China’s state-owned enterprises (SOEs) have existed since the founding of the People’s Republic of China (PRC). Similar to the country’s economy, which remained largely isolated until forty years ago, how these enterprises were owned and operated garnered little attention. However, as China’s economy has become more integrated with the global economy, the global impact of SOEs as well as interest in these enterprises have grown. As other major economic powers have taken issue with state influence in China’s domestic market in recent years, the eyes of the world have turned to SOEs. It is vital that observers outside of China understand what these enterprises are and how they are changing to better understand both China’s domestic economy and its economic impact around the world.

Chinese SOEs appear to be evolving in two contradictory directions; in some respects, they are moving away from government control and towards greater private governance and decisionmaking. Simultaneously, state-owned enterprises—along with nearly all organizations in China, both private and public—are having to give increased formal leadership to the Chinese Communist Party (CCP). For those interested in the conditions of China’s domestic market, from policymakers to investors to academic observers, acquiring a baseline understanding of how these enterprises are changing is essential to fully consider the implications that this somewhat contradictory evolution will likely have on China’s future.

This article seeks to provide readers with a baseline understanding of Chinese SOEs, the implications of mixed-ownership reform, and the larger context of these trends in corporate governance.

**THE REFRESHING FLAVOR OF SOE CLASSIC**

The classic impression of SOEs is one of large, powerful Chinese companies with unlimited backing from the state. Such support allows these entities to compete on the global stage with an arsenal of resources not enjoyed by counterparts in other countries.

However, the truth is that SOEs are hardly unique to China. SOEs play a role in every major economy, including the United States. They are not necessarily at the heart of each country’s national industrial plans, as evidenced by examples in South Korea and Japan.
Broadly, an SOE is a company owned and managed by the government. Examples in the United States include the U.S. Postal Service and Freddie Mac. Although an SOE may exist in a sector that serves a public good or in a sector considered essential to the national interest, the existence of an SOE does not necessarily preclude private or foreign competition within that sector. Unlike services provided by the government, SOEs still are at least notionally profit driven, though in practice their profit sensitivity depends on the outlook or policies of the government that owns it.

SOEs should not be confused with so-called “national champions,” or companies earmarked by the state for success. South Korea’s chaebols are an excellent example of private national champions. To facilitate development and create internationally competitive companies, South Korea’s government both protected selected domestic industries from international competition and ensured resources went to a handful of chosen companies. Eventually, these companies became international giants in their given industries. Though these “national champions” had very close ties to government, they were privately owned and managed, meaning they were not SOEs. Though an SOE also could be a national champion, the qualities that make a company an SOE or a national champion are a separate set of characteristics.

China’s SOEs are unique in several ways. First, they have a disproportional footprint in China’s economy. One hundred fifty thousand SOEs account for one in five urban jobs in China and approximately 25 percent of the nation’s economic output. This footprint extends to Chinese outbound FDI, which makes up nearly 60 percent of outward investments and has ranged from $40 to $100 billion in real USD annually between 2007 and 2017, according to China’s Ministry of Commerce. Second, the relationship between the state, banks, and SOEs allows SOEs inordinate access to credit from Chinese banks, unlike their counterparts in many other countries. Because of strong incentives to continue collecting tax revenue from SOEs as well as maintain high levels of employment, local and provincial governments push banks to issue credit to state-owned enterprises regardless of their competitiveness. As a result, SOEs account for nearly 60 percent of China’s corporate debt, and conservative estimates place the number of unprofitable but still operable entities (so-called zombie companies) in the thousands. The result has led to massive overcapacity in industries such as steel—and barring an economic crisis, gives national-level economic planners the ability to allow overcapacity in any industry they choose. The combination of these two factors has led the United States and other countries to label China a “non-market economy” where the state excessively distorts markets.

**STATE-OWNED MAKEOVER**

Foreign companies and governments have expressed frustration with the non-competitive aspects of China’s SOEs, and they are in good company. Chinese leadership, including President Xi Jinping and Premier Li Keqiang have often
spoken about the need to reduce the ratio of zombie companies and increase the competitiveness of SOEs. A number of reforms have been enacted to address this, but one of the more counterintuitive approaches is the so-called mixed-ownership reform (MOR).

Mixed-ownership reform involves private ownership of SOEs to increase price consciousness and efficiency. This allows greater say and corporate oversight from the private sector and provides the impetus to cut the fat from SOEs and increase their competitiveness. The idea was first endorsed by President Jiang Zemin in his 1997 speech to the Fifteenth Party Congress but was formally started in 2013. After starting with a few select national-level enterprises, the policy has expanded gradually in waves as more companies have fallen under its jurisdiction. By 2018, two-thirds of all central state firms (at all levels of government) and more than half their subsidiaries fell under mixed ownership reforms involving equity purchases by the private sector exceeding 338.6 billion RMB (50.5 billion USD). As recently as March 2019, it was announced that private sector entities could hold a majority stake in SOEs in certain key industries.

From a legal point of view, this is not a drastic change. Reforms in the 1980s and 1990s also changed SOE management and control, leading to the creation of a specific office—the state-owned Assets Supervision and Administration Commission (SASAC)—in 2003 to act as majority shareholder of SOEs and exercise shareholders’ rights on the state's behalf. In their seminal paper on the topic, professors Li-Wen Lin and Curtis Milhaupt argue that Chinese national SOEs are governed as though all fall within a diversified metagroup under control of SASAC, which they assert is the largest controlling shareholder in the world. SASAC was highly useful in clarifying the relationship between SOE chains of command and other branches of government, but has been ineffective in addressing problems such as overcapacity and zombie companies.

However, there is optimism that where SASAC failed, private shareholders can succeed. The distinguishing characteristic of the MOR approach is the increased voice private shareholders are expected to have within state-owned enterprises. As SASAC spokesperson Peng Huagang told reporters in 2018, “mixed ownership enterprises will promote improvements in [SOE] corporate governance structure, improve their market-oriented operation mechanisms, and help transform state-owned enterprises.”

If carried out as asserted, MOR could reduce market imbalances and cut overcapacity by forcing SOE management to make decisions based on price incentives rather than national objectives. As the scope of MOR expands to include more enterprises, it could be an important intermediate step towards removing the distorting effects of state subsidies and make China a true market economy.
PARTY TIME
As promising as the concept of MOR may seem, observers should remain cautious about actual follow-through. Despite the prospect of greater corporatization of China’s state sector, in practice many private companies have concerns over how much input they will have over MOR enterprise decisionmaking. Critics complain that in practice, little has changed in SOE management despite the presence of private ownership. Without the accompanying changes in corporate governance promised in MOR, these reforms are little more than an attempt to receive private sector payments without offering anything in return—an empty box with nice wrapping paper.

Even the prospect of removing state influence from the economy has been publicly refuted by Chinese officials. When speaking to reporters in March, SASAC official Xiao Yaqing explicitly stated that mixed ownership is not privatization. In the same press conference, he tried to assuage concerns that mixed ownership was being used for state acquisition of private companies—essentially working in the opposite direction of the articulated intention. These concerns are not unfounded. In October 2018, amid a sinking stock market and stressed equity, China’s national and local governments bought stakes in private companies to prevent mass defaults. Although state funding served as a buffer against market volatility, analysts are concerned that state investors will be reluctant to give up control and that the private sector could be nationalized.

Moreover, other powerful shifts are simultaneously taking place in Chinese enterprises that could carry SOEs in a different direction. Although MOR and other market-oriented reforms are attempting to move SOEs farther from government control, other initiatives are increasing the role of the Chinese Communist Party. Though there is significant overlap between the Chinese government and the CCP, legally the two entities should be understood as separate. Party cells within SOEs or other organizations were largely passive until a few years ago, but have since become an increasingly powerful force. Since 2013, soon after the start of Xi Jinping’s administration, a concentrated effort was made to increase the roles of SOE party committees in making major decisions for their enterprises. In 2015, the trend was given greater teeth when party leadership ordered that the CCP become the “political core” of state-enterprise corporate governance. Subsequent legal requirements over the following years have similarly clarified that party organizations should serve a “leadership function” within SOEs and that the CCP must legally possess the ability to influence personnel appointments and discuss major proposals before SOE boards make their final decision. Although these changes are not part of MOR, MOR’s implementation timeline matches closely with the party’s rise in SOE corporate governance.
The increased role of the party is not limited to state affiliated entities. Since 2015, private Chinese companies, including foreign-owned joint ventures, have had to accommodate demands to give party organizations legal standing within their governance structure and allow CCP input on major decisions such as the promotion or firing of personnel. Experts assess that this increased role of the party is unlikely to lead to a more centrally-planned economy, but it does reflect the Party's priority to prevent the private sector from becoming too independent and possibly pose a threat to the party-state.

Taken together, these elements cast significant doubt on how successful MOR will be in achieving its stated objectives—namely, creating more efficient, market-oriented incentives for SOEs through initial public offering (IPO) buy-in from private entities. With decision-making authority in the hands of people who either represent or must accommodate the will of the party, it is unlikely private partners will have much leverage in situations that do not align with party objectives. As Chinese regulators cut down on shadow banking, we may see the parallel counter emergence of “shadow corporate governance” through party leadership within SOEs including MOR companies. Moreover, the increased importance of political loyalty and study of “Xi Jinping Thought,” the president’s political philosophy, in Chinese society at large—especially in government affiliated entities—further foreshadow party-oriented decisionmaking regardless of how MOR is implemented.

OUTSIDE LOOKING IN

Within SOEs and China’s economy, it is very possible that MOR will lead to little more than a change in window dressing. As China’s economy is put under greater stress, cadres will have to balance the need to reform SOEs with the goal of maintaining employment and consumer confidence. In doing so, they will need to choose whether to allow or ignore the voices of MOR private investors. The task will be daunting, and it would not be surprising if leadership chooses inefficient stability over painful changes (without factoring in further distortionary effects from increased party loyalty in the corporate governance structure).

International negotiations are another means by which MOR could take a prominent role. The United States, Japan, and the EU have separately and jointly issued statements condemning the outsized role of Chinese SOEs in the economy. All three powerful economies are pushing for less direct state control and greater free market forces in China’s domestic economy.

MOR provides a counterargument for the Chinese government to rebut foreign criticism. In fact, Chinese officials and business leaders have already started to use this defense. In an op-ed in the Financial Times, Liu Jun, executive vice-president of China Investment Corp., told readers, “Much is made by critics of China of the role played by state-owned enterprises (SOEs). In fact, most such enterprises in China today are stockholding companies with shareholders from both the public and private sectors. Identifying where government ownership of indi-
vidual companies begins and ends can be extremely difficult.” As outside scrutiny of state-owned enterprises continues, we are likely to hear more statements to this effect from Chinese policymakers and business advocates. Though the eventual effect on China’s economy is uncertain, MOR provides a speed bump for foreign policymakers, negotiators, and investors trying to build policies around and in response to China’s SOE practices.

**MOR THINGS TO WORRY ABOUT**

Chinese lawmakers have identified state-owned enterprise reform as a priority for domestic economic policy, and the world’s largest economic powers have recognized China’s SOEs as an area of concern for global markets. It is therefore of interest for external actors to understand what reforms are in action and for internal actors to understand the effectiveness and implications of reforms in progress.

**CHINESE LAWMAKERS HAVE IDENTIFIED STATE-OWNED ENTERPRISE REFORM AS A PRIORITY FOR DOMESTIC ECONOMIC POLICY, AND THE WORLD’S LARGEST ECONOMIC POWERS HAVE RECOGNIZED CHINA’S SOEs AS AN AREA OF CONCERN FOR GLOBAL MARKETS.**

Mixed-ownership reform could in theory be an intermediate step towards reducing the role of the state in major industries and increasing market-driven efficiency in China’s economy. In practice, however, it has provided SOEs with an additional source of funding while having little discernable effect on enterprise management. This limited effect, combined with the growing role of the Communist Party in state- and private-owned enterprise management, indicate that although the formal role of government may recede in China’s economy, the informal but more powerful role of the party will take a stronger lead.

These distinctions are highly relevant for observers and policy makers interested in legally constraining Chinese SOE market distortions. Whether it is through multilateral institutions or bilateral negotiations, the governments of major economies including the United States will need to apprise themselves of the shifting landscape, the content of China’s economic reforms, and the implications these reforms have in practice. MOR has been a source of money for SOEs, but MOR is not solving the problems it set out to fix.

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5. Ibid. 31, 37.

6. Ibid. 43–44.


16. Ibid., 745.

17. Wang, Sun, and Ban, “State-owned Enterprises Mixed Reform, Groups Welcomed Breakthrough.”

18. Qu and Han, “More State Enterprises Set for Mixed-Ownership Reforms.”


23. Ibid.

24. Bloomberg notes that currently only a small percentage of China’s private sector has been acquired by state entities. Never the less, concerns remain of the practice expanding.


28. Ibid., 24.


30. Readers should note the reason the timelines for MOR and increased formal control of the CCP in SOE governance overlap is due to two scheduled events in 2013 – the Third Plenum of the Eighteenth Central Committee and the start of Xi Jinping’s administration in late 2012. The former laid out intended economic reforms, while the later brought about major changes in government. Although it would be a gross simplification to say that MOR and CCP governance in SOEs have no shared roots, one did not cause the other and their concurrence is likely not intentional.


32. Ibid.


36. Liu Jun, “China is committed to playing by the rules on global trade,” Financial Times, October 25, 2018, https://www.ft.com/content/2bbdsc0-d7aa-11e8-aa22-36538487e3d0.