a matter of top priority.[19] According to the CCP's Fifteenth Congress, measures will be taken to eliminate enterprises' regional, trade, and ownership boundaries. The policy of enabling larger and more efficient enterprises to bring along the smaller and less efficient ones will be implemented. Invigoration of SOEs will be realized by way of reorganization, association, merger, joint stock partnership, leasing, trusteeship, contract operation, or sell-off. Those SOEs with serious losses should go bankrupt according to law. Moreover, large enterprise groups will be formed on the basis of local advantaged products and trades.

To seek a breakthrough in SOE reform, the CCP's Fifteenth Congress proposed a three-stage plan: (1) enabling three to five big enterprises to obtain a position among the world's five hundred largest enterprises before the end of this century; (2) establishing a modern enterprise system among large and medium-sized enterprises by 2010 so that they will not need state subsidies any more; and (3) adapting large and medium-sized enterprises to the market economy and further improving the joint stock partnership system among small and medium-sized enterprises.[20] To realize these objectives, Beijing hopes that most large and medium-sized SOEs can improve on their difficult situations within three years.

Beijing plans to raise the 1 trillion *yuan* needed to extricate SOEs from their difficulties from the following channels:

1. *Listing of SOE shares on the stock market*: The annual sales of about 30 billion *yuan* of shares on the stock market at a conservative fourfold to fivefold premium during the three years before the end of 2000 will raise about 450 billion *yuan*.

2. *Sales of state assets*: According to an estimate of the National Administration of State Property, the 291,000 SOEs have a total of 3.8 trillion *yuan* in assets. After nonoperative assets are deducted, there are still more than 3 trillion *yuan*. If 10 percent of these assets are sold, 300

[19]"New Offensives in the Reform of SOEs," *Zhongguo jingji xinwen* (China Economic News) (Beijing), 1996, no. 22:15.

[20]*Lianhe bao* (United Daily News) (Taipei), September 23, 1997, 9.

billion *yuan* will be raised.[21]

3. *Bank reserves for bad debts*: Annual bank reserves for bad debts amount to about 30 billion *yuan*, so about 100 billion *yuan* will be accumulated before the end of 2000. Moreover, local governments may also help write off 50 billion *yuan* in bad debts during these years.

4. *Stock transaction stamp duties*: It is estimated that about 100 billion *yuan* can be raised through this channel before the end of 2000.[22]

The Central Economic Work Conference, the Economic and Trade Work Conference, and the Structural Reform Work Conference held after the CCP's Fifteenth Congress have set schedules for the tackling of some concrete enterprise reform problems, but no improved reform strategy has been drawn up. For instance, it has been decided that 5,500 large and medium-sized SOEs will be reorganized by way of merger, bankruptcy, lay-offs, and interest reduction in three years. About 2,000 large and medium-sized deficit SOEs will be the key reform targets, with about 40 billion *yuan* allocated as reserves for writing off their bad debts, and they will receive priority in listing their stocks on domestic and foreign stock markets to raise money for development. Moreover, to prevent unemployment caused by enterprise reform from affecting social order, a new social security welfare system is to be introduced this year: every person will be issued a social security card with his own social security number on it, and with this card, he may receive the social welfare benefits that were originally provided by enterprises, including medical treatment and retirement pension.[23]

At a press conference on March 19, 1998, Zhu Rongji, the new premier elected at the Ninth National People's Congress (NPC), emphasized "revitalization of the country through science and education" and explained the new policy orientation of "ensuring one, putting three into place, and five reforms." The first refers to ensuring that mainland China's annual economic growth rate reaches 8 percent, keeping inflation lower than 3 per-

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[21] "How Can SOEs Eliminate Losses," *Jingji ribao*, December 24, 1997, 2.

[22] *Sing Tao Daily* (Hong Kong), September 10, 1997, B4.

[23] *Gongshang shibao* (Commercial Times) (Taipei), November 29, 1997, 7.

cent, and not devaluing the RMB. The second refers to enabling most large and medium-sized SOEs to be extricated from their current difficult situations, thoroughly reforming the financial system, and reducing the staff of government institutions by 50 percent within three years. The third refers to reforms of the circulation system for grain, the investment and financing systems, the housing system, the medical care system, and the fiscal and taxation system. In brief, Beijing hopes to completely transform government functions through State Council restructuring so that the central and local governments will gradually withdraw from enterprise production and management activities so that supervision of enterprises will then be supplied through macro-control measures.

Since the CCP's Fifteenth Congress, invigorating small SOEs has no longer been the chief focus, while successfully managing and internationalizing large ones has become the most important long-range objective. Specifically, out of mainland China's 305,000 SOEs, 512 have been selected as the key foundation for establishing large enterprise groups. They will be provided with huge amounts of loans and granted the priority of listing their shares on stock markets. They will also be given priority of choice when other SOEs come up for mergers. These enterprises' output values account for 40 percent of mainland China's total consumption, and the taxes and profits they deliver to the state amount to 85 percent of annual state revenues. One hundred eighty-one of them have already had their shares listed on domestic or foreign stock markets, with the largest being Shanghai Motors, a joint venture with Germany's Volkswagen. Those enterprises listed include arms manufacturers, computer industrial enterprise groups, textile factories, petroleum companies, oil refineries, steel works, and nonferrous metal smelteries.[24]

Recently, in order to make SOEs more competitive against foreign-owned large transnational enterprises and prepare itself for joining the World Trade Organization, mainland China has actively promoted trans-regional and trans-trade mergers and reorganizations among enterprises

[24]"The Names of 500 Large Enterprises to Which the Mainland Chinese Government Will Give Strong Support Are Exposed," *Zhongguo shibao* (China Times) (Taipei), December 8, 1997, 9.

to achieve the objective of enabling some enterprises to rank among the world's five hundred largest enterprises. In 1995, only the China National Petrochemical Corporation and two other enterprise groups were on the list. The future emphasis of state support will also center on industrial enterprises. Since the CCP's Fifteenth Congress, the first batch of enterprises selected for such support include the Shanghai Baoshan Steel Works, the Haier Electrical Appliances Group, the Sichuan Changhong Electrical Appliances Group, the Shanghai Jiangnan Shipbuilding Corporation, the Beida Fangzheng Group engaging in computer software production, and the Huabei Pharmaceutical Corporation. These six SOEs have been promised that starting from 1998, at least 20 million *yuan* will be invested in their technical renovation.[25]

Problems Arising in the Course of Reform

Since the CCP's Fifteenth Congress, large and medium-sized SOEs have tried hard to reorganize themselves into joint stock economic entities; some of them have completed the process and have had their shares listed on stock markets. Small SOEs have experimented with diverse forms of reform, but most of them have chosen joint stock partnership for their reorganization. Thus, the joint stock system has become a remarkable characteristic of enterprise reform. However, it should be noted that soon after the close of the Fifteenth Congress in September 1997, Beijing issued four official documents on serious problems that had arisen in the course of reform.[26]

The first document, issued on October 15, reprimanded SOEs in Shaanxi, Shanxi, Henan, and Shandong for forcing their staff and workers to sign voluntary resignation papers, take early retirements, and give up their welfare benefits such as medical treatment and labor insurance. A

[25] *Xianggang jingji ribao*, November 19, 1997, A24.

[26] Luo Bing, "Documents Have Shown That the Enterprise Reform Has Encountered Bottlenecks," *Cheng Ming* (Contending) (Hong Kong), 1997, no. 12:17.

subsequent document issued on October 24, reproached SOEs in Guangdong, Hainan, and Hubei for using reform, mergers, and introduction of the joint stock system to illegally transfer their assets and funds, thus causing losses of state-owned assets. It was pointed out that some enterprises had deliberately underestimated their assets to achieve quick sales, some had sold part of their assets to staff and workers at low prices, and some had transferred their funds to cadres running enterprises in Hong Kong. Some had also exaggerated their business volumes and total assets in order to attract foreign investment, while others had underestimated their total assets to realize low-cost sales to their parent companies. All these practices had caused losses of state assets.[27] A third document issued on October 30 stated that some local governments in Shanxi, Shaanxi, Sichuan, Jilin, Henan, and Shandong had supported enterprises using administrative means to force staff and workers to subscribe for or purchase shares. The fourth document, dated November 4, contained blunt comments on controversies among some leaders over SOE reform. Fujian, Liaoning, and Yunnan had requested postponing the submission of preliminary plans for SOE reform because the leaders of provincial governments and party committees could not reach unanimity on the issue.

The following three sets of recently disclosed official figures also prove that mainland China's SOE reform is facing bottlenecks:

1. Up to the end of August 1997, bad bank debts of SOEs amounted to as high as 806 billion *yuan*, accounting for over 20 percent of the total business volume of the four state-owned specialized banks.

2. In September 1997, a total of 9,240 large, medium-sized, and small SOEs filed in applications for bankruptcy. These cases involved more than 12.7 million staff and workers.

3. In October 1997, there were 455 cases of strikes, demonstrations, and assemblies among industrial and mining enterprises, and 391 of them took place because staff, workers, and cadres were dissatisfied with enterprise reform measures.

On the whole, mainland China must deal with a multitude of prob-

[27]*Ming Pao* (Hong Kong), December 11, 1997, A11.

lems in implementing the enterprise reform. The following ones deserve special attention:

The Joint Stock System Among SOEs

Experimentation of the joint stock system began in July 1984, and by the end of 1996, there were about 9,200 restructured or newly established joint stock companies dominated by state ownership. The face values of their shares totalled 600 billion *yuan*, or 25 percent of the total share values of large and medium-sized SOEs.[28] Of these shares, 43 percent were state-owned and 25.1 percent were owned by institutions, so the dominant position of public ownership had been consolidated.[29] The implementation of the joint stock system has provided SOEs with a direct fund-raising channel and more than 80 billion *yuan* of foreign funds has been raised. However, the operations of joint stock companies have not yet been standardized. When issuing shares, some companies have adopted the differential price system: shares are sold to employees and outsiders at different prices and bonus distributions per share can also be different. In many companies, the ownership rights of their shares have not been clearly defined. Moreover, there are more than twenty kinds of shares, such as state shares, collective shares, enterprise shares, shares for individual staff and workers, society shares, institutional shares, and cooperative shares.[30] However, since the concept that the state should have absolute control of shares still prevails and assessment of state-owned shares is often exaggerated, the ratio of state-owned shares of many joint stock companies far exceeds 51 percent, and in some cases, even reaches as high as 80 percent. Furthermore, many original higher-level authorities in charge of joint stock companies have continued to stick to past measures for SOE management, so these companies cannot really decide their own operations independently.

Since the joint stock system is widely regarded as an almighty instru-

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[28]*Renmin ribao* (People's Daily) (Beijing), April 16, 1997, 2.

[29]Su Yiping, "The Joint Stock System Will Become the Major Form of SOEs," *Wen Wei Po*, May 12, 1997, A4.

[30]Zhang Wenmin et al., *Zhongguo jingji dalunzhan* (China's economic polemics) (Beijing: Jingji guanli chubanshe, 1996), 115-16.

ment, indiscriminate promotion of the system has emerged. Some local government leaders have blindly issued administrative orders requiring enterprises to adopt the system regardless of their specific conditions, and some enterprise leaders have forced staff and workers to buy shares by threatening them with dismissals. These acts, which are not in line with the objectives of the enterprise reform, will affect mainland China's social stability.

The joint stock system or shareholding partnership implemented in mainland China is different from complete privatization in capitalist countries. Under the capitalist joint stock system, assets are privately owned; the use of capital goods and other economic operations are decided by enterprise leaders; and transfers of shares are free. However, under the joint stock system in mainland China's large SOEs, capital goods and an overwhelming part of shares are still under state control; staff and workers own certain shares and have the obligation to share profits and losses of enterprises, but they are not allowed to sell their shares freely.

Beijing believes that implementation of the joint stock system may help overcome the difficulty of finding buyers for inferior SOEs and solve the problem of distribution of vested interests among employees. However, if managers and staff and workers have different objectives under this system, managers may not be able to control workers. The problem will be more serious if the enterprises involved are performing badly.

The transformation of SOEs into joint stock companies involves some important problems. In the first place, enterprise managers have focused on the system's fund-raising functions but neglected the need to establish feasible organization and management systems as well as operational mechanisms; and funds raised have often been used improperly. Some enterprises have not yet established management organizations and operational systems for the implementation of the joint stock system and their old operational mechanisms are still functioning. Important managers have decided on business policies while shareholders' meetings, boards of directors, and boards of supervisors exist in name only. On the other hand, governments have continued to exert pressure on enterprises by way of administrative control. The state assets management system is obviously lagging behind, preventing joint stock enterprises from operating according to the criteria of the joint stock system. Finally, the transformation of SOEs into joint stock companies has been slowed by mainland China's deficient stock and securities markets.

Mergers and Bankruptcies of SOEs

At present, mainland China's bankruptcy rate is only 0.5 percent, although the number of registered cases of enterprise bankruptcy increased from 98 in 1989 to 6,232 in 1996.[31] The greatest obstacle to enterprise bankruptcy is that some enterprises and relevant departments have committed bankruptcy fraud, mostly by transferring their funds to other registered companies to avoid debt repayments, thus causing disputes between banks and enterprises. If such problems as past administrative guarantees for bank loans to enterprises and guarantee responsibilities among enterprises are not resolved, liquidation and bankruptcy of enterprises cannot be carried out.

One important issue in bankruptcy work is that it is difficult to use banks' bad debt reserves to write off the bad debts caused by enterprises. Generally, banks have not had sufficient bad debt reserves, and specialized banks have drawn only 0.7 to 0.8 percent of their total loan balances as bad debt reserves. Moreover, according to mainland China's banking regulations, the use of these reserves cannot be regulated among regions and banks. Therefore, most bad debts of specialized banks cannot be written off after enterprises have gone bankrupt.

Mainland China promulgated a Bankruptcy Law at the end of 1986. However, the law overemphasizes the closure and liquidation of bankrupt enterprises: only six of its chapters touch upon enterprise reorganization and no articles in these chapters refer to such key issues as transformation of debts into shares and reinvestment. On the other hand, bankrupt enterprises have many creditors, including banks, SOEs, private enterprises, and bankrupt enterprises' staff and workers. At present, the average debt repay-

[31]Cao Siyuan, "The Legislation and Enforcement of China's Bankruptcy Law in the Past Ten Years," *Dangdai Zhongguo yanjiu* (Modern China Studies) (Princeton, N.J.), 1997, no. 2: 58, 60.

ment rate of bankrupt enterprises is as low as 5.6 percent.[32] Taking local stability and economic profits into account, the State Economic and Trade Commission's Bankrupt Enterprise Liquidation Group often underestimates the residual values of bankrupt enterprises to increase the ratio of compensation to staff and workers and private enterprises. Underestimation of bankrupt enterprises' residual values has thus given rise to an irresistible trend of state property losses.

Before a sound social security system has been established to coordinate with the bankruptcy system, it will be difficult to carry out enterprise bankruptcies in practical terms. In order to avoid losses of bank assets, mergers have been encouraged instead of bankruptcies. However, mergers may also involve two unwilling partners. Most acquiring enterprises favor traditional ways for enterprise expansion such as investing in new items since they have not yet adopted the development concept of low-cost expansion and business combination. Thus, enterprise mergers have often been the results of arrangements or direct intervention on the part of government departments, while most acquired parties are poorly-managed, bankrupt enterprises in a hopeless plight.

Unemployment and Reemployment of SOE Staff and Workers

Mergers among large and medium-sized SOEs have caused a large amount of lay-offs (*xiagang*) and unemployment. Up to the end of September 1997, laid-off employees of SOEs totalled 9.6 million. In the next three years, about 2.7 million workers in heavy industries may lose their jobs because of "privatization" among SOEs. Planned employee reductions involve the six "big" industries, which currently employ about 11.6 million people. The present unemployment rates of cities and towns range from 5 to 8 percent, and a total of about 12 to 14 million laborers in cities and towns are in a state of unemployment. The unemployment problem has thus become a major issue in mainland China's economic development and reform.[33]

[32] *Ming Pao*, December 20, 1997, A11.

[33] *Yue Gang xinxi ribao* (Guangdong and Hong Kong Information Daily) (Guangzhou), September 4, 1997, 2.

A 1996 World Bank report pointed out that SOEs in mainland China had a total of 15 million redundant personnel, which accounted for 10 percent of their total employees.[34] To overcome difficulties in SOE reform, reduction of personnel is necessary; however, a high unemployment rate will also hinder SOE reform. The SOEs that have not yet reformed will continue to shoulder the heavy load of wages and social welfare paid to their staff and workers, which will lead to Beijing bringing down the prices of grain to subsidize urban residents. Hence, the incomes of rural dwellers will decline and the difference between the city and the countryside and between the rich and the poor will be widened again.

The number of laid-off cadres and workers will also place great pressure on mainland China's society and give rise to social unrest. Zhu Rongji believes that a successful SOE reform depends on proper handling of the unemployment issue; one of his important measures in this field is to increase and speed up investment in the infrastructure (such as transportation, environmental protection, telecommunications, and public works) to increase the overall domestic needs for laborers, stimulate economic recovery, and maintain an 8 percent annual economic growth rate. According to his plan, a total of US$750 billion will be invested on infrastructure projects in the next three years, affording a livelihood to about 40 million laid-off staff, workers, and peasant workers each year. However, enlarging investment so speedily could cause the reemergence of inflation. Therefore, the greatest challenge to Beijing's macroeconomic policies is how to solve the unemployment problem without causing serious inflation.

Establishment of a Social Security System

According to mainland China's present reforms of the unemployment, pension, medical insurance, and housing systems, payment burdens are shared by the state, enterprises, and individuals. However, all three parties have had difficulty in fulfilling their obligations. Most SOEs are losing money, and with heavy debts, only a few are able to pay cash deposits. The state cannot put in sufficient money because of financial difficulties. More-

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[34] *Xianggang jingji ribao*, October 4, 1997, A17.

over, individual staff and workers are not very willing to bear their share of responsibility because most of them earn low wages.

As far as unemployment insurance is concerned, according to official stipulations, enterprises have to hand in 0.6 percent of the total wages of all staff and workers to the state as unemployment premiums. However, mainland China's total annual unemployment insurance funds is only about 2 billion *yuan*, which is insufficient for maintaining a basic livelihood for 2 million people; at present, the SOEs have a total of 24 million surplus personnel. In awaiting reemployment, these people's medical insurance, training courses, and lump-sum placement allowances are estimated to be as high as 120 billion *yuan* per year. Since only about 2 billion *yuan* of unemployment funds are raised each year, there has been a shortage of 118 billion *yuan*. It is impossible that such a heavy load can be completely shouldered by enterprises and individuals.[35]

As for the pension insurance system for SOE staff and workers, the mode of realizing payments with premiums collected recently has been in use for a long time. Mainland China's present circulating balance of pension insurance premiums is only 30 billion *yuan* and many large and medium-sized cities have had difficulties in achieving a balance between receipts and payments. If individual accounts are to be established, it will be necessary to compensate for incumbent staff and workers' average shortage of twenty years of accumulated pension funds. Presuming that each employee should have 5,000 *yuan* of pension insurance accumulations, 550 billion *yuan* will be needed to fill up the total shortage of accumulations of the 110 million incumbent staff and workers in mainland China's state-owned units (including governmental institutions). The state-owned sector also has a total of 23 million retirees. If each of them has an average pension insurance accumulation of 10,000 *yuan*, a total of 230 billion *yuan* will be needed. Thus, it can be said that mainland China's total shortage of pension insurance accumulations is as high as 780 billion *yuan*.[36]

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[35]Zhang Weida and Xie Di, "Our SOE Reform Methods Need to Be Reformed," *Gongye jingji* (Industrial Economy) (Beijing), 1997, no. 4:108.

[36]Ibid.

SOEs' Technical Innovation Capability

Technical innovation is not only important to economic restructuring, but is also the key to survival for individual enterprises. The average input of large international enterprises in technical research and development amounts to 10 percent of their total sales while that of mainland enterprises is less than 1 percent. In developed and newly industrialized countries, the input of enterprises in scientific and technological development account for 60-70 percent of their total inputs, but the average figure for mainland enterprises is only 39.1 percent. Many mainland enterprises have even failed to put aside 1-2 percent of their total incomes from sales as technical innovation funds as stipulated by official regulations. Mainland China's annual input in technical innovation declined from 0.67 percent of its gross national product (GNP) in 1990 to 0.5 percent in 1996, with a per capita technical innovation input of less than US$3.50. In contrast, the United States' per capita technical innovation input in 1995 was US$650.[37]

Up to 1995, mainland China's patent contribution ratio in the field of technical innovation was less than 0.1 percent of the world total. Therefore, mainland China's utilization of a large amount of technology, especially high technology, relies mainly on introduction from foreign countries. At the same time, since its reforms of the economic and scientific and technological systems are lagging, it has a low transformation rate of scientific and technological results. Its popularization ratio of scientific and technological results has been 20-25 percent, while its ratio of scientific and technological contributions to economic growth has been 30-35 percent, far lower than the 60-80 percent of Western countries.[38]

In utilizing foreign funds, mainland enterprises have rarely introduced soft technology such as technical consultation and patent licensing; most funds have flowed toward key equipment and whole sets of equipment (the 1992-96 composition of technological introduction indicates that

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[37]Zhou Shuhua, "The Way by Which Enterprises Walk Out of Difficulties," *Jingji ribao*, November 28, 1997, 2.

[38]Hao Zhigong, "Our Country's Opportunities and Challenges as Seen from the Perspective of the High-Tech Revolution," *Guangming ribao* (Guangming Daily) (Beijing), March 6, 1997, 5.

equipment accounted for 59.3 percent, whole sets of equipment for 18.5 percent, and design technology for only 5 percent). This has had a serious effect on investment in technology licensing. Moreover, a survey report shows that in "digesting, absorbing, and applying introduced foreign technology" and "achieving further improvement of introduced foreign technology in the course of production," mainland enterprises' average ratio is only 51.6 percent. Thus, it is clear that mainland China will have difficulty in speeding up the pace of industrial upgrading.[39]

Recently, consumer goods have been sold at reduced prices on mainland China's domestic markets, and various industries are facing a recession. The root cause for this is SOEs' long-term neglect of research and development. Without the ability to improve their products, they have tried to encourage sales by cutting prices, but price wars cannot improve their economic performance. In fact, sales of industrial enterprises have continued to decline.

Essential Reform Difficulties

SOEs are confronted by complicated problems, including such external factors as historical burdens, social burdens, and the market environment as well as internal factors such as management mechanisms, the ownership relationship, and the leadership system. These problems have had varied impacts on SOE reform.

As early as 1988, the shareholding partnership system was adopted by all small SOEs in Inner Mongolia's Zhuozi County and Sichuan's Yanyuan County. However, at that time, introduction of shareholding partnerships was not officially allowed mainly because government departments in charge of enterprises were unwilling to give up their vested powers and interests. The SOE reform plan proposed after the CCP's Fourteenth Congress should have contained breakthroughs in such realms as introduction of foreign funds for enterprise transformation, implementation of the

[39]See note 37 above.

shareholding system, and selection of factory directors by workers. However, CCP General Secretary Jiang Zemin asserted at a discussion meeting that the core of reform was not privatization but marketization, with establishing a modern enterprise system and accelerating scientific and technological transformation of enterprises being the most urgent tasks. Thus, plans to transform ownership of SOEs and let workers participate in enterprise management were shelved. In the past ten years, most enterprise reform plans have avoided such topics as selection of factory directors or managers. Out of their own interests, departments in charge of enterprises often do not care for the latter's profits and losses and appoint persons they trust to be factory directors.[40]

Despite market-oriented reforms and power delegation, SOE managers have continued to follow the old behavior model under the planned economic system: they carry out instructions of government departments instead of adjusting production according to market demands. Most SOEs are still incapable of self-development, and have even become stumbling blocks to economic development. Therefore, priority should be given to instituting an enterprise system that can ensure effective supervision over enterprise managers.

To achieve the objective of separating government administration from enterprise management, mainland China hopes to thoroughly transform government functions through a State Council restructuring. However, to separate government administration from enterprise management, the government must withdraw from the role of enterprise sponsor and owner, and the state-owned economy should withdraw from all competitive trades and small and medium-sized enterprises. The state-owned assets thus recouped should then be invested in large noncompeting enterprises that have a vital bearing on the national economy and the people's livelihood. In other words, mainland China should institute a new system for management of state-owned assets: a nongovernmental state-owned assets management organization directly responsible to the NPC should be established, and earnings from its operations will be used as reinvested

[40]Liu Binyan, "Why Has Reform Been Reversed?" *Cheng Ming*, 1997, no. 12:45-46.

state-owned assets to enhance industrial upgrading. Moreover, an investment or financing system separating government functions from those of enterprises should also be established. Local governments should give up investment behavior and all investments should be made by enterprises according to the market mechanism of free competition. However, the Ninth NPC avoided discussing political reforms; thus, the objective of separating government administration from enterprise management will not be achieved in a short time and it will be difficult to improve the production efficiency of SOEs.

From the perspective of SOEs, they and state-owned banks belong to the state (banks are cashier's offices of the state coffers before they are commercialized); their capital and the capital of state-owned banks are all state capital. Therefore, they have no scruples about borrowing from banks for various purposes, including production and operation, wage payments, bonus distributions, and public money consumptions. For many SOEs, bank loans are destined to become bad or dead debts as soon as they are borrowed. When triangular debts are formed among enterprises, between enterprises and banks, and even among banks, many SOEs have attempted to rely on governmental assistance to write off their bad and dead debts.

In addition to their dependence on government financing, SOEs have also depended heavily on loans from state-owned banks. Their debt ratio exceeds 80 percent; such a high ratio plus their bad debts have already had a serious impact on the operation of state-owned banks. The ratio of equity capital to deposit balance of mainland China's state-owned banks declined from 31.9 percent in 1979 to 7.02 percent in early 1995, lower than the 8 percent criterion of international practice,[41] and their debt ratios have been above the safety warning level. Thus, SOEs cannot rely on banks to reduce their debt ratio.

SOE reform is closely related to state-owned banks; hence, enterprise reforms should go faster than bank reforms to facilitate the elimination of bad debts incurred by enterprises. The core of bank reforms should also be ownership transformation; otherwise, banks will continue to extend loans

[41]Zhang and Xie, "Our SOE Reform Methods Need to Be Reformed," 104.

to enterprises regardless of risks. Beijing is trying to accelerate the pace of bank reforms this year, as banks are expected to recognize that they themselves are enterprises and should also pay attention to profit realization while supporting industrial upgrades. In the future, new breakthroughs will need to be made in developing regional banks, urban cooperative banks, and rural credit cooperatives.

This year, mainland China's investment in fixed assets for its whole society is about 2.8 trillion *yuan*. Where can such a large amount of money be raised? As foreign investment and overseas fund-raising are declining, the only source of funds is domestic savings, which amount to 4.8 trillion *yuan*. It is expected that governments at various levels and enterprises will scramble to issue bonds and stocks to draw on these savings, and this will produce a squeezing effect on bank deposits and affect banks' lending capability. If Beijing allows banks to wantonly extend credits and fund-raising units to engage in duplicate investment or short-term speculative undertakings, inflation like what happened before 1994 may be easily induced.

Mainland China's implementation of "managing large SOEs well while adopting a flexible policy toward small ones" seems to be conducive to privatization. However, in reality, the government's granting of privileges and strong support to large SOEs will certainly hinder the development of small and medium-sized SOEs and private enterprises, which will produce detrimental effects on the mainland economy's long-term development as a whole. With the acceleration of mergers and bankruptcies among SOEs since the CCP's Fifteenth Congress, essential productive factors will mainly be directed toward large SOEs and the number of large enterprises and enterprise groups will increase. These large enterprises, with public capital as their basic foundation, will monopolize resources through various channels, causing serious distortions in mainland China's economic resource distribution.

The aforementioned policy has enabled advantaged enterprises to grow in scale. From January to September 1997, 94.8 percent of the profits and taxes realized by the state-owned industrial sector was handed in by large and medium-sized state-owned enterprises, which in turn accounted for only 22.3 percent of total SOEs, while most small and medium-sized

SOEs had serious deficits.[42] At present, mainland China's objective is to foster one thousand well-managed large enterprises. Whether the reorganization of these enterprises will succeed depends on how the reorganization process is designed and promoted, as it will be crucial to achieve coordination between the central government's preference for certain industries and the preference of enterprise groups as well as between the interests of the central and local governments. Moreover, in pursuit of rapid growth, mainland enterprise groups have placed excessive emphasis on pluralization and low-cost expansion before they are sufficiently developed, which might easily lead them into a predicament like what has occurred to large Korean enterprise groups during the recent Southeast Asia financial crisis.

Conclusion

The establishment of a "survival of the fittest" mechanism has enabled some advantaged SOEs to make remarkable progress. Although the 512 key enterprises with preferential government support account for only 0.44 percent of the total number of state-owned industrial enterprises, their sales incomes account for 43.7 percent of the total sales incomes of state-owned industrial enterprises, and their profits for 65.8 percent of the total profits of state-owned industrial enterprises. However, mainland China's road to SOE reform has not been without potholes. Only a small number of "model" SOEs which receive key support from provinces, municipalities, or departments can achieve outstanding economic performance, and enterprises that join the reform tide early have a comparatively higher success rate, while others might gradually decline or vanish for the following reasons: (1) present mergers and reorganizations of SOEs are not voluntary actions in a market economy but the results of government policies; (2) even after transregional and transdepartmental mergers and reorganizations are completed, there are still many difficulties, as the issue of interest relationship is involved; (3) there is a serious shortage of talented persons ex-

[42]*Ming Pao*, December 12, 1997, A14.

perienced in the management of large SOEs; (4) under an unsound social security system, Beijing does not encourage enterprise bankruptcies, so a large number of redundant personnel exist in SOEs; (5) SOEs continue to provide social welfare services, posing a heavy financial burden on the state; (6) the policy of separating government administration from enterprise management has not been thoroughly carried out and responsible persons of some provinces, municipalities, and departments are concurrently chairmen of SOEs' boards of directors; and (7) the state remains the biggest shareholder of large and medium-sized SOEs, while shares of smaller ones are not completely sold to individuals.

Under a backward banking system, SOEs have been a long-term burden on the state. Objectively speaking, a relatively deep and long-term reform is needed, and a rush to complete the reorganization of SOEs in order to achieve a turn from losses to profits in three years might cause adverse effects. Since the root cause of the SOEs' lagging production lies in the socialist system, Western scientific management should be adopted in the SOE reform. However, scientific SOE reform will be impossible if equalitarianism among the SOEs, the gap between production and societal needs, Communist control of ideology, and the patriarchal political system continue to exist.

The course of SOE reform before the turn of the century has a vital bearing on mainland China's development of a socialist market economy. So far, SOE reform has mainly been in innovations of the enterprise system promoted from top to bottom by the state. An increasingly obvious characteristic of such a reform method is that "the state promotes while enterprises wait passively." On the one hand, governments at all levels and relevant economic departments are used to promoting the SOE reform with administrative means; on the other hand, faced with various unavoidable contradictions, SOEs have taken a wait-and-see attitude and their dependence on governments increases. In other words, government administration has not yet been truly separated from enterprise management. Should this situation remain unchanged, the chief objective of mainland China's enterprise reform—transforming SOEs into principal competitors on the market—will never be reached.