CPC Futures

The New Era of Socialism with Chinese Characteristics

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China's Enduring Pursuit of State-Owned Enterprise Reform

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State presence in China's economy remains strong, despite decades of market-oriented reforms since the late 1970s. State-owned enterprises (SOEs) account for approximately a quarter of GDP and have done so for nearly 25 years (Batson 2020). SOEs are leading players in Chinese industry, equity markets and overseas direct investment. Today, there are 97 central SOEs under the administration of China's national-level government ownership agency, the State-Owned Assets Supervision and Administration Commission (SASAC) (Guoyou 2021). Subnational governments also own and operate large portfolios of local SOEs at home and abroad. China now ranks first worldwide with both the largest total number of SOEs and the highest share of SOEs among its biggest companies (OECD 2017).

Chinese SOEs endure because they serve crucial functions for the state. They contribute to central and local government revenues through dividends and taxes, support urban employment, keep key input prices low, channel capital towards targeted industries and technologies, promote sub-national redistribution to poorer interior and western provinces, and aid the state's response to natural disasters, financial crises and social instability (Batson 2017). For Xi Jinping, as for earlier Chinese leaders, SOEs "constitute an important pillar of the national economy and play a role as pillars of the economic foundation of the CCP's rule and China's socialist state power" (see Barry Naughton's article in this volume) (Xinhua 2014).

Although SOEs hold nearly a third of China's industrial assets, they account for less than a fifth of total industrial profits. SOEs also deliver weak returns on assets: only 3.9 per cent compared with 9.9 per cent for private firms as of the end of 2017 (Rosen, Leutert and Guo 2018: 9). At the same time, SOE debt as a percentage of GDP reached a record high of more than 142 per cent in 2020 (Yeung 2021).

China's SOE reform has long pursued political as well as economic goals. Xi Jinping, like his predecessors, aims to achieve CPC control and market competitiveness on a global scale through concentrated state ownership and overseas expansion (Leutert and Eaton 2021; see also the chapter by Frank Pieke in this volume). The Xi administration's reform efforts have combined limited steps to increase SOE marketisation while deepening Party influence in corporate governance. What are the main elements, outcomes and prospects of SOE reform under Xi?

SOE reform under Xi Jinping

Xi's assumption of leadership in 2012 initially raised hopes for a far-reaching overhaul of China's state sector. At the 2013 Third Plenum meeting, Xi outlined an array of ambitious market-oriented reforms (Central Committee 2013).

Subsequent developments have failed to realise initial reformist hopes. The use of SOEs to arrest domestic equity market turmoil in the summer of 2015 solidified Chinese leaders' conviction in the importance of state ownership and control. That fall, the Xi administration's first major SOE reform policy document, *Guiding Opinions of the CCP Central Committee and the State Council on Deepening the Reform of State-Owned Enterprises*, made no mention of a "decisive role for markets in resource allocation", the core promise of the 2013 Third Plenum (Central Committee 2013).

As Xi nears a decade in political office in 2022, the key elements of his SOE reform agenda have become clearer. The Xi administration is committed to SOEs serving non-market objectives under tighter CPC control, combined with limited steps towards market liberalisation.

Party building

The first policy document released after the 2015 *Guiding Opinions* in September 2016 ordered SOEs to make the Party the "political core" of their "corporate governance structures".[1] The following month, Xi chaired a national work conference on party building in SOEs. There, he made clear that party organisations should serve a "leadership core" function as well as a "political core" function, giving party actors the green light for a more expansive role in directing enterprise activities (Xinhua 2016).

In January 2017, SASAC ordered SOEs to revise their articles of association to formalise requirements for party building work and the party committee's role in corporate governance.[2] Later that year, the Xi administration even revised the CPC constitution to enshrine the Party's leadership role in SOE governance (*Zhongguo gongchandang* 2017). The China Securities Regulatory Commission's (CSRC) *Code of Corporate Governance for Listed Firms*, released in September 2018, further required publicly-listed firms of all ownership types to support party building activities, and for state-controlled listed firms to codify party leadership into their articles of association (Zhongguo zhengquan 2018). Such activities and leadership include but are not limited to the Party's ability to influence personnel appointments and proposals going to the board.

Mixed ownership

Another key element of Xi's SOE reform agenda is mixed ownership. This concept, which dates back to the 1980s, refers to the diversification of state-owned enterprises' shareholding structures via publicly listing a proportion of state-owned enterprises' assets, selling a portion of state shares to the private sector, and/or granting employees stock ownership. The 2013 Third Plenum Decisions revived the idea of mixed ownership as a strategy to inject private capital and expertise into SOEs, thereby making them more responsive to market conditions (Central Committee 2013).

Mixed ownership under Xi targets SOE subsidiaries rather than group companies. Large Chinese SOEs are typically organised as enterprise groups with multiple levels of member entities—including joint venture firms, research institutes and publicly listed and non-publicly listed subsidiaries—layered under a group company (Leutert 2020). Levels of mixed ownership decrease significantly as one moves up the levels of the SOE enterprise group (Wang 2020: 426).

Implementing mixed ownership reform in SOEs at the group company level will be far more challenging. Despite a November 2017 directive urging central SOEs to implement mixed ownership reform at the group company level, no companies have done so yet, and a successful model for scaled-up implementation of mixed ownership reform has yet to emerge (Guojia 2017).

State capital management

State capital management is another key element of the Xi administration's SOE reform agenda. It encompasses two types of reforms. The first involves granting some SOEs increased autonomy for capital management decision-making within their own firms. The second calls for treating SOEs with broad cross-industry holdings as asset management companies, allowing them to manage state-owned assets on the government's behalf (Rosen, Leutert and Guo 2018).

Implementing state capital management reform has been slow and its results uneven. The government has tapped 10 central SOEs as state capital investment company pilots, and local SASACs in provinces and major municipalities have also established a limited number of state capital investment companies and state capital operations companies.

A closer look at some of these pilots underscores that more autonomy does not automatically yield better performance. Despite its potential, some SOEs simply treat state capital management reform as a means to pursue empire building via risky acquisitions in non-related industries (Xie 2016).

Mergers

Central SOE mergers have occurred routinely in the past, with more than 70 occurring between 2003 and 2010, and the pace of mergers is picking up again under Xi.[3] The current wave of SOE mergers has two main aims. The first is to create bigger, more competitive national champions with a larger share of global markets in sectors like nuclear power and railways. Theoretically, these mega-mergers will reduce price competition among Chinese SOEs abroad and help to integrate upstream and downstream industries.

The second aim of SOE mergers is restructuring of surplus capacity industries like steel and heavy machinery. Xi's proposal of a new strategy of "supply-side reform" at the Central Committee's economic meeting in November 2015 renewed momentum for SOE mergers. It also shifted focus from fostering "national champions" to tackling "zombie firms": commercially unviable enterprises that rely on government and bank support to survive. Such mergers appeal to China's leaders because they avoid state-owned asset sales, which raise corruption concerns, or bankruptcies that could involve layoffs that trigger social unrest.

Obstacles to SOE reform

Xi's reform agenda faces multiple political and economic hurdles. Shortly after assuming leadership, the Central Leading Small Group (LSG) for Comprehensively Deepening Reforms charged its "Economic System" sub-group with integrating inputs from SASAC, the National Development and Reform Commission, Ministry of Finance, and others to design its SOE reform agenda (see the chapter by Nis Grünberg and Vincent Brussee in this book). In practice, however, the inclusion of diverse bureaucratic actors, as well as the divergent interests of SOEs themselves, resulted in a watered-down blueprint for SOE reform, revealing both the limits of Xi's LSG approach to bureaucratic gridlock and the stickiness of entrenched interests (Leutert 2016; Zhonggong 2015).

Financialisation of SOEs is also running into obstacles. The first wave of SOE initial public offerings (IPOs) in the 2000s targeted Hong Kong and international equity markets. Today, the Xi administration's drive to strengthen China's industrial base—and mounting scrutiny from international regulators—is instead pushing some SOEs towards exiting stock exchanges in Hong Kong and New York.

Marketisation of SOE assets via mixed ownership reform must additionally overcome participant concerns. Private sector investors wary of state control remain reluctant to, quite literally, buy into the reform (Beck 2022: 12). Government departments, local SASACs, and SOEs themselves also worry about the risk of losing state-owned assets through corruption and bribery during mixed ownership reform (Yue et al. 2018: 15).

State firms today frequently have sprawling corporate structures. The lure of profits in real estate, finance and unrelated industries has prompted stubborn sectoral sprawl. The increasingly global scope of Chinese SOEs' business further complicates reform and regulation alike, with central SOEs alone holding more than RMB 6 trillion (USD 906 billion) in assets abroad in more than 185 countries and regions (Reuters 2017).

In 2019, SASAC formally devolved new powers to central SOEs, explicitly authorising them to approve their subsidiaries' mixed ownership reform plans, unless they operated in a handful of industries related to national security, key sectors or major projects (Guoyou 2019). While this and other formal steps to promote greater marketisation of SOE organisations and operations are notable, in practice SOEs remain bulky conglomerates strongly subject to state influence.

Conclusion

Xi's SOE reform agenda combines limited steps to increase state firms' marketisation and international competitiveness, while simultaneously strengthening party control. Efforts to promote mixed ownership, state capital management and mergers continue, despite delays and mixed results. At the same time, intensified party building aims to specify and institutionalise the CPC's leadership role in SOE corporate governance.

Reform under Xi aims to improve SOEs' performance, boost their competitiveness, and realise other economic goals like industrial restructuring.

However, the Xi administration is also willing to sacrifice these economic objectives to a certain degree in favour of political priorities and stronger party control.

The administration during Xi's putative third term (2022-2027) is unlikely to remake SOEs to approximate the form and function of private companies. However, this does not mean that the objectives of SOE reform under Xi are entirely political. The administration will almost certainly continue efforts to enhance SOEs' performance at home and abroad and use them to serve other economic aims, ranging from crisis management to urban employment to technological development.

As China's enduring pursuit of SOE reform continues, its context, content and consequences are becoming increasingly global. State firms own and operate assets worldwide, and international investors have greater exposure to Chinese SOEs on equity markets. As a result, policy makers and regulators abroad are increasingly concerned about the national security implications of SOE business, especially technology exports and involvement in critical infrastructure.

Notes

[1] *Guanyu zai shenhua guoyou qiye gaige zhong jianchi dang de lingdao jiaqiang dang de jianshede ruogan yijian* 关于在深化国有企业改革中坚持党的领导加强党的建设的若干意见 [Several opinions on adhering to party leadership and strengthening party building in deepening the reform of state-owned enterprises], 20 Sep. 2015. While this document is not publicly available, its main ideas are expressed in the official explanation accompanying its release and subsequent documents issued by local governments.

[2] Guoziwei weiyuanhui 国资委委员会 [SASAC], *Guanyu jiakuai tuijin zhongyang qiye dangjian gongzuo zongti yaoqiu naru gongsi zhangchengyouguan shixiangde tongzhi* 关于加快推进中央企业党建工作总体要求纳入公司章程有关事项的通知 [Notice on matters regarding speeding up and advancing the inclusion of overall requirements for central state-owned enterprises' party-building work in articles of association], 3 Jan. 2017. While this document is not publicly available, official sources state its key ideas. For example, see Guoziwei weiyuanhui 国资委委员会 [SASAC], *Cong "luoshi" dao "tisheng" guoqi dangjian kaiqi xin zhengcheng* 从"落实"到"提升" 国企党建开启新征程 [From "implementation" to "elevation," party building of state-owned enterprises starts a new journey], available at http://www.sasac.gov.cn/n2588025/n4423279/n4517386/n9320196/c9321179/content.html, 1 Aug. 2018 (accessed 6 June 2022).

[3] Calculations based on author's research about the survival outcomes for all 189 central SOEs officially under SASAC's administration since 2003.

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Guoyou zichan jiandu guanli weiyuanhui 国有资产监督管理委员会 [State-owned Assets Supervision and Administration Commission of the State Council (SASAC)]. 2019. *Guowuyuan guoziwei shouquan fangquan qingdan* 国务院国资委授权放权清单 [List of authorized powers delegated to SASAC by the State Council], 5 Jun. Available at http://www.sasac.gov.cn/n2588030/n2588924/c11421043/content.html. Note: this document is password-protected and not publicly accessible.

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