

Chapter V

Enterprise Reform Since the Party Congress

Introduction

The recent Party Congress officially reaffirmed the policy of mixed ownership of state-owned enterprises (hereafter SOEs) first floated in the third plenary session of the 14th Central Committee of the Chinese Communist Party (hereafter CPCCC) of 1993. The policy has already been tempered through more than four years of experimentation and controversy. This is the major achievement of the recent Party Congress in the economic area. This chapter looks back over the trends in enterprise reforms from 1993 to the recent Party Congress and gives a tentative outlook on the directions enterprise reform and the transition to a market economy after the Party Congress. It concludes that the Chinese economic system will evolve into an East Asian type of market economy, in which, on the basis of mixed ownership, government and business keep a close relationship, though the latter retains increasing independence from the former.

1. 15th Party Congress and Enterprise Reform

China made rapid progress in the process of transition to a market economy in the 1990s. The existence of vast number of SOEs in almost all sectors is the sole remaining reason for China's claiming to a "socialist market economy". Along with the growth of non-SOEs like village and township enterprises, foreign ventures, etc., the weight of the SOEs has falling rapidly, SOEs are nevertheless, still dominant in terms of some indicators such as total assets and gross value added (Fig. 1).

As the growth slowed down since 1993, value added SOEs have seen their operations deteriorate further. This deterioration of operations has brought forth two crises. The first is the de facto unemployment of over 8 million workers in urban areas. The second is the accumulation of bad loans which is established to be 20 to 40 percent of their outstanding loans by the four major state-owned banks. Both of them may potentially trigger serious

economic and social instability. Thus one of the points which attracted observers' interests in the 15th Party Congress was what kind of policies the Party would set forth regarding SOEs reform.

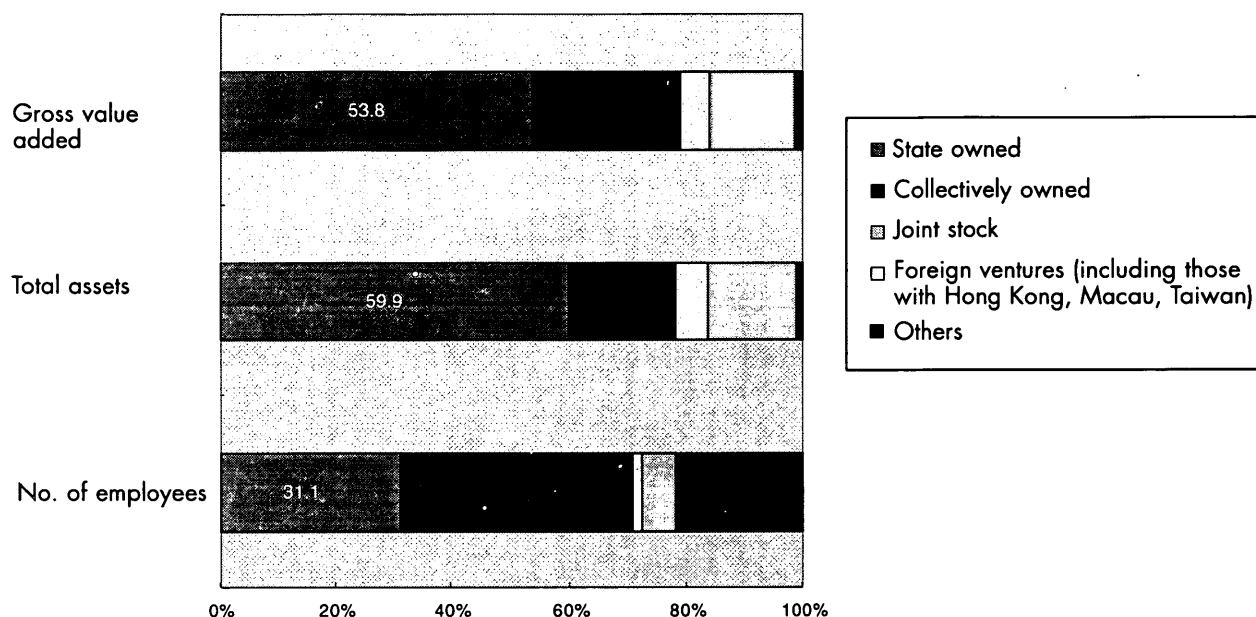
1-1. Succession of Policy of Third Plenary Session of 14th CPCCC

In his report before the Party Congress, Jiang Zemin declared that "it is China's basic economic system for the primary stage of socialism to retain a dominant position for public ownership and to develop diversified ownership side by side" and thereby took a clear stance toward continuation of the lines of the 14th Party Congress of October 1992 and the third plenary session of the 14th CPCCC of November of 1993, which set out the transition to a socialist market economy.

Figure 2 compares the basic line regarding enterprise reform in the decision of the third plenary session of the CPCCC and the Jiang Zemin's report of the recent Party Congress. The decision virtually accepted joint stock system as the basic direction of reforms of SOEs, using the expression "construction of a modern enterprise system" (*jianli xiandai qiye zhidu*). Further, it allowed the conversion of small SOEs to "joint-stock cooperative system" (*gufen hezouzhi*) and sale to other firms or individuals along with contracting and leasing and thereby gave de facto recognition to privatization. In this sense, the third plenary session of the 14th CPCCC was a major turning point in the SOEs reform. Compared with this, the "report" of the Party Congress lacked any groundbreaking developments. As shown in Fig. 2, part of the main points of discussion were just repetitions of the "decision". This shows that the Party Congress continued with the spirits and basic lines of the third plenary session of the 14th CPCCC.

1-2. Policy Controversies Successfully Ridden Out

Should the fact that the recent Party Congress

Figure 1. Still Large Share of State-Owned Enterprises (Industry/1996)

Notes: 1) Only industrial enterprises with separate accounts. Not including enterprises belonging to villages and lower level units.
2) Figures for number of employees are for 1995.

Source: Prepared from *Zhongguo tongji nianjian* 1997 (China Statistics Yearbook 1997) and *Zhonghua renmin gongheguo 1995 disanci quanguo gongye pucha diliao huibian* (The Data of The Third National Industrial Census of The People's Republic of China in 1995).

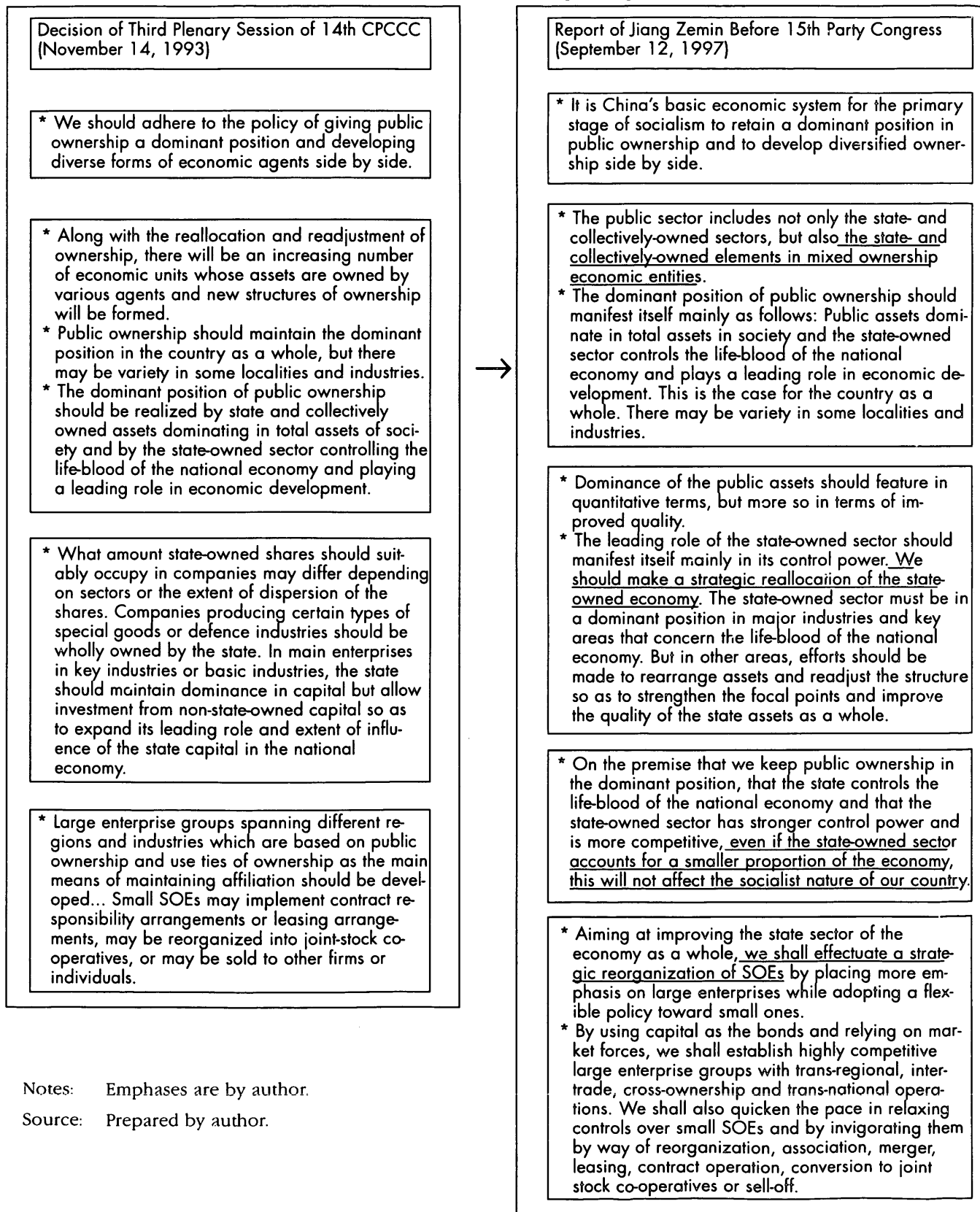
failed to come out with any new ground-breaking policies mean the reforms are coming to a standstill? The truth is actually just the opposite. It is significant that the ground-breaking policies set in the "decision" have been reaffirmed after four years of experimentation and controversy.

The "decision" of the third plenary session of the 14th CPCCC, which came at the crest of the acceleration of reforms sparked by Deng Xiaoping's "tour of the South" in early 1992, was in large part anticipatory in nature. As of the end of 1993, there were only 181 companies listed on stock markets. The joint stock system had only just begun, while privatization of small and medium sized enterprises had only been practiced in Zhucheng city (Shandong province), Yibin county (Sichuan province), and other small cities — without formal approval from the central government. There has been respectable progress in this in the years since the "decision" gave formal recognition to the joint stock system and de facto privatization. The new policies of full introduction of the joint stock system and

privatization of small and medium sized state-owned enterprises, however, drew strong criticisms from some quarters for their ideological contradictions¹.

A typical example of how the "report" managed to ride out policy debate and reaffirm the policies of the "decision" was the handling of the "joint stock co-operative" system. The "joint stock co-operative" system, a type of system of ownership by employees, has been recommended by the central and local governments as a desirable form of reorganization of small SOEs. It fits well in the framework of public ownership and is regarded to have little effect on employment. Some conservatives, however, have not only opposed direct privatization such as the sale of SOEs to individuals or other enterprises, but have also fiercely criticized the joint stock co-operative system alleging that "it has no nature as collective ownership at all .. and is a completely capitalist joint stock system"². The recent "report" stated that "what should be specially advocated and encouraged is the kind of

Figure 2. Comparison of Basic Policies in Enterprise Reforms From Third Plenary Session of 14th CPCCC to 15th Party Congress



Notes: Emphases are by author.

Source: Prepared by author.

collective economy that features, in the main, the association of laborers in labor and capital" and thereby came out in clearer support of the joint stock co-operative system than the "decision".

1-3. "Strategic Reorganization" of State-Owned Sector — Faster Move Toward Mixed Ownership and Structural Adjustment

As seen in the example of the joint stock co-operative system, while based on the lines of the "decision", the "report" clearly went one step further than the "decision" in its expressions. The most important points were the modifications in the idea of "public ownership" and the repeated stress on the "strategic reorganization" of the state-owned sector.

The "report" clarified the scope of "public ownership", which has previously been vague, as "including not only the state- and collectively-owned sectors, but also the state- and collectively-owned elements in the sector of mixed ownership"³. Conventionally defined "State-owned enterprises" used to mean just solely state-funded enterprises, that is, enterprises wholly owned by the state (*guoyou duzi qiye*). This meant that once a SOEs institutes a joint stock system and accepts investment from outside the state, it would leave the scope of SOEs. In other words, there would have been a head-on clash between the premise of the dominant position of public ownership and the basic policy of reform through promotion of the joint stock system. This ideological clash was skirted by the inclusion of state-owned equity in the mixed ownership system, specifically the joint stock system, in the scope of "public ownership". The idea was that even if the percentage of wholly state-funded enterprises falls due to the joint stock system, so long as the state holds a dominant position in shares, the dominant position of state-ownership will not be affected. This considerably strengthened the idea of mixed ownership first floated in the "decision".

Another factor behind the modification of the idea of public ownership was the need to promote "strategic reorganization" of the state-owned sector. This "strategic reorganization" of the state-owned sector means readjustment of the position of state

capital in terms of both industries and scale. In terms of industries, it means concentration of state capital in waterworks, electric power, railroads, and other naturally monopolistic industries, like postal services, telecommunications, national defense, and other security related industries, high tech industries and other important high risk industries in which participation by non-state capital is difficult. State capital flows into automobiles and other basic manufacturing industries, and withdraws gradually from general manufacturing industries. In terms of scale, it means focusing support on important enterprises and allowing privatization of small enterprises such as seen by the phrase "support large enterprises and free small ones" (*zhuada fangxiao*).

The expression of a "strategic reorganization" of the state-owned sector first appeared in official government documents in the "outline of the ninth five-year plan and the long term goals for the year 2010" passed by the National People's Congress in March 1996. The idea itself, however, was clearly first floated in the "decision" of the third plenary session of the 14th CPCCC and was embodied in the Company Law established in 1993 (see next section).

In the final analysis, the significance of the recent Party Congress lies in the official recognition by the CPC of the changes already steadily occurring on the practical level and thereby the final settlement of the ideological dispute. The current reform policies will probably not be contested on ideological grounds at least for foreseeable future. Rather, the problem will be how to deal with the practical difficulties which arise in the promotion of the joint stock and mixed ownership systems and structural readjustments.

2. Enterprise Reforms Since 1993

If the significance of the recent Party Congress lay in the official affirmation by the Party of the reform since 1993, then it is essential to analyze the events of the past few years when considering the direction which reforms will take in the future. Below, we look back over the trends in reforms since 1993 and then make some projections on the future⁴.

2-1. Background Behind The Major Shift in 1993

From the late 1980s to the end of 1993, the dominant system of operation in SOEs was the responsibility contract system. This proved successful in that it gave managers a certain degree of autonomy and gave them an incentive to pursue profits. Ironically, however, the performance of SOEs has rapidly deteriorated since the end of the 1980s when enterprises were given significant autonomy (Fig. 3). Figure 4 summarizes the factors behind the swelling losses in the 1990s and reform measures taken to deal with them stressing the large enterprises.

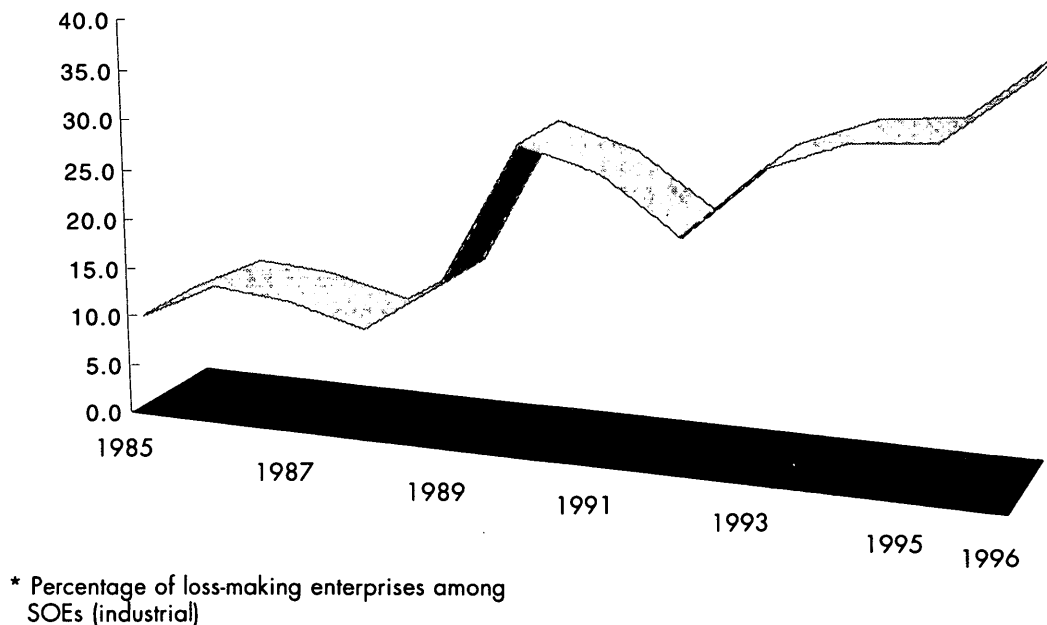
One of the reasons frequently given for the inefficient operations of SOEs in the past was the excessive social obligations placed on them, for example, the need for SOEs to absorb surplus labor and provide certain social services. This problem, however, has basically persisted from the 1980s. An even more significant factor behind the deterioration of performance in the 1990s has been the problems in the corporate governance system or management mechanism.

The reforms of the 1980s gave enterprises the motivation to make money, but failed to set up a system giving managers accountability for the results of their actions. In the 1990s, consumer goods markets in urban areas changed from sellers' markets to buyers' markets. SOEs however continued to invest in expansion going far beyond the capacity of the markets, due mainly to sheer inertia from the 1980s. As a result, many industries suffer from serious idling of their facilities and have seen performance deteriorate⁵. Moreover, despite the deterioration in performance wages have continued to raise⁶.

At the core of this excessive investment and excessive hikes in wages is the lack of management accountability resulting from soft budget constraints. The state was never able to impose hard budget constraints on SOEs due to their important social function – the guarantee of social stability. This came to be recognized and the need for comprehensive reforms covering the corporate governance system and, in turn, the nature of state-ownership itself began to be discussed.

The third plenary session of the 14th CPCCC of November 1993, bolstered by the policy of a "socialist market economy" in the 14th Party Congress of 1992, was a major turning point in enterprise re-

Figure 3. Growing Deficits of State-Owned Sector



form, as touched upon in the previous section. The "decision" of the third plenary session of the 14th CPCCC made the limited liability system, as represented by the joint stock system, and diversification of ownership (meaning de facto mixed ownership) the core of enterprise reforms, using the expression "construction of a modern enterprise system".

2-2. Company Law — Establishment of a Legal Framework for Mixed Ownership System

The Company Law, passed and established by the Standing Committee of the NPC in December 1993 and enforced starting in July of 1994 provided important legal grounds for the enterprise reforms after the "decision"⁷. The Company Law defined two types of limited liability companies: limited liability companies and joint stock companies. They roughly corresponds to Japan's limited companies and stock companies respectively⁸. In drafting the law, the company laws of the main countries of the world were examined. The structure of corporate governance defined by the law is basically identical with that of the Japanese company system.

The major feature of the Company Law is the provisions in Chapter 2, Section 3 regarding wholly state-owned companies as a special form of limited liability company. In particular, the following provision of Article 64 at the top of this section is important: "Companies producing special goods designated by the State Council or companies belonging to special industries shall be of the form of wholly state-owned companies". This provision means that in the future, mixed ownership will be the general form of ownership and that complete state ownership will be limited to specific industries. This provision provides the legal grounds for the policies of strategic reorganization of the state-owned sector and diversification of investment entities laid out in the "decision". At the present stage, the great majority of the SOEs remain to be wholly state-owned, so this provision is less of a legal definition and more of a policy goal.

2-3. Reforms of Enterprise Governance System

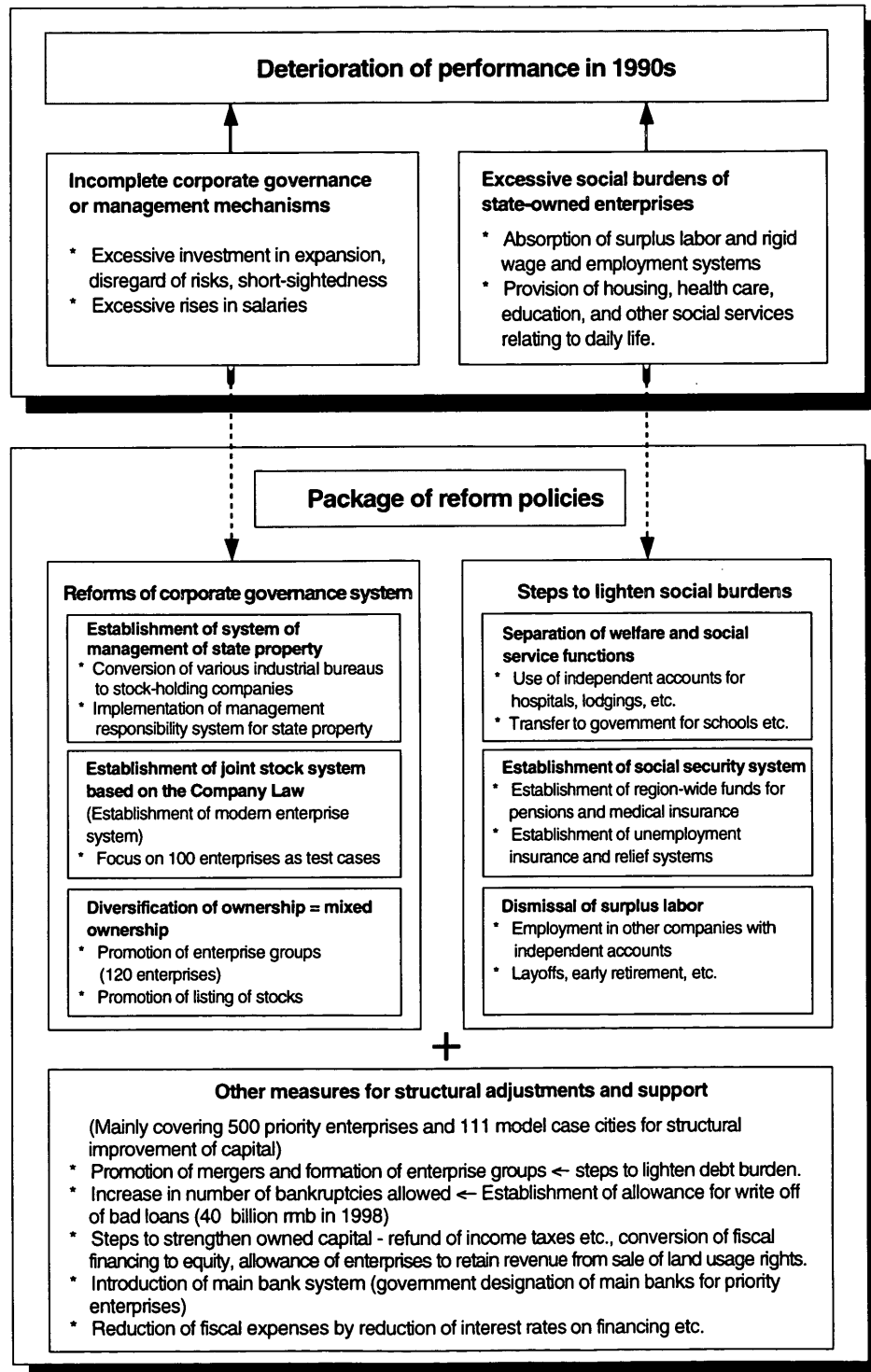
The enterprise reforms since the "decision", as

seen by the slogan "support large enterprises and free small ones", have stressed large enterprises. They may be classified as of roughly two types: reform of the corporate governance system and various measures of assistance (Fig. 4).

Reform of corporate governance system has been aimed at establishment of a market-economy-oriented system of corporate governance based on the Company Law, that is, China's so-called "modern enterprise system", which allows managerial autonomy, but strengthens supervision by owners over the managers. In 1994, 100 leading SOEs were selected by the central government as model cases for establishment of modern enterprise system. The government proceeded to work to convert these to enterprises operating under the Company Law setting a time limit of two years from 1995⁹. Progress proved to be much slower than initially planned and the time limit was extended by another year to the end of 1997. Local governments, on their own level, selected about 2500 enterprises as similar model cases. These model case enterprises are all to be converted to limited liability companies (wholly state-owned or owned by several entities) or joint stock companies under the Company Law.

2-4. Establishment of a System of Management of State Property

While the goal is the diversification of investing entities, the state continues to be the largest investor at the present time. In parallel with the reforms of the corporate governance system, a system is therefore being established enabling the state, as an investor, to supervise enterprise management. In this area, the cities are ahead of the central government and provinces in the reforms. Shanghai made major reforms in this area in 1993. It reorganized industrial bureaus, which used to directly supervise SOEs, into industrial holding companies. Under this new system, a municipal state property committee comprised of the heads of the municipalities entrust management of state property in different industries to these holding companies. The holding companies had at first been funded by the municipalities' budget, but are now working to become financially independent and in the end are supposed to be separated from the government. In recent years, the Shanghai model of

Figure 4. Factors Behind Deterioration of Performance of SOEs and Framework of Reforms

Notes: 1) Figure shows mainly reform measures stressing large enterprises.
 2) In the figure, the solid line arrows indicate relationships of cause and effect, while the broken line arrows show relationships of problems and countermeasures.

Source: Prepared by author.

management of state property has been becoming the national model.

In addition, work has been proceeding on a "property management responsibility system" as a transitional corporate governance system for wholly SOEs. Under this system, the enterprise management and supervisory government bureaus would conclude contracts for achievement of certain targets such as growth rates of state property (more precisely net assets of the enterprises) and profits. Managers would be awarded or fined according to their achievement in normally one year terms.

2-5. Strengthening of Assistance to Large Enterprises

The reforms in the corporate governance system originally were the heart of the enterprise reforms. Starting from around 1995 to 1996, however, the emphasis has shifted to reducing social obligations, making structural adjustments, and providing other assistance to large enterprises. This assistance began to be given to both the model case enterprises of the modern enterprise system and cities designated as "model cases for improvement of the capital structure" by the central government starting from 1995. Eighteen cities were initially designated as "model cases". This was expanded to 58 cities in 1996 and to 111 cities in 1997 and now includes the majority of the main cities (all seats of provincial and autonomous region governments and municipalities).

Looking at the reduction of social obligations, progress has been made in the divestiture of surplus labor, the establishment of region-wide funds for pensions and medical insurance, the separation of social services into independent operations (dining halls, hospitals, etc.), and the transfer of certain services to local governments (schools etc.) Of the assistance provided, the most focus has been on the reduction of the debt/assets ratio (debt/total assets) of the state-owned industrial enterprises, said to be close to 80 percent. Steps are being taken to increase net worth by refunding income taxes and value added taxes, converting fiscal financing into equity, and allowing enterprises to retain part of the proceeds from sale of land usage rights.

Along with the reduction in these burdens on enterprises, the model case cities have stressed readjustment of stock through mergers and bank-

ruptcies. To encourage mergers, reduction of interest payment has been allowed on the existing debt of companies absorbing a failing enterprise. They have also recognized priority allocation of revenue from the disposal of assets for reemployment of the workers and other steps to lighten the social impact when enterprises cannot be saved by merger and are forced to go bankrupt.

The central government has also designated 1000 leading SOEs as priority recipients of assistance. In the first phase, the State Economic Commission and the People's Bank of China were designated the main bank for 300 enterprises and helped arrange financial aid. In 1997, another 200 enterprises were added bringing the total to the current 500.

2-6. Freeing Small and Medium Enterprises

For the small enterprises, in addition to the previous reforms such as the leased and contract operations, along with the policy for a strategic reorganization of the state-owned sector, there have been moves to sell off the enterprises to their employees, other enterprises, individuals, and foreign ventures. This de facto privatization of small enterprises had been experimented since around 1992 in Zhucheng city in Shandong province, Yibin county in Sichuan province, and other small cities with the de facto official stamp of approval from the "decision," it spread throughout the entire country starting in 1994. In 1996, the State Economic and Trade Commission issued its "opinions on the freeing and stimulating of small state-owned enterprises". Approved by the State Council, this became an official policy of the central government.

The main trend in the regions working to free up enterprises has been the joint stock co-operative system in which the entire assets of enterprises are sold to their employees. In this case, the ownership of the enterprise changes from state ownership to collective ownership, so the enterprise remains publicly owned. A distinctive feature of this practice is that shares are only allowed to be transferred among the current employees. Different practices are adopted in different regions, however. The system normally does not meet with the provisions of the Company Law¹⁰. The State Commission for Restructuring Economy finally came out with guide-

lines on the system in November 1997, but there continue to be no legal regulations governing it.

3. *Trends in Enterprise Reforms Since 1997 — Mixed Ownership and Structural Adjustments*

Progress in the reforms is speeding up due to the ideological nod given to the direction taken in enterprise reform these past few years at the recent Party Congress. The last section will summarize recent developments and take a look at the future.

3-1. Accelerating Reforms of Small and Medium Enterprises

Rapid progress has been made in reforms of small and medium sized enterprises in some regions in the past few years. In Shandong and Sichuan provinces, which began experimenting with freeing up enterprises early on, a large proportion of the medium and small SOEs are already being changed. There is little quantitative data on what share denationalization, such as conversion to joint stock co-operative systems or sale to individuals or other enterprises, now accounts for. Official statistics show that only in Tianjin and another few provinces and municipalities the numbers of SOEs are actually falling. Therefore, it is difficult to obtain an accurate grasp of the situation. At least, conversion to joint stock co-operative systems and sales to individuals and other enterprises seem to be becoming mainstream¹¹. With the performance of SOEs as a whole deteriorating, local governments will be forced to concentrate on assisting large enterprises and will therefore probably divest themselves of the small and medium enterprises at an even faster pace.

This being said, major difficulties accompany divestiture. The positive aspects of the joint stock co-operative system are being stressed officially, but the system is predicated on all of the employees taking part in the decision-making process. There are limits to this. Recently, cases have appeared of even relatively large sized enterprises converting to joint stock co-operative systems, but the larger the size, the greater the need for concentration of the decision-making process in the hands of a few. In fact, the official interpretation of the recent Party

Congress "report" recognized the limits to "employee democracy" when stating that it was appropriate for managers to hold larger shares in the case of relatively large enterprises¹². In Shanghai, which leads in the use of the joint stock co-operative system, steps are already being considered which will allow managers to hold as much as 15 to 30 percent of the shares¹³. In addition, situations may arise necessitating sale of shares to outside parties in order to raise funds. In the final analysis, the joint stock co-operative system is a transitional one. In the long term, these enterprises can be expected to evolve into small businesses similar to those in the capitalist countries.

3-2. Progress in and Limits to the Establishment of a State Property Management System

In Shanghai, which leads in the establishment of a state property management system as well, management of property by holding companies has apparently been an effective means of restructuring. In some cases, however, this has led to trends running counter to the reforms, such as the supervisory government organizations given authority over management of state shares interfering more in the management of enterprises as "owners". The "property management responsibility system" now being applied to wholly SOEs resembles the past responsibility contract system in many points such as the determination of management goals by one-to-one negotiations between the government and enterprise.

In the end, in order for the state property management system to be really effective in terms of reforming the corporate governance system, it will be necessary for certain preconditions to be met, such as the completion of the separation of the holding companies and other entities managing the state shares from the government and further progress in the conversion to mixed ownership.

3-3. Steady Increase in Joint Stock Companies

No systematic data has ever been released on the state of conversion of SOEs to the joint stock system, so it is difficult to obtain an accurate grasp

of the situation. Table 1 shows the increase in joint stock enterprises (joint stock companies and limited liability companies) as a whole. Table 1 shows that since 1993 the number of these enterprises has grown by a rate of over 30 percent a year. Joint stock companies require as a minimum capitalization a large 10 million yuan (rmb), so chances are that the majority were built on existing SOEs. At the very least, in terms of numbers, steady progress has been made in conversion to the joint stock system since 1993. Table 2 shows the shares of joint stock enterprises and listed enterprises in sales, capital (net assets), and total assets of the industrial sector.

While growth has not been as spectacular as the number of enterprises, the shares have steadily risen since 1993¹⁴. In 1997, the number of listed enterprises jumped all at once from 530 at the end of the previous year to 745.

3-4. Diversification of Ownership

A large scale census of state-owned assets was conducted from 1994 to 1995. Only a very small part of its findings have been released to the public, however. It is therefore even more difficult to ob-

Table 1. Trends in Joint Stock System (1993 to 1996)

	1993	1996	Growth rate (annual average)
Total number of joint stock companies	Approx. 12,000	Approx. 32,000	39%
Of which, joint stock companies (Listed companies)	3935 167	Approx. 9000 530	32%
Limited liability companies	Approx. 8000	Approx. 23,000	42%
Of which, industrial enterprises	2579	7760	44%
Non industrial enterprises	Approx. 9500	Approx. 24,000	36%

- Notes: 1) "Joint stock enterprises" are a total of joint stock companies and limited liability companies.
 2) Regarding the data for 1996, while the year was specified only for the industrial enterprises, the year was deduced as being 1996 from context.
 3) "Industrial enterprises" are only enterprises with independent accounts.

Source: Prepared by author from *Liaowang* weekly newspaper, no. 36 1997, pp. 5 to 6; *Jingji ribao* (Economic Daily), August 6, 1997; *Zhongguo jingji tizhi gaige nianjian* (China Economic System Reform Yearbook), various years; *Zhongguo tongji nianjian* (China Statistical Yearbook), various years; *Zhongguo shanghai gongsi jiben fenxi* (China Listed Company Reports), various years.

Table 2. Shares of Joint Stock Enterprises and Listed Enterprises in All Enterprises (Independent Account Industrial Enterprises)

(%)

	1993	1994	1995	1996
Total sales	100.0	100.0	100.0	100.0
Joint stock enterprises	3.8	5.9	4.9	5.3
Listed enterprises	n.a.	n.a.	3.5	3.9
Total capital	100.0	100.0	100.0	100.0
Joint stock enterprises	6.6	8.8	7.2	8.3
Listed enterprises	n.a.	n.a.	4.4	6.4
Total assets	100.0	100.0	100.0	100.0
Joint stock enterprises	3.1	6.6	5.5	6.6
Listed enterprises	n.a.	n.a.	3.1	4.7

- Notes: 1) "Joint stock enterprises" are a total of joint stock companies and limited liability companies.
 2) "Listed companies" are a total of companies listed on the Shanghai and Shenzhen stock exchanges.
 3) Sales of listed companies are sales of only main lines of business.

Source: Calculated from the following two materials: *Zhongguo tongji nianjian* (China Statistical Yearbook), various years, and CHINA CHENGXIN SECURITIES RATINGS LIMITED COMPANY ed., *Zhongguo shanghai gongsi jiben fenxi* (China Listed Company Reports), 1997, Beijing, Zhongguo kexue jishu chubanshe, 1997.

tain a grasp of the state of mixed ownership of SOEs than the conversion to the joint stock system.

Of the 100 model case enterprises given priority for the establishment of a "modern enterprise system", only 20 percent have realized mixed ownership (11 joint stock companies and six limited liability companies). Eighty percent of the enterprises are still wholly SOEs. In the case of wholly SOEs, even if converted to a joint stock system, the manager continues to be appointed by the supervisory government bureau, thus few substantial changes can be expected in the corporate governance system. The conversion of the model case enterprises, including the model case enterprises of the local governments, to mixed ownership probably has not proceeded as fast as hoped for due to the low profitability of the enterprises and the difficulty of divestiture of social obligations.

On the other hand, signs of progress may be seen in several other areas. There is clear progress in the reduction of the percent of state shares and conversion to mixed ownership in the listed enterprises, for which systematic data on ownership is open to the public (Table 3). A third census of industrial enterprises conducted in 1995 found that state capital controlled enterprises had 934.04 billion rmb in assets in that year. This was the equivalent of 16.4 percent of the 5,681.25 billion rmb of total assets of the state-owned industrial enterprises as a whole – including both wholly state-owned and state capital controlled enterprises¹⁵.

3-5. Acceleration of Structural Adjustments

The reforms of the corporate governance system, which began in earnest along with the start of the model cases for establishment of a "modern enterprise system" in 1994, turned out to be more time consuming than initially anticipated. Around the time of the Party Congress, the government took the stance of giving priority to the restructuring of enterprises, that is, formation of groups, mergers, and bankruptcies, along with the longer term work of reform of the corporate governance system. At the same time, with the official nod given to the past policies of enterprise reforms by the Party Congress, the number of spontaneous groupings and mergers between enterprises, which had grown since 1993, are reported to be increasing as well.

Table 3. Diversification of Stock Ownership of Enterprises Listed on the Shanghai and Shenzhen Stock Exchanges (%)

	1993	1994	1995	1996
Total shares in circulation	28.8	32.9	35.4	35.2
A shares	16.8	20.9	22.1	22.0
B shares	6.4	6.1	6.6	6.3
H shares	5.7	6.0	7.7	6.9
Total shares not yet in circulation	71.2	67.1	64.6	64.8
State holdings	48.1	42.7	38.3	35.0
Corporate holdings	21.3	23.1	25.2	27.6
Others	1.7	1.3	1.2	2.2
Total	100.0	100.0	100.0	100.0

Notes: Total of enterprises listed on Shanghai and Shenzhen stock exchanges.

Source: CHINA CHENGXIN SECURITIES RATINGS LIMITED COMPANY ed., *Zhongguo shanghai gongsi jiben fenxi* (China Listed Company Reports), 1997, Beijing, Zhongguo kexue yishu chubanshe, 1997.

The government is recommending the maximum avoidance of bankruptcies – which incur large social costs – and are encouraging mergers in their place. In the model cities for improvement of capital structure, the key regions for restructuring, 623 enterprises were absorbed by merger in 111 model cities in the January to September 1997. Enterprise groups are being formed faster, under government direction, as part of the policy to assist large enterprises. An outstanding case of this was the alliance of four major petrochemical manufacturers in Nanjing and the Jiangsu Province Petrochemical Group in November 1997 for the creation of the China Eastern United Petrochemical Group. These alliances and mergers among enterprises can be effective to a certain extent in the conversion to mixed ownership. On the other hand, since they are being orchestrated by the government in many cases, they may result in even greater inefficiency.

The pace of bankruptcies is being controlled carefully by the government. As performance has further deteriorated, however, the government has shifted to a policy of encouraging enterprises with no hope of recovery to go bankrupt. The number of

bankruptcies is therefore rising sharply. In the January to September period of 1997, 389 enterprises completed bankruptcy procedures in the model cities (all only SOEs). The ceiling on writeoffs of bad loans by the banks was raised from the 30 billion rmb of 1997 to 40 billion rmb in 1998 and will be raised further to 50 billion rmb in 1999, so even more bankruptcies are expected in the future.

Conclusion

The deterioration in the performance of the SOEs damaged their social duty of guaranteeing employment in the cities. Progress in the reforms and slowing of growth have led to a deterioration in employment in the cities. This is inviting social unrest in the Northeast and other parts of the country. Therefore, the government will probably not make any major change in its cautious stance toward reforms in the future.

The reaffirmation of the existing reform policies in the recent Party Congress, however, means that the Chinese government has chosen to try to solve its problems by going forward rather than stopping. There will be steady progress in freeing up small and medium sized enterprises and converting large enterprises to joint stock systems and mixed ownership. On the other hand, the state will remain the biggest owner of property even if it reduces its percentage of ownership. The central and local governments will be able to continue to exert influence over the enterprises using the state equity under their control. Under the policies set at the recent Party Congress, while becoming increasingly market oriented, the Chinese economy will probably develop into an East Asian type of market economy in which government and business still keep a close relationship, though the latter retains increasing independence from the former.

Notes:

1. Part of the ferocity of the controversy can be glimpsed from the summary of the ideological debate given in ZHANG WENMIN et. al ed., *Zhongguo jingji dalunzhan: dierji* (The Great Debate Over the Chinese Economy: Part 2), Beijing, Jingji guanli chubanshe, 1997.
2. Editorial signed JIANG MING in *Zhenli de Zhuiqiu*, No. 6, 1996 (reprinted in JIANG WENMIN et. al. ed, op. cit, pp. 122 to 125). Further, editorial signed QI YU carried in *Qiu shi*, No. 6, 1996, criticized this as being "privatization in guise of 'reforms of ownership system'" (reprinted in JIANG WENMIN et. al. ed, op. cit, p. 80).
3. This thinking had already appeared in the speech of Jiang Zemin at the closing of the fifth plenary session of the 14th CPCCC.
4. For the enterprise reforms as a whole, see NAOOKO YAMANAKA, *Chugoku no kokuyu kigyo kaikaku – mitsu no shoten* (China's Reforms of State-Owned Enterprises – Three Points of Focus), LTCB Research Institute, September 1997.
5. According to the third census of industries of 1995, less than half of the production capacity was used in 18 of the 94 industrial products surveyed and about half used in another 17 or a total of close to 40 percent (ZHAO MINSHAN, "Woguo mouxie gongye chanpin shengchan nengli xiangdui guosheng yuanyin fenxi" (Analysis of Reasons for Relative Surplus of Production Capacity of Some Industrial Products in China), *Jingji guanli*, No. 4, 1997 (No. 220), p. 12).
6. The wages spoken of here include housing, welfare services, and other benefits.
7. The fact that this law, which has been worked on since the 1980s, was established at about the same time as the "decision" shows that while the line of the "decision" on the enterprise reforms may appear on the surface to have been a sudden shift, in fact they both were the result of careful study taking much time in the CPC and government.
8. It should be noted that when China refers to "conversion to a joint stock system", it is including limited companies. Strictly speaking, the Chinese "gufenhua" may better be translated as "conversion to a limited liability system" or "corporatization".
9. Of the 100 enterprises, one was later broken up and one merged with another enterprise.
10. The Company Law limits the number of shareholders in a limited company to no more than 50. Of course, if the holdings of the employees are concentrated in an employee holding group, which has a corporate status, then this provision could be passed even with employee ownership. A joint stock company is not limited in the number of shareholders, but requires a minimum capitalization of 10 million rmb, which substantially eliminates the possibility of conversion of small and medium sized enterprises to joint stock enterprises.
11. According to Wei Jie (Director of Scientific Research Institute of National Administration of State Property) etc., "many regions have adopted reform systems based on 'sale + the joint stock co-operative system' and have achieved good results from the same" (WEI JIE and WANG YIMING, "fangkai

- guoyou xiaoxing qiye' de ruogan sikao" (Some Thoughts on "Freeing Small State-Owned Enterprises"), *Jingji wenti*, January 19 to 22, 1997 issue; China People's University Reprinted Periodical Materials F31, *Gongye qiye guanli*, No. 4, 1997, p. 55. In the case of Zhucheng, Shandong province, famous as a city pioneering the liberalization of small and medium sized enterprises, 77 percent of the 272 companies reformed (of which 37 were state-owned enterprises and the rest were collectively owned enterprises) were reorganized into joint stock co-operatives.
12. YANG TIANCI ed., *Dang de shiwuda baogao jingji ciyu jieshi* (Explanation of Economic Terms in Report Before 15th Party Congress), Zhongguo caizheng jingji chubanshe, Beijing, p. 110.
 13. WANG XIANGYANG, "Shanghai jinan jinyibu fangkai fanghuo xiaoqiye" (Shanghai and Qinan Go One Step Further in Freeing and Stimulating Small Enterprises", *Gaige yuebao* (Hangzhou), November 26 to 27 1996 issue; China People's University Reprinted Periodical Materials F31, *Gongye qiye guanli*, No. 3, 1997, p. 61.
 14. The reason for the jump in joint stock enterprises in all indicators in 1994 is not clear. This may have something to do with the reform of accounting standards in July 1993.
 15. The "state capital controlled enterprises" spoken of here also included relatively controlled enterprises with state equity less than 50 percent but still the largest (therefore, even including some foreign ventures). GENERAL OFFICE FOR THIRD NATIONAL INDUSTRIAL CENSUS, STATE STATISTICAL BUREAU, "Guanyu disance quanguo gongye pucha zhuyao shuju de gongbao" (Announcement Regarding Main Figures in Third National Industrial Census), *People's Daily*, February 19, 1997, 2nd issue.