SYSTEM REFORM OF CHINA’S STATE-OWNED ENTERPRISES, 1978-1993 — REVIEW AND APPRAISAL —

CHERNG-SHIN OUYANG

OCCASIONAL PAPER SERIES No.9501
March 1995
Occasional papers are intended to provide economic information and stimulate further research. The opinions expressed within are solely those of the authors and not those of the Chung-Hua Institution for Economic Research.

Any comment or communication, please write to: Publications Department, Chung-Hua Institution for Economic Research, 75 Chang-Hsing Street, Taipei, Taiwan 106, ROC.
SYSTEM REFORM OF CHINA'S STATE-OWNED ENTERPRISES, 1978-1993 — REVIEW AND APPRAISAL —

CHERNG-SHIN OUYANG

OCCASIONAL PAPER SERIES No.9501
March 1995
Occasional papers are intended to provide economic information and stimulate further research. The opinions expressed within are solely those of the authors and not those of the Chung-Hua Institution for Economic Research.

Any comment or communication, please write to: Publications Department, Chung-Hua Institution for Economic Research, 75 Chang-Hsing Street, Taipei, Taiwan 106, ROC.

by

Cherng-Shin Ouyang

Research Fellow
Chung-Hua Institution for Economic Research

March 1995

Chung-Hua Institution for Economic Research
75 Chang-Hsing St., Taipei, Taiwan 106
Republic of China
-- Review and Appraisal --

I. Introduction

Conversion of the ramshackle state-owned enterprises (SOEs) in the former centrally-planned economies (CPEs) into dynamic and efficient operation units is now moving ahead at full speed. The task at hand involves, ultimately, a fundamental reconstruction of both the property rights and property relations in a system dominated by state ownership of the means of production. There has been, up to now, no fierce objection to this policy goal in these countries. But opinions differ, in this connection, with respect to both its concrete objective configurations and the means that are deemed competent. Hence, it seems contentious to formulate a generalised and all-embracing approach to the subject while the ends themselves are diffused. Moreover, from the viewpoint of overall system reform, the enterprise reform figures only as a component -- though perhaps the most significant component -- of a united front.

Quantitatively, successful rejuvenation of SOEs through properly-conceived methods would most probably favourably dictate the appropriate path of transition of the ex-CPEs. Because the bulky state sector in each of these countries traditionally consumes and delivers to the national economy an overwhelming proportion of goods and services; its recovery would help alleviate the burdens presently shouldered by the comparatively more dynamic nonstate sector. In qualitative terms, transformation of SOEs into purely private or mixed-ownership entities inescapably raises the
question of the intended degree of approximation to a capitalist system imparted by privatisation of state assets. The successive outcomes of the changing property rights and property relations brought about will determine the very nature of the economic system being examined. The evolving structure of the reforming economy will, in due course, be received as the basis of decision for subsequent reforms, *ad infinitum*. The Chinese practice, as documented in this essay, is not exceptional on this score. It is only because the mode and structure of the interdependence of the two undertakings in the Chinese setting are so different from those of other ex-CPEs that it is quite unique.

Regarding the transformation of SOEs, there have, however, been great differences between two major reforming blocs: that of the PRC in Asia, and that of the economies of Central and Eastern Europe (CEE) as well as the ex-USSR within the vast Eurasian continent. Currently, a great deal of attention has been directed to the contrast formed by the experiences of the two blocs. The more revolutionary East European and Russian approaches have spared practically most condition-creating works required which resulted in what seems an obvious solution to the demise of the pre-reform command system. In this case there has been a straightforward and massive campaign for quick privatisation (see e.g., Lipton & Sachs, 1990). The more conservative Chinese approach shows just the opposite attitude in the same undertaking. A cursory reflection on the relative merits of the two approaches suggests that to prescribe sufficiently compelling reform measures it is not strategically feasible to isolate the reconstruction of property rights and treat it as though it were a self-contained and sufficient tool for curing the ailing SOEs. In fact, a thoroughgoing transformation of SOEs necessitates adequate and simultaneous reform of all the structurally interdependent parts of the whole system.

This simultaneous reform sounds plausible in theory, but can hardly be pursued in practice. The Chinese experience in this respect since 1978 gives just such an example of overall reform, and is chosen as the testing ground for drawing useful inferences.

Implicit in any such an attempt is the often-neglected fact that economic reform must be a process taking place in time. This gives rise to the notion of reform package "sequencing" (Fisher & Gelb, 1990, pp.29-35; Newberry, 1991; Schmieding, 1992), as opposed to the "synchronising" perspective. This sequencing approach, as exemplified by China’s "evolutionary gradualism" (Murell, 1990; Weizman, 1993), allows
sufficient room for the development of basic institutions and mechanisms lacking both in China and other transforming economies. In comparison, the enforced radicalism of the East European type which emphasises speed more than anything else in reform sequencing is doomed. Numerous questions about reform sequencing and other debatable propositions are certain to arise in seeking to deduce some rules for reform of SOEs. This is notoriously the case for China's SOEs. Although gradually diminishing in relative importance compared to the nonstate sector, the state sector in China remains, notwithstanding, the backbone of a rapidly expanding national economy. It is perhaps not a coincidence that, being a lagging sector, like their East European counterparts, these badly-behaved enterprises appear to be quite resistant to reform. In China's ongoing modernisation, their very existence looms as a curiously dark shadow. But it is perhaps unfounded to maintain that SOEs themselves are the primary source of all troubles. Whether this recognition can stand the test of the new policies now being implemented in China is a vital point warranting further investigation. No less significant therefore is the question of the adequacy of these new reform prescriptions and possible alternative means for continued improvement in the event of abnormal repercussions.

To pursue these topics in a logical order of thematic development of related arguments, the materials of this paper are organised as follows: Section II sketches the status of Chinese SOEs prior to and during the current reform process. Section III turns to the ordering of the sectoral transformation process of SOEs according to the series of measures adopted in the PRC. That is, only the "sequencing" perspective is considered. Section IV gives an appraisal of both the merits and pitfalls of the ongoing enterprise transformation. Lastly, the main findings and implications of the present investigation are summarised in Section V.

II. The Pre-Reform Status of China's SOEs

To properly grasp the evolutionary nature of the current reform of SOEs in China, it is important to gain an understanding of their historical status, their mode of operation within the traditional state planning system, and their gradually-declining importance in the economy over the period of 1978-93. A description of these changes is given below as the base for further analysis in Section III.
II.1 Some Terminological Digressions

Chinese SOEs are juridically defined as “enterprises owned by the whole people.” But this official appellation leaves unconcealed the fact that, like their East European and Soviet counterparts, these enterprises are, in substance, deprived of a true owner. During the pre-reform period, the notion of public ownership of the means of production was the foundation for the use of a “mandatory plan.” To coherently execute the mandatory plan, a complex system of administrative-bureaucratic management was established in the name of socialised mass production. As such, the rights of ownership and management were unified under various state organs. However, the impersonal state cannot be responsible for the day-to-day operation of enterprises that run to hundreds of thousands in number, nor for their profits and losses that result. Even if enterprise autonomy were expanded, and enterprises held responsible for the consequences of self-management, they would still have to follow the incremental layers of administrative decrees, laws, and regulations contained in the mandatory plan. Thus, it was the administrative bureaucrats and party cadres who were making decisions in their role as the composite leadership.

The dubious nature of this system lies in the fact that, distracted from a symmetrical, penalty-incentives mechanism, the enterprise managers are not adequately motivated either to cut production costs or to raise operational efficiency. The allegation has been made that loyalty to their supervisory bodies counts more than any display of managerial talent. This, if true, is only a manifestation of the lack of standardised code of conduct required in a competitive market economy. Be that as it may, accusations of this very deficiency cannot be taken to suggest that establishing fully privatised property ownership is the only viable cure. It must be conceded that there is, in this connection, a wide spectrum of intermediate solutions between the two extremes, i.e., between the polarised full private and full public ownership patterns. Indeed, it is against the (reform-) path-dependent uncertainty that current pro-market Chinese leaders look for a way out. The prevailing official line has been to approve the existence of a plethora of enterprise ownership structures: i.e., collective-owned enterprises (COEs), cooperatives, township and village enterprises (TVEs), joint ventures (JV) with complete or incomplete foreign participation, individual (private) enterprises, and so on. As for SOEs, the tendency is to set up corporate or shareholding companies with legal person status. In this case, the state is decreed to be the ultimate owner of company assets. Other legal entities, associations, trade unions,
and individuals have tangible rights to "hold, use, and dispose of" assets in a corporatised, institutional setup. This has ushered in "mixed economic ownership" without dispensing with "juridical state ownership." It is hoped that by divorcing partial asset rights to accountable owners from composite state ownership the state enterprises will prosper. This is the so-called "dual responsibility system" (Chen, 1993, p.23).

II.2 SOEs under Central Planning

Chinese SOEs are widely dispersed across different industries. The reform of state enterprises is often called urban reform as most of these industries are located in highly populated municipalities or counties. Of the 100 thousands odd SOEs, about one-tenth are classified as large- and medium-sized enterprises (LMEs) on basis of the book value of their fixed assets. These make up the privileged core of state administered enterprises within a fairly comprehensive industrial system. The guaranteed privileges of state enterprises include: planned allocation to them of cheap resources; purchase of their output guaranteed at a fixed price; soft credit for meeting investment demands; provision of secure employment to workers. However, these enterprises also carry a huge load of duties owed both, etc. to their various superior authorities and to their oversized industrial workforce and their dependents.

According to the system of classification of control, in principle, enterprise managers are directly accountable to the State Planning Commission and to the various ministerial supervisory bodies of either the central or local (provincial) government. Activities of SOEs are traditionally supposed to be regulated by the mandatory plan, but actual regulation has been modified to varying extents depending on the cycles of centralisation and decentralisation over the different periods in the past. More realistically speaking, although China's planning system is recognisably a duplicate variant of the Soviet model, it has never been implemented to the same degree of tautness as seen in the latter. Rather, historically, the Chinese economy has always harboured great flexibility and plurality in managing the activities of SOEs, even well before it turned to actual open reform. The emergence of the much less restrictive "guidance plan" was, then, a reaction to the needs of pre-reform adaptive transformations. Three main reasons may be cited in support of this view: 1) the alleged difficulty of state enterprises in meeting the "variety targets" under multiple leadership in the mandatory plan; 2) direct state
control in managing detailed, sector planning presupposes abuse of power and superfluity of the law of value which is vital to the operation of a competitive commodity economy, and, more constructively, 3) market forces are being partly released by allowing self-marketing of SOEs under the guidance plan.

A further deviation of the hybrid Chinese planning system from an ideal centralised type is represented by the "cellular model" (Dornithorne, 1972). In this model, state enterprises (be they under the jurisdiction of central, provincial, or municipal government) conduct transactions with their counterparts at an equivalent hierarchical level. This does not rule out the fact that on both regional and enterprise basis, China was eager to maintain "self-sufficiency" in resource availability. A built-in mechanism of autarchic development ensued, therefore, as an inextricable part of its planning system.

In view of the above, it may be inferred that even prior to the aggressive reform campaign was launched in 1978, the Chinese planning system for SOEs had already become quite slack. The command nature of its regulating framework had actually been seriously eroded by the fact that it had to accommodate numerous extra-plan practices. In the former Soviet Union and in most East European countries, the plan was, however, more rigorously carried out. It is from this perspective, but certainly not this alone, that China enjoys a decisive advantage over the former economies in pushing for evolutionary system reform.

II.3 The Changing Position of SOEs during Reform

The extraordinary, structural setup of China's SOEs may be comprehended by examination of both the absolute and relative positions they occupy in the national economy. A description of recent changes in the relative magnitudes of selected statistics according to types of industrial organisation is given in Annex I. It shows that, excluding the predominant agroeconomy, in 1992, SOEs stood out as the single most important sector against other entries in terms of relative shares of investment (67.1%), output (48.1%), retail sales (41.3%), and budget revenue allowance (73.1% of 1991). However, measured by its relative share in number of activity units (18.3%), and employment (1.0%), it is disproportionately much smaller. The most striking feature deserving close attention is understandably not the capital-intensive and state-dependent feature of the SOEs. Rather, it is their evident and sharp decline over the period of
observation in practically all measures cited above.

It may seem curious that the diminishing importance of China’s SOEs has not caused the economy to stagnate. On the contrary, super-high growth in practically all macroeconomic indices has been registered (Annex IIa and IIb) throughout. The expected negative trends associated with the transforming SOEs are therefore powerfully counteracted, and the net effect -- that resulting from the excess of value-added of the nonstate sector over the state sector -- turns out to be positive. It is from this standpoint that the Chinese reform model is strategically much superior to its East European counterparts. *A posteriori* the recessionary path of the latter has entailed an abrupt short-term drop in output, whereas its long-term benefits remain as remote as ever.

### III. The Periodisation of Reform Packages

Transformation of China’s SOEs through changes in their regulatory framework has been a recurrent theme along with parallel reform in other regulatory regimes since 1978. Depending on the different policies prescribed, this process may be divided into six (not entirely) overlapping stages: 1) expansion of enterprise autonomy; 2) contract responsibility system, Phase-I (CRS-I); 3) the tax remittance system (TRS); 4) formation of enterprise groups; 5) contract responsibility system, Phase-II (CRS-II); and 6) shareholding system, and others.

#### III.1 Expansion of Enterprise Autonomy, from 1978 to the end of 1980

Reform of China’s state industries was heralded by the promising results of some limited experiments carried out first in Sichuan Province in 1978. The core of this movement was the expansion of enterprise autonomy, consonant with the new responsibility system being applied simultaneously in the agricultural sector. Other auxiliary reform measures included several rights devolving to enterprise managers; the right to engage in production outside the state plan; to market off-target output; to issue bonuses; and to hire and fire workers. During this early phase, the policy course consisted mainly of the ‘profit-retention’ scheme. This scheme allowed SOEs to keep a fixed share of gross profit (10-100% of above-quota profits) left after deducting the portion to be remitted to the government. The retention
ratio of the enterprise in the first fiscal year was determined on the basis of the ratio of the realised profit to some funds traditionally lodged with the enterprise in the previous year. Namely, the mandatory quota of profits (to be surrendered to the state) were set at the same level earned in the year prior to the implementation of the system. This ensured that the government’s tax revenues would not fall short of the level before the system was instituted. In subsequent years, the profit targets could be raised incrementally. There were also experimental profit tax systems, dividend systems and other variants. Among them, greater proportions of depreciation fund allowances were made available to state enterprises.

The formal recognition and devolution of limited fund disposal rights to state enterprises is undeniably a major policy breakthrough. It also provided industries with the badly needed incentives essential for profit-seeking enterprise management. Naturally, this scheme was favourably received and carried through nationwide. But; following its implementation, continued erosion of the government revenue base called for subsequent remedial measures.


The second stage enterprise reform was initiated with two motives: to more effectively secure the sources of profit transferred to the state; and to motivate managers to produce the most profits possible. Entitled the “profit-and-loss contractual responsibility system” (abbreviated CRS-I), the new scheme was formulated on a different calculation basis. Unlike the former scheme, which based calculation of retained profits on the performance record of the preceding year, this practice specified targets for profits to be turned over by enterprises to the government, with high retention rates applying to any above-quota profits (often 60-80%, or even 100%). Since targets were based on negotiations between firms and their supervisory agencies, and could be adjusted from year to year, or even within each year, the new system offered considerable flexibility in situations of market fluctuations. At the beginning of 1982, more than 80% of enterprises within the state budget system adopted the CRS-I. The amount of profits retained by state enterprises jumped from 2 billion yuan (from now on “Y”) in 1978 to Y10 billion in 1980.

The new system did remedy some defects inherent in the former system. However, no sooner was it set in motion than a series of problems
began to emerge. Partial reform in the incentive structure of enterprises created increasing bias and inner contradictions as below:

1) Incentive asymmetry: The CRS-I encouraged the profit-seeking behaviour but inflicted no punitive discipline on behaviour of loss-making enterprises. At both ends, SOEs habitually bargained for relaxed terms ("soft-budget constraints" à la Kornai, 1986). That is, they either endeavoured to enlarge their above-quota retention rates if they were profitable, or to solicit generous state subsidies if they were not.

2) Strengthened bureaucratic-administrative control: CRS-I was meant to delegate determination of profit targets from higher government authorities to enterprises themselves. But the sum total of profits to be remitted by all SOEs was pre-fixed in accordance with the annual budget plan. Given this plan, the successive bureaucratic-administrative organs further down the hierarchy of the planning system were assigned fixed quotas of profits to be surrendered above. With this scheme, the mandatory nature of profit extraction was not lessened but transformed in two ways: a) the direct target-fulfillment practice was replaced by indirect target-fulfillment; b) soft-budget constraints assumed the form of incessant bargaining between SOEs and all relevant supervisory organs, and between the multi-tier organs themselves.

III.3 The Establishment of the Tax Remittance System, 1983-84

In reaction to the more centralised CRS-I, various tax systems were instituted to complement further improvement of the incentive scheme in enterprise management. The "tax-remittance system" (TRS) was introduced by incorporating into the tax base the following charges: a) fees for using fixed or circulating capital; b) a sales tax; and c) the adjustment tax. This undertaking involved two separate steps. The first step followed the approval by the State Council of the Measures Regarding the Implementation of the Tax-Remittance System of State Enterprises in April, 1983. According to this measure, an uniform 55% income tax would be imposed on all LMEs and would be retroactive in the beginning of 1983. The profit left after this tax would still be divided between the tax-remitting enterprises and the government. Enterprises were entitled to claim part of their after-tax profits at a rate allowed for by the government. The disposal of the rest would be determined in accordance with the
different redistribution schemes as stipulated through negotiations.

The second step began in October, 1984, through the use of a non-uniform "adjustment tax" upon an unified income tax. This system was designed to take the place of the former unified tax that had been distorted by the after-tax profit remittance scheme of step one. However, as the irrational price structure and endowment differences between LMEs had not been eliminated, there was a delay in this reform; not even after 1986 - the year planned for phasing out the former system - was it yet in place.

III.4 The Formation of Enterprise Groups: 1984 --

The mid-1980s stood out as the period in which several ambitious enterprise reform programmes and supportive measures were inaugurated or strengthened, given the results of previous reforms. One of the new directions which had been strictly guarded against in the traditional cellular model but was now opening up was the formation of large enterprise groups and horizontal linkages. The genesis of this experiment originated from two mutually reinforcing motives: the innate urge of enterprise managers to exploit market potentials outside the traditional planning framework, and the government-sponsored programme to rationalise the industrial structure. At issue throughout the campaign was the highly integrated vertical allocation system and the age-old irrational pursuit of self-containedness at both the enterprise and regional levels. The aim of industrial reorganisation was to rationalise the system of self-reproduction and exchange, so as to reap the benefits of economies of scale and specialisation that were being suffocated by departmental, regional, and ownership barriers in the economy. A connected aim was to eradicate wasteful duplication of production lines or whole plants.

Encouragement of the formation of enterprise groups was officially promulgated as a part of the Provisional Regulations Regarding Enlarging the Autonomy of Industrial Enterprises, issued by the State Council in 1984. However, both before and after this promulgation, various regulating measures surfaced. Having received official support, horizontally-linked enterprise groups increased substantially and developed as conglomerates of varying sizes. Preferential treatment, such as trading rights and the right to diversify into other fields of activity, were provided to some core enterprises. In 1990, more than 2000 enterprise groups were registered, some consisted of ten or even a hundred operating arms as subsidiaries to their parent companies. These conglomerates covered an
extensive range of commercial and industrial origins and of diverse geographical territories. Outward-looking conglomerates were formed at the same time to replicate the formation of purely home-bound enterprise groups.

Development of horizontal links between enterprises has now become a daily event and appears as a concomitant part of sectoral enterprise reform, and of overall system reform. Numerous achievements may be credited to this policy directive. Yet, there are also formidable adaptive problems, as reforming consolidated and multipurpose enterprise groups is, admittedly, far more complicated than treating and reforming each enterprise as a separate entity. Furthermore, rationalisation of the vast and heterogenous set of SOEs within a half-reformed economy necessarily runs into incessant difficulties with matching up appropriate companies for partnership. In choosing the means of joining enterprises together, for example, the options available range from direct acquisition (with or without compensation to the objects acquired), debt-ownership swap (between the supplier of use rights of company assets and its potential buyer), assumption of contract-responsibility (by proxy undertaker), leasing, and cross-ownership, to formation of a holding company, outright corporatisation, and so forth.

Indeed, there are numerous patterns in the grouping of enterprises. The possibilities for contracting alliances between industries exhibiting convergent strategic interest increased, henceforth, with every relaxation of official policy on the structure of industrial organisation and in the bureaucratic control and management methods of SOEs. Obviously, there were cases in which state industries as a group succeeded in unjudiciously breaking the legal-administrative framework to which they are subjected, what was denied to them when they offer to do the same as isolated individuals.22

Other deficiencies arising from the upsurge of enterprise groups include: a) blind annexation of enterprises for the sole purpose of benefiting from ad hoc concessionary government policies available to enterprise groups; b) formation of enterprise groups out of complacent bureaucratic-administrative considerations, rather than for well-defined and economically justifiable reasons; c) unjudicious conversion of administrative or quasi-administrative organs into profit-oriented market economy entities; d) abuse of group power by engaging in lucrative land and building speculations, mainly in the coastal provinces (though it is
entirely legal); and generally e) inadequate preparation for reform, in monitoring and regulating the operation of the new group, and in fostering intra-group cohesion via a common economic rationale.


Concurrent with expansion of the horizontal links between enterprises, a more advanced contract responsibility system was instituted after 1987. To distinguish it from the rudimentary enterprise reform of early 1980, we can call the present version CRS-II.

The CRS-II was partly a policy reaction to the unsatisfactory results of previous reform measures, and partly an attempt at circumventing the pernicious, price inflation and general economic overheating of 1984-86. To deepen enterprise reform amidst mismanagement of macro-instability, there was now greater concern with the structural causes of the inertia of SOEs and with their lack of discipline in fulfilling the reform programmes already implemented. One of the most crucial steps conceived to combat the inertia was to disengage (economic) ownership from management of SOEs, so as to strengthen enterprise autonomy in profit and loss accounting. The other was to reassess and realign the financial interflows between the taxation authorities and SOEs.

The main driving force underlying CRS-II was set forth in the Provisional Regulation on the Contract Responsibility System of Individual Enterprises Owned by the People. This regulation was promulgated by the State Council in 1988. Following this promulgation, four new directions of change, in addition to the rapidly evolving horizontal links described above in subsection 3.4, began to take shape. These are:

1) Increasingly tough selection of superior managers through competitive bidding: Qualified bidders (the managing body of SOEs) have to compete more openly to win contracts offered by public authorities, and to manage their enterprises under increasing constraints as stipulated in the contractual agreements.23

2) Rediscovering the risk elements and means for their minimisation: The contracted SOEs now have access to a composite insurance fund to hedge against the risks of possible management failure. The composite fund has three main components - i.e., a managers’ insurance fund, a workers’ insurance fund, and an enterprise
insurance fund - ordered according to their respective priority of responsibility for meeting the claims of the contractual partner (the government). The detailed structure of internal responsibility is very complicated. But the principle of CRS-II is to match the level of responsibility of all management staffs and classified workers in the enterprise with realised financial loss and to force groups or sub-groups of company staff to take responsibility for misconduct. The bonuses and fringe benefits due to managers, bureaucrats, and workers will be cut according to their respective shares of responsibility in case of misconduct (Luan & Lee, cf, pp.82-87).

3) Transformation of internal management mechanisms: To realign the relations between enterprises and the government in such areas as leadership, worker management, distribution, system build-up, and so on.

4) Streamlining legal and institutional set-up: to clearly specify the rights and obligations in contractual form; to render reward and penalty measures transparent; to safeguard management contract responsibility in rational, scientific, and legally binding terms against ill-conceived "egalitarian" and "anti-mercantilist" spirit; and hence to protect the rights of enterprise managers against possible infringement.

Following the advent of CRS-II, the tax-remittance system (TRS) adopted earlier also underwent some modifications. Two major changes were: 1) contractual terms were fixed after tax remittance, and 2) an across-the-board reduction of the tax schedule.

1) Fixation of the post-tax financial base of enterprises for CRS-II: (Negotiable) accounting base for concluding of CRS-II requirements = net revenue of enterprise - tax due - (agreed) quota of retained earnings pre-fixed in a contractual agreement -(old) debt outstanding (i.e. incurred prior to 1986). The last term means that loan repayment is not tax deductible and must be accounted for in the base used for determination of CRS requirements.

2) Across-the-board reduction of the tax schedule: In general, the 55% enterprise income tax was brought down to between 10% and 35%. The degree of tax concession granted depended on the profitability of the enterprise. Coupled with this new scheme, the former "adjustment tax" applicable to individual enterprises was discontinued.
Usually the period of the revised CRS ranges from 3 to 5 years.

III.6 Inauguration of the Shareholding System and Other Reforms, mid-1980s -- present

By being exposed to certain limited restructuring initiatives, China's system of state enterprises was brought to the threshold of more fundamental reform around mid-1980s. The new frontier for such an effort was openly hailed as the development of a corporate economy. Once they are granted independent legal status, the corporate structure of state enterprises may be transformed into either of two principal norms: "companies with limited liabilities" or "joint-stock companies." The management systems of transformed companies are supposed to conform well with standard international practice. This means that, theoretically, in acquisition and disposal of stocks, decision-making, and in division of rights and responsibilities, etc., the capital investors are expected to act in ways set out in the various company laws. But in reality, this has not been the case. Owing to pre-existing ideological and institutional drawbacks, corporatisation of China's SOEs is still saddled with great difficulties. Up to now there has not been an apparent or tactically conclusive reform package that simultaneously addresses all transformation issues.

Rife with incalculable risks, the current move to develop China's corporate economy is once more experimental in nature and is largely consistent with an already long-established pattern of reform sequencing: practice comes prior to the advent of regulatory machinery. Preceded by initial scholarly advocacy, a Shanghai-based hi-fi manufacturer completed its transformation in late 1984 into the first incorporated form by offering shares for public acquisition. Urban enterprise reform received official support only in 1986, when the State Council issued some Regulations Regarding the Strengthening of Enterprise Vitality through Deepened Enterprise Reform. After the 13th Party Congress in 1987, a more vigorous campaign for expanded and selective corporatisation experiments was evidently in vogue. Plurality in ownership structure -- including, most importantly, the role of the state per se as a part owner -- emerged then as a major theme of the campaign adopted by the Congress. However, it was not until after the goal of a "socialist market economy" was incorporated into the PRC's Constitution, in particular, after the 3rd Plenum of the 14th Party Congress in late 1992, that the booming enterprise reform saw a vigorous upsurge. A chain of regulatory measures were then released to
facilitate this and related institutional changes.

Of them, the most prominent was the Regulations on Transforming the Operation Mechanism of State-Owned Enterprises, announced by the State Council's Economic and Trade Office (on 23 July, 1992).\textsuperscript{25} In these regulations four additional rights were conferred upon SOEs, in addition to those originally set out in the 1984 provisions (see note 20) and the revised 1988 Enterprise Law. Conceived of as being the regulatory base required for conducting comprehensive enterprise reform, these changes are currently being set in motion as an interconnected part of the enterprise modernisation programme. Together they form a schematically more coherent and complete action plan, laying the micro-foundation essential for overall system reform and macroeconomic management.\textsuperscript{26} By contrast, all previous rounds of enterprise reform were strategically partial and inconclusive operations. They were undertaken against a considerable institutional vacuum. This amounts to saying that although companies with modern corporate entities may be traced back to the mid-1980s, there has been no concrete effort to activate the real process of change until after 1992. The latter effort comprises concurrent reform both with respect to the core (the SOEs proper) and its peripheries (the market institutional framework).

Perceptible improvement in the broad institutional framework for enterprise reform can certainly be perceived. But it has been far too slow and restricted.\textsuperscript{27} During the pre-1992 period, the main targets set for enterprise reform were problems of two origins: structural and functional. The structural problems may be further broken down into factors on two levels: those arising from mismanagement of SOEs, and those from force majeure, assuming in this connection that the scope for ex-market policy coordination and intervention (in the sense of W. Brus, 1972) was virtually exhausted. Functionally, a consensus was reached that to improve the performance of SOEs continued reform was indispensable. This concern becomes increasingly acute as the dimensions of loss-making industrial SOEs keep on breaking past records. Cumulative tensions are being built up, and some of the more critical issues are outlined below (see e.g. FSM, 1994):

1) Growing enterprise indebtedness: In 1993, the total assets of all state budget-financed industrial SOEs amounted to Y2.56 trillion. The total outstanding debt of these enterprises in the same year rose to an unprecedented height of Y1.78 trillion, or 70% of all assets
2) Excessive tax burden: Having completed successive tax reforms, the overall financial burden of SOEs has increased and exerts growing pressure upon the already illiquid company accounts. This has been manifested in the levelling-up of the tax schedule of a variety of taxes and levies, both across industries and regions.  

3) Sluggish enterprise cash-flow and other problems: Recurrent macro-rectification campaigns have imposed a brake upon bank credit- and budget-financed investment. This has resulted in growing financial distress for the reforming SOEs, with a series of interrelated constraints as its clearest manifestation. These constraints include: sluggish cash-flow, stock-piling, protracted investment turn-over, partial or full factory closings, disguised unemployment, and so on.

In consequence, the net worth of a growing fraction of SOEs is continually being surpassed by liabilities at an increasingly wide margin. Triangular debts or debt-chains are being expanded, therefore, as inevitable management loopholes in the absence of lawful bankruptcy or other threats.

The scale of financial illiquidity is a summarised expression of the overall state of enterprise inefficiency. To break the vicious circle of illiquidity and raise enterprise management efficiency, two approaches are immediately available. The first and perhaps more straightforward approach consists merely of the direct truncation of productive services of insolvent industrial firms by either bankruptcy proceedings or self-dissolution. This rule could be applied to those branches of SOEs which, despite all internal reorganisational efforts, are still unable to meet current debt claims even if all old debts are forgiven. The second, more complicated and structurally involved approach, aims at revitalising the working apparatus of SOEs that can be rescued through proper means.

Construction of a shareholding system through corporatisation of state enterprises is recommended, then, as the critical, if not the ultimate, viable scheme. Corporatisation of China’s state enterprises in the form of shareholding companies is closely associated with development of the securities markets. Chinese authorities envisage three fundamental tasks in this pursuit: a) the separation of state ownership from management; b) the mobilisation and rational allocation of social capital; and c) the provision of greater internal management cohesion in rights, responsibilities, and interests, so that enterprises can become more efficient
and respond swiftly to changing market conditions. By converting each enterprise into a shareholding company, the (central and/or local) government as the sole owner will, except for such cases as natural monopolies and public utilities, disappear. Being one among many new owners of equity rights, the government will only participate in the decision-making of the enterprise boards to the extent of its share representation. Depending on the nature of the enterprises being corporatised, the state may or may not be the majority shareholder. Whatever the consequences, the rights and responsibilities of state would be dictated and restricted by company laws and various other amendments, much as any other shareholder represented at the board of directors.

The State Property Agency (SPA), set up in 1988, will act on behalf of the government, as the latter cannot directly participate in day-to-day management of the enterprise. Quite awkwardly, SPA and its local affiliates are assigned the role of asset owner as state trustees. However, they are also responsible for approving the applications of SOEs to restructure themselves as shareholding companies, for monitoring and assessing the valuation of their assets, for reviewing the price of shares, and for determining which agents will actually hold the state’s share. This dual or triple role concentrated in one body is surely troublesome, and may be clarified only upon incessant trials and reshaping.

In connection with the above, two experimental stock exchanges were opened, respectively, in Shanghai (1990) and Shenzhen (1991). The mode of operation of the two stock exchanges is different; this gives rise to two models. In the case of the Shanghai model, shareholders of equity rights are of three main types: the government, the collective units (including enterprises of legal person status), and individuals. The shares owned by the government cannot be traded in the stock exchange; only individual shares are marketable (Chen & Wu, 1992, p.68). In the Shenzhen model, the company shares are divided into listed and unlisted shares. Four groupings in equity ownership structure are devised: the government, the enterprise, the legal persons, and individuals. The proportion of the government owned shares representing equity rights cannot, in this case, exceed 30% of the company’s net worth. Again, in the Shenzhen model the government shares are not marketable. As an alternative scenario, the shares listed on both stock exchanges were issued only to domestic residents (A-shares). Foreign nationals have been allowed to purchase shares since 1991, with payment made in foreign exchange obtainable in local swap markets (B-shares).
By the end of 1993, thirteen thousand SOEs have already been transformed into corporate entities. Those with company shares quoted in the two markets numbered 120. In mid-1994, this number more than doubled and reached 260. The shares of a few more powerful corporations have already been listed on New York and Hong Kong stock exchanges. These represent the latest wave of advance in building a corporate economy in a still-embryonic and mixed-ownership institutional environment.

IV. An Interim Appraisal

Irrespective of their different policy implications, the five reform packages presented in subsections III.1 - III.5 may be generalised and reduced to one conclusive theme: that of valuation and distribution. Subsection III.6 tackles issues rooted at a much deeper level, one that is basic to reconstruction of the conditions affecting determination of valuation and distribution. In formal affinity with the "three agent model" formulated by an East European writer (Mihalyi, 1992/3) transformation of the ownership rights and management system of SOEs in the PRC also involves, in broad schematic classification, three agents: the state, the enterprises, and the workers. Enterprise reform in the Chinese context revolves around the redistribution mechanism linking these three agents in keeping with an as yet incomplete valuation system. Namely, one which incorporates emerging market discipline with a greatly-relaxed planning system.

At the centre of the model stands the managerial class. This class is responsible for concluding deals with its supervising governmental bodies on behalf of the workers, concerning the rights, obligations, and interests of the enterprise in question. It is charged also with the task of seeing that the contractual terms as specified in the deal are fulfilled. These terms, directly or indirectly, are reducible to two parallel and greatly simplified financial flows, that between the taxation bureau and the enterprise, and that between managers and wage-earners. The crucial question then becomes one of specifying the valuation base and mechanism for determining, out of the total value-added of the state sector, the respective shares of the distribution variables. In current Chinese literature, ceremonial tribute has been paid to the surviving Marxist dictum: "to each
according to his labour." This is, of course, an oversimplified and categorically-free dictum. But the real operational mechanism, and one that is distinctively a Chinese innovation, is the CRS and connected packages. Being themselves transient arrangements, these packages contain still the following defects:

1) Irresponsive valuation base for contract fulfillment: Usually, the three-year average performance record of the individual enterprise is the base for negotiating the terms of the responsibility system with the government. This base is, however, not sufficiently responsive to, and thus not amenable to, modification because of: a) the lack of pressure from comparison in performance between one SOE with other SOEs in the same industry, and therefore b) the lack of a competitive contractual base. It is equally irresponsible to expected profitability of the enterprises concerned for want of reliable market forecasting.

2) Institutional distortions: the market for competitive open bidding for any particular management contract is still rudimentary. There is inadequate transparency and a retarded flow of the information required for rationalising the valuation base of the CRS.

3) Lack of an objective and invariant criterion for stipulating the terms of the contract: Owing to the divergent endowment and operating conditions in SOEs, application of discriminatory tax policies, profit-and-loss sharing, and other devices are widespread. These practices are made possible by the lack of any theoretically unassailable and objective grounds for determination of the base in fixing the term of CRS. As a result, enterprises are keen in bargaining for favourable contractual agreements.

4) Soft-budget constraints amid lax market discipline: Against a declining share of budget-financed investment (see col.9, Annex IIb), SOEs resort instead to extra-budgetary fund-raising and intra-firm credit-drawing as a means for circumventing illiquidity and meeting their investment demands. Survival of literally insolvent LMEs is furthermore safeguarded by the absence of a credible threat of bankruptcy, merger, acquisition, etc., as in normal market economies. Practically speaking, there is generally no operating monetary mechanism by which the asset-based earning ability of an enterprise may be linked with credit-rating and rationing.
5) Persistence of multitier asymmetry in the CRS: Operating under multiple leadership and other constraints, enterprise managers are forced to meet post-tax profit targets (CRS-II) yet are not given adequate incentives or full rights in management. Generally, over the top of the SOEs are three supervisory state organs responsible for fixing the bottom line of bidding and for signing the contract with the enterprise. But the three organs are to different degrees informed about, administratively involved, and concerned with, both the performance and interests of the SOE in question. It is therefore most unlikely that they will be in accord with each other regarding the contents of any contractual agreement. This leaves the factory manager no option but to succumb to the one that assures maximum gains to himself, to the workers, and to the staff at large. Distribution of tripartite gains tied to a specific CRS would then be a matter of internal administration. The enterprise managers have of course some discretionary power in this. But relative to their duties and obligations, the rights delegated to them are proportionally less. Because of differences in the bargaining ability of managers, this observed asymmetry is unevenly distributed among SOEs, whatever the basis of industrial classification. Within a given enterprise, the asymmetrical distribution of value-added tends to fall more upon wages, bonuses, and investment funds. Namely, extensive growth, emphasising scale, is encouraged at the expense of concerns such as maintenance of capital stock, renovation, quality upgrading, and so forth, which are required for intensive growth.

In the previous pages, we have outlined six strategic steps undertaken in the reform of China’s SOEs. The general tendency of the in-progress movement has been to incorporate greater and increasingly sophisticated chains of reform measures. Enterprise reform involving the separation of management from ownership rights has symbolically taken place only since the mid-1980s. This was the beginning of corporatisation or shareholding arrangements in China’s LMEs. Interesting enough, in certain CEE and ex-Soviet economies, enterprise reform began by plunging directly into reconstruction of property rights in line with the civil codes of privatised western capitalist societies. In these cases, the pioneering Chinese practice was superseded both in scope and depth already at the outset.
V. Concluding Remarks

Phasing of reform programmes is logically inevitable. Devising and improvement of structurally complementary strategic means for reform is also essential for ensuring consistent programme-phasing. The aim of economic transformation then, be it socialist or post-socialist in nature, is to organise the timing of interrelated subsections of reform packages so that they can be implemented at minimal costs. For individual economies, this transformation then becomes a matter of imposing concrete programmes upon the changing economic situation through an unified process of "creative destruction."

In this study, China's LMEs, dominated traditionally by state ownership, management, and control, are the objects chosen for investigation. Six distinctive stages since 1978 have been demarcated as the crucial intervals in surgical operation on the ailing LMEs. It has been found that enterprise reform in China: a) is oriented towards a bastard market economy, admitting a plurality of management and control types as a transient arrangement; b) is a continuous sectoral restructuring process; c) is exempted from the general programme for complete property rights transfer, i.e., from state to private ownership of the means of production; d) assumes the form of an experimental and recurrent boundary-testing exercise; e) relies predominantly upon fiscal means for mobilising the initiative, self-interest, and creative potential of enterprise managers through various forms of the CRS; and f) is based on rapidly expanded simulation of market discipline in an environment that forgoes the vital penalty mechanisms of bankruptcy, merger, take-over, or any other competitive forces.

China's enterprise reform entered a new phase since mid-1980s while execution of various versions of the CRS was still in progress. This marked the beginning of a more complete transformation of property rights and property relations, targeting SOEs. Establishment of joint-stock companies and companies with limited liabilities is now vehemently carried out. To facilitate this process, structural and institutional changes are being installed concomitant with development of the stock exchange and financial markets. Additionally, the State Property Agency was set up as the key management body for the state assets of the ex-SOE. Technically, the process of corporatisation aims both at cessation of the services of the
nonviable SOEs and at revitalising the potentially viable SOEs. It is advanced also as an indispensable part of the efforts required in laying the micro-foundation required for effective macroeconomic management. Needless to say, economic levers will be relied upon to an increasing extent in managing and influencing the behaviour of SOEs and other macro-variables in the Chinese economy as a whole. The use of bureaucratic-administrative control is expected to diminish.

All these changes indicate that, though China’s reform strategy is less than truly radical, it is a secure and promising approach.
Notes

1. See Annex I for the changing share of SOEs in the national economy of the PRC by different measures.

2. In the Chinese literature, "synchronising" as an alternative expression of "coordinating" and "complementary" package formation (Peitau Gaige) has been put together to denote what is meant here by "synchronising". See e.g. Jiang (1993, p.32).

3. Buying time for a self-evolving pattern of growth was precluded at the outset in Eastern Europe and the ex-USSR. The abrupt collapse of the communist system had left no option to the new democracies but to "enforce" any reform recipe, and to offer the apparently miscalculated fantasy of capitalist abundance to their electorates to secure legitimacy. Moreover, the frequent reshuffle of political parties in power in Eastern Europe and the ex-USSR clearly is the "result" rather than the "cause" of economic failure.


5. See Annex III for the views of Chinese professionals scattered in the relevant studies.

6. See Ju & Fung (1989) for references in which this view is indicated.

7. It is not exceptional for Chinese state enterprises to be under dual or multiple leadership or agencies at different levels of government. For example, before decentralisation in late 1983, Shenyang Smelting Plant was under the Ministry of Metallurgy, the Liaoning Provincial Government, the Municipal Bureau of Metallurgy for arranging supply of materials and electricity, distribution of output, for determining financial and output targets, and so on. As a result of interest conflicts throughout the planning hierarchy, inconsistency between plan targets occurred. See e.g. Tidrick (1987, pp.180-182).
8. In the pre-reform era, enterprises were compelled to fulfill 8 to 10 binding targets with the gross value of industrial output and the physical output being the most important ones. Sometimes the targets were so detailed that they comprised 300 to 400 sub-targets. These should in fact be regarded as "quality-cum-quantity" specifications rather than targets per se. Despite that, the variety targets were arrived at nevertheless through continuous bargaining between SOEs and the various planning authorities. See Tidrick (cf. p.178).

9. Motivated, on the one hand, by the practice of compulsory target-fulfillment and sporadic shortages of vital intermediate goods, on the other, state enterprises tend to build up more stocks than they can consume. Financial illiquidity arising from overdue payments to state banks was further aggravated by a prolonged cycle of turnover, because most SOEs were engaged in capital-intensive equipment acquisition and construction activities characterised by long "recoupment periods." The pursuit of the goal of being self-contained is of course a main defect of in all SOEs:

10. These include: workers' bonus, collective social welfare fund, fund to support test runs of new products, the fund for product development, etc.

11. The officially allowed depreciation rates for SOEs in China are low by tradition. In 1980, the average rate of "composite depreciation charges" was 4.1%. By comparison, the Japanese rate in the same year ranges between 11.6% to 19.1%. Only after 1985, when the Chinese State Council promulgated a "Provisional Clause on Depreciation Allowance on Fixed Capital of SOEs" was it raised to 5.1%, a figure still considerably lower than the necessary level. In the actual operation of cost-accounting in enterprises it was even much lower. See Luan & Lee (1993, pp.19-23).


13. This system has been alternatively described as an "enterprise management responsibility system" (EMRS), or "contract management responsibility system" (CMRS). For the distinction between this, see World Bank, 1989, p.11.

14. The Chongqing Clock and Watch Company and the Qinghe Woolen Textile Mill were among the first to undergo the experiment with the profit-tax method. See Byrd & Tidrick (1992), and Sabin (1992).
15. The sales tax was a component of the previous “Consolidated Industrial and Commercial Tax” (CICT). CICT was now divided into three separate indirect taxes: the VAT, the product tax (levied on industrial sector enterprises), and the business tax (levied on the service sector).

16. The adjustment tax was intended to siphon away excess profits (defined as a return on sales) accruing to an enterprise as a result of the operation of beneficial external factors. These factors included: the structure of administered prices in relation to input costs of, geographical sites of, and natural monopoly endowed by the state to, the firm.

17. There are at least five different forms of extra-profit tax schemes. For details see Annex IV.

18. This form of industrial structure is ironically coined in China as the pursuit of “big and complete, small and complete” by individual factories. The practice stemmed from the early 1960s, when the unreliability of planned allocations of intermediate inputs were frequently caused by natural disasters and man-made mistakes.

19. It is believed that up to 1984 China still owned 136 automobile assembly plants, more than the sum-total of Japan, the U.S., Germany, England, France and Italy put together. The concentration ratio of four major steel producers (Anshan, Wuhan, Baoshan and Beijing Metropolitan) accounted only for 30% of national steel production. See Luan & Lee (1993), p.94.

20. In the Provisions of 1984 ten rights were devolved to enterprises. They were: a) to make their own production and business decisions; b) to set their own prices; c) to market their own products; d) to purchase raw materials; e) to decide on use of retained earnings; f) to dispose of assets in accordance with production requirements; g) to form partnerships and mergers; h) to control personnel management; i) to set wages and bonuses; and j) to determine internal organisations. In the 1992 “Regulations on Transforming the Operating Mechanism of State-Owned Enterprises,” four more rights were granted to enterprises: a) to import and export; b) to make investment decisions; c) to assign labour; and d) to refuse arbitrary levies and charges. It was also declared upon issuance of the 1992 Regulations that the earlier Provisions must be more rigorously executed.
21. In due succession, the first official document was the "Provisional Regulations on the Promotion of Economic Union" on July 1, 1980. In 1981, three northern provinces and two municipalities jointly summoned the first meeting for economic-technological coordination. This was followed in 1983 by a coordination conference among four southern provinces plus Chengdu City (provincial capital of Sichuan Province) and by a host of parallel activities elsewhere. In 1986, the State Council made public seven juridical regulations contained in "Regulations on Further Promoting Horizontal Economic Union". The next year, the State Economic Commission set out "Some Opinions Regarding the Organisation and Development of Enterprise Groups".

22. The granting of trading rights stands out here as a typical example. To maximise individual and thus intra-group gains, peripheral production units are encouraged to attach themselves to a core or parental firm with trading rights in exchange for the right to claim a proportionate share of the export proceeds accrued to the latter. Conceivably, a fraction of these proceeds may be kept in an overseas bank account. The premiums on imports due to them in part because of differences in official and market exchange rates also can go to their overseas account. These practices have resulted in tax evasion and other negative side-effects. But it is difficult, without a broad and empirically-based analysis, to weigh individual gains in reform-engendered economic prosperity against public loss as witnessed in China.

23. See e.g. Koo (1990), drawing on the case of the First Steel Mill of Beijing to illustrate details of the system and incentives as well as constraints introduced.

24. It should be noted that only after the Act for Revision of the Constitution of the People's Republic of China received approval in the 1st Meeting of the 8th People's Congress in March 1992, that the idea of the "socialist market economy" was formally promulgated. The Congress's approval was triggered, however, directly by a message released by Deng Xiao Ping, China's paramount leader, on his unusual trip to the south in early 1992. This message reads that (nothing but) "development is the solid truth," which implies and helps bring about an end to the three-year "rectification campaign" since 1989.

25. Other legal-administrative devices include: a) Provisional Regulations Concerning Registration of Owners of State-Owned Assets, issued jointly by the State Management Bureau, the Ministry of Finance, and the State Industrial and Commercial Bureau (11 May, 1992); b) the practice of
separating taxes between central and local governments, and separating profit from the taxes of enterprises. In addition, creation of a two-tier budget system, reform of tax system, introduction of a new accounting system, and reform of the state asset management system, announced by the Ministry of Finance (30 July, 1992); c) Detailed Measures on Changing the Business Mechanism of State-Owned Commercial Enterprises (17 Nov., 1992); d) and Provisional Regulations on the Management of Stock Issues and Trade, approved by the State Council (April, 1993), etc. (see Bell et al., cf, pp.24-25).

26. The items coming under increasing scrutiny and reconstruction according to the rule of market include e.g., cost-accounting, auditing, depreciation formulas, (computerised) trading networks, the technique of leveraged buy-in and lay-out, varieties of company forms, and so forth. Whereas refinement of these rules is trivial in well-established market economies, for transforming economies it is clear that rule-formation must take precedence over continuous refinements.

27. A pre-1992 survey of 1637 SOEs of 37 industrial classifications gives some mixed results according to the following criteria: a) investment decision-making autonomy, b) rights on buying-and-selling, c) labour management, and d) rights of internal remuneration distribution (see Annex V).

28. Itemwise, those that subjected to a rise include, for example: VAT, consumption tax, city building tax, dwelling house tax, land use tax, etc. The reduction of enterprise profit tax from 55% to the nominal 33% represented an improvement. But it has left unaccounted for the fact that, at the original 55%, the real profit rate was 20% because of the adaptation of various CRSs. Similarly, recent abolition of tax concession granted by the government to SOEs and foreign JVs has raised the tax burden. Regionally, the expected percentage increase of general tax burdens in 1994 are as follows: Jiangsu Province (4.3%), Beijing (retail tax, 15%; income tax, 1.5%), Fuzhou city (retail tax, 1.02%), Datong city (5%), Baotou city (30%), etc. See FSM (cf., PP.10,11).

29. See e.g., Chen & Wu (1992).

30. The bankruptcy law of the PRC was enacted in 1986, but only in 1992 did the first sentence of bankruptcy on a glass factory in Fusheung pass court ruling. (Special Report, 1993)
31. The *first* tier is the immediate supervisory department responsible for the particular industrial enterprise. The *second* tier is the budgetary section of the Finance Ministry. Of the *third* various units of state economic organisations are involved: e.g., the Planning Commission, the Bureau of Industry and Commerce, the Bureau of Finance, banks, the auditing bureau, etc.

32. An IMF report (Bell et al., 1993) tabulates nine main areas of economy-wide reform in the PRC over four consecutive phases since 1978. The position and evolutionary path of the state enterprise reform may be fruitfully gauged by contrasting it with the contents of parallel reform sequences given in this report.

33. There are of course alignment problems, as CRS is supposed to be phased out in 1995. But the funds to be reimbursed to some SOEs, such as the tax-deductible share according to CRS, are suspended. This will create liquidity problems unless compensatory measures are adopted.
References


Jiang, T.Z. (1993)*, "Progress towards Marketisation of the Chinese


Sheko Chronicle (1989), *“Economic Advance and Private Property,”*

Feb.20.


*: In Chinese
## Annex I Main Components of Industrial Organisation in China

<table>
<thead>
<tr>
<th>Indicators</th>
<th>1978</th>
<th>1985</th>
<th>1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Number of Production Units</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(in 10,000)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOEs</td>
<td>9.4</td>
<td>10.3</td>
<td></td>
</tr>
<tr>
<td>COEs</td>
<td>174.2</td>
<td>164.1</td>
<td></td>
</tr>
<tr>
<td>TVEs</td>
<td>334.8</td>
<td>685.4</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>0.2</td>
<td>1.4</td>
<td></td>
</tr>
<tr>
<td>2. Total Active Employment (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOEs</td>
<td>18.6</td>
<td>18.0</td>
<td>18.3</td>
</tr>
<tr>
<td>COEs</td>
<td>5.1</td>
<td>6.7</td>
<td>6.1</td>
</tr>
<tr>
<td>Others</td>
<td>0.1</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>IPs</td>
<td>0.9</td>
<td>1.4</td>
<td></td>
</tr>
<tr>
<td>Rural Economy</td>
<td>76.3</td>
<td>74.3</td>
<td>73.7</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>3. Fixed Capital Investment (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOEs</td>
<td>66.1</td>
<td>67.1</td>
<td></td>
</tr>
<tr>
<td>COEs</td>
<td>12.9</td>
<td>17.3</td>
<td></td>
</tr>
<tr>
<td>IPs</td>
<td>21.0</td>
<td>15.6</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>4. Fiscal Revenue (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOEs</td>
<td>86.8</td>
<td>73.1</td>
<td></td>
</tr>
<tr>
<td>COEs</td>
<td>12.7</td>
<td>21.8</td>
<td></td>
</tr>
<tr>
<td>Individual</td>
<td>0.5</td>
<td>4.1</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>5. Total Industrial Output (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOEs</td>
<td>77.6</td>
<td>64.9</td>
<td>48.1</td>
</tr>
<tr>
<td>COEs</td>
<td>22.4</td>
<td>32.1</td>
<td>38.0</td>
</tr>
<tr>
<td>IPs</td>
<td>1.8</td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>1.2</td>
<td>7.1</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>6. Total Retail Sales (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOEs</td>
<td>54.6</td>
<td>40.4</td>
<td>41.3</td>
</tr>
<tr>
<td>COEs</td>
<td>43.3</td>
<td>37.2</td>
<td>27.9</td>
</tr>
<tr>
<td>Cooperatives</td>
<td></td>
<td>0.3</td>
<td>0.7</td>
</tr>
<tr>
<td>IPs</td>
<td>0.1</td>
<td>15.4</td>
<td>20.3</td>
</tr>
<tr>
<td>FNF</td>
<td>2.0</td>
<td>6.8</td>
<td>9.8</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Notes:  
SOEs: state-owned enterprises  
COEs: collectively-owned enterprises  
TVEs: township & village enterprises  
IPs: individual proprietorships  
FNF: from farmers to non-farmers

Source: *China Statistical Yearbook, 1993.*
## System Reform of China’s State-Owned Enterprises, 1978-1993

### Annex IIa China’s Macroeconomic Indicators, 1978-92

<table>
<thead>
<tr>
<th>Period</th>
<th>(1) GDP (100 mil Yuan)</th>
<th>(2) GDP Per head</th>
<th>(3) NI (100 mil Yuan)</th>
<th>(4) NI Per head</th>
<th>(5) GVSP</th>
<th>(6) GVAP</th>
<th>(7) GVIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>3,588.1</td>
<td>3,010</td>
<td>315</td>
<td>6,846</td>
<td>1,397</td>
<td>4,237</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>3,998.1</td>
<td>3,350</td>
<td>346</td>
<td>7,642</td>
<td>1,698</td>
<td>4,681</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>4,470.0</td>
<td>3,688</td>
<td>376</td>
<td>8,534</td>
<td>1,923</td>
<td>5,154</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td>4,773.0</td>
<td>3,941</td>
<td>397</td>
<td>9,075</td>
<td>2,181</td>
<td>5,400</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>5,183.0</td>
<td>4,258</td>
<td>422</td>
<td>9,666</td>
<td>2,483</td>
<td>5,811</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>5,809.0</td>
<td>4,736</td>
<td>463</td>
<td>11,131</td>
<td>2,750</td>
<td>6,461</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>6,962.0</td>
<td>5,652</td>
<td>545</td>
<td>13,171</td>
<td>3,214</td>
<td>7,617</td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>8,557.6</td>
<td>7,020</td>
<td>668</td>
<td>16,582</td>
<td>3,619</td>
<td>9,716</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>9,696.3</td>
<td>7,859</td>
<td>737</td>
<td>19,045</td>
<td>4,013</td>
<td>11,194</td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>11,301.0</td>
<td>9,313</td>
<td>859</td>
<td>23,034</td>
<td>4,676</td>
<td>13,813</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>14,068.2</td>
<td>11,738</td>
<td>1,066</td>
<td>29,807</td>
<td>5,865</td>
<td>18,224</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>15,993.3</td>
<td>13,176</td>
<td>1,178</td>
<td>34,519</td>
<td>6,535</td>
<td>22,017</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>17,695.3</td>
<td>14,384</td>
<td>1,267</td>
<td>38,035</td>
<td>7,662</td>
<td>23,924</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>20,236.3</td>
<td>16,557</td>
<td>1,439</td>
<td>44,142</td>
<td>8,157</td>
<td>28,248</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>24,036.2</td>
<td>19,845</td>
<td>1,703</td>
<td>55,842</td>
<td>9,085</td>
<td>37,066</td>
<td></td>
</tr>
</tbody>
</table>

### Growth Rates, % (against the previous year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(100 mil Yuan)</td>
<td>11.7</td>
<td>7.6</td>
<td>7.9</td>
<td>4.4</td>
<td>8.8</td>
<td>10.4</td>
<td>14.7</td>
<td>12.8</td>
<td>8.1</td>
<td>10.9</td>
<td>11.3</td>
<td>4.4</td>
<td>4.1</td>
<td>8.2</td>
<td>13.0</td>
</tr>
<tr>
<td>NI</td>
<td>12.3</td>
<td>7.0</td>
<td>6.4</td>
<td>4.9</td>
<td>8.2</td>
<td>10.0</td>
<td>13.6</td>
<td>13.5</td>
<td>7.7</td>
<td>11.2</td>
<td>11.3</td>
<td>3.7</td>
<td>5.1</td>
<td>7.7</td>
<td>14.4</td>
</tr>
<tr>
<td>NI Per head</td>
<td>12.5</td>
<td>9.8</td>
<td>8.7</td>
<td>5.6</td>
<td>6.3</td>
<td>9.7</td>
<td>17.7</td>
<td>22.6</td>
<td>10.3</td>
<td>16.6</td>
<td>24.1</td>
<td>10.5</td>
<td>7.3</td>
<td>13.6</td>
<td>18.3</td>
</tr>
<tr>
<td>GVSP</td>
<td>13.0</td>
<td>8.5</td>
<td>8.4</td>
<td>4.4</td>
<td>9.5</td>
<td>10.2</td>
<td>14.7</td>
<td>22.6</td>
<td>10.1</td>
<td>14.1</td>
<td>15.8</td>
<td>5.4</td>
<td>6.6</td>
<td>11.4</td>
<td>18.3</td>
</tr>
<tr>
<td>GVAP</td>
<td>8.1</td>
<td>7.8</td>
<td>7.8</td>
<td>5.8</td>
<td>11.3</td>
<td>7.8</td>
<td>12.3</td>
<td>17.1</td>
<td>3.4</td>
<td>5.8</td>
<td>15.8</td>
<td>3.9</td>
<td>7.6</td>
<td>3.7</td>
<td>6.4</td>
</tr>
<tr>
<td>GVIP</td>
<td>13.5</td>
<td>8.8</td>
<td>9.3</td>
<td>4.3</td>
<td>7.8</td>
<td>11.2</td>
<td>16.3</td>
<td>21.4</td>
<td>11.7</td>
<td>17.7</td>
<td>20.8</td>
<td>8.5</td>
<td>7.8</td>
<td>4.8</td>
<td>27.5</td>
</tr>
</tbody>
</table>

### Notes:
1. Figures in Column 4 (lower part) are derived directly from annual changes in absolute amount (upper part of the table);
2. Figures in Columns 1–3, 5–7 (lower part) are inconsistent with those which may be calculated directly from figures in the upper part because changes in price have not been accounted for. No explanation whatsoever was given in the original source about this inconsistency.
3. GVSP: gross value of social product;
   GVAP: gross value of agricultural product;
   GVIP: gross value of industrial product.

## Annex IIb China’s Macroeconomic Indicators, 1978-92

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total FDI#</td>
<td>FL#</td>
<td>Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount (1000 in Yuan)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>66.9</td>
<td>50.1 (77.7)</td>
<td>97.5</td>
<td>168.9</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>69.3</td>
<td>52.3 (75.8)</td>
<td>136.6</td>
<td>156.7</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>74.6</td>
<td>55.9 (53.7)</td>
<td>181.2</td>
<td>200.2</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td>66.8</td>
<td>44.3 (30.3)</td>
<td>220.1</td>
<td>220.2</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>84.5</td>
<td>55.6 (41.8)</td>
<td>223.2</td>
<td>192.5</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>95.2</td>
<td>59.4 (49.8)</td>
<td>222.3</td>
<td>213.9</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>118.5</td>
<td>74.5 (48.4)</td>
<td>261.4</td>
<td>274.1</td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>160.1</td>
<td>107.4 (35.5)</td>
<td>273.5</td>
<td>422.5</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>197.9</td>
<td>117.6 (35.5)</td>
<td>309.4</td>
<td>429.0</td>
<td></td>
</tr>
<tr>
<td>1987*</td>
<td>229.8</td>
<td>134.3 (32.6)</td>
<td>396.4</td>
<td>432.2</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>276.3</td>
<td>157.4 (24.2)</td>
<td>475.2</td>
<td>552.8</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>253.5</td>
<td>155.2 (20.8)</td>
<td>525.4</td>
<td>591.4</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>291.9</td>
<td>170.4 (21.3)</td>
<td>620.9</td>
<td>533.5</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>362.8</td>
<td>211.6 (16.5)</td>
<td>718.4</td>
<td>637.9</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>527.4</td>
<td>301.3 (19.2)</td>
<td>850.6</td>
<td>896.1</td>
<td></td>
</tr>
<tr>
<td>Growth Rates, % (against the previous year)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>22.0</td>
<td>31.0</td>
<td>28.5</td>
<td>51.0</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>4.6</td>
<td>4.5</td>
<td>40.1</td>
<td>43.9</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>6.7</td>
<td>6.8</td>
<td>32.7</td>
<td>27.8</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td>-10.5</td>
<td>-20.8</td>
<td>21.5</td>
<td>10.0</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>26.6</td>
<td>25.4</td>
<td>1.4</td>
<td>-12.0</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>12.6</td>
<td>6.9</td>
<td>-1.1</td>
<td>10.9</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>24.5</td>
<td>25.1</td>
<td>17.6</td>
<td>28.1</td>
<td></td>
</tr>
<tr>
<td>1985*</td>
<td>41.8</td>
<td>44.6</td>
<td>4.6</td>
<td>54.1</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>17.7</td>
<td>9.5</td>
<td>13.1</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>16.1</td>
<td>14.2</td>
<td>27.5</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>20.2</td>
<td>17.2</td>
<td>20.5</td>
<td>27.9</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>-8.2</td>
<td>-1.4</td>
<td>10.6</td>
<td>7.0</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>15.1</td>
<td>9.8</td>
<td>18.2</td>
<td>-10.0</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>24.3</td>
<td>24.2</td>
<td>15.7</td>
<td>19.6</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>45.4</td>
<td>42.4</td>
<td>18.3</td>
<td>26.4</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total FDI#</td>
<td>FL#</td>
<td>Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1978-92</td>
<td>17.26</td>
<td>15.96</td>
<td>17.95</td>
<td>19.13</td>
<td></td>
</tr>
</tbody>
</table>

Notes:  
- a) At current price.  
- b) At current price; figures in brackets denote percentage shares of budget-financed investment;  
- Column 9 is a constituent fraction of Column 8.  
- d) FDI: Foreign direct investment  
- FL: Foreign loans  
- e) Cumulative for 1979-82.  

Annex III Chronicle of Selected Current Views on Privatisation in China

The issue of privatisation has generated intense discussions among professionals in current Chinese literature. The overwhelming majority of the Chinese writers reject the course of privatisation of state properties as seen in Category II economies.

Some authors (e.g., Ho, 1994) draw upon the notion advanced by R.H. Coase, that "property rights" are, logically, not equivalent to "ownership rights." It has been maintained that property rights, as broadly defined, contain a) judicial ownership rights (or ultimate ownership rights, which belong to the capital provider), b) economic ownership rights (or legal ownership rights, legal property rights), and c) management rights.

Some take note of the extensive types of "popularisation" (Tung & Chien, 1993, p.12,13) of state assets and argue that "popularisation" is not equivalent to "privatisation." The privatisation programme carried out by the Thatcher government in England is, for example, categorised by Tung & Chian as "popularisation" (cf., 1993, P.12).

Others refer to the pending difficulties of reform and the special circumstances China presently faces as the reason for complete rejection of the privatisation route to modernisation (Su, 1991).

Some writers praise the merits of corporatisation of SOEs, but refrain from tying that with privatisation (Ju & Fung, 1989).

However, views, advocating the establishment of private property, have appeared in an anonymous chronicle of the most liberal "special economic zone" in Southern China (Sheko, 1989).
Annex IV. Different Forms of Treatment of After-tax Profits of SOEs

1) Guaranteed progressive tax (GPT): after payment of the product tax (or VAT), the enterprises transfer an annually increasing profits on an initially approved tax base to the Finance Ministry at rates fixed for several years.

2) Guaranteed extra-quota tax (GEQT): after-tax extra profits are redivided at a proportionate ratio between the enterprises and government for additional remittance on a predetermined tax base.

3) Guaranteed tax refund (GTR): depending on the concrete profitability conditions of individual enterprises, after-tax profits are partly or wholly kept by the enterprises on a predetermined base. This applies primarily to those exhibiting poor profitability records. Negative profit tax (i.e. state subsidies) are not ruled out in this case.

4) Two guarantees and one link (TGOL): the profit remittance ratio rests on two irrevocable guarantees by SOEs. Namely, the guarantee to pay tax and transfer (extra-)profit; and the guarantee to undertake technological renovation. The one link relates total wage fund to the level of enterprise operating efficiency.

5) Guaranteed reinvestment tax scheme (GRTS): based on contract responsibility enterprises pay tax and remit profits at terms fixed by obligatory reinvestment quota for SOEs.

Note: Contained in the Measures regarding the Implementation of the Tax-remittance System of State Enterprises, the State Council, April 1983.

### Annex V Degree of Autonomy in Decision-Making of SOEs of Varying Sizes, in %

<table>
<thead>
<tr>
<th></th>
<th>Manufacturing</th>
<th></th>
<th>Material Processing</th>
<th>Energy</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Investment</td>
<td>Consumer</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>goods</td>
<td></td>
<td>goods</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment Decision-Making</td>
<td>35.5</td>
<td>35.7</td>
<td>24.3</td>
<td>10.1</td>
<td>30.8</td>
</tr>
<tr>
<td>Purchasing</td>
<td>86.0</td>
<td>83.4</td>
<td>69.1</td>
<td>43.5</td>
<td>73.6</td>
</tr>
<tr>
<td>Pricing</td>
<td>31.1</td>
<td>28.8</td>
<td>21.1</td>
<td>5.2</td>
<td>22.3</td>
</tr>
</tbody>
</table>

| Remuneration Distribution      |               |         |                    |        |         |
|                                | Wage level    |          |                    |        |         |
| discrepancies                  | -              | -       | 46.0                | 34.8   | 43.0    |
| Remuneration Distribution      |               |         |                    |        |         |
| Bonus discrepancies            | -              | -       | 91.6                | 88     | 93.2    |

Note: Only 1.1% of all enterprises enjoy recruiting rights for their factory staff; 23.2% enjoy worker recruiting rights.

Source: Based on survey conducted under the Enterprise Tracing Observation (ETO) system jointly established by the Institute of Economic System and Management, the National System Reform Committee, and the State Statistical Bureau, Nov. 1991.

For details see NSRC (1992).
Occasional Paper Series

17. Chin Chung. "Impacts on Domestic and Host Economies of Taiwan's DFI
toward Mainland China," January 1992. (No.9202)
37. Tzong-shian Yu. "Does Taiwan’s Industrialization Have Its Own Paradigm?" June 1994. (No.9404)