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CHINESE STATE-OWNED ENTERPRISES: AN OBSERVER'S GUIDE

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Abstract:

Not all of China's SOEs have evolved equally. To understand modern SOEs the paper contrasts the giant centrally owned firms in the energy and utilities sectors under the control of the central State-owned Assets Supervision and Administration Commission (SASAC) in Beijing – some of which have financial resources comparable to medium-sized countries - with the tens of thousands of provincially and locally owned SOEs that have survived reform with various degrees of state ownership and across all sectors. The paper finds that giant central SOEs may be politically important to Beijing, but most SOEs are provincial and local businesses operating in competitive, rather than monopolistic, environments. Instead of dealing with SOEs as a class, the challenge for policymakers is to deal with market structures that undermine competition, and to regulate socially harmful behaviour, irrespective of the ultimate owner of the capital involved.

Keywords: Chinese economy; state-owned enterprises; reform

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1 Introduction

State ownership is still at the heart of China's 'socialist market economy'. While China's economic reforms since 1978 have seen a radical rejection of central planning in favour of market coordination of economic activity, the basic ideology of state ownership of capital remains a persistent feature of Chinese economic policy. The Third Plenum 'Decision' in 2013 was remarkable not only for promoting the "decisive role of the market in allocating resources", but also for seeing this as being consistent with "the dominant position of public ownership" and "the leading role of the state-owned sector" (Communist Party of China 2014).

For those doing business with China, and for governments which are required to set their own policies in response to China's economic re-emergence, it is useful to have a solid understanding of how public ownership is organized though state-owned enterprises (SOEs), and whether state ownership is likely to affect how businesses behave – both in China and abroad.

There is a persuasive case for framing the central narrative of China's economic success story around the emergence of a dynamic private economy (Naughton 1996; Lardy 2014); however, both the initial ubiquity of state ownership, and gradualist reforms that have replaced direct administrative controls over SOEs with market-based discipline, help explain the evolution and adaptation – and in some sectors, continued dominance - of SOEs throughout the economy. Despite the importance of the private sector to China's economic growth, fewer than a third of China's top 500 firms by revenue are private, and they earn less than 14 per cent of that group's revenue.

Not all SOEs have evolved equally. To understand modern SOEs the paper contrasts the giant centrally owned firms in the energy and utilities sectors under the control of the central State-owned Assets Supervision and Administration Commission (SASAC) in Beijing – some of which have financial resources comparable to medium-sized countries - with the tens of thousands of provincially and locally owned SOEs that have survived reform with various degrees of state ownership and across all sectors.

Provincial and local SOEs are highly fragmented, with the supervision of assets spread across 36 provincial-level asset management commissions, with hundreds more at the municipal and even district level. The category is not trivial. Among China's top 500 companies, central SOEs and financial institutions account for roughly half of the revenue, but another quarter goes to provincial-level SOEs. Adding in smaller firms, provincial and local SOEs collectively account for more capital than the central government.

The diversity of SOEs makes it difficult to draw reliable conclusions about a firm based on state ownership alone. While China's largest and most important firms are almost all SOEs, the converse is not true – most Chinese SOEs are neither large nor strategically important to Beijing. Similarly, while players in China's monopoly sectors are SOEs, most SOEs have long since lost their protected status in the domestic market.

Finally, it is not likely and perhaps not even desirable that Chinese SOEs should quickly disappear from the landscape. The 2013 Decision of the 3rd Plenum of the Communist Party Central

Committee signaled more private capital for, but not privatisation of, SOEs. Rather than looking for a bright line between state and private ownership, Chinese and international business and policymakers will need to be comfortable with a much more androgynous approach to state capital.

2 State owned enterprises, and state holding companies.

The term 'state owned enterprise' is defined by the Chinese National Bureau of Statistics as an entity registered in accordance with the relevant state regulation, of which the assets are entirely owned by the State (National Bureau of Statistics of China 2013b).

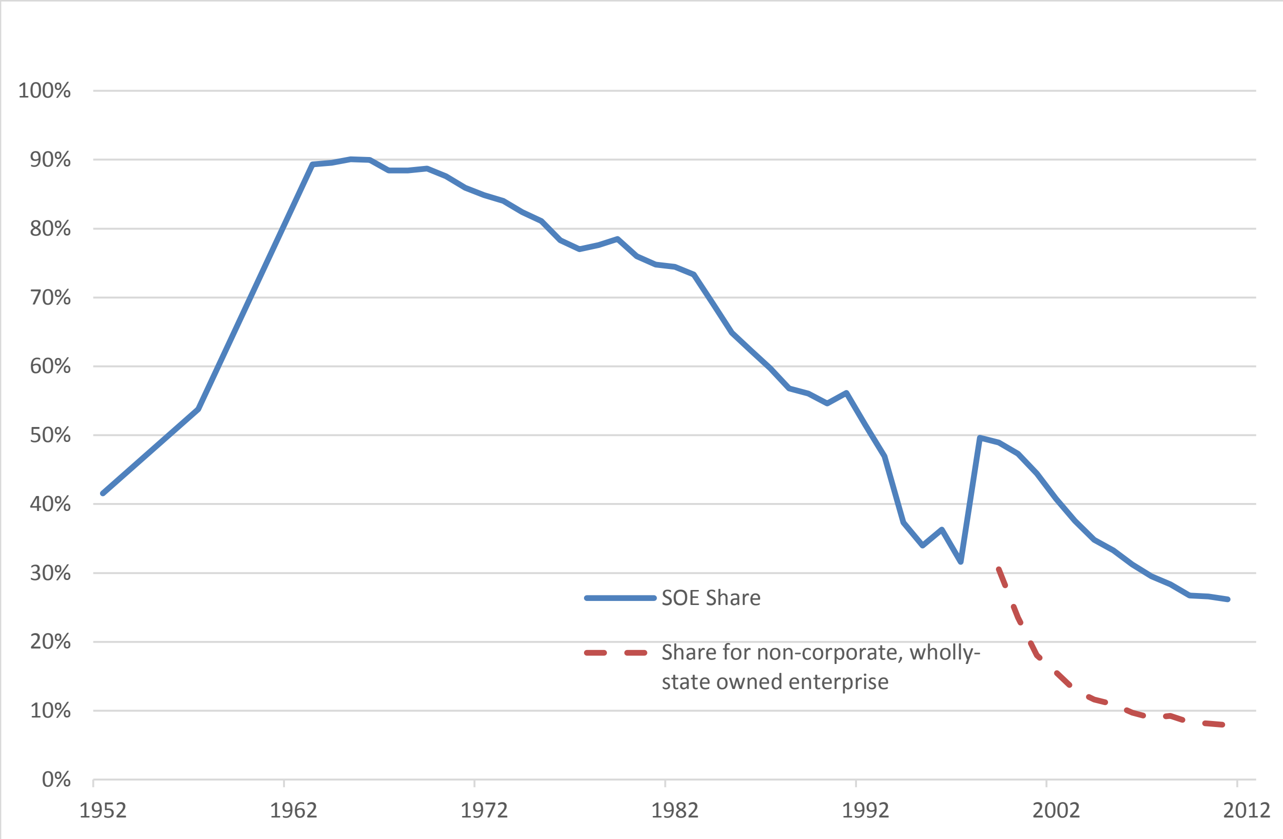
State owned enterprises often act as holding companies for 'state-holding enterprises', which are enterprises with mixed ownership in which the state is the largest (but not necessarily the majority) owner. These are often partially privatised or publicly listed enterprises, in which an SOE (or another state-holding enterprise) is the largest shareholder (National Bureau of Statistics of China 2013b).

Official documents often use 'state-owned enterprise' in a broader sense encompassing both state owned enterprises and state-owned holding companies. This paper follows the broader definition, reflecting the state's position as ultimate controller of the firm. Where the distinction is relevant, 'wholly state-owned enterprises' will be used to refer to state owned enterprises entirely owned by the state, and 'partial state-owned enterprises' will refer to state owned holding enterprises.

2.1 Origins and reform of state owned enterprises

China's first generation of communist leaders sought to rapidly develop the economy by promoting capital-intensive industrialisation. Given China's particularly early state of development (90 per cent of the population remained rural and lived in subsistence), leaders needed to create a new set of institutions to be able to force industrial investment, and to carry out the 'heavy industry-oriented development strategy' that they had chosen (Lin et al. 2003, p.21). Reforms included the collectivisation of agriculture and the monopolisation of industry by the state. Beginning in the late 1950s, all non-agricultural industries and urban labourers were brought into the "Party State Inc." (Wu 2005). Urban workers were employed in SOEs that provided not just employment, but also social services from birth to death. By the beginning of the 1960s, SOEs produced 90 per cent of output in the industrial sector (figure 1).

Figure 1 SOE share of gross industrial output



Source: Author calculation based on CEIC China Database

The plan was not strictly monolithic. Due to China's geographic size, its large population, its low industrialisation, and weak central administrative capacity, the layout of industry and its administration was created differently from other planned economies. The economy was organised according to a multi-layer-multi-regional form. Regions were divided into 'cellular' and relatively self-sufficient economic operating units. The largest of these economic and administrative units was the province, which was divided further by prefecture, county, township (previously commune) and village (previously brigade) (Qian 1993, p.544).

The state managed these divisions through corresponding levels in the state hierarchy. Each level managed enterprises and organisations assigned to it, as well as the hierarchical levels beneath it. Enterprise activity at each level was based on necessities at that level. The county government controlled the enterprises assigned to that level in the hierarchy (for example, the finance bureau and textile industry), and it also oversaw township governments within its territory. The provincial administrative level would control larger-scale enterprises such as steel production. This system continued down the levels of state hierarchy.

The planning mechanism also suppressed interest rates, input prices, wage rates and living expenses which further drove up industrial profits which in turn financed the state. By the 1970s over 80 per cent of budgetary revenues were collected from the industrial sector (Naughton 1992, p.16) and then largely reinvested. But the system did little for efficiency. State officials appointed the management of firms, assigned labour and administered cash flows. They took little responsibility for firm efficiency, since additional resources could be negotiated bureaucratically (Wu 2005).

By the beginning of China's modern economic reforms in 1978, it was inevitable that the bulk of China's industrial output – around 80 per cent – came from these urban state owned enterprises. The subsequent growth of the industrial sector can then be seen as a gradual decline in the relative importance of state owned enterprises, as rural collectives, and later private enterprises expanded to take advantage of China's rapidly liberalising markets for industrial goods.

2.2 Early reforms to the state sector

China's leaders began to experiment with elements of the market mechanism alongside the planned economy in the late 1970s. They adopted two important firm-level reforms to redirect enterprises toward market-based behaviour.

The first was the 'profit retention system' that allowed firms to retain some of their revenues. The state quickly realised the value of the new system to motivate production growth, and made the system universal across the country by 1980. Profit retention rates were initially set very low, but their success in motivating production growth saw retention rates increase. The amount of profit retained by a firm was based on the total funds it had been granted in the previous year from the state to carry out its industrial activities (Naughton 1996, p.101).

The second significant enterprise-level reform was the 'managerial responsibility system'. Its feature was to impose on SOE managers a profit delivery target to the state for the year, combined with a high profit retention rate - frequently 80 per cent - for profit above the target (Naughton 1996, p.122). This system both guaranteed increased revenue for the state, and encouraged firm managers themselves to seek above-target growth.

The early reforms to increase SOE autonomy were made in conjunction with the removal of administrative restrictions that had been in place during the planned era. This effectively lowered barriers to entry into new industrial markets, which 'de-monopolised' state industry (Naughton 1992, p.14). As a result the 'township and village enterprises' (TVEs), which belonged to lower levels of the state hierarchy, rapidly expanded to produce goods in sectors that had previously been monopolised by urban SOEs.

While technically owned by local governments, many TVEs were de facto private enterprises and were either owned or leased by private entrepreneurs. They wore a 'red hat' in order to receive preferential support of local government and to escape the political harassment still associated with private enterprise (Garnaut & Song 2004). Access to cheap rural labour, and lower capital requirements in light industry led them to chase profits in this sector, sharply increasing the competition facing SOEs and eroding the monopoly profits they had enjoyed.

By the 1990s, the consolidation of China's marketisation was effected in conjunction with the lessening of restrictions on private ownership. China's markets by this time were comprised of state and non-state firms in competition with one another. In this new market environment many small and medium SOEs became unprofitable and loss making, incurring debt for their local state owners. This was in part because SOEs remained burdened by costly social obligations to their employees, for example, by being obligated in providing education; housing; healthcare and other general living allowances. Non-SOEs, on the other hand, were unburdened by social obligations and were more nimble profit-maximisers in the market environment.

The Third Plenary Session of the 14th Central Committee meeting in November 1993, which sought to establish China's 'socialist market economy', pushed ahead with SOE reform by encouraging SOEs to adopt corporate forms, though not yet forcing them to face modern corporate incentives (Wu 2005). But many state owned enterprises were unprofitable and being left behind by the private economy.

Growing local government debt became the most important impetus for the eventual corporatisation and, in many cases, the privatisation of SOEs. In 1995, 72.5 per cent of local SOEs were unprofitable, compared to only 24.3 per cent of larger central SOEs (Garnaut et al. 2006, p.38). By 1995 the central government had decided on the policy "keeping the large and letting the small go" which saw a massive retrenchment of loss-making SOEs and their employees (Zhang & Freestone 2013). The 'red hatted' TVEs were ordered to privatise officially in 1998 (Garnaut & Song 2004).

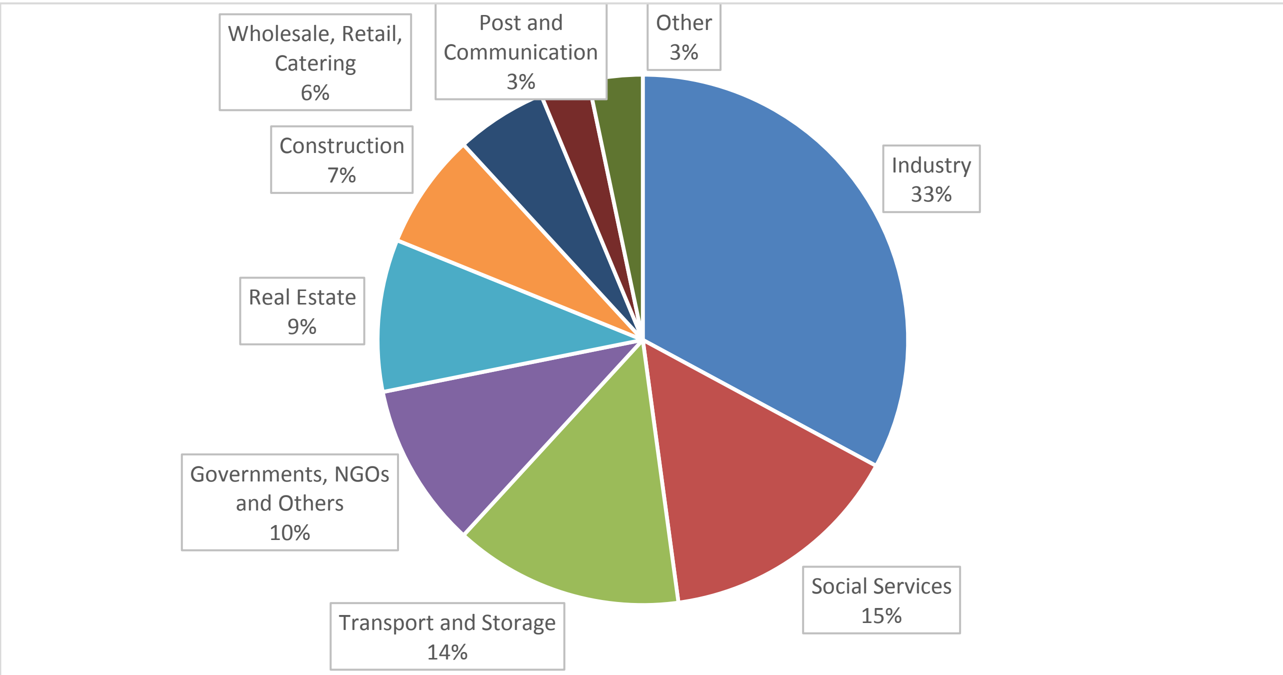
SASAC was created in 2003 to be responsible for the supervision and management of state-owned assets of non-financial enterprises (SASAC n.d.), and today serves as the link between the state as owner and the state owned enterprise. In 2005 the State Council removed formal barriers to private investment in most areas (Rong 2013). However SASAC identified in 2006 a number of strategic industries in which it was to maintain a majority shareholding in all firms (armaments, power generation and distribution, oil and petrochemicals, telecommunications, coal, civil aviation and shipping) as well as 'basic and pillar' industries in which it would maintain a majority shareholding in the leading firms (machinery, automobiles, information technology, construction, steel, base metals, chemicals, land surveying, research and development). In other sectors SASAC need maintain a controlling stake in key companies (United States International Trade Commission 2007).

2.3 The modern state sector

Despite the relative decline of the state sector, and particularly of the old-fashioned non-corporatised SOE, China still had 155,000 state owned enterprises by 2013, collectively controlling US$16.9 trillion of assets. After liabilities, the Chinese Ministry of Finance estimated the net value of SOE assets at $6.0 trillion. After subtracting the equity of minority (non-state) shareholders, the state's equity was $4.7 trillion (China Ministry of Finance 2014).

Just over a third ($5.6 trillion) of total SOE assets were held by the 113 SOEs that are administered by the central SASAC. Around ten per cent ($2.2 trillion) is controlled by SOEs that are controlled by 75 other central government ministries. These include financial institutions, which were not brought into the SASAC system, cultural institutions, China Post and the national tobacco monopoly. These are subject to different reporting and regulatory mechanisms. This leaves more than half of total SOEs assets ($9.0 trillion) in the hands of local governments (China Ministry of Finance 2014). This is spread across the economy (Figure 2).

Figure 2 Total SOE assets by economic sector, 2013

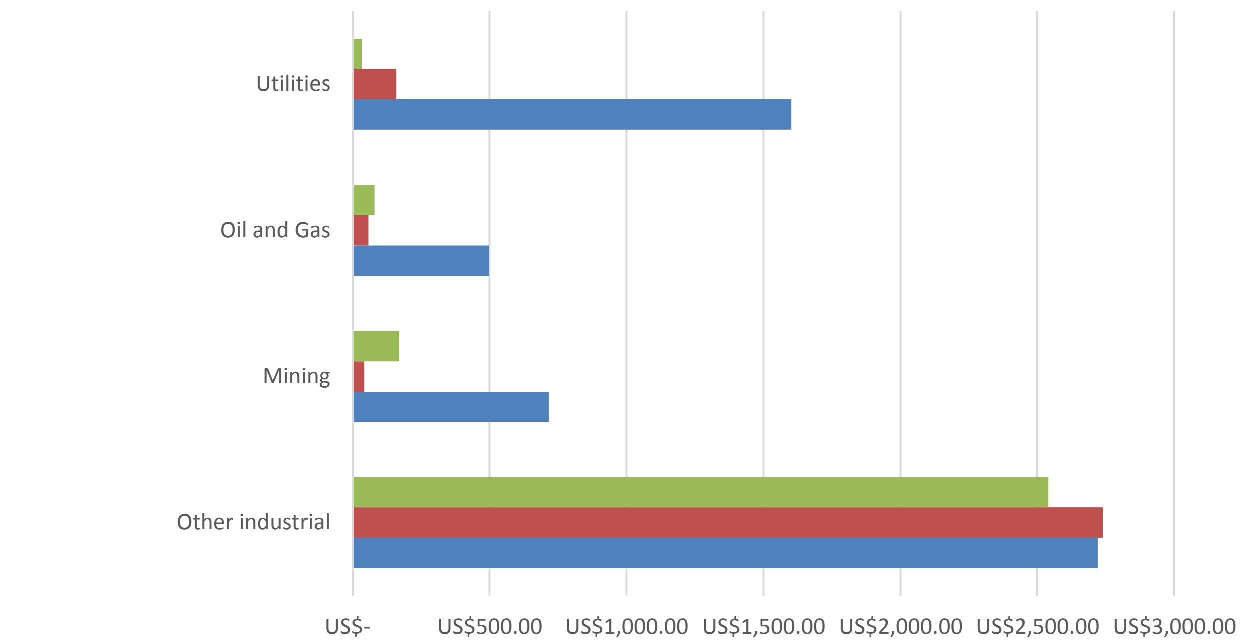


Source: (China Ministry of Finance 2014).

Note: Other includes Science Research and Technical Services, Agriculture, Education, Culture and Broadcast, Geological Exploration and Water Conservancy, IT and Health, Sports and Welfare.

Despite the relative decline of SOE importance in the industrial sectors, around half of total industrial assets held by SOEs are either in industries that are either naturally monopolistic, or strategically important – including utilities, oil and gas, or resources. In other industrial sectors, SOEs continue to hold around $2.7 trillion in total assets, similar to the shares held by private capital and foreign (including Hong Kong and Taiwan) capital, making SOEs a minority player in the competitive rump of the industrial sector (Figure 3).

Figure 3 Industrial sector assets by owner



	Other industrial	Mining	Oil and Gas	Utilities
Private	US$2,540.39	US$169.87	US$80.24	US$32.71
Foreign	US$2,739.22	US$42.89	US$57.07	US$159.12
State-owned and State Holding	US$2,720.10	US$716.29	US$497.84	US$1,601.47

Total Assets (2013 billion USD)

Source: Authors calculation from National Bureau of Statistics of China Yearbook, (2014a; 2014b; 2014c). Note: Oil and gas includes Extraction of Petroleum and Natural Gas and Processing of Petroleum, Coking and Processing of Nuclear Fuel, Utilities includes production and supply of electricity, gas and water.

3 The Giants – Large Central SOEs

While the central government has let go of small, unprofitable SOEs, it has certainly consolidated and retained China's largest companies, sometimes as direct descendants of entire government ministries, which are directly controlled by the central government. Figure 4 lists the top 50 Chinese firms in 2013 by revenue. These firms accounted for over $4.3 trillion in annual revenue, and just under half of the $9.2 trillion in revenue accrued in total by China's 500 largest firms as reported by the China Enterprise Confederation/China Enterprise Directors Association (2014). Twenty-seven of the top 50 Chinese enterprises are central SOEs under the control of central SASAC, accounting for $2.8 trillion in revenue. A further ten are controlled centrally by other ministries, accounting for $861 billion in revenue.

Figure 4 Top 50 Chinese firms by revenue

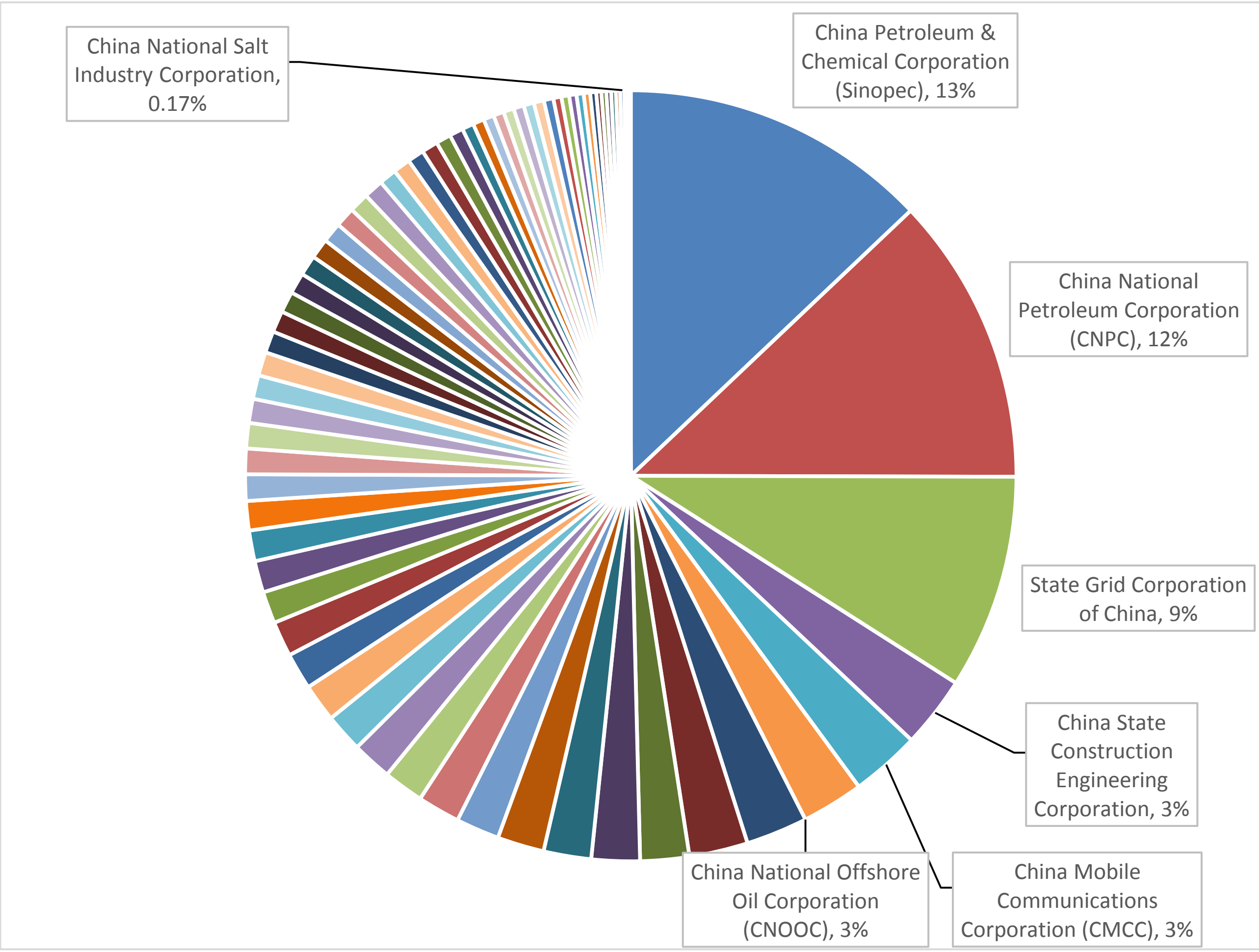
Ranking	Group or Company Name	2013 Revenue ($US Billion)	Owner
1	China Petroleum & Chemical Corporation (Sinopec)	475.7	Central SASAC
2	China National Petroleum Corporation (CNPC)	445.7	Central SASAC
3	State Grid Corporation of China	331.1	Central SASAC
4	Industrial and Commercial Bank of China Limited (ICBC)	149.5	Central Other
5	China Construction Bank Corporation (CCB)	124.5	Central Other
6	Agricultural Bank of China	114.1	Central Other
7	China State Construction Engineering Corporation	110.0	Central SASAC
8	China Mobile Communications Corporation (CMCC)	106.9	Central SASAC
9	Bank of China Limited (BOC)	104.9	Central Other
10	China National Offshore Oil Corporation (CNOOC)	95.3	Central SASAC
11	China Railway Construction Corporation Limited	95.1	Central SASAC
12	SAIC Motor Corporation Limited	91.4	Provincial SASAC
13	China Railway Group Limited	90.5	Central SASAC
14	ChinaLife Insurance Company Ltd.	80.4	Central Other
15	Sinochem Group	75.4	Central SASAC
16	FAW Group Corporation	74.5	Central SASAC
17	Dongfeng Motor Corporation	73.5	Central SASAC
18	ChinaSouthern Power GridCo., Ltd.	72.2	Central SASAC
19	China Development Bank	70.9	Central Other
20	Ping An Insurance (Group) Company of China	67.1	Provincial Other
21	China Minmetals Corporation	67.0	Central SASAC
22	China Resources (Holdings)Co., Ltd	65.5	Central SASAC
23	China North Industries Group Corporation	62.2	Central SASAC
24	ChinaTelecom Corp. Ltd.	61.6	Central SASAC
25	CITIC Group	60.6	Central Other
26	Shenhua Group Corporation Limited	59.4	Central SASAC
27	China Pacific Construction Group Limited	59.2	Private
28	China Post	58.6	Central Other
29	China South Industries Corporation Group	58.4	Central SASAC
30	Aviation Industry Corporation of China	56.4	Central SASAC
31	Tianjin Material＆Equipment (TEWOO）Group Corporation	54.6	Provincial SASAC
32	China Communications Construction Group	54.2	Central SASAC
33	People's Insurance Company (Group) of China	49.2	Central Other
34	China United Network Communications Corporation Limited (China Unicom)	49.2	Central SASAC
35	Bao Steel Group Corporation	49.0	Central SASAC
36	Bank of Communications (BOCOM)	47.9	Central Other
37	China Huaneng Group	47.4	Central SASAC
38	Suning Corporation	45.2	Private
39	China Aluminum Corporation	45.1	Central SASAC
40	BeijingAutomotive Industry HoldingCo., Ltd.	43.0	Provincial SASAC
41	China National Building Materials Group Corporation	40.7	Central SASAC
42	Greenland Group	40.7	Provincial SASAC
43	HebeiIron & Steel Group Co. Ltd	40.6	Provincial SASAC
44	China National Chemical Corporation	39.4	Central SASAC
45	Lenovo Holdings Ltd.	39.4	Private
46	China National Machinery Industry Corporation	39.2	Central SASAC
47	ShandongWeiqiao Pioneering Group Co.Ltd	39.0	Private
48	Huawei Technologies Co Ltd	38.6	Private
49	ShanxiCoking Coal Group Co., Ltd.	38.1	Provincial SASAC
50	Amer International Group	37.8	Private

Source: Firm rankings and revenue from the China Top 500 Enterprises list (China Enterprise Confederation/China Enterprise Directors Association 2014), private firms from the China Top 500 Private Enterprises 2014 list (Sina 2014), firm ownership information from central and local SASAC websites, central Huijin website and annual reports.

Even among these companies, the top three are not 'typical' or broadly representative of central SOEs. Together they account for nearly one third of the revenue of China's top 50 firms. As an indication of the scale, the leading firm, China Petroleum & Chemical Corporation (Sinopec)'s 2013 revenue was $476 billion, only marginally behind the Australian entire taxation revenue of $510 billion in 2013 (according to the IMF). The second largest firm by revenue is Sinopec's twin, the China National Petroleum Corporation (CNPC) with annual revenue slightly less at $445.7 billion. China's national electricity utility, the State Grid Corporation, is third. It has almost three times more revenue than the next largest central SOEs – the China State Construction Engineering Corporation and telecommunications monopoly, China Mobile.

But these are not typical, even for SOEs. In 1983 Sinopec was created from the Ministry of the Petrochemical Industry – which monopolised downstream production - and in 1988 CNPC was established from the Ministry of the Petroleum Industry – which had monopolised upstream domestic production. While generally perceived as monopolists today, they in fact represent a duopoly following a restructure in the mid-1990s that mixed the upstream and downstream assets of the two in an attempt to engender competition (Wu 2005). Even though central SOEs tend to be large – more than half of them are amongst the top 500 Chinese firms – they are not comparable in size or scope to the these. For example, the China National Salt Industry Corporation has revenue of $6 billion – making it about 1.4 per cent the size of Sinopec.

Figure 5 Revenue in 2013 of China's 69 largest central SOEs



Nevertheless, the top fifty or so SOE heads have their business leadership reportedly appointed by the Organisation Department of the Communist Party with the approval of the Politburo. Leadership of central SOEs listed prominently on the Communist Party's "Chinese Leadership Cadre Database" alongside Politburo Members, government ministers, judges and provincial governors.[2]

Also toward the top of China's largest enterprises are the centrally owned banks and insurance groups, the sovereign wealth fund China International Trust and Investment Corporation (CITIC), as well as China Post and the national tobacco monopoly. These sit outside the SASAC system account for a further 20 per cent of revenues of the top 50.

Despite the emergence of a flourishing private sector in China's economy private firms have hardly breached the ranks of the largest Chinese SOEs. China's 20th largest company – Ping An Insurance Group – is relatively widely held by private shareholders, although its largest shareholder (5.41) is Shenzhen Investment Holdings (Ping An Insurance (Group) Company of China 2015). China Pacific Construction Group, ranked 27th by revenue, is an unlisted, private infrastructure development company (Pacific Construction Group Company Limited. 2015)

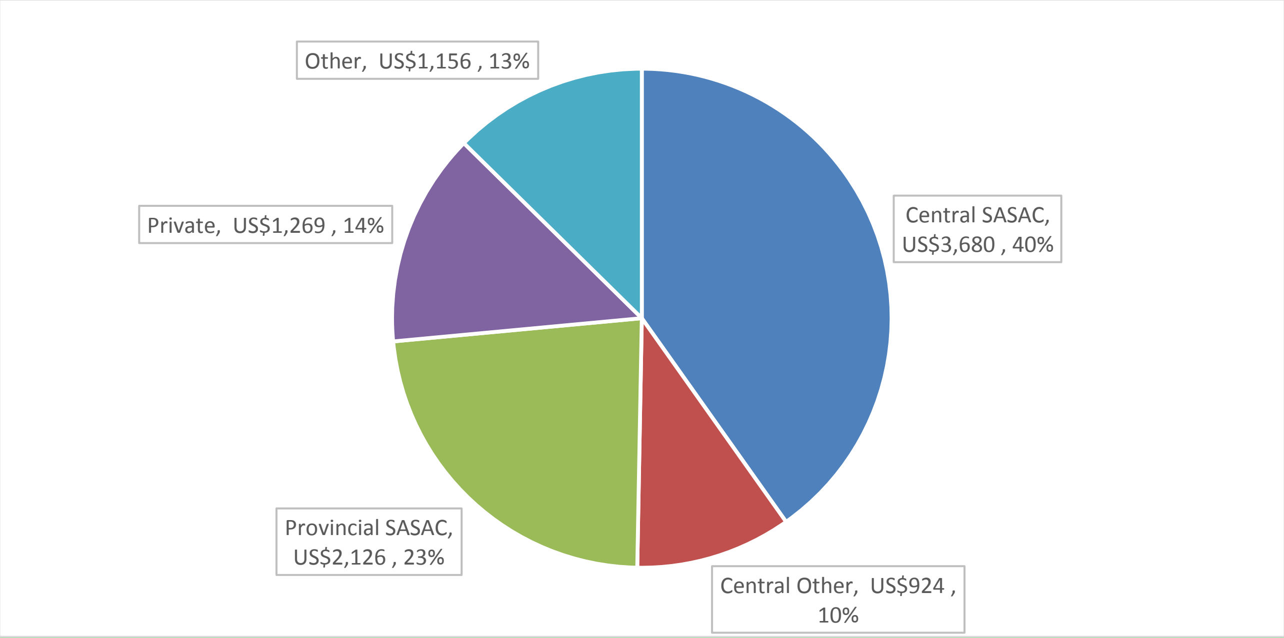
Using the list of China's Top 500 Private Enterprises 2014 (Sina 2014) to identify remaining private firms, retailer Suning (38th), computer manufacturer Lenovo (45th), textiles manufacture Shandong Weiqiao (47th), mobile electronics manufacturer Huawei (48th) and metals producer Amer International Group (50th) had revenue between $35 billion and $46 billion for 2013.

3.1 The rest – Provincials and local SOEs

While the central government (through central SASAC and other central ministries) controls half the revenue of the top 500 firms (Figure 6), the next most important owners are China's provinces. Provincial SOEs lack the sheer scale of the central SOEs and are often not in the protected strategic or pillar industries. Nevertheless, they are the survivors of the corporatisation, privatisation and reform of state assets over the last twenty years.

[2] This official web database (http://cpc.people.com.cn/gbzl/flcx.html) contains the names and biographies of over 2,000 top cadres, of whom 146 belong to central state owned enterprises and 39 belong to central financial as at 15 June 2015.

Figure 6 Revenue in 2013 ($US billion) of China's top 500 companies, by ownership



Note: State ownership of firms is established based on listings of provincial SOE names on the central SASAC and provincial SASAC websites. Due to the number of municipal level SASAC sub-branches, the ownership of municipal level SOEs is not identified in this list and so are included in the 'other category' which also includes collectively owned enterprises. Companies in the 'other' category are local SOEs, or cooperatively owned 'collective enterprises' – which are the descendants of township and village enterprises that have not been officially privatised.

For a more representative view of provincial and local SOEs it is necessary to look beyond China's biggest or most politically important companies. There were 36 SASACs, including at provincial and six at municipality level, that reported directly in China's State-owed Assets Supervision and Administration Yearbook 2013 (SASAC 2013). This covers 103,637 SOEs, and includes a further breakdown of state assets from 499 city, county and district level SASACs. This shows that more than half of the state assets are held at levels below provincial level. Moreover, even at the provincial level some SOEs are not administered through the SASAC system.

While all provinces have substantial SOE holdings, richer provinces tend to have larger state assets. This is not to suggest that the more prosperous regions of the Chinese economy are state led – rather, provinces with a higher concentration of state ownership in the industrial sector tend to be in the poorer interior region. Even these can have one or large SOEs – for example, among Guangxi's 41 listed provincial level SOEs, the Guangxi Construction Engineering Group is the 220th largest Chinese firm by revenue in 2013. Four other Guangxi SOEs are listed in the top 500 (China Enterprise Confederation/China Enterprise Directors Association 2014).

Figure 7 Provincial and local SOEs by region, 2012.

Province or major municipality	Number of SOEs	Value of State Equity ($US billion)	Local units reporting state assets	Percentage of State Assets held by local units
Beijing	6688	98.4	18	22%
Tianjin	4158	103.7	N/A	32%
Hebei	2592	41.7	11	47%
Shanxi	5355	45.6	11	22%
Inner Mongolia	843	32.9	12	N/A
Liaoning	3157	66.8	14	76%
Including Dalian	*638*	*21.5*	9	51%
Jilin	917	20.2	10	73%
Heilongjiang	2770	17.0	13	67%
Shanghai	10667	209.2	17	20%
Jiangsu	7056	164.2	13	88%
Including Ningbo	*782*	*29.7*	15	45%
Zhejiang	5242	237.8	11	83%
Anhui	2767	95.8	16	72%
Fujian	4511	69.6	9	75%
Including Xiamen	*1190*	*19.3*	6	14%
Jiangxi	1654	58.6	11	52%
Shandong	5328	90.0	17	69%
Including Qingdao	*890*	*18.6*	13	25%
Henan	4062	43.5	18	34%
Hubei	2499	70.1	17	58%
Hunan	2106	57.5	14	77%
Guangdong	8136	129.3	21	76%
Including Shenzhen	*1151*	*28.8*	4	100%
Hainan	713	15.0	19	46%
Guangxi	3488	58.3	14	54%
Guizhou	2236	50.5	9	58%
Sichuan	3580	112.9	21	78%
Including Chengdu			20	69%
Chongqing	2588	145.1	40	100%
Yunnan	2848	65.7	16	63%
Shaanxi	3362	65.7	11	35%
Gansu	1462	38.3	14	23%
Qinghai	551	17.0	8	29%
Tibet	403	1.5	7	44%
Ningxia	477	6.3	5	16%
	1421	24.7	15	73%
Totals	103637	2,253.0	499	59%

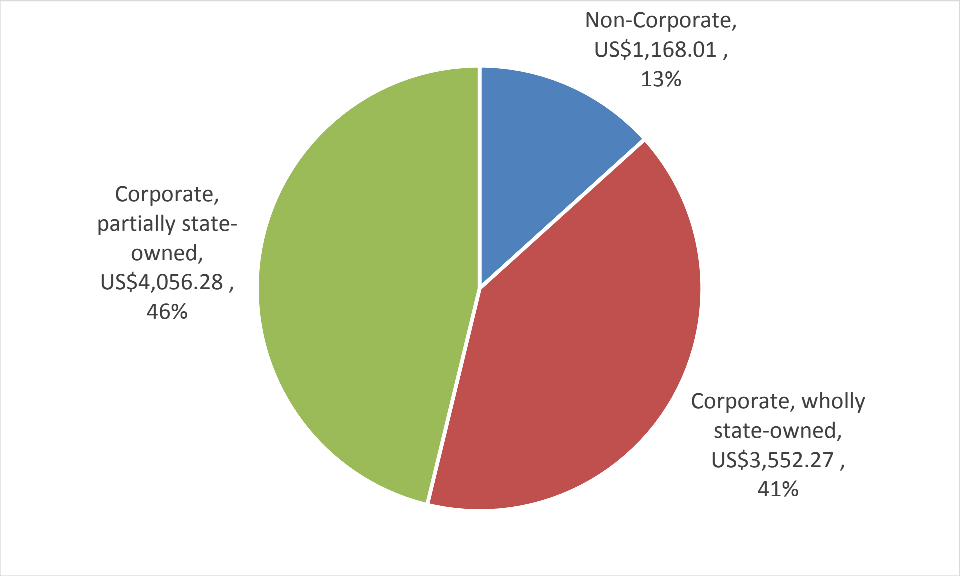
Source: (SASAC 2013). Note: Percentage of state assets held by local units is not calculated on the same basis as state equity.

Mixed capitalism

Not only is a large share of SOE assets held outside the large, central SOEs, but much of it is also held in corporate structures that are only partially state-owned. In 2012 there were 25,314 SOEs that met the stricter National Bureau Statistics definition as an entity registered in accordance with the relevant state regulation, of which the assets are entirely owned by the State, which combined held \$1.2 trillion of assets, or around 13 per cent of state assets (figure 8).

The remaining 126,506 SOEs are more correctly classified as state-owned holding corporations – of which \$3.6 trillion in assets is held by SOEs which have been corporatised but remain wholly state owned, and \$4 trillion of which have been corporatised and partially privatized. In these cases the state is usually the largest shareholder, but need not be a majority shareholder.

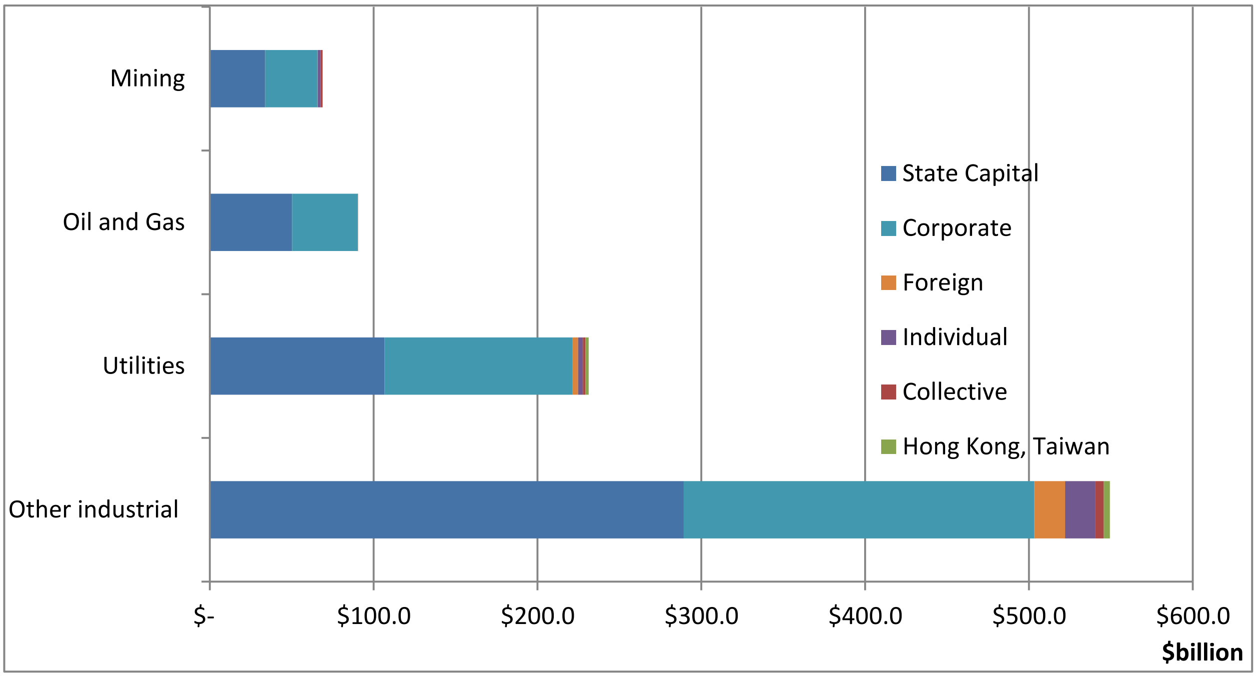
Figure 8 State assets by SOE type



Source: Authors calculation based on (SASAC 2013, p.713)

Further insight into the nature of this partially state-owned sector can be revealed by a closer look at industrial sector statistics for that year. Around half the capital registered for SOEs actually comes from non-state sources – even in utilities, oil and gas, and mining sectors that are dominated by SOEs (figure 9).

Figure 9 Sources of capital in industrial State-Owned and State-Holding Companies



(National Bureau of Statistics of China 2013a)

The enthusiasm for corporate forms created multi-tiered corporate groups in which a holding company nominally controls "daughter companies", "great-granddaughter companies" and so on without clear accountability or coordination between levels. But in many cases, even partially-privatised listed companies can still effectively be controlled by their 100 per cent state-owned parent companies (Wu 2005).

As a consequence, while it is easier to determine which Chinese companies are wholly state-owned (they are controlled directly by SASAC and usually listed on SASAC websites), it is harder to determine which firms are controlled by SOEs. In the case of publicly listed companies, the identity of their largest shareholders can be ascertained from public records; for non-listed companies, a more forensic investigation is needed to determine whether or not it is controlled by an SOE.

4 Reform directions

The forces that have supported China's rapid development in the decades after reform are fading, as the productivity benefits from structural change slow as China moves toward the technology frontier. Capital efficiency rather than gross investment will be an important determinant of China's further growth – and so improving the efficiency of state owned capital is a priority. The Chinese policy debate surrounding SOEs today often revolves around perceptions that they are less efficient than private firms. Relative to the private sector, SOEs consume a large proportion of capital, raw materials, and intermediate inputs to produce relatively small shares of gross output and value added (World Bank; Development Research Centre 2013).

While it is beyond the scope of this paper to explore the question of SOE performance, it is commonly argued that a large share of state enterprise profits comes from a few enterprises where profitability is associated with limits on competition. This can be either through natural monopoly or administrative 'state enforced' monopoly (World Bank; Development Research Centre 2013).

'Administrative monopoly' refers to the market power artificially created by government policies that restrict competition. The most important contemporary policies that create administrative monopolies are explicit or implicit restrictions on private or foreign firm entry into various economic activities, such as government mandated use of specific products or services. The incentive for local governments to create administrative monopolies remains in place, and the recent rapid expansion of provincial and local SOEs is an issue needing renewed policy attention, in case their growth crowds out private sector investment or dampens competition.

The imperative to improve efficiency by further dismantling monopolies runs up against a long-standing Chinese development goal to nurture a group of SOEs and non-state enterprises into 'national champions' (Nolan , 2001). Drawing inspiration from the industrialisation experience in Japan and Korea (Perkins 2013), the idea is that leading Chinese brands would be able to compete with the world's leading companies. But the idea of adopting government policy in support of designated 'national champions' often means shielding them from various forms of domestic competition. Managing this dual objective of raising the efficiency of the market, while providing special privileges to specific champions remains debated among policymakers (Zhao 2014).

4.1 The 2013 Third Plenum Decision

The Third Plenum of the 14th Central Committee meeting in 1993 established China's 'socialist market economy'. Twenty years of economic development later, the "Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform" (Communist Party of China 2014) agreed by the Third Plenum of the 18th Central Committee in November 2013 has not backed down from public ownership. The decision states "[w]e must unswervingly consolidate and develop the public economy, persist in the dominant position of public ownership, give full play to the leading role of the state-owned sector, and continuously increase its vitality, controlling force and influence."

This does not signal a return to old-style SOEs. An overall theme of the decision is to "deepen economic system reform by centering on the decisive role of the market in allocating resources". While preserving public ownership as the "foundation of the socialist market economy", the decision attempts to improve efficiency by greater exposure to market discipline, including breaking up "all forms of administrative monopoly" and the "separation of government administration from enterprise management" in naturally monopolistic sectors.

The decision places the property rights of the state and private sectors on an equal level. It states that "property rights of the public sector are inviolable, as are those of the non-public sector". At the same time, it blurs the boundary between what is the public and non-public by further mixing state and private capital, noting that "[w]e will allow more state-owned enterprises and enterprises of other types of ownership to develop into mixed enterprises. We will allow non-state-owned capital to hold shares in projects invested by state-owned capital”

This emphasises the state as an asset manager and investor, rather than a controller of assets. Early reports from China suggest that it is looking at Singapore’s sovereign wealth vehicle Temasek as a model for development on the Chinese mainland (Yang 2014), but as at the time of writing (June 2015) no detailed policy directions have been issued.

This may disappoint reformist economists who hoped for more outright privatisation as a means of clearly delineating the scope of state ownership and control in the economy (Lin 2012). The closest the Decision gets to privatisation is a pledge to “transfer part of the state-owned capital to social security funds” – but even this could be interpreted as a way of absolving existing SOEs from their stock of pension liabilities (Wu 2005).

However, the merit of this approach is that it allows for further market discipline to be imposed on SOEs – effectively reducing state control in the economy – while maintaining ideological continuity with the ‘socialist market economy’ established in 1993. This implies that the ‘SOE’ label may be here to stay in the Chinese economy, even as its character becomes further removed from its initial conditions as part of “Party State Inc.”

5 Conclusion

State ownership in China’s economy will persist, although slowing growth and concerns about the misuse of state privilege for private gain will attract even closer scrutiny to SOEs. Wholesale privatisation is not on the table, but non-state capital could further dilute the state’s ownership share of SOE assets. This should both be palatable to China’s policymakers, and also importantly, help increase the overall performance of the economy thanks to increased market discipline.

Giant central SOEs may be politically important to Beijing, but most SOEs are provincial and local businesses operating in competitive, rather than monopolistic, environments. Instead of dealing with SOEs as a class, the challenge for policymakers is to deal with market structures that undermine competition, and to regulate socially harmful behaviour, irrespective of the ultimate owner of the capital involved.

Foreign businesses and governments need not read too much into the ‘state owned enterprise’ label when assessing the appropriate business or policy risks associated with a particular firm. Sinopec – China’s largest central SOE – is qualitatively different from the Guangxi Construction Engineering Group. Chinese SOEs are here to stay, even as the practical distinction between state and non-state enterprise fades away. Moreover, in sectors of particular political or strategic interest, the Chinese authorities will naturally consider all available instruments – not just formal state ownership – in order to pursue their goals.

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