

Governing Through the Market:  
SASAC and the Resurgence of Central State-owned  
Enterprises in China

by

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## **Abstract**

This thesis argues that the Chinese political economy is best understood as a hybrid form of governance in the context of a differentiated developmental state. This argument is developed through an analysis of China's central state-owned enterprises (SOEs), and in particular the complex relationship between central SOEs and the ministerial institution created by the Chinese state to oversee them, the State Assets Supervision and Administration Commission (SASAC). Central SOEs have experienced a significant rise and expansion under the SASAC's leadership since 2003. However, the state's role in the promotion of this institutionalisation process is rarely explored. This research starts with a theoretical investigation of the developmental state. It then explores principal-agent relations among the central SOEs, the SASAC and the market. After this, the research moves to an empirical analysis that provides a detailed examination of the SASAC, a competitive central SOE – the China National Building Material Group Corporation (CNBM) – and a monopolistic central SOE – the China National Petroleum Corporation (CNPC). Based on government policy papers, company annual reports, financial disclosures, and semi-structured interviews with more than 30 SASAC officials, SOE senior managers and government research staff, the conclusion reached is that the SASAC's management of central SOEs follows a developmental state path, partially adopting market forces and market competition while rejecting neoliberal ideology. Ultimately, this

research suggests that the Chinese central state's practice of "governing through the market" is a strategy that benefits both the state and the central SOEs: the state can strengthen its principal's control more effectively, whilst the enterprises can function as market actors to increase their competitiveness and profitability.

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The idea of investigating state-owned enterprises and the people who worked in them came to me five years ago. Some SOEs succeeded in China's great transition into a market economy; some failed. Some SOE workers survived the reform and became business leaders; but a large number were laid off. This thesis contributes to the debate about the state's and the market's roles in promoting state-owned enterprises' development in China.

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## Abbreviations

Beijing New Building Materials Group Company (BNBMG)  
British Petroleum (BP)  
Central Commission for Discipline Inspection (CCDI)  
Central State-owned Enterprises (CSOE)  
China Cinda Asset Management Co., Ltd (Cinda)  
Chinese Communist Party (CCP)  
China Electronics Technology Group Corporation (CETC)  
China General Nuclear Power Group (CGN)  
China National Petroleum Corporation (CNPC)  
China Petroleum and Chemical Corporation (Sinopec)  
China Railway Rolling Stock Corporation (CRRC)  
China Security Regulatory Committee (CSRC)  
China State Construction Engineering Corporation (CSCEC)  
China National Building Material Import and Export Company (CNBM Trading)  
China National Building Materials Group Corporation (CNBM)  
China National Chemical Corporation (ChemChina)  
China National Materials Corporation (Sinoma)  
China National Offshore Oil Corporation (CNOOC)  
Economic Value Added (EVA)  
Hong Kong Exchanges and Clearing Limited (HKEx)  
Ministry of Commerce (MoC)  
Ministry of Commerce Anti-Monopoly Bureau (MoCAMB)  
Ministry of Finance (MoF)  
Ministry of Housing and Urban-Rural Development (MOHURD)  
Ministry of Industry and Information Technology (MIIT)  
National Development and Reform Commission (NDRC)  
National Audit Office (NAO)  
National Oil Company (NOC)  
SinoChem Group (SinoChem)  
Sinopec Group (Sinopec)  
State Assets Supervision Administration Commission (SASAC)  
State Assets Supervision Administration Commission Bureau of Planning and Development (SASACBPD)  
State Assets Supervision Administration Commission Enterprise Restructuring Bureau (SASACERB)  
State Assets Supervision Administration Commission Bureau of Evaluation and Distribution (SASACBED)  
State Assets Supervision Administration Commission Discipline Committee (SASACDC)  
State Assets Supervision Administration Commission Enterprise Reform Bureau (SASACERB)

State Assets Supervision Administration Commission Property Management  
Bureau (SASACPMB)  
State Assets Supervision Administration Commission Research Center  
(SASACRC)  
State Council General Office (SCGO)  
State Grid (SG)  
State-owned Enterprises (SOE)  
U.S. Energy Information Administration (EIA)

## **Chapter 1 Introduction**

### **1.1 Research Agendas: What are we talking about when we talk about central state-owned enterprises in China?**

The core debate in the study of the political economy of China is how to characterize the dynamic and the process of China's economic growth. Specifically, the role of the Chinese state and how it relates to China's economic development is seemingly a perpetual puzzle. This thesis studies the interactions among the Chinese central government, the market and state-owned enterprises, to reflect on and contribute to the grand debate on state and market as it relates to the country's political economy. To be specific, this research provides a comprehensive and dispassionate investigation of Chinese central state-owned enterprises and their government supervisor—the State-owned Assets Supervision and Administration Commission (SASAC). The importance of state enterprises in China is not universally recognized (Tsai and Naughton 2015, 2). In fact, state-owned enterprises are often seen as a drain on state assets, and as running contrary to globally acknowledged market principles. However, the current economic performance and financial data of these central SOEs tell a different story. As seen in figure 1.1, in 2003, when the SASAC was founded, there were in total 12 Chinese enterprises ranked on the Fortune Global 500 list, of which six were central SOEs. However, by 2016 there were 50 central SOEs on the Fortune Global 500 list, which represented almost half of the total number,

102, of central SOEs.

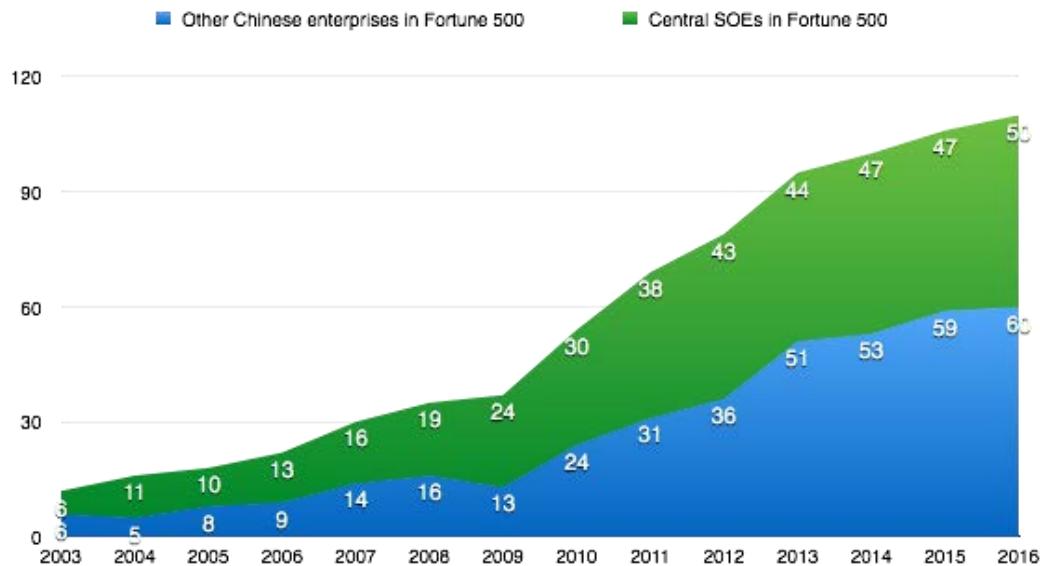


Figure 2.1 Source: SASAC; Global Fortune 500; Xinhua News Agency. Organised by the author from information accessed in January 2017. Note: The Chinese enterprises here include companies from the Chinese mainland, Hong Kong and Taiwan.

Acknowledging the strength of the central SOEs today, it is worth mentioning the importance of the state's role and its influence on the growth of the SOEs. Given that China is the fastest growing developing country in the world, the country's economic growth and the roles the central SOEs take in this development are both unique and doubted by the western world. The fact that China actively joined the WTO and opened its own markets showed the Chinese government's willingness to engage in the global market. China has largely abandoned its

planned economy system; but what remains unchanged is that the Chinese central government still holds a small number of world-class state-owned enterprises tightly under its administration, while at the same time listing these SOEs on overseas stock exchanges. Why and how is it possible to make these central SOEs globally competitive without their being held back by an ossified structure, the government's close surveillance of them, and their inherited social welfare burdens? How can state-owned enterprises win on the standardized global market while rejecting neoliberal ideology? The Chinese state and its central SOEs are very important to an understanding of how China has been able to achieve rapid industrialization in a short period of time without being crushed by privatization, and the extent to which this growth is sustainable.

The impact of the growth of Chinese central SOEs has gone beyond domestic China to influence the global market. In the past, attention was paid to studying how these SOEs' overseas investments had an influence on the politics of less developed areas, such as Africa and South America. Now, central SOEs' overseas investments have started to affect the political economy of developed countries in Europe. The debates and criticisms center on, but are not limited to, investment by the China General Nuclear Power Group (CGN) in the Hinkley nuclear plant; a bid by the China Railway Rolling Stock Corporation (CRRC) to invest in the UK's HS2 high-speed railway project; and the purchase by the State Grid (SG) of 24% of shares in Greece's power grid operator (China Daily 2017) three years after it had acquired 25% of Portugal's national power grid (Reuters

2014). Coincidentally, all these controversial overseas investments were made by central SOEs under the SASAC's administration.

This research has both empirical and theoretical contributions. It offers a valuable insight into how central SOEs operate within a developmental state framework and how they interact with government and regulatory institutions at different levels. This research is important for the study of the political economy of China for five main reasons. Firstly, through explaining how the Chinese state interacts with its central SOEs and how the central SOEs function in boosting China's economic growth, such research contributes to a larger debate about the state's role in markets. Secondly, both developed countries and developing countries can draw on China's experience of governing and administering its SOEs. Thirdly, the research explores principal-agent relationships within complex administrative networks. Fourthly, China's experience in developing central SOEs can also be incorporated into developmental state theory. Lastly, in terms of domestic impact, this research can serve as a reference for policymakers seeking a more productive style of economic governance, and for central SOEs seeking to achieve more fruitful solutions in their negotiations with different government institutions over various issues and policies.

The central problem of the existing literature is that there is no comprehensive in-depth analysis of the SASAC as the core institution that directs the Chinese state's most valuable assets. There is plenty of literature that assesses China's

different models for its political economy, among which the developmental state model is the most widely analyzed. The most popular interpretations of China's economic success tend to divide into two categories. One group of scholars focuses on the uniqueness of China, especially its governance system, to construct a "China Model". The other group of scholars studies the various shapes and dimensions of China's political economic system and works to fit China into existing models. The most representative academic works by these two groups are, Breslin (2011; 2012) on China as a variant of the developmental state; Pearson (2007; 2011; 2015) on China as a regulatory state; and McNally (2007) on China as a state drawing on a variant of capitalism. This thesis argues that China is a variant of the developmental state in its management of central state-owned assets; and it adopts the market as a tool to practice its strategy of governing through the market. After all, although Beijing rejected the neoliberal policy package suggested by Western economists and went for an alternative developmental model, the market maintains a central role in the latter model. As Peck and Zhang (2013, 388) suggest, China's developmental model went through a market nexus and thus it is "*not an alternative to market rule but an alternative modality of market rule*". Following this line of thought, the present thesis suggests that the Chinese government's economic governance of its central SOEs uses a strategy of governing through the market.

## 1.2 Research Questions

To be more specific, this research seeks to answer a key research question: How can central SOEs be owned by the state while being effectively based on market standards? The aim and the objective of the research are to provide an empirical understanding of the multiple roles central SOEs play in China's economic growth and their seesaw battle with the central government. Through the theoretical lenses of the developmental state and principal-agent theory, the thesis pursues a detailed examination of how a 2003 established ministry level institution—the State Assets Supervision Administration Commission (SASAC) – functions, and the struggle it experiences between following the official line and tightly controlling the central SOEs and pushing these central SOEs into global market competition. In particular, the following five sub-questions are related to the key inquiry that this thesis intends to answer:

1. Is China a developmental state? How should we interpret the market characteristics appearing in China's economic development processes in the developmental state context?
  
2. To what extent can the SASAC be seen as an important actor, and how does it find its position among all the other government institutions regarding SOEs' supervision?

3. What kind of roles does the SASAC play in promoting the growth of central SOEs?

4. How can central SOEs operate as enterprises and have their high-performing assets listed on overseas stock exchanges while being constrained by the administrative rules of many different ministries?

5. What are the differences between central SOEs in competitive industries and those in monopolistic industries regarding relations with the government, social responsibilities, reform plans and listing processes?

### **1.3 Argument and Structure of the thesis**

This thesis argues that China is a variant of the developmental state that established a pilot agency—the SASAC – to govern its central SOEs through the market, adopting market as its tool. The principal-agent theory is the most appropriate analytical tool for the examination of interactions between the principal, the SASAC, and the agents, the central SOEs. Through performing its multiple roles as an investor, supervisor, facilitator, policy-maker, peace-maker and sometimes as a buffer area for negotiation, the SASAC is able to exercise sufficient control of its agents. In particular, the Commission's most important role is to supervise the central SOEs because it is their largest investor. Therefore,

efforts can be seen in the SASAC's activities that indicate constant improvement of its ex ante and ex post supervision methods. This thesis argues against the neoliberal idea that state-owned enterprises are a drain on state assets and cannot be seen as a market actor. The two case studies provided here show that, for central SOEs in competitive sectors, they can be seen as a market actor and can be competitive and profitable under state ownership. As for central SOEs in the monopolistic industries, these have shouldered more social burdens and historical legacies as part of a monopolistic status inherited from the planned-economy of the past. Surprisingly, the Chinese state has pushed them too into global market competition, and even creates competition among central SOEs in the same monopolistic industry to improve their business performance. It can clearly be seen that, for the Chinese state, the market is not an abstract concept, but rather it can be employed by the state, and the market can be selectively adopted to achieve the Chinese government's developmental state goals.

As for the empirical section of the thesis, the analysis focuses on the performance of two different types of central SOE and examines the importance of the market in the reform and transformation of central SOEs. It provides an innovative understanding of the internal operational structure of SOEs and argues that the three-layers of operational structure that appeared after years of reform unintentionally created a division of labor among the three. The group level mainly deals with government-related issues and works as a strategic center for the entire company, thus blocking the administrative concerns of the

developmental state above listed company level. The listed company controls the enterprises' high-performing assets and operates according to market rules, taking the maximization of shareholders' interests as its top priority. The subsidiary companies, operating under the listed company, focus on production and business competition in the domestic and global markets. In other words, the listed company and the subsidiaries mainly follow market concerns.

The thesis consists of seven chapters. After the introduction, it moves to the theoretical chapter, 2, that sets the scene with the macro theoretical debate on the developmental state. It then moves to the theoretical chapter, 3, which uses principal-agent theory as a theoretical lens to examine the relationship between the pilot agency, the SASAC, and the central SOEs. Chapter 4 focuses the discussion on the SASAC's various roles, such as supervisor, manager, transmitting body and buffer area, and its interactions with the central SOEs. Chapters 5 and 6 offer case studies in which two central SOEs, one representative of the competitive industries, one from the monopolistic industries, are analyzed. One SOE is the CNBM, which belongs to the competitive industries; the other is the CNPC, which belongs to the monopolistic industries. It concludes that China is a variant of the developmental state that adopts market forces and market competition to govern its central SOEs through the market.

## 1.4 A Brief Methodological Note: Case Study and Elite Interviews

The methods this thesis adopted are case study and elite interview, with documentary analysis as a supplementary method of analysis. First-hand material was collected by interviewing SASAC officers and central SOE executives, as well as by analyzing a sample of central SOEs' annual reports and financial disclosures since the year of their listing, and over 200 official documents issued by the SASAC and relevant ministries. Using the totality of the interview materials, companies' financial reports since they were listed, and policy documents issued by relevant central government bodies and regulatory committees, it was possible to support a triangulation of the present realities of operational and institutional interactions within the companies.

This research uses case study, and the method of analysis is paired-comparison, which means sorting similarities from differences by comparing two cases. *“Case study is an empirical inquiry that investigates a contemporary phenomenon (the case) in depth and within its real-world context, especially when the boundaries between phenomenon and context may not be clearly evident.”* (Yin 2014, 17) Hence, case study should not represent a “sample” to show something in its specificity, but should be used to produce generalized theories (Yin 2014, 21). Case study as a method can bring evidence from all aspects of sources to support arguments that cannot be supported by other methods (Thomas 2011, 216). For this reason, the thesis compares two cases –

the China National Building Materials Corporation and the China National Petroleum Corporation – to examine the government's means of supervision, and the differences and similarities between the different perspectives of these two companies' business operations, as well as their interactions with government institutions. So, the choice of the cases for this study was based on three major points: firstly, the selected companies should be representative of the category of SOE; secondly, the selected companies must be listed on stock exchanges; and finally, as well as the first two points, the existence of contacts and connections who could be helpful in arranging interviews had to be considered.

Let us start with the first indicator for the choice of cases. In 2015, when the fieldwork of this thesis were designed and conducted, there were 106 central SOEs, and these were roughly divided into two categories for the purposes of this thesis—central SOEs in monopolistic industries and central SOEs in competitive industries. Companies in the monopolistic industries were 53 central SOEs operating in the strategic sectors, and these were managed by the First Bureau of Personnel Management of the SASAC, and their senior executives were appointed by the Organization Department of the Communist Party of China. As for the companies in the competitive industries, these were operating in non-resource rich sectors and in industries that were fully open to all kinds of companies. Their senior executives were managed and appointed by the Second Bureau of Personnel Management of the SASAC.

Taking into consideration the division between these two large categories, the China National Petroleum Corporation (CNPC) was chosen to represent the monopolistic central SOEs for the following three reasons. Firstly, the CNPC is the successor of the former China Petroleum Corporation (CNPC) run by the Ministry for Petroleum Industries. It is China's largest oil and gas producer and supplier. It is one of the three national oil companies (the other two are Sinopec and the China National Offshore Oil Corporation) that are licensed by the Chinese state to conduct upstream petroleum exploitation. It is also the most problematic national oil company, and has long been criticized for its abundant employees, lack of transparency, soft budget constraints, profits based on monopolistic status, and repeated appearances in corruption cases. Secondly, the CNPC has a company, PetroChina, which is listed on the stock exchanges of New York, Hong Kong and Shanghai. Although the CNPC is PetroChina's largest shareholder, holding 86.17% of the shares in 2016, the listing of PetroChina in overseas markets means that there are company annual reports and relevant financial disclosures available for research. Thirdly, what about contacts for interview opportunities? Unlike the case of the CNBM, the CNPC is more conservative and meticulous when it comes to interviews. Fortunately, there are more academic research articles and books available on the CNPC and China's oil and gas industry. However, in order to make up for a deficiency of interviews on the CNPC, efforts were made to visit some other central SOEs in monopolistic industries and central-government-directed research institutions to conduct

interviews, in order to give a full account of this category of monopolistic central SOEs.

The case chosen to represent central SOEs in the competitive category was the China National Building Materials Corporation (CNBM). This was selected because it is China's largest building materials company and was directed to follow market logic from its establishment. The CNBM formed its listed company and has been listed on the Hong Kong Stock Exchange since 2006, which means more transparency of the shareholding structure and business performance of the company. Most importantly, I have extensive connections in the CNBM, which allowed me to interview senior executives and various department directors in the CNBM group, the CNBM listed company, the CNBM operational companies and their local third-tier companies. Having done so, I have been able to present a clear understanding of the company so as to develop my idea of the three layers of operational structure and to sharpen my arguments about governing through the market. In order to make the analysis more representative I also interviewed staff from other central SOEs in the competitive industries: for example, the China State Construction Engineering Corporation (CSCEC).

Burnham et al (2008, 73) suggest that the chosen cases should not be isolated ones: "*It is necessary to choose cases that are representative, not one-off or unusual, and to minimize the effect of all other factors.*" The CNPC is one of

China's largest and wealthiest central SOEs by international business standards, while being one of China's most problematic central SOEs, and having all the shortcomings of a stereotypical SOE. By contrast, the CNBM is one of the best performing central SOEs in the competitive industries, and represents SOEs that compete in markets without being privatized. All in all, the two cases were carefully selected and efforts were made to tell the story of China's central SOEs to the best of the researcher's ability.

Let us turn now to a discussion of the interview as a research method. Since case studies have an exploratory nature (Gerring 2007, 40), the interview as a method can be helpful in finding relevant evidence that provides a short-cut to help the researcher understand the situation (Yin 2014, 113). Thus, the in-depth interview allows the researcher to understand the lived experience of other people and those people's own understanding of the experience (Seidman 2013, 9). In the case of China, interviews can be very helpful for understanding the logic of the political economic context. They can not only provide insightful comments based on the experience and career paths of interviewees, but can also help the researcher to distinguish which are the important policies from a large number of policy documents, thus saving time that might be spent going through papers. It is rare to hear interviewees simply repeat the official line, because if they do not want to undergo an interview with a researcher, they can simply ignore or reject the researcher's request. If they agree to an interview and spend time on it, the interview can usually be useful.

According to Yin (2014), interviews are a valuable resource for enabling the researcher to have a systematic understanding of organizations' behaviors. Besides, political economic elites who hold senior positions usually have a long working experience and have been involved in many institutional reform activities over time. In the Chinese context, it is not easy for young early career officers to have a deep understanding of the politics of the system, as their work is usually limited to acting on orders passed down by senior staff. Moreover, young officers are more concerned and nervous about interviews that may have a negative impact on their future career, while higher-ranking officers are more relaxed about sharing their opinions. It is worth noting that high-ranking officers usually have more than 10, and even up to 30, years of working experience inside the government, and their comments may contain bias and personal interpretation of the government; so checking with relevant policy documents can be useful to increase the validity of these interviews. Moreover, whenever possible the researcher crosschecked the answers with a similar set of answers from other interviewees. As Yin (2014, 121) suggests, "*Data triangulation helps to strengthen the construct validity of your case study. The multiple sources of evidence essentially provide multiple measures of the same phenomenon*". O'Brien (2004, 36) used an iterative approach during his interviews in China by testing arguments directly with interviewees. After the first few interviews, I also started to test arguments and sought confirmation of my findings with the later interviewees.

Rubin and Rubin (1995 in Sæther 2004, 48) suggest that the interviewer should be critical and prepare follow-up questions for the interviewees. However, Sæther (2004: 49) notes that her interviews in China were more like seeking affirmation than posing critical and open questions, due to the language barrier. O'Brien (2004, 35) notes that China's political elites are uncomfortable at being led step-by-step by the interviewer. He sometimes let the conversation flow, since members of the Chinese elite regard themselves as intelligent, with abundant knowledge in their own field. It is also crucial to maintain control over the direction of the interview. In this research, the interview questions were divided into six main categories to make sure that no matter how talkative the interviewees encountered were, at least one question in each category could be covered during the interview. Interviews were conducted in Chinese, for this research depended on note taking as the method of recording. There were two main reasons why a recorder was not used: the unpredictable nature of political phenomena in Beijing; and, most importantly, to protect interviewees who were concerned at being recorded, in case their interviews appeared in the news. It is better not to use a recorder if this may cause concern to interviewees. In order to benefit from a fresh memory of what had been said, and to recall as much information as possible, the interviews were transcribed immediately (within the same day), based on the notes I took. The advantage of note taking was that officers were less concerned and more talkative, providing valuable comments that turned out to be very useful in generating the grand arguments of the thesis.

Let us move on to discuss the selection of interviewees. In the fieldwork for this thesis, policy makers in both central and local departments of the SASAC were visited. There were six in-depth interviews conducted in the central SASAC, to help the thesis to explore how the SASAC worked, thus providing a broader idea of China's state ownership system. The interviews with four local SASAC officers provided a closer look at the individual implementation of SASAC policies. This was because the local SASAC deals with more detailed problems caused by state ownership reform on a daily basis, due to the experiment-based policymaking characteristic of China.

Before going on, it is worth mentioning that years of internationalization and marketization have substantially improved social equality and freedom of speech in China. However, government officers and employees in the state sector maintain a relatively conservative and sometimes rigid demeanor. The lack of democratic elections means that government employees have no incentives and no need to respond to researchers' interview requests. Therefore, diverse ways of getting in touch with interviewees have to be used. Government officers can be reached through personal or family connections. Another way to contact them is through middlemen. The snowball technique is also practicable. An efficient way to use the snowball technique in China is to roll the snowball from government to SOEs, which is much easier than the other way round. The positive side of conducting academic research in China is that the Chinese

authorities are more concerned with negative information gained from interviews that might be published by international media and news agencies. Less attention is paid to the work in academic disciplines. Moreover, the Chinese authorities care more about quantitative research than qualitative research, which they do not consider a real scientific method (Thøgersen and Heimer 2006, 13).

Coping with interviewees who just give the official line can also be a challenge. Contrary to the stereotypical assumption, in all my 38 interviews, there was only one interviewee who gave the official line in answer to some, though not all, of my questions. At this point, the strategy of interjecting "*Please give me an example*" mentioned by O'Brien (2004, 31) is very useful. When this official started to talk about how "*we are serving the whole people of China, therefore, even if the salary is lower than in private enterprise, we find ourselves satisfied and proud*" I used the question, "*Since you are satisfied with your salary, would you please give me an example of how the reform of SOEs' salary structures affects your life? Are there any differences between today's salary system and that of the old days*" to redirect and continue the interview. I had noted Halliday's (2002, 149-153) discussion of "*the complex politics created by the cultural baggage*" brought to the interview by both the interviewer and the interviewee, and therefore the questions were designed to be quite open and easy to answer. On the one hand, this allowed the elite enough space to talk about their experiences. On the other, it was easier for the interviewee to avoid important

points and address trivial issues. It was important for the researcher to be familiar in advance with the policy documents issued by the central government. By mentioning policy documents with their specific number, issuing authority and the date, the researcher was able to earn more respect from the officers and thus have more productive and fruitful interviews.

The fieldwork experience also showed that people in higher positions were more open-minded and talkative, while young employees were more concerned and frightened. Also, employees in non-monopolistic industries and in both central and local government were much more flexible and showed high levels of intelligence in the conversation. By contrast, employees in the monopolistic industries were more conservative and careful, because some monopolistic enterprises have part of their business in the military and defense industries. In order to conduct a useful interview, a middleman can be very helpful in getting the researcher well prepared for the interview by introducing the interviewee's personality and education background. The middleman also helps in guiding the researcher through the office politics inside a bureau, so that the factional relations inside the institution can be avoided. Another great challenge for anyone who is going to conduct interviews in China is interviewees' variable and frequently adjusted working schedules. Due to interviewees' flexible schedules, the researcher has to be ready for interviews at any time and to sort out problems such as overlapping appointments.

## 1.5 Doing Fieldwork in China: Keeping up with the Government's Reform

### Path

The Chinese government is known for its adaptability and flexibility. The literatures mentioned above did provide a comprehensive understanding of how to do fieldwork in China and what to expect when doing this fieldwork. Nevertheless, it is also very important for political science researchers to keep up-to-date with the government's latest policies and measures. The empirical materials in this thesis consist of interviews, government issued policy papers, policies and regulations issued by relevant regulatory committees, central SOEs' annual reports, and extensive fieldwork interviews. SASAC officers from different bureaus provided views from different working backgrounds; and the interviewees also included officers in the Development and Research Centre of the State Council, which is the official "think tank" that directly reports to China's highest state administrative organ, the State Council, in order to provide a different perspective on the story of central SOEs from officers who work outside the state assets management system but still inside the central government system. For the fieldwork period, from June 2015 to October 2015, the researcher visited, and interviewed in, central SOEs' headquarters in Beijing, and their operational companies in local areas, such as Shanghai and Hangzhou. There were interviews with central SOE staff ranging from group company level senior executives to listed company board members, as well as with departmental directors, central SOEs' operational companies' (subsidiaries')

general managers, and independent shareholders, to present a full-scale picture of how central SOEs conduct their business activities; how they respond to SASAC orders and policies; and how they cooperate with the SASAC and other relevant government institutions.

Policy papers issued by bureaus and departments in the central government ministries should be given more attention, as they can be very useful for triangulation. These policy papers are available on the official websites of individual ministries and governmental institutions. Noticeably, unlike the carefully organized government policies and archives published online in the West, Chinese archives and policy documents, although published on websites, are not well organized. They may be classed according to policy titles, sometimes by policy number, or even have the issuing date as the title. Sifting through these requires patience and care on the part of the researcher. Through a systematic analysis of 195 SASAC policy papers publicly displayed on its website under the heading “policy announcements”, this thesis provides an analysis in Chapter 3 of *ex ante* measures devised according to the principal-agent theory. This was in addition to searching on the website, for the SASAC regulation, Notice on Issuing *the Implementation Measures of the SASAC for the Disclosure of Information on State-owned Assets Supervision and Administration* (SASAC 2009, No. 18). In chapter 2, article 8, it reads: “*Chinese citizens can request the disclosure of documents by the SASAC*”. Contrary to what might be

generally assumed, I had a response from the SASAC the next working day after I sent them the request form.

As for the government-issued policies that are analyzed in this thesis, they consist of 195 policy documents issued by the SASAC; policy papers issued by other ministries related to the management of central state assets; SASAC departmental regulations; and central SOEs' annual reports from their year of listing to 2016. Other approaches for acquiring useful information from traditional media were also used. For example, a series of conference reports and videos of the SASAC's director meeting the press and SASAC spokesmen meeting the press were very useful, because the director's answers to questions were less bureaucratic than his public speeches. Furthermore, up-to-date social media tools were also used for acquiring information. For example, the SASAC news agency provides an official account, "guozixiaoxin" [国资小新], on WeChat (the most popular social media application developed by Tencent) which offers updates on newly issued policies, and the latest data related to central SOEs' financial performance. Furthermore, because most central SOEs are listed companies, they have a responsibility to answer to questions from their shareholders and the general public, which provides another way for researchers to acquire information. The CNPC has a section called "*Mailbox of the Secretary of the Board*" [董秘信箱] that serves as a question and answer platform for anyone who is interested in asking questions related to the CNPC and the energy industry. The questions are carefully worded, with sufficient data provided,

and are easy to access from this SOE's official website. When this researcher used this site, only some questions asking for a prediction of the rise and fall of market share prices were refused, although McCulloch (2004, 30) points out that primary sources are usually fragmented and scattered, and thus may constitute imperfect raw evidence. However, with the assistance of the policy documents and media mentioned above, these primary sources can be triangulated with each other and can thus make more sense. So, to summarize, the Chinese government does to a certain extent improved its transparency, which provides more opportunities and possibilities for researchers to conduct empirical research in China.

## **Chapter 2 Governing through the Market—Towards a Differentiated Developmental State?**

### **2.1. Introduction:**

#### *Setting the State and Market Debate in China*

This chapter focuses on the macro-theoretical debate that is central to the thesis, arguing that China is a variant of the developmental state type and that it selectively introduces market competition and criteria to reinvigorate central SOEs and make them powerful domestic actors and increasingly important actors in the global market. Is China's success story of economic prosperity a story of the success of the market, or a story of state-led development? Lardy (2015, 97) argues that China's economic success after the reform and opening up should be seen as contributing to the rise of the market, the elimination of state regulated price mechanisms, the prosperity of private enterprise and an improving regulatory system. In *Markets Over Mao*, he emphasizes the increasing importance of market allocation of resources and a vibrant private sector. He also discusses the Chinese party-state's evolving role in facilitating the emergence and growth of a prosperous private sector. The state sector is a drag on China's economic growth that has impeded China as a liberal market economy (Lardy, 2014). China's marketization and the country's integration into the global market have fundamentally transformed China from a state-planned economy to a quasi-market economy.

China encourages the inflow of private capital, invites market competition, and celebrates the growth of a vibrant private sector. However, a discussion on SOEs is unavoidable. According to The Economist (2018), China's state-owned assets account for 40% of its stock market holdings, a third of the country's investment, and 45% of its debt. By the end of 2016 (SASAC 2017B), the total value of the assets of SOEs (excluding financial SOEs) in China was 131717.45 billion RMB, of which the central SOEs' total assets accounted for more than half the value – 69478.87 billion RMB. As illustrated by the data, SOEs, in particular central SOEs', company performance, can affect the economic situation of the whole country, and can decide the stability of the country's financial system.

The state maintains the privileged position of the central SOEs. It creates an uneven playing field, especially in sectors with absolute state monopolies, to ensure that the market central SOEs act in discriminates against potential competitors and enhances the opportunities of these central SOEs. At the same time, the state acknowledges the drawbacks that such practices bring to its SOEs; so, it has introduced the market standards and practices of multinational corporations and private enterprises to evaluate and assess these state sectors. Branstetter and Lardy (2006, 21) note that China dramatically increased its openness to trade and FDI in the late 1990s to prepare for its 2001 WTO entry. The Chinese premier of that time, Zhu Rongji, expressed the view that the market competition China's WTO membership would bring would lead to a more

rapid and more healthy development in China and would encourage state-owned enterprises and banks to undertake additional structural reforms.

In Nee and Opper's pioneering work, *Capitalism from Below*, they paint a picture of the rise of a prosperous private sector in the Yangzi Delta. One of the vital points they raise is that the promulgation of the Company Law of 1994, which was intended primarily to "rescue" the dismal state-owned enterprises, accidentally created an institutional contingency which triggered the initiative of private entrepreneurs. This is an inspiring story, but Nee and Opper leave half of the story untold. They touch on the 1994 SOEs' reform and modernization program but refrain from tracing the processes of the SOEs' diversified and vibrant development post-1994. How do SOEs and private capital co-existent with each other? How do SOEs survive in a capitalized market? The concept of capitalism from below tells us how private capital has grown in China as a result of contingency. The other half of the story this contingency tells is how the prosperity of private firms has stimulated SOEs to exert and exercise their entrepreneurship to fit in with market competition. Because SOEs realized, or were told at some point, that their monopolistic status in most industries had vanished, even in oil and petroleum, SOEs now have to face competition from their counterparts. This competition is, ironically, created by the state. The state has used state-led market competition to mobilize and revitalize its state-owned enterprises. So, how should we understand China's economic development?

This thesis argues that China is a variant of the developmental state that is using market forces to revitalize its central state-owned enterprises. This is achieved by adopting state-led developmental models and market experience from other countries without being trapped in any related ideology. The government's 'Socialism with Chinese Characteristics', as Kennedy (2011, 9) points out, leaves space for it to interpret its chosen policies and development models freely. Thus, this thesis argues, market forces and market competition are simply tools for the Chinese government to promote its own developmental state model, especially in the management of central state-owned assets. It is not wise to be too black and white about what China is, or to put China into a particular category. The country has, in fact, a magpie approach to economic policy making. It provides an evolutionary example of how to make economic policies.

#### *Locating China in a Political Economy Model?*

It is simplistic to distinguish China from any other political economy model in the world by establishing a '*China Model*' or a '*Beijing Consensus*'. It is also superficial to class China as a '*post-communist state*' or as belonging to the '*BRICS*', because China does not share any political, economic or sociological characteristics with these countries. This thesis argues that China can best join the grand political economy discussion as a variant of developmental state. The term '*developmental state*', as discussed in this thesis, refers to the classical developmental states, namely Japan, South Korea and Taiwan. Like the classical developmental states, China has experienced a significant GDP growth, with an

average of nearly 10% a year since 1978 (World Bank 2017). So, is China another developmental state? One that is continuing the East Asian miracle in the twenty first century?

How should we interpret China's economic success since there are diversified state-market relationship happens all together? Yang and Zhao (2015, 68) suggest that China's economic success does not build on a particular set of policies it has adopted, but lies in strong state capacity and state autonomy. Given these conditions, the government can free itself from ideological constraints and from lobbying by interest groups. It can implement new policies, or adjust impractical policies, when necessary. Yang and Zhao's observation partly echoes the reference to "*policy experimentation*" that Heilmann (2008 and 2011) identifies as explaining the Chinese government's policymaking processes. Heilmann observes that the Chinese government tests a "*pilot policy*" on its more experimental points before issuing it as a nation-wide policy. Drawing on previous research, this thesis argues that China adopts an ideologically light approach in its management of central SOEs, despite the fact that its state ownership system is ideologically based on communism, and is a legacy of China's historical relationship with the Soviet Union. This is similar to the situation in South Korea, which has "*not shifted from developmentalism to neoliberalism but neoliberally restructured their developmental system*" (Chang, Weiss and Fine 2012, 4). The Chinese government follows a developmental state path in leading its economic growth, while it is adaptive, flexible and

responsive to market signals and uses market competition as a tool to better achieving this goal.

I argue that China is a differentiated developmental state that varies its practices from industrial sector to industrial sector and from province to province. It is a big country that brings together variations on a developmental state model. It is a continental-size country that has long been studied as “fragmented authoritarianism” (Lieberthal and Lampton, 1992). Goodman (1994, 11) studied the roles and characteristics of China’s sub-central level of government—the province. However, the characteristics of economic development are not even province-wide. Goodman (1997, 2) assessed the importance of provincial government in pursuing economic growth based on provinces’ particular comparative advantages, and how national policy was mediated by local conditions. Nee and Opper (2016, 37-51) paint a completely different picture of the economic development patterns of the Yangzi Delta. Zhejiang province is a hub for vibrant private economies; and Jiangsu province is largely advancing its township and village enterprises (TVEs). Shanghai is dominated by a large number of giant joint-capital firms and strong state-owned enterprises, while private capital has been suppressed and its development has been limited. Indeed, local government’s capacity and policy-making processes have very different characteristics from those of national government. The sub-provincial level of government—the city – has different characteristics yet again. Shen and Tsai (2016, 121) examine and compare three cities – Suzhou, Wenzhou and

Dongguan – situated in different regions of China. They argue that the three cities have different developmental models, among which they single out Suzhou's strong economic performance and crisis-managing ability based on a “*local developmental state model*”: that is, “*adaptive governance as proactive*”. Chen and Lees (2016) see China's growing renewable energy sector, led by the pilot agency, NDRC, as embodying an effort at re-centralization and re-intervention that is consistent with the developmental state paradigm. Binz, Gosens, Hansen and Hansen (2017, 433) argue that China's development of the wind industry has followed the top-down mechanism in which policy measures take a decisive role; whereas the government's roles in the solar PV industry and biomass power plant industry are much less significant. So, whether China can be said to be a developmental state depends on the industry sector and geographical location under discussion.

The chapter proceeds as follows. Before we examine the developmental state model, a brief discussion will be provided on how scholars understand China's political economic models, and why I believe that the developmental state is the most appropriate concept to help us analyze China. For many years, academia has been arguing about how to characterize China's political economic model. The official discourse of the Chinese government —‘Socialism with Chinese Characteristics’ — has failed to persuade academia to accept this ‘simplified’ notion. The following section reviews the literature of the academic debate on Chinese political economic models other than the developmental state. There are

four main ways in which China's economic governance has been studied, none of which I find persuasive. I argue that, of these, the developmental state model is the most helpful for understanding China.

In studying China's political economy, some scholars have suggested there is a uniqueness about China that they call the 'China Model' or the 'Beijing Consensus'; or they have analyzed China as a regulatory state, as Margaret Pearson does, or as a 'civilization-state' as Martin Jacques does. Ramo (2004) proposes the concept of a Beijing Consensus as an opposite to the Washington Consensus. However, Kennedy (2010) strongly criticizes the concept of a Beijing Consensus for its misguided and inaccurate positing of China's development as the opposite of the Washington Consensus and neoliberalism. This view is supported by Breslin (2011, 1323) who points out that there is no agreed understanding of a China Model: China has simply followed a statist development path which is an alternative to orthodox neoliberalism. Furthermore, China's territorial size means that different provinces and industries have different development paths. China frequently adjusts its policies as a result of experimentation in government policy-making.

Building on this understanding, Breslin (2011, 1328) echoes Heilmann's (2008) comment on the Chinese government's policy experimentation. "*For most observers, it is this experimentation and non-ideological (perhaps even de-ideologized) commitment to doing whatever it takes to promote growth while*

*maintaining the political stability that is the defining hallmark of the Chinese mode of governance.*" Referring back to the previous section, one of the distinctive characteristics of the countries mentioned there was that an authoritarian government was in power during their developmental-state period. The characteristic of high state capacity that usually coexists with a developmental state in the East Asian context was compatible with the collective goal of pursuing modernization. Thus, state capacity can lead rather than follow the market, especially in industries that have a connection with national security matters (Wade 1990, 303). Consequently, research on China can contribute to expanding developmental state theory to make it applicable to a larger country. Apart from that, the theory has reshaped the understanding of China as an 'ideologically light' country that uses state capacity to push forward economic development and thus, in turn, consolidate the political stability of the state.

Apart from focusing on the uniqueness of China, academic discussion has brought into the discussion various kinds of political economic model other than the China model. Chu (2010, 307-310) sees China's high economic growth as caused more by internal than external factors, and as thus being a form of market socialism. It is not caused by insulation from the outside world, but by the government's willingness and ability to stimulate aggregate demand, reflecting Keynesian economic thinking. China's strong economic performance during the financial crisis supports Gerschenkron's theory of the '*advantage of backwardness*', according to which a government consistently intervenes in

economic growth in order to enable a latecomer to catch up with industrialized countries. Pearson (2011, 25) argues that China is not unique: rather, its experiences support the theory of '*varieties of capitalism*'; and she further expands her argument to apply it to China's emerging regulatory state. The fact that this restructuring of state ownership was started by the government instead of by the private sector, as Oi (2011, 5-6) argues, does differentiate China from the standard capitalist model. Nevertheless, as Boltho and Weber (2015, 247-261) conclude, although China may perform differently from other developmental states, if broader comparative standards are applied, it can be firmly described as following the East Asian model of development.

China's GDP, the growth in its productivity, and its rising share of world exports of manufactured goods share certain level of similarity to those of a developmental state. Nevertheless, it is arguable whether China is a developmental state, because of the many characteristics that differentiate it from the classical developmental state. There is the process of industrial modernization, eliminating the orthodoxy of a communist planned economy while the Communist Party maintained its legitimacy as the ruling power. Secondly, China has a much higher inequality of income distribution than the other developmental states. Also, China's industrial planning, in the form of five-year plans issued by the central government, was general and descriptive, rather than providing detailed industrial development plans. This is particularly different from that of Japan. Thirdly, China's large territory, and the economic decentralization

in the early years of reform and opening up, may have allowed local interests to challenge central state capacity. Lastly, the international situation had become more liberalized when China started its developmental state process. So that, compared to Japan, South Korea and Taiwan, when China opened its market to foreign investment and businesses, as the largest recipient of FDI in the developing world (Harvey 2005, 135) it was more involved in the global trading system, especially after WTO accession and the development of its external policies. China's policies regarding openness to FDI were more relaxed than those of Japan and Korea were during their developmental state stage. China's FDI between 1985 and 2005 accounted for 2.9% of its GDP, compared with the developmental state periods of South Korea (0.6%), Taiwan (0.4%) and Japan (less than 0.1%) (Kroeber 2011,44). However, these are not particularly problematic issues, and they can be accommodated in the developmental state model.

Although the above characteristics may make it sound as though China was in a difficult position to start, and coherently conduct, its developmental state model, there were other characteristics according to which China could be viewed as having had an advantage over the classical developmental states. For example, Naughton (2010, 438) emphasizes China's potential to attract foreign investment into its inland areas. China's underdeveloped inland market provided the potential to expand China's developmental state growth. Besides, China's abundant labor force helped to give it a comparative advantage in labor-intensive

industries, which gained time during which the state could move towards industrial upgrading. All of these are fundamentally important points for China's economic success. Most importantly, China had a high percentage of state ownership, especially in the infrastructural sectors. The state maintained full control of the infrastructure sectors and key energy sectors, which contributed to its ability to adjust the economic situation when necessary.

To conclude, there are various arguments which attribute China's success to its being a developmental state, a regulatory state, a civilization state, and many other models of state. Among all these, the developmental state provides the most suitable category into which to fit China and analyze and compare its performance, especially when trying to place China in a discussion of international political economy. Despite the debates about which political economic model China is, Johnson (1982, 306) is correct to argue that a country "*must, first of all, be a developmental state—and only then a regulatory state, a welfare state, an equality state, or whatever other kinds of functional state a society may wish to adopt*".

Turning back to the discussion of China as a variant of the developmental state, the next sections of the thesis start with a literature review of developmental state theory and then move to a discussion of whether China is a developmental state, or the extent to which it can be seen as a developmental state. The subsequent section investigates how the emergence of marketization in China affects the

practices of the developmental state. It then moves the discussion to the core question of the thesis—how to manage central SOEs from a developmental state perspective. This thesis examines China as a differentiated developmental state, in which different provinces and industrial sectors present different shapes and variants of the developmental state. The main argument is that China follows the developmental state model of economic governance in the management of central state-owned assets. This research contributes to the broad debate about whether government's involvement in market activities can bring prosperity, and also argues against the idea that state-owned enterprises are a drain on the country's economy.

This chapter comes to the conclusion that the developmental state can be seen as offering a group of examples for latecomers to follow in order to achieve industrialization within a comparatively short period, but not a model for other developing countries, given the variants embedded in it. Since we acknowledge the fact that the developmental state is not in complete opposition to market and everything it brings, discussion of the developmental state cannot avoid touching on state-market relations, and this thesis identifies and explores the market characteristics that are involved in the developmental state model. Discussion then moves to how the authoritarian government leads state development through effective supervision of its agency in the developmental state. After a discussion of the extent to which China is a developmental state, the next chapter attempts to explore the analytical theory of this thesis, the principal-agent

theory, in the context of China's management of central SOEs. The empirical chapters that follow will provide first-hand fieldwork materials to facilitate the theoretical discussion.

## 2.2 Developmental state theoretical review

Developmental state theory was built on the development experience of capitalist Northeast Asia, which used state policy to increase a nation's economic competitiveness and took development as its priority. The theory of the developmental state drew on Chalmers Johnson's analysis of the Ministry of Industrial Trade and Information in the book *MITI and the Japanese Miracle* (1982). Late industrialization developmental states are under the twin influences of '*social mobilisation*' and '*economic nationalism*'. The developmental state is interventionist, that is, plan-rational, through state-guided, privately-owned enterprises (Woo-cumings 1999,2-3). The rise of neoliberalism brought the idea that the general public lived a better life in a neoliberal world (Harvey 2005,37); but such discourse may not be true. Developmental state theory and the rapid economic growth in North East Asian countries challenged the neoliberal domination of Western economic thought and questioned whether the state could be a positive factor in economic growth.

The discussion of the developmental state focuses on the state's capacity, and its advantage in having a broader social and political ability to push forward economic growth (Wade and White 1985,20). The idea of the state's capacity to lead industrialization presented here is hugely different from the interpretation of the Soviet planned economy. That is, the Soviet Union's actions in providing state planning were not plan rational but "plan ideological". The goals the Soviet Union set for its already inefficient SOEs were not developmental driven. The Japanese state took on a developmental function that led to the country's industrial development, which Johnson (1982, 18) believes was fundamentally different from that of the Soviet Union. He distinguished the United States from the Japanese developmental state, because the US's developing strategy was regulatory oriented. The Japanese developmental state, despite having the state take the leading role, was developmental oriented. It was "*developmental, plan-rational, and has a dominant feature precisely the setting of such substantive social and economic goals*" (Johnson 1982, 19). When a state proposed economic development in its national policy, "*its state intervention was more performance-oriented and targeted than in western countries*" (Kjær 2004:135 in Chen and Lees 2016, 4). In other words, the state's capacity to direct economic growth can be effective and efficient.

The notion of the developmental state became widely adopted by scholars in their interpretation of the economic success of the Northeast Asian countries. Research into this experience expanded the theory—developmental state theory

does not have a long history. The main authors pioneering the concept have been: Chalmers Johnson (1982) on Japan—*MITI and the Japanese miracle*; Robert Wade (1990) on Taiwan—*Governing the market*; and Alice Amsden (1989) on South Korea—*Asia's Next Giant*. The key point of the developmental state is the state's national policy of recognizing economic development as its top priority and providing sufficient intervention and support to achieve that goal. The state itself takes on a developmental role and leads industrialization in the developmental state model. There are several characteristics that are shared by the developmental states. The developmental state provides government intervention in the development of national economy that aims to catch up with industrialized countries. The logic underneath is that the developed countries enjoyed the first-mover advantages so that the later-comers require the assistance from their government (Bramall 2009, 399). The developmental state also has a pilot agency with a supportive bureaucratic staff. The government maintains an authoritarian approach throughout the developmental state period (Boltho and Weber 2015, 242). Weiss (2000, 23) turns the discussion of the developmental state to focus on the institutional setting of what makes a successful developmental state. It was she who generated the term '*governed interdependence*' to illustrate the combination of three essential criteria for the formation of a developmental state.

All in all, the developmental state focuses primarily on industrial governance, the state persistently pursuing a development goal through strong state capacity and

the conducting of an effective plan-rational intervention in economic development. There is no consensus on the precise definition of this experience-distilled concept. In the following section, a table of the 10 main characteristics of the developmental state will be presented, based on the type of background against which a developmental state is formed; the factors that determine a developmental state; and the distinctive features of how a developmental state achieves economic success. A separate discussion of the three groups of characteristics will be offered.

Characteristics of the Classical Developmental State	
<b>Historical Context</b>	The state is undergoing post-war restructuring, and is still under an external security threat.
<b>Drivers of Developmental State</b>	<p>The state has the motivation and determination to catch up with advanced Western economies.</p> <p>The state's prioritises on economic success and industrial development.</p>
<b>Approaches and Instruments</b>	<p>The state uses its capacity to achieve developmental goals and strategically intervene in development activities; it can adjust unsuccessful policies over time.</p> <p>The state is aiming to go through a state-led industrial upgrading.</p> <p>The state maintains control over key resources, such as Finance.</p> <p>The state dispenses support/subsidies on a merit basis.</p> <p>The state has an institution (such as the MITI pilot agency) that forms a focus for the developmental process.</p> <p>The state governance system draws on a meritocratic/elite bureaucracy.</p> <p>The state bureaucracy has external institutional links with organised economic actors.</p>

Figure 2.1. Characteristics of the classical developmental state.

Source: Drawn up by the author

This section illustrates the historical background and the geographical conditions that motivate a country to become a developmental state. The classical developmental states are undergoing post-war restructuring and, at the same time, are under an external security threat. As argued above, the rapid industrialization of the East Asian developmental states happened under the guidance of the state. There was another common characteristic of the historical backgrounds of these developmental states: their future was under threat from external enemies. For example, Taiwan's potential enemy was mainland China, located just across the strait; and South Korea's enemy, North Korea, was much closer (Wade and White 1985, 7). Also, the post-war period saw a major redistribution of power and wealth – an egalitarian redistribution of income – that accelerated rapid industrialization (Öniş 1991, 117). Gore (2014, 306) used the metaphor of '*the rebirth of Phoenix after a fiery baptism*' to refer to the historical background of the post-war East Asian developmental states.

Traumatic memories of wars, revolutions, and foreign colonial occupations motivated the developmental states to start on their developmental path. Under these circumstances, the state started to pave its way to economic development. Robert Wade (1985), in his pioneering study of Taiwan's developmental state path, suggests that the authoritarian one-party state governed by the Nationalist Party (KMT) aimed at industrialization. It did not choose to let Taiwan maximize its profitability based on the country's comparative advantages. Through its

control of capitalist interest groups, and through major land reform, the KMT was able to center political power in the party. The agrarian reform provided people with a sufficiently high standard of living to avoid major political turmoil. In fact, it is argued that the developmental state process always starts with an authoritarian regime: for instance, the military dictatorships in Taiwan and South Korea, the strongman style of rule in Singapore under Lee Kuan Yew, Japan's domination by a single party (the Liberal Democratic Party), and the communism of China (Gore 2014, 305).

Apart from a post-war historical situation, a latecomer position and an external threat to the developmental state's security are also determining factors that generate a developmental state. Weiss (2000, 26) points out the importance of an external security threat to the forging of a developmental state. In fact, a long-term intensive security threat can drive the developmental state to act cohesively to achieve industrialization (Zhu 2002, 9), because the external threat can give it a clear indication of the importance of economic strength as the core of its political survival (Knight 2014, 1337). Apart from the external security threat's importance in the post-war construction period, Beeson's (2009, 13) argument is also worth noting. He addresses the similarities in the historical backgrounds that these East Asian countries share. The political history and cultural background of the East Asian developmental states made it possible to have a powerful, centralized, interventionist state.

This section demonstrates the importance of a developmental state's motivation and determination to catch-up with advanced Western economies: in other words, the driver for the adoption of developmental state institutions. It also examines the state's prioritizing of economic success and industrial development, and how that affects the economic development of the country. It is very important to address the key factor of what makes a developmental state so determined to catch-up with developed economies, and its prioritizing of industrial upgrading and economic growth. Elizabeth Thurbon focuses on the '*developmental mindset*' of the state in promoting a developmental state path, rather than a particular institution or a particular set of policies. She then addresses the importance of state capacity in formulating and executing such a developmental strategy based on this mindset (Thurbon 2016, 4%). The industrial policies that follow the development-oriented mindset, however, may change over time and be adjusted to suit changing conditions in both local and international terms (Thurbon 2014,8). For example, an historical case of having a strong state in forming and adjusting short-term economic policies according to fast economic growth is South Korea (Amsden 1989,93). Therefore, strong state capacity in making development plans, and the capacity to adjust plans, are crucial for a state to be a developmental state.

A developmental state's determination to achieve industrial modernization helps significantly to improve a country's general industrial productivity and upgrade the industrial value chain. Developing countries have often been advised by

neoliberals to focus on labor-intensive production (Chang 1999, 185). However, Dudley Seers (in Payne and Phillips 2014, 72) suggests that countries with a peripheral status should not rely on comparative advantage to produce export commodities. The developmental states have rejected the western economists' advice on producing products that have comparative advantages in the international trade system. Their peripheral status can only be changed if they invest in industrial upgrading in order to change this status. The East Asian 'newly industrializing countries' are in a better position because they have not been constrained by a focus on the export of raw materials like the Latin American countries, and have had a stronger desire to catch up with advanced industrial countries (Evans 1995, 11). For example, the Chinese government redirected China's dependence on export-led growth to a domestic-market-driven one. It also promoted the upgrading of China's industrial structure from being labor intensive to having a higher value-added and more technologically advanced focus (Gore 2014, 303). It is the developmental state's determination and capacity for industrial upgrading that leads the country out of a peripheral status in the global trading system and leads to prosperity. According to Kay (2002, 1097), the East Asian states' capacity for making and conducting effective development policy is one of the main reasons why they have outperformed Latin American countries, even though the latter enjoy abundant resources and started their industrialization half a century earlier. Therefore, in order to achieve rapid growth, state-led industrial upgrading is a crucial factor and can be better achieved by a developmental state government.

This section explores the characteristics of the developmental state as well as the elements that constitute a functional developmental state government. One of the determining factors is that state capacity for achieving developmental goals strategically intervenes in development activities and can adjust policies over time. Also, a developmental state's economic success can be achieved through state-led industrial upgrading. In *Governing the Market*, Robert Wade (1990, 7) notes the crucial feature of East Asian developmental states: he sees in Japan, South Korea and Taiwan an "*intense and almost unequivocal commitment on the part of government to build up the international competitiveness of domestic industry.*" Wade (1990, 6) uses Taiwan's developmental state period to illustrate the successes of what he defines as a 'nearly free market' and government's role in raising Taiwan's international competitiveness and finally making Taiwan into an industrialized economy. In the case of China, the SASAC's higher authority—the State Council – issued administrative orders directly in relation to the management of state assets, calling constantly for industrial upgrading and promotion of the international competitiveness of SOEs. An example of this are the Interim Measures for the Supervision and Administration of the State-owned Assets of Enterprises, which aim to "*promote the strategic adjustment of the layout and structure of the state-owned economy.....*" (State Council 2003, No.378). Similar orders can be seen in the Guiding Opinions of the General Office of the State Council on Promoting the Structural Adjustment and Restructure of Central SOEs (State Council 2016, No.56) which ".....*promote*

*the reform and restructuring of the central SOEs to optimize the distribution of state capital.....and to push forward the industrial upgrading of assets”.*

In his theory of '*causal relations linking state intervention with rapid economic growth*', Chalmers Johnson (Woo-Cumings 1999,2) challenges the western neoclassical economic idea of seeing free trade, lower protection, a free labor market, high interest rates and conservative government budgeting as the five main factors in Taiwan's rapid economic growth (Wade 1990,52). The problem now moves from whether the state should intervene, since the late-industrialized countries have seen significant government intervention, to the challenge of finding a mixture of state intervention and market orientation that provides a rapid and effective industrialization of the country (Öniş 1991,110). The East Asian Miracles that took place drew fundamentally on '*activist industrial, trade and technology policies by the state*' (Chang 2006,49). South Korea's case certainly demonstrates the importance of the state's strategic intervention in development. Amsden (1989) emphasizes the Korean state's role in directing capital into particular industries and selected groups of companies, rather than depending on market rationality. At the same time, the Korean government imposed a strict supervision mechanism to guarantee the efficiency of the allocated resources, which Öniş (1991, 113) defines as a dual policy of support and discipline by the South Korean government.

The fundamental characteristic of East Asian development is to prioritize industrialization, rather than maximizing profitability based on a country's current comparative advantages according to market rationality (Öniş 1991, 110). Lin (2014) calls for the government to take a role, but holds a different view, believes that a catching-up state's central government should follow its comparative advantages in order to achieve economic growth. He conceptualizes the framework of the "*new structural economy*" and argues that, from eighteenth century Western European countries to the most recent example of China, the government's positive role in promoting industrial upgrading and diversification can be seen in almost every successful catching-up economy in the world. The way in which state policy changes in order to achieve development varies over time; but state policy should have a determining role in policies deployed for development purposes.

It is also worth emphasizing the state's control over key resources, such as finance. Wade (1990) notes Taiwan's strategy of government direction of capital accumulation and investment towards a small number of key industries, which has made them competitive in the international market (Stubbs 2009,2). The government's capacity to apply strict control over the financial system (Öniş 1991, 113) can, in fact, enable the state to impose its industrial plans. One of the strengths of the East Asian developmental state model is companies' high debt-to-equity ratio and high investment. The potential for financial instability has been reduced due to the close and long-term interlinking of government, banks and

firms (Wade 2000,98). The question is, to what extent can we identify a causal relationship between the state controlled financial system and economic growth in China's transitional economy period.

In the Chinese context, where the financial system has been heavily influenced by the state, the state has had the flexibility to mobilize financial resources in order to provide sufficient support for the development of the state sector. The four big banks, namely the Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China, and the Agricultural Bank of China, are owned by the state, which shows that the Chinese state retains a powerful position in the financial system. Breslin (2014, 997) identifies the role of the financial and banking system in facilitating the Chinese state's control over capital allocation to preferred industrial sectors. He further adds that, although vigorous reform of banks has taken place since 1994, banks should still be acknowledged as a key tool of control by the state. Consequently, due to the state sector's privileged position in the economic structure, Breslin believes development was funded by state-owned banks. Other research, however, has shown that the lending bias and preferential loans to SOEs by the big four state-owned banks have been reduced in the recent years. Lardy (2012, 33-36) notes that the Chinese government's 4 trillion RMB stimulus program through the People's Bank of China did not reinforce the state's power at the expanses of the market and the private sector. The individual businesses and private firms also

can access to a large share expanded supply of bank credit as the SOEs continued underperformed.

According to Lin, Sun and Wu (2015, 141), there are three interpretations of the decline of ownership bias in loan decisions made by the big four banks. One is that the 2003 financial reform significantly changed banks' lending behavior; another is that the SOEs achieved better market performance after 2003, so that loans were given on a merit base; a third possibility is that bank loans to SOEs went through '*redistribution channels*' to non-SOEs. After all, the commercialization of state-owned banks in 1993 gave a positive direction for China's state-owned banks to be less state-directed, and more like a normal bank. The big four banks' listing in Hong Kong is beneficial for them in terms of both raising capital and raising standards (Allen et al. 2012 in Breslin 2014, 1001). The listing of central SOEs will be discussed in the empirical chapter, because the listing activity itself not only shows the lack of internal funding from government and state-owned banks, but can also be examined as a supervision method in the principal-agent relations between the SASAC and central SOEs.

State control over finance is seen as one of the core factors for the developmental state model. Then, discussion of the Asian Financial Crisis is unavoidable. Can we attribute the financial crisis to the widely adopted developmental state model of economic governance? Neoliberals tend to attribute the East Asian Financial Crisis to the high level of state intervention in

the economy in the East Asian developmental states. However, Weiss (2000, 38) opposes this view and argues that the East Asian Financial Crisis was not generated as a result of the developmental state mode of governance. The Southeast Asian countries that were badly hit were not developmental states, but interventionist ones. The two developmental states that were affected by the crisis were Korea and Japan. However, Weiss believes that it was Korea's reduction of its transformative capacity and its neoliberal trend that caused its crisis, while Japan's was more like a self-induced banking crisis. In her earlier work on state power and the East Asian Crisis (1999, 337), she points out that it is "*low domestic transformative capacity*", not a high level of state intervention, that "*increases vulnerability to international shocks like financial crisis*". Wade (2000, 107) attributes the East Asian Financial Crisis in the late 1990s not to the developmental state model but to the quick opening up of the affected countries' financial systems. This meant that these countries were easily affected by other core economies and their governments in the international financial market.

Thus far, this thesis has argued that the developmental state cannot be defined only by certain criteria of institutional arrangements or a set of policy settings. As the developmental state evolved over time to cope with domestic and international challenges, so the conceptualization of the developmental mindset is also important in understanding the developmental state (Thurbon 2006, 11115). The developmental state is known for state intervention through preferential policies and favorable loans; but it is also important to notice that

developmental state support and subsidies have been decided and granted based on performance. Through a complicated but precise supervision mechanism, the SASAC has managed to adopt both internal and external supervision strategies to manage the national team of central SOEs. A detailed document analysis of SASAC-issued regulatory policy papers will be presented in the principal-agent chapter.

### **2.3. Is China a variant of the developmental state?**

The above section covers the debate on what makes a developmental state function. This section assesses whether China possesses the ten key features of the developmental state. China is normally viewed as a developmental state, since the Chinese government has prioritized economic growth since the reform and opening-up in 1978, which set the cornerstone of China's developmental state path. According to Nolan (2008, 4), for a long time the principal goal for any Chinese leadership was to reduce the poverty rate in China. More recently, China has started the institutional adjustment of its governance system to support its developmental state strategy. Institutional capacity can turn a government's developmentally driven intervention into effective policy outcomes (Thurbon 2014, 11). China's development strategy has constructed a strong foundation of institutional settings and series of policies, though the institutional settings and policies change frequently. This section starts with an overview of the extent to which China fits into the ten main characteristics of the

developmental state listed above. It then moves to discussion of the variant of the developmental state that China represents and how the changing global political economy makes China's developmental state different from the classical developmental states in the 1980s.

Although China's market reform did not start at the same time as those of the classical developmental states, after the Second World War, it was in a similar historical situation at the starting point of its developmental state. After the end of the war, China experienced the Great Leap Forward, between 1958-1960, and the even more tragically, the Cultural Revolution, from 1966-1976. China's history of wars and revolutions left it a weak society. Then, the weak society met a communist government that was "*strong, authoritarian, developmentally oriented and interventionist.*" (Gore 2014,320). Similarly to Taiwan, which was an authoritarian state under the National Party's control at the same time, it was a corporatist developmental state (Wade 1990, 228). The years of political turmoil had given China a similar latecomer position and a relatively authoritarian political system (Stubbs 2009, 2) to fit into the developmental state model. Nolan (2008, 8) develops this argument on the causal relations between political democracy and economic development, pointing out that there is hardly any example that shows a country that has had its income rate increased from low to medium under political democracy.

Similar to the classical developmental states, China has various security threats including, but not limited to, territorial disputes with Russia and India, and the internal security threat from Tibet and Xinjiang. The Chinese government also has to deal with cross-strait disputes with Taiwan, as well as disputes over ocean territories with many neighboring countries. This makes the social and economic situation of China similar of that of the post-war developmental states. China's determination to catch up with the advanced western economies is strong. The state also gives high priority to economic development because economic performance is one of the sources of the legitimacy of the authoritarian government.

Another significant aspect China's situation is that the Chinese central state has a strong state capacity for achieving developmental goals, as illustrated by the continuous growth of GDP over the past 30 years. It is also able to intervene in the economy strategically and adjust policies as needed, which studies by Heilmann (2008, 12) identify as experimental-based policymaking. Furthermore, the Chinese state has aimed to move from labor-intensive industries to technologically advanced industries. The Ministry of Industry and Information Technology (MIIT) of China issues industrial development plans every five years to promote the upgrading of Chinese industries to a higher value. For example, the state council issued *Industrial Transformation and Upgrading Plan 2011-2015* (State Council 2011, No. 47), and also the MIIT issued *Made in China 2025*, which announced a state strategy for advancing industrialization (MIIT 2016, 433).

We shall now move on to consider the state's control over key resources, such as finance. The Chinese government maintains close supervision in the financial market, and the big four banks, namely, the Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China, and the Agricultural Bank of China are all owned by the state. Although financial reform and the commercialization of state-owned banks has taken place since 1993, the state's influence on these banks should not be underestimated. Regarding state support and subsidies to industries and SOEs, the subsidies have been given on a performance basis. In the management of central state-owned assets, the government's rigorous assessment and requirements of central SOEs has shown that preferential policies and loans (if any) have been given based on market performance.

Institutions such as the MITI, which triggered the Japanese miracle, can be found in the Chinese context too. A similar body is the Ministry of Industry and Information Technology (MIIT), which is in charge of China's industrial development and upgrading; and there is the National Development Reform Committee (NDRC), which is in charge of economic development and reform, and which issues licenses to new industrial projects. However, the difference is that China also has a pilot agency in many different sectors, and this thesis explores the role of the SASAC as the pilot agency that leads the growth of the central state-owned sector. Another criterion for a developmental state is the

meritocratic nature of the central government bureaucracy. A likely explanation for this in the Chinese context is that China's nation-wide public servant entry test for central state institutions has only around a 1.2% acceptance rate, which may be sufficient to construct an elite bureaucracy. Likewise, the developmental state requires the bureaucracy to have an external institutional link with organized economic actors (Öniş 1991, 111). Apparently, China's central SOEs are the most influential economic players in each industrial sector, and this means they can provide information that enables the SASAC to have a better understanding of the market. Also by joining market competition, the central SOEs can serve as an information-gathering point and can be actively involved in industrial associations.

As discussed in the introductory section of this chapter, there are four key features that may challenge China's status as a member of the developmental state group. One is China's continental-size territory, in which governance difficulties, for example, central-local relations and the decentralization and recentralization of decision-making powers, have occurred. However, the size of the territory can bring a larger market into operation on the Chinese mainland, to the benefit of the country's industrial growth, which is highly concentrated in the eastern area. Another crucial change is that the twenty-first-century global political economic environment has changed greatly from what existed 30 years ago. Cumings (1984) argued that the key to the success of the classic developmental states had been the support of US policy. The US had tolerated

these countries' import substitutions and opened its market to them without demands for commensurate access to their markets. America's Japan policy after the Second World War had marked a key turning point and fundamental change in the geopolitics of North East Asia. The Korean War had won South Korea and Taiwan an ironclad commitment of American defense from communism. "*Japan, Taiwan and South Korea have been protected markets dependent upon American grain, among which Japan is ultra dependent on the US*" (Cumings 1984, 20-25). Thus Cummings believed the developmental successes of the classic developmental states were historically and regionally specific.

The world situation China is facing today is nothing like that facing the classic developmental states in the 1980s. Horesh and Lim (2017, 437) see China as a "*Chinese variant of the East Asian developmental state*", with its goal being to "*secure freedom to engage the global system of capitalism while keeping intact its primary domestic focus of state-led development*". This leads to the third crucial difference, which is China's full integration into the global market. Ha-joon Chang (2003, 24) notes in many of his works that virtually all countries currently considered as developed actively used state intervention in protecting infant industries, promoting industrial growth, and developing trade and technology in their catch-up periods. That is, state planning, mercantilism and protectionism are characteristics unique to East Asian countries. These forms of state intervention in leading industrial growth could also be found in Britain in the 18th

century, and similarly in America's economic path before its later 20th century prosperity (Horesh and Lim 2017, 438). Besides, the Communist Party maintains its position, following the elimination of the orthodox planned economy, through the process of industrial modernization. Johnson describes China's communist power as a "*specific nationalist movement*" (Woo-Cumings 1999, 7). All in all, the developmental state theory is one that draws upon the development experiences of newly industrialized countries. As I argued earlier in the chapter, China's economic policymaking has both state-led and market-led characteristics. There is no common definition of what constitutes a developmental state. Furthermore, there are also many interpretations of developmental state theory and practices in China, whether these relate to a local area or to a particular industrial sector. These interpretations again give rise to a series of discussions on whether China is or is not a developmental state. For example, Heilmann and Melton (2013, 617) refuse the East Asian developmental state interpretation of China but see it as "*recombined governance based on loosely institutionalized, malleable, and adaptive policy processes*". A developmental state should not be defined by a list of policies. Moreover, as Chen (2016, 77) points out, the common characteristic of these debates is that a "*developmental state seems to be considered a desirable policy paradigm that political leaders have intended to pursue*". This echoes my previous discussion on the developmental state mindset in achieving industrialization to catch up with the West.

The question this thesis intends to explore is whether the Chinese government is

achieving the goal of revitalizing its central state-owned enterprises through a developmental state strategy. Since the central SOEs are operating as the “*lifeline of the economy*”, as Weiss and Hobson (1995, 244) argue, “*Institutionalized collaboration between policy-makers and industrialists lies at the root of state capacity and thus national competitiveness, in the modern world*”. These authors emphasize the state’s success in terms of the infrastructural power and industrial performances it has achieved. The infrastructural power refers to the state’s capacity to mobilize resources for developmental ends, which is increased by public-private collaboration. This is particularly significant when we look at Japan’s economic growth (Weiss and Hobson 1995, 168). Zhu (2018, 198) sees how the East Asian late developers “*stressed government-business cooperation governed by the developmental state*”. The Communist countries, on the other hand, represent an extreme version of organizational power in terms of central planning systems. So, to what extent can the Chinese government’s policy paradigm in governing these CSOEs contribute to China’s economic development? Most importantly, the rise of market forces and the flow of foreign capital into China has created a highly competitive market. The rise of market competition is an irreversible trend to which the central SOEs have to become accustomed. In the next section, I will discuss the rise of market forces in China and how the Chinese state has been using the market as a governing strategy to reactivate the ossified legacy of Leninism. I shall also argue that privatization is not the only solution to stop the foundering of SOEs, as we can see from the massive failure of such experiments in Eastern Europe and Latin America.

Contrary to the neoliberal idea that rejects the possibility of state planning for economic development and encourages the privatization of state-owned assets (Birch and Mykhnenko 2010, 3), China's developmental experiences provide an example that opposes such a claim. This thesis argues that with strong state capacity, proper supervision and adequate positive and negative incentives, SOEs have in recent decades been able to increase their short-term gains and, most importantly, their longer-term perspectives under the leadership of the SASAC.

#### **2.4. The emergence of market forces in China. How does it affect the developmental state?**

As discussed above, I argue that China can best be understood as a variant of developmental state. The developmental state model is effective in explaining central government's management of state-owned enterprises. In the next chapter, by adopting the principal-agent theory as the analytical tool for this thesis, we shall discuss the dilemma caused by central government's strict supervision mechanisms, and the profit managerial autonomy can bring. We shall argue that the evaluation of central SOEs' performance largely rests on business performance and the financial indicators of a company's revenue, profitability and return on assets. If central SOEs are evaluated based on their competitiveness as a business entity, does this mean that China also recognizes

the positive results that market mechanisms can bring? This leads to a discussion of China's increasing involvement in the global market, and the nature of market competition. To what extent is China embracing marketization? Should we attribute China's success to state-led development or the rise of private sector? This section starts with a literature review of marketization. It then moves on to a discussion of the emergence of market competition in China and how that has affected SASAC's governing strategy in managing its Central SOEs. It argues that the Chinese state has adopted market mechanisms to facilitate the growth of its Central SOEs. In this context, the market, rather than being seen as an abstract notion, can be viewed as an institution. The government has taken the decision to govern central SOEs through the market to achieve economic success.

### *Open door to the market*

Zhu Tianbiao (2018, 199) argues that China's ending up on the Soviet side and embracing an extreme form of central planning in the Cold War was an historical contingency, and one consequence of this was an extreme form of government-business relations. The break between the Soviet Union and China in the 1960s meant that China and the US had mutual interests, which later led to China's incorporation into the world trading system. After being incorporated into the international system, the Chinese state gave up its central planning system; but it did not want to completely surrender to a free market economy, and it has been

struggling to guide the process of economic development. As Breslin (2017) explains, China's economic development is actually part of deregulating processes. The deregulation here can be understood as being less ideological, more experimental, more practical, and more development-oriented. It has moved from the extreme of central planning to its current situation in which private capital is allowed to flourish and contribute to tax revenues and employment. China has broken through the communist ideological limitations and is determined to pursue rapid economic development, while maintaining socio-political stability. Its top-down state intervention undoubtedly assists rapid economic growth (McNally 2008a, 117). China does not reject the idea of the market mechanism in resource allocation. In fact, it is the Chinese government that has loosened its control and made the market appear as it is today. Polanyi is correct when he talks of the market mechanism and argues that "*contrary to conventional economic wisdom, markets are neither neutral in their distribution nor natural in their origins*" (Blyth 2002, 3). Market competition has been used and market indicators have been adopted as one of the decisive factors in the evaluation of central SOEs' performance. Furthermore, Pearson (2015, 27) believes that the growth of state capitalism in China does not conflict with the hardline aspect of the government's ideology; on the contrary, it is recognized as a positive factor in strengthening the legitimacy of the one-party state. Changing global political and economic conditions, and China's involvement in the world trading system, make it less possible to practice a classical developmental state strategy in closing the domestic market to foreign capital.

Based on the argument that the market is not neutral, and a self-regulating market does not exist, the discussion then moves to focus on the government's role in the dysfunctional market. McNally (2008, 31) offers an analysis of modern China and argues that China's political and economic transition is driven by capitalist development, as seen in the UK, the US, Germany and Japan, through the "*twin processes of urbanisation and industrialisation*" (2008, 107). A similar argument is made by Pearson (2011, 41), who sees China's uniqueness expressed in the ruling Communist Party's vague adaptation of capitalism as well as its policy moves towards capitalism. She sees China's state intervention in the economy after the global financial crisis as being "*ahead of the wave rather than the last vestiges of socialism*", and thus as an emerging regulatory system (Pearson 2015, 28). However, it is worth acknowledging the fact that China is, even today, not a liberal democratic state. Besides, two key factors differentiate China from a capitalist country. One is its state ownership; and the other is the structure of party control (Pearson, 2011). Oi (2011, 6) supports this idea and points out that, although China's reform, and the privatization of its small and medium size SOEs, are sometimes seen as China moving towards the capitalist group, the reform was initiated by the state, not the firms themselves, which distinguishes China from this category.

### SOEs, Private enterprises and the local government: Is Guanxi important?

The pyramid structure created for central SOEs contains multiple layers, reaching right down to the operational companies that conduct their business at local level. Also, there are many different actors with various interests who are involved in central SOE businesses. Apart from the central state, there are local banks, local officials, foreign investors, private firms, and many others. As Lampton (2014, 90) rightly notes "*China is not one voice.*" China's policy-making system has become increasingly complex and fragmented. This has presented a major policy-making challenge for the multiple actors positioned across China's administration system, and has caused coordination problems among them, leading to equivocation over decisions throughout the system. Unresolved decisions wait until they reach the overloaded top leaders, who, although they have the power to decide, have only limited information (Lampton 2015,766). Xu (2017,98) provides a similar picture in his analysis of the competition among central agencies with regard to overseeing one particular central SOE--the State Grid Corporation of China. Xu argues that central agencies such as the SASAC, NDRC and SERC have different interests and perceptions. They will reach agreement on managing the State Grid only when there is a shared interest among them, or the "top leaders" intervene. Top leaders at the central level make the most important decisions in China. On the other hand, principal central bureaus, their local branches and local governments have an enormous capacity to make independent decisions in actual practice.

Apart from offering local government the capacity to make decisions and adjust policies based on local conditions, China's policy of fiscal decentralization has strongly incentivized local government to support market-oriented economic reform. According to the fiscal revenue-sharing system, lower-level governments have to submit a fixed proportion of their fiscal revenues to the level of government above them, retaining the remainder for their own budget (Nee and Opper 2007,103). The cadre evaluation system imposes heavy pressures on local government officers to promote economic development. However, such evaluation focuses on only a few economic indicators, such as GDP, and can lead to uneven development, inequality and social instability (Zhan 2013,96). Having acknowledged that economic indicators are local government's and local cadres' priority, the assumption of SOEs is that strong political capital puts them in a superior position in business; while private enterprises are operating in a more difficult situation and the success they achieve is more vulnerable. However, the value of political connections varies among different industries.

Nee and Opper (2007, 111) argue that entrepreneurs whose businesses are in the free market sectors are not interested in playing the game of politics, whereas entrepreneurs whose businesses are in highly regulated sectors are likely to invest more effort in building personal connections with government officers. This argument is based on the extensive interviews these researchers carried out in the Yangzi Delta. In fact, the advantages of political capital and

political connections are particularly important in state dominated markets, such as the credit market, and in acquiring government contracts. In competitive markets, firms' political capital cannot guarantee a positive payoff. Zhu and Wu's (2018, 175-177) research supports this view. They find that private firms in industries which rely more on government support, for example through government policies or licenses for state-controlled resources, are more likely to be actively engaged in formal politics. Private entrepreneurs in industries such as agriculture, mining, manufacturing, energy and construction have more political connections and are more interested in building strong ties with government officials, while entrepreneurs working in industries like science and technology and social services have the lowest degree of political connection. Zhu and Wu's findings also reveal that private enterprises' strong ties with government in sectors such as real estate and mining should not be underestimated, because these enterprises rely on state-controlled resources and favorable government policies. This shows that the decentralization and privatization of economic activities in China's path to marketization have led to a decline in the value of political connections in the marketized sectors, which also promotes the creation of a rational-legal bureaucracy. An increase in the competitiveness of a market sector will be accompanied by the declining value of political capital in that sector (Nee and Opper 2010, 2128-2132).

All in all, the global political and economic environment provides an entirely different situation for China today than the one faced by the classic

developmental states 40 years ago. Developmental state theory views the state as the key engine for achieving development goals, whereas neoliberal ideas contend that a market-led mechanism of resource allocation is the most effective way to achieve industrialization. (Payne and Phillips 2014, 93). By engaging in the global political economy, China's series of political acts, from "*reform and opening up*" to the warm welcome it gave to foreign capital, to the establishment of private enterprises, to joining the WTO, shows that the Chinese state has sought a balancing point between state and market. So, how has the emergence of the market in China accelerated China's developmental state path?

## 2.5. Managing central SOEs: from a developmental state perspective

The previous sections explained and analyzed the many aspects of the developmental state and its relationship with neoliberalism. The following sections focus the discussion on managing central SOEs from a developmental state perspective; the Chinese government's determination to hold onto '*the lifeline of the economy*'; and its official discourse, which describes central SOEs as "*the eldest son of the People's Republic of China*". Economists tend to praise the efficiency with which the market, trade, privatization and the labor force have moved from agriculture to industrial production. State ownership of investment and production is seen as a non-important factor in China's implementation of developmental state policies (Knight 2014,1341). However, the Chinese

government's determination in maintaining central government control of SOEs and its motivation in building a strong team of central SOEs to compete in the domestic and global markets is based on a developmental state logic. Two years after the SASAC's establishment, its aim was to deepen reform by "*using the reform of the state assets management system to promote the reform of SOEs*" (Li 2004). An example can be seen in the SASAC 2006 version (No.16 [expired]) of the Interim Measure for the Supervision and Administration of Investments by Central Enterprises, which decrees in Article 6 (1) that the enterprise's investment has to follow the principle of complying with national development strategy and industrial policy. In the latest revised version of this measure (SASAC 2017, No.34), this principle was eliminated. However, this does not mean there has been a decrease of government power in regulating these enterprises. The 2017 version pays more attention to the SASAC's role as the investor, and focuses on the supervision of CSOEs through the investment process. The above characteristics make it possible to analyze China through the theoretical lens of the developmental state. Under the strong influence of globalization and neoliberalism, China has partially adopted neoliberalism while rejecting the ideology. Unlike the widely criticized way in which governments have picked winners in the classical developmental states, the SASAC adopts market criteria to evaluate and assess its central SOEs' performance, thus ensuring that subsidies and preferential policies are allocated on a merit base. For a long time, the state sector has been seen as an obstacle that held back industrial growth and the reform process in China.

Under the direction of the SASAC, through years of merger and acquisition, China's central SOEs have either gained oligopolistic status and competed with their oligopolistic counterparts; or they have managed to be in one of the top three positions in the competitive sectors. Consequently, the central SOEs have performed strongly in raising revenue and profits that have made them powerful enough to confront competition from the global market and the inflow of foreign capital and products. China's official political discourse asserts that contemporary China is practising '*socialism with Chinese characteristics*' which, although far different from orthodox socialism, provides flexibility and a plausible position from which the government can adopt western capitalist policies (Kennedy 2011,9). China's ambiguous attitude towards the theory and ideology in Western political science, alongside its partial acceptance of neoliberalism, has formed a political economy model that has not been designed or led by economists or political economists in the Anglo-Saxon world. China's constantly adjustable political economic policies have formed a developmental state model that coincidentally uses neoliberalism as its tool in the pursuit of economic development. The core of a successful developmental state lies in its institutional setting. In the Chinese context, the SASAC is an institution that serves as a pilot agency leading the central SOEs down the developmental state path, and this will be discussed in separate chapter later.

Developmental state characteristics can be identified in China's governance of SOEs ever since the economic reform started, in the 1980s, and private enterprises gained a legal position. Naughton (1995, 1090) raises the subject of a new '*de facto division of labor*' between growing investment from non-state companies in competitive sectors and state-, especially central state-, dominated investment in not-fully-competitive sectors. In terms of profitability, private enterprises have easily outperformed SOEs in competitive sectors, while at the same time, there has been a need for increased investment by government in public goods and infrastructure development. As a consequence, the state's investment has largely been allocated to infrastructure and strategic industrial sector development. After that, SOEs, in particular, central SOEs, have been recognized as a 'pillar' of the economy, in serving the national strategy (State Council 2016 No. 56). Political continuities have enabled the SOEs to offset the impact of imported neoliberal ideology since reform and opening up. During the years of institutional change, central government even established a new institution to exert its forceful political power in lifting the profile of central SOEs. This view contrasts with that of Beeson (2009, 37), who argues that China's socialist ideology restrains powerful political SOEs as problematic and representing an obstacle to future reform. In fact, China's management of central state assets follows a market standard and uses market criteria to assess the performance of central SOEs. A '*grasping the big, letting go the small*' policy gets rid of the majority of low-efficiency SOEs with their surplus staff. Besides, since the SASAC's establishment, its *assessment of the operational performance of*

*people in charge* (SASAC 2003, No.2) has focused on two major points, which are profit and return on assets. The SASAC's first director, Li (2005), explained in an interview with CCTV that "a central SOE has to be in the top three of its industry, otherwise, we will get rid of it. The SASAC has also issued "*Guidelines on Strengthening the Management of CSOEs by Using the Economic Value Added*" (SASAC General Bureau 2014, No.8) to promote the industrial upgrading of central SOEs and increase their competitiveness. In other words, the company will be acquired or sold to other businesses, and the senior executives will be fired. Certainly, the team of central SOEs, after ten years of the SASAC's administration, are not only the top SOEs in strategic sectors but are also the winners in each industry based on the market standard.

As noted above, the government's strategic intervention, and its capacity in carrying out such intervention, is a crucial feature of the developmental state. State-industry relations are a determining factor for a successful developmental state. "*Strategic industrial policy forms a central component of the developmental state model*" (Öniş 1991,121). The government has its selection of 'important' industries for import subsidies and export promotions, which challenges the fundamental neoliberal doctrine of market liberalization and rationality. So, how does the developmental state make sure its industrial policies are implemented properly? This makes the examination of the ties between government and industries crucial. Evans (1995, 49) addresses the "*maze of ties*" between the Japanese central government and major industries. MITI has constructed an

inter-personal coherent network inside its bureaucratic structure that gives it a better participation in external work and guarantees its efficiency. Johnson (1999, 27) points out that one of the fundamental problems of the developmental state is the relationship between state bureaucracy and privately-owned businesses. This view is supported by Pearson (2011, 40) who argues that “*Japan’s industrial policies were carried out through comprehensive or sector-specific bureaucracies, Japan’s MITI being the archetype.*” Yeung (2014, 76) echoes this view by arguing that the “*highly interventionist and yet controversial industrial policy*” is the most powerful instrument of the developmental state.

The previous section has shown that a linking of government with enterprises can be a positive factor in promoting industrial development. This view is echoed by Gomez (2012, 69), who sees the developmental state’s core concern as lying in the “*nature of state-business ties*”, that is in the government’s financial support for privately owned enterprises to help them realize industrial modernization. This is the characteristic that differentiates China from the classical developmental states: a strategy that avoids the formation of big ‘interest groups’ that can challenge the Chinese government’s power and efficiency in policy implementation, and also keeps the central government distant from lobbying. The Chinese government has drawn on Japan and Korea’s experiences and mixed these with the remaining part of the communist heritage of state-owned enterprises. China uses SOEs, especially central SOEs, to promote economic growth and industrial modernization. Through the selection of the board of

directors by the SASAC and Central Organization Department, the Chinese government also tries to minimize cohesiveness problem, so as to make policy implementation processes run more smoothly and efficiently.

The developmental state in China's central state sector cannot guarantee its success only through subsidies to government-picked-winners and preferential policies and loans. Leftwich's (1995, 401) argument fails to acknowledge the market side of the developmental state. He argues that "*developmental objectives have been politically driven*" although "*political purposes and institutional structures of developmental states have been developmentally-driven*". Wade's (2010, 155) argument, however, that East Asian industrial policy comprises both "*leading the market*" and "*following the market*" sounds more reasonable. In China's developmental state model of governing central SOEs, market factors are seen as one of the most important factors. The central SOEs in free market industries have to be in the top three of their industry to maintain their position in the national team. For those who cannot reach the top three in their industry, they will be eliminated and absorbed by other central SOEs. Central SOEs in monopolistic industries also face government-created competition from oligopolistic central SOEs. It is arguable that the Chinese government adopts some neoliberal criteria in evaluating central SOEs' performance as well as in making decisions on state support grants.

Thus, Thurbon (2016, 35) is correct to argue that the developmental state is the most suitable conceptual framework for explaining the East Asia countries' rapid economic success and industrial upgrading from labor intensive industries to more skilled ones. It is the most suitable theoretical tool for examining China's rapid success in raising its national team of central SOEs from being a major drain on the economy to being globally competitive firms. Not only do central SOEs achieve good market performance, but they also fulfill other roles. Central SOEs operate in many different areas of the domestic arena and sometimes carry out roles of social responsibility on behalf of the government, especially when an environmental disaster happens. Central SOEs are in a leading position in industry, so they can provide a general overview of industry to government, which contributes to efficient policy making by the latter. Central SOEs also offer an experimental field on which the government can test its proposed measures. To create adequate supervision of these central SOEs, the Chinese government has even set up a pilot agency that has gathered together fragmented aspects of power from other central government institutions to focus its developmental state strategy on the management of central SOEs. The institutional settings of the central state ownership system and the interactions among the SASAC, the central SOEs and other institutions will be analyzed in the empirical chapters of the thesis.

Developmental states vary in terms of their policies and institutional settings. Although close ties between large private sector enterprises and the government

were seen in the case of Japan and South Korea, in Taiwan, a large public enterprise sector remained in control of the commanding heights of the Taiwanese economy (Wade 2010, 155). The Chinese government's methods in promoting development have been ideologically light, and thus instrumental and pragmatic. It has partially adopted neoliberalism, while rejecting neoliberal ideology. It does not practice one '*ism*', but rather it conducts a mixture of ideologically free methods in its economic development processes. It adopts neoliberal criteria to evaluate, assess, supervise, motivate and eventually strengthen central SOEs using a developmental state logic. Thurbon and Weiss (2006, 18) define both the inward and outward FDI of South Korea and Taiwan as driven by strategic considerations relating to the developmental state. They argue that it is "less a matter of protecting domestic firms and their market share from technologically superior foreign competitors, and more about pushing domestic firms to cooperate with - and even to acquire - foreign corporations." The SASAC also issues orders to regulate central SOEs' foreign investment, to encourage these companies to increase their global competitiveness, for instance, the *Measure for the Supervision and Administration of Investments outside China by Central Enterprises* (SASAC 2017, No.35), revised, and based on 2012 order No.28. Therefore, this thesis argues that China being a continental-sized country, the application of the developmental state concept varies in different regions, provinces, sectors and industries. In the management of the central state-owned sector, China is on a developmental state path. China's central SOEs are operating in every strategic sector and in leading

positions in non-strategic industrial sectors. The SASAC functions as the pilot agency on which the management of central state-owned sectors centers. This section not only provides a fresh analysis of the growth of China's state sector but, more importantly, it fills a gap in the literature of the developmental state theory and its application to China.

China's authoritarian government has taken an economic decision to create highly efficient policy implementation processes that are more effective than those of liberal democratic countries. As Breslin (2011, 1342) notes, China has made national development the priority of its national policy. The Chinese government has opted for '*soft planning*' of its national economic development through a state-led growth project. China's activities also include the protection and promotion of its main industrial sectors and economic actors, as well as a centralized financial system. This research argues that the Chinese government's determination in maintaining and supporting central SOEs in non-monopolistic sectors demonstrates a strategy to remedy China's shortcoming in not having globally competitive firms like Japan and Korea. Chinese central SOEs' leading position in industry makes it possible for them to influence industry regulations and build production standards. As Kennedy (2011, 133) suggests, industry's influence on China's policy making has increased significantly. In the formulation of economic regulations and laws, big business's suggestions are taken account of, so that despite state ownership this policy making is no longer dominated by political elites.

Besides, the strong position of central SOEs in industry has, to some extent, built an invisible wall to prevent the formation of giant private companies, since the Chinese government is unwilling to have regime change or social turmoil caused by robust private businesses. In Japan and Korea, private enterprises have had a high political impact. It is true that a developmental state is heaven for big businesses, given the oligopolistic nature of these industrial groups (Woo-Cumings 1999,17). Therefore, it is crucial for the Chinese state to help in the formation of central SOEs instead of supporting the formation of large privately-owned businesses. As Tsai (2011, 136-158) suggests, China's newly formed private capitalists are not likely to start promoting massive democratic transformation, because of their diversified social, economic and regional backgrounds. However, China's fragmented but influential private entrepreneurs' impact on policy-making should not be neglected, because the class power of society has been reconstituted due to a neoliberal transition, albeit one with Chinese characteristics (Harvey 2005, 151). However, major political and institutional transformations are likely to happen without regime change. Also, as Evans believes, the developmental state model has adopted many of the characteristics of the embedded autonomy he describes: that is, the state has the capacity to implement developmental goals and direct social change. The state's capacity can be exercised through collaborating with business groups and directing them towards its economic development plan (Kohli 1999, 132). Notwithstanding this, in the case of China, having large business groups like the

central SOEs has made it relatively easier for the central government to direct its development plan.

It is also worth acknowledging that the power of the central government may also be challenged by the decentralized power it shares with local governments, due to China's unique horizontal and vertical lines of administration (the Tiao-Kuai relations). Yeung (2014, 92) argues that China's developmental model has been less directed by central planning, due to decentralization programs since the 1990s which left local authorities large bargaining spaces. It is likely that the significant role that local governments play in economic development will challenge the central government and make Chinese central government less powerful than the governments of other developmental states. However, the Chinese central government is still able to intervene in economic activities through its half 'market actor' half 'quasi-governmental body', central SOEs. Breslin (2011, 1331) believes in the Chinese state's power to impose direct control in economic activities, unlike the South Korean state, which has chaebols as the middle layer in between government and economic enterprises. However, the central SOEs' operational branches also need to negotiate carefully with local government for local policy support. This argument will be further expanded in later chapters. All in all, Robert Wade (1990, 345) is correct to argue that, even though this does not indicate any failure by the market, it is possible for the government rather than the free market to produce better industrial performance.

## 2.6. Conclusion

The theoretical framework of this research focuses on the debate on whether China is a developmental state and whether neoliberalism has influenced China's developmental state path. The analytical theory of this thesis—the principal-agent theory – will be studied in the next chapter. The principal-agent theory aims to provide a detailed understanding of how the SASAC regulates and supervises central SOEs. The developmental state as a conceptual and theoretical term centers on the idea of the state's ability to direct market forces to achieve the state's developmental goals, based on the post-war development experiences of East Asian countries (Gore 2014, 304). Developmental state theory is helpful in the search to answer the question of why East Asian countries succeeded in their post-war construction and achieved sustainable economic growth, while other third-world countries failed to do so.

It should be noted that one of the greatest challenges in understanding the political economy of contemporary China is the difficulty of using one single western theory to interpret the country's development path. This is due to its continental size, to unequal development among the provinces, and to unbalanced growth in different industrial sectors. Although the developmental state model is the most discussed one, there are other interpretations. David Harvey (2005) sees China as being on a path towards neoliberalism. Margaret Pearson (2007) sees China as a regulatory state. After all, the developmental

state model is about the state's determination in prioritizing economic development and its capacity to do so through effective institutional settings. Central state-owned enterprises are an important component, both good and bad, in China's economic system. However, things may change over time. As Kim (1999, 456) notes, the relationship between the Korean state and large business groups (Chaebols) experienced a fundamental shift because of economic liberalization and the democratic movement. State capacity had largely declined, so that it was hard for the Korean government to continue its authoritarian rule, and this led to a decrease of the old-style developmental state.

This thesis argues that the developmental state model is a useful theoretical tool with which to explain the enormous economic success achieved in their post-war recovery by the East Asian countries. It concludes that China's continental size makes it difficult to explain its development using a single theoretical framework, such as that of the classical developmental state. Instead, China can arguably be seen as offering a kaleidoscopic presentation of a developmental state. The developmental state model of economic governance can be found in many different regions, sectors and industries in China. The developmental state theory is particularly suitable for analyzing the growth of the 102 central SOEs, for which the SASAC is the pilot agency which acts as a central point for the management of their growth. China is a developmental state and adopts a developmental state model of governance in the central state-owned sector of its economy, which contributes to the economy's development and success. The government's

determination and its capacity to make and implement policies has contributed to the growth of China's central-government-owned sector. It is also believed that China will continue to advance its support of the central state-owned sector. The SASAC is the pilot agency from which the development of central SOEs is managed. The central SOEs themselves can also serve as a think-tank, providing feedback to government and taking part in policy-making processes. The role of central SOEs in China's economic development will be discussed further in the empirical chapters. These SOEs also act as an experimental field in which to try various industrial policies which will have broader implications for China's development of effective industrial policies that lead the country along its developmental state path to industrialization.

The key to building a developmental state lies in its institutional setting and its ability to minimize information asymmetry between principal and agent. East Asia has proved that institutions can have a positive role in promoting economic growth (Haggard 2004,81). A system of multiple supervision mechanisms, incentives and punishments have all contributed to the Chinese central government's efforts to promote its national team of central SOEs. As Meisel (2008 in Wade 2010, 157) argues, the state's capacity in coordinating institutional agents and implementing national development plans is crucial for catch-up economies. This chapter has focused on discussion of the developmental state and its application to China, and it has also invoked the controversial debate on neoliberalism to illustrate how China plans its catch-up functions. All in all, this

thesis is about how the state achieves its objectives through the market. The state, through an arm's-length strategy, gives some control to the market. By doing so, the state retains and even strengthens its capacity for control. The market may be employed by the state. It is not the state or the market that predominates: it is how the state uses the market; or we can say it is how the state governs through the market.

The keys to understanding of effective twentieth century developmental states are bureaucratic capacity and state-society ties. A well-functioning institution can bring productive and dynamic economic outcomes (Evans 2008, 18). The following chapter moves to a discussion of principal-agent relations in the key institution that manages the growth of China's state-owned enterprises. It adopts principal-agent theory as the theoretical lens through which to analyze the institutional dynamic of state sector management and answers the question of how the government achieves its developmental state objectives. One central feature that this thesis identifies is the establishment of the SASAC, which serves as the principal institution for China's central state sector management. The Chinese central government's reassignment of power from various other central government institutions to a newly established institution, the SASAC, has helped to reduce the multi-principal problems that have challenged SOEs for years. By limiting my research to central SOEs directly administrated by the SASAC, rather than dealing with the general category of SOEs, I am able to offer a more focused discussion. It can be argued that China's developmental state strategy

for building its national team of central SOEs has not only allowed the central government to have tight control over key resources but has also had broader implications for China's developmental state path towards achieving industrialization. At the same time, its institutional setting contributes to the application of principal-agent theory in government-business studies and provides new ideas on how to minimize the goal of conflict and how to solve information asymmetry by using various institutions and, most importantly, the market.

## Chapter 3. Principal-Agent Theory and Institutional Interaction

### 3.1. Introduction

The previous theoretical chapter argued that China is a variant of the developmental state and discussed its upward spiraling economic growth, which incorporates a seemingly contradictory market mechanism. This argument is especially suitable for explaining how China's group of central SOEs has grown significantly since they were first administered by the SASAC in 2003, and why the SOEs are not necessarily a drain on state assets. In fact, given an adequate supervision mechanism, these enterprises can be competitive and profitable. To support a macro-theoretical debate on the developmental state, the principal-agent theory is adopted as an analytical tool to illustrate institutional interaction. Hindmoor (2006b, 134) explains that "*the principal agent model is an analytical expression of the agency relationship*". The interactions here are not limited to principal-agent relations between the principal, the SASAC, and its agent, the central SOEs; rather, various other central government institutions that are involved in oversight activities are also taken into consideration. As Chang (2007, 105) has rightly noted, "*the principal-agent problem is at the center of the neoliberal argument against SOEs.*" This chapter builds upon such observations and further argues that market standard can be an effective tool with which the Chinese government can solve the principal-agent problem between the SASAC and the central SOEs. Thus, this theoretical chapter seeks to explain the

application of the principal-agent theory to current relations between the SASAC and central SOEs. Drawing on Chinese laws, 195 SASAC policy regulations issued between 2003 and 2017, in-depth fieldwork interviews and relevant secondary literature, this chapter highlights the principal-agent relations between the SASAC and central SOEs. It argues that these relations depend first and foremost on the government's innovative and rigorous supervision mechanisms; secondly, on its ability to impose and constantly adjust policies; and thirdly, on the its new strategy to use the stock market and the interests of third-parties to assist the principal. These measures have proved to be the key to explaining how central SOEs have performed increasingly well since 2003.

#### *From Fragmented Authoritarianism to the Developmental State*

In this thesis, the principal is the State-owned Assets Supervision and Administration Commission (SASAC), which acts as a shareholder for central SOEs, and which can and does affect central SOEs in many ways. The SASAC has recentralized powers which had previously been spread among many other ministries, and it can be seen as the most important principal in the state ownership management system. However, its status is not as stable and powerful as the SASAC itself has claimed. Brødsgaard (2012: 630) argues that its policy-making processes are fragmented, which gives more power and opportunities to business groups to act according to their own interests. Although the SASAC has gathered together previously dispersed powers for the

management of state owned assets, there are other government institutions that can interfere in the administrative processes.

The built-in conflicts that exist between departments within China's government system are still seen as one of the unavoidable obstacles to the efficient working of enterprises. As part of everyday practice, enterprises in China need to go through lengthy application processes to get their projects approved by the government. In the years of 2011-2013, on average, applications to the government by the enterprises in question numbered 17.67 applications per year, with the long waiting time for government approval of a project standing at an average of 171.35 days. Enterprises have to interact with an average of 5.67 governmental departments and go through an average of 9.40 processes to gain approval (DRC Enterprise Research Institute 2013 No.147). Therefore, it has become important for the government to clarify responsibilities and decrease overlapping bureaucratic functions. It is also worth noting an improvement has been seen in bureaucratic procedures. Zhu (SHSE/28/2015) points out the noticeable delegation of power from the government to the enterprises; for example, project application procedures have been shortened and simplified.

China has long been regarded as exhibiting 'fragmented authoritarianism', due to its economic decentralization process in the early years of reform and opening up. According to Lieberthal (1992, 6), there are three dimensions to the study of decentralization and centralization: "*value integration; structural distribution of*

*resources and authority; and processes of decision making and policy implementation*". If, as Liberthal (1992, 8) argues, China's political system below the central government level is "*fragmented and disjointed*", Gore (2014, 303) also identifies the problem of the application of the developmental state model to China, due to its size and the decentralized power held by local governments. This kind of fragmented institutional setting can lead to problems like bargaining between bureaucracies (Pearson 2007, 727). Indeed, the fragmented authoritarian nature of government in China leads to frequent bargaining activities in China's bureaucratic system. The bargaining activities happen among bureaus which have significant power to negotiate for resources. The fragmented authoritarian system thus encourages the bureaus' search for consensus in the development of major projects (Lieberthal 1992, 9), so it is the central government that must meet the challenge of how to align local developmental agendas with national strategy through political and economic incentives (Lim 2016,431). Although there are many issues that need to be coordinated among different governmental actors, the SASAC was founded to institutionalize the complex bureaucratic system for the management of state assets. It is acknowledged that the SASAC represents the central government's move to transform its state assets system from fragmentation to a coordinated developmental state model of economic governance.

Nevertheless, the Chinese government has long been devoted to building mechanisms to retain power in central government. A lively state sector requires

not only a market mechanism but also new forms of state oversight (Pearson 2015, 27). In the old state assets management system, there were tensions between various central government agencies and central SOEs. The State Council has the authority to establish special institutions to manage any affairs that are not well managed by the ministries responsible for institutions (Yang 2011, 58). The SASAC's first director, Li (2009), noted that there would have been no future development of SOEs if no reform had taken place. The SASAC was created to clarify ownership of, and take responsibility for the management of, state assets. If the SASAC was appointed to be in charge of the problematic state ownership system, then is principal-agent theory the most suitable analytical theory to help us understand China's state ownership system?

As argued in the previous chapter, China is a variant of the developmental state with market characteristics. Hailmann (2008; 2009) and Breslin (2011) both note that China is going through a period of policy experimentation to pursue a gradual economic reform. That is to say, the Chinese government has issued laws and regulations based on experiences of both success and failure gained through local policy experimentation So, China has employed its top-down administrative orders to direct policy experimentation at local level and has adopted the experiences and feedback drawn from this top-down method of policy experimentation to form and improve the policy that will later be issued to the entire country. Thus, it can be argued that policy experimentation and gradual market reform activities require a principal with strong capacity and one that can

build an effective mechanism to supervise, manage and evaluate agent activities. Therefore, the principal-agent theory has been adopted to examine the relations between the principal, the SASAC, and the agent, the CSOEs. The characteristics of asymmetry of information and conflict of interests can be found in all principal-agent relations. If the principal is a rational actor, it will adopt some methods to mitigate these problems through administrative controls and oversight procedures (Moe 1984, 761). The discussion will then move to ex ante and ex post control, as well as to police patrol and fire alarm oversight mechanisms. There are many scholars who have done this before; and discussions of the practice in western contexts are found in the work of McCubbins (1984; 1987; 1989; 1994), Pollack (1997; 2006; 2007), Tallberg (2002; 2006) and Waterman (1998; 2004a; 2004b). This chapter expands the understanding of principal-agent theory into the Chinese context. It also serves as a bridge that links the grand theoretical debate with the empirical chapters in the second half of this thesis.

There are, admittedly, intrinsic problems embedded in rational choice theory. Hay (2004, 46) criticizes the simplistic assumptions that rational choice theorists make based on modeling. The problematic aspect of rational choice is its assumption that any actor's actions are based on the choice of utility maximization in a given institutionalized scenario (Hay and Wincott 1998, 952 and Hay 2011, 66). Furthermore, rational choice theorists fail to acknowledge the complexity and contingency of the political system (Hay 2004, 39). They tend to

focus on the power of choice the actors have, and the seemingly everlasting game of choice, rather than on the power of the state or the power of the structure (Blyth, Helgadottir and Kring 2016, 148 and Smith 2009, 32).

Even given the flaws in rational choice theory, I still think principal-agent theory is the most appropriate one for analyzing how the SASAC supervises CSOEs, for the following reasons. Central SOEs cannot define '*utility maximization*' in this context based on their interests. Instead, the developmental state has its pilot agency, the SASAC, to visualize the goals that both the principal and the agent should have. That is to say, according to the macro plan driven by the developmental state model, the pilot agency is appointed, to be precise, to limit the scope of '*utility maximization*'. Moreover, as argued in the previous chapter about state strategy in governing through the market, principal-agent theory here allows me to explore how the SASAC could use market and, most importantly, market indicators as a tool to promote the growth of central SOEs.

While the existing literature rarely adopts the principal-agent theory in discussing China, Chen (2016, 89-102) uses the principal-agent theory in the study of central-local relations in the making and implementation of renewable energy policy in China. He uses the principal-agent lens to argue against the notion of decartelization and fragmentation of China's governance system. His research context – that of governing renewable energy in China – can also be explained by the above understanding of having central government establish a goal to

‘visualize’ the concept of the undefined and sometimes ambiguous assumptions of ‘utility maximization’. This chapter argues strongly against Jones and Zou (2017, 7) who believe that “*there is no single ‘principal’ with a clear goal that could be imposed upon SOEs*”. In fact, they fail to examine the various roles the SASAC plays and the powerful status it has in the management of central SOEs. Besides, there is no causal relationship between central SOEs’ overseas expansion in pursuit of market interests and the SASAC’s diminishing power to control and supervise them. This point will be analyzed further in the following chapters.

This chapter consists of four main sections. It starts with a theoretical literature review of publications on the analytical theory of this thesis—the principal-agent theory, its origins, assumptions and debates. From the second part onwards, the discussion moves to the detailed analysis of the oversight mechanism under the circumstances of conflict goals and asymmetric information between the principal and the agent. This is followed by an analysis of the two oversight mechanisms that are discussed here—police patrol oversight and fire alarm oversight. In the fourth part, *ex ante* and *ex post* supervision mechanisms will be addressed, as well as the incentives and constraints agents to have to follow their principal’s line. The debate on principal-agent theory will be blended with extensive empirical evidence that includes the application of principal-agent theory to the Chinese central state’s management of central SOEs. Administrative procedures (*ex ante*), like laws and government regulations, and oversight mechanisms (*ex*

*post*) will be addressed. The argument is that the SASAC is the primary principal in the supervision system, but other institutions that conduct surveillance activities should not be underestimated. There is the Ministry of Finance (MoF), which has final control over finance-related activities, and the Organisation Department of the CCP, which is the most important character in the CCP nomenklatura system. Besides these, there is the significant role that the Central Commission for Discipline Inspection (CCDI) has played since Xi Jinping took office, as well as the rising importance of the National Audit Office (NAO). It is worth noting that although significant, these ministries and institutions should not be defined as multi-principals of the agent (CSOEs). The chapter also discusses, most importantly, the market's role in assisting the state (principal) to supervise its central SOEs (agent) effectively.

This chapter provides a novel understanding of the mechanisms of principal-agent theory. As discussed in the previous chapter, the management of central state assets has followed a developmental state model. The crucial feature that drives the developmental state from rags to riches is its highly efficient institutions. The principal-agent theory in political science was further developed with rational choice institutionalism. Rational choice institutionalism is part of a new institutionalism set of ideas that takes institutions into account in the understanding of political activities. Hay (2002, 11) suggests that the key contribution new institutionalism makes to political science is to “*acknowledge the crucial mediating role of institutions in shaping political conduct and translating*

*political inputs into political outcomes.*" Therefore, this chapter adopts the principal-agent theory to help explain the SASAC's way of promoting the developmental state path for the growth of central SOEs. It seeks to answer the following sub-questions of the thesis:

1. How does the principal (SASAC) regulate its agents (CSOEs)?
2. Which government institutions are involved in the supervision mechanisms?
3. What kinds of oversight mechanism are practiced in the conducting of supervision? Are these mechanisms sufficient?

The following figure shows the basic principal-agent relations of the State Council of the People's Republic of China, the State-owned Assets Supervision and Administration Commission (SASAC) and the 102 central groups. The State Council is the principal, and the SASAC is the agent; the SASAC is the principal, and the central SOE groups are the agents. The principal-agent relations between the State Council (principal) and SASAC (agent) are based on state power, laws and government regulations—the *Law of the People's Republic of China on the State-Owned Assets of Enterprises* [effective] (2009 Order No. 5 of the President of the PRC). In Article 3, it reads, "State-owned assets shall be owned by the state, i.e. owned by the whole people. The State Council shall, on behalf of the state, exercise ownership of state-owned assets." The law further

clarifies the SASAC's authority over state-owned enterprises by describing it as a ministerial-level institution under the direction of the State Council. Here is what it says in Article 11: "*The state-owned assets supervision and administration body, under the State Council.....according to the provisions of the State Council, shall perform the contributor's functions for state-invested enterprises on behalf of, and on the authorization of, the corresponding people's government.*" It can be seen from this clause in the law that the SASAC is one of the State Council's direct operational arms in the management of state assets. Therefore, a possible assumption is that there have not been many principal-agent problems between the State Council and the SASAC, as one is the operational arm of the other. Thus, this thesis focuses on discussion of principal-agent relations between the SASAC and the central SOEs. Figure 3.1. presents the structure of basic principal-agent relations. Detailed figures and analysis of the principal-agent relations between the SASAC and the central SOEs, as well as of other relevant governmental actors, can be found in the following chapter of this thesis.

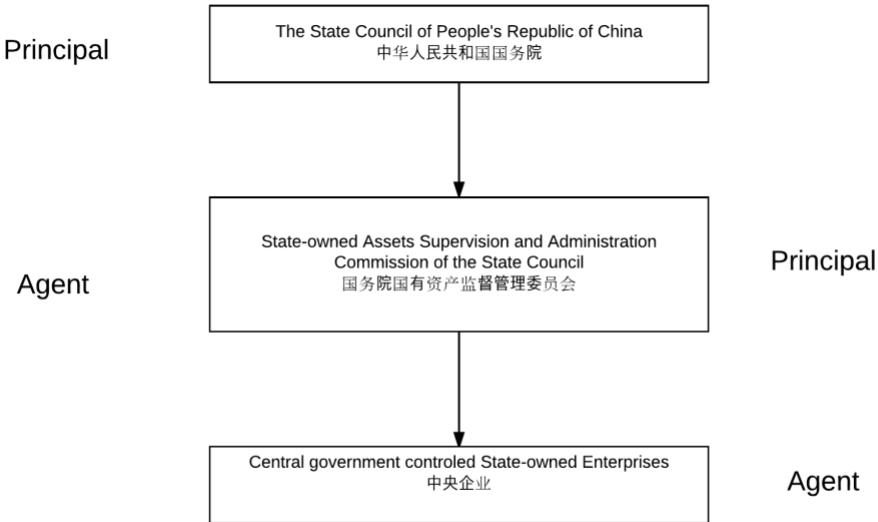


Figure 3.1, Principal-agent relations among the State Council, the SASAC and central SOEs. Drawn up by the author.

This chapter provides three innovation points in the theoretical discussion. First and foremost, China's principal-agent mechanisms build on the checks and balances idea of supervision. The police patrol oversight mechanism is not conducted by a single police team but by many different teams of police. Teams of police regulate its patrol activities, in turn adopting a '*wheel war*' strategy. These rotating wheel wars of supervision not only provide continuous oversight of agents but also unintentionally perform '*cross-check*' supervision among different inspection teams. In the monitoring of central SOEs, the police patrol '*wheel war*' teams include, but are not limited to: 1. An inspection team sent by the SASAC; 2. A central inspection team dispatched by the Central Commission

for Discipline Inspection (CCDI); 3. An accounting team sent by the China National Audit Office (NAO).

The second innovative point is that the police patrol is conducted on a dual track of '*resident on-site*' and '*short-term inspection*' tours. For example, the SASAC sends the Board of Supervisors onto the site of every central SOE's headquarters to serve as a means of police patrol. These Board of Supervisors teams are permanently located in the central SOEs, whose meetings they audit and whose reports they review. The SASAC also dispatch inspection teams to the central SOEs randomly to conduct oversight activities. The inspection teams are sent for regular visits, or because complaint letters sent by a third party as a '*fire alarm*' have been received by the SASAC.

Thirdly, this chapter gives a new interpretation of the CCP's role in the management of state assets. The party is too important to be ignored in the study of contemporary Chinese political economy. It is widely believed that enterprises have the motivation to innovate, whereas the government is stubborn and ossified. If this were true, how could the party not be a negative factor? However, the Party can also be seen as the origin of innovative activities, such as restructuring institutions and improving regulatory activities. In the democratic countries, ruling parties gain legitimacy through elections. However, there is no causal relation between democratic government and good governance (Fukuyama 2013, 350). Teets (2013, 35) proposes a new concept of 'consultative

authoritarianism' to understand China's civil society, and argues that the operationally autonomous civil society does not necessarily act as an indicator of democratization, but can exist inside an authoritarian regime. The Chinese Communist Party legitimizes its rule from sources other than democratic elections. Moreover, the party has evolved over time to provide good governance, so as to continue economic growth and thus enhance its legitimacy. The oversight mechanisms of the principal-agent theory fit with discussion of the institutional setting of the Communist Party. The central SOEs used to have two people, each taking a separate role: one was the '*president of the company*', and the other was the '*party secretary*'. The SASAC (2017) issued a new regulatory call for the top leader of each central SOE to have a dual position in the company's system, taking both the top role of the party secretary and the other top role of president or chief executive in the company's business operation system. This clarification not only improves the company's corporate governance structure but also provides a solution to avoid the problem in principal-agent relations where the president and the party secretary blame each other for any misconduct of the business. The SASAC's (2017) official discourse of "*uphold party leadership, strengthen party construction*" [In Chinese: 坚持党的领导, 加强党的建设] can be interpreted as a method of clarifying responsibilities and enhancing the principal's oversight capacity.

The three principal-agent mechanisms mentioned above are unique to China's central state assets management system. This chapter offers only limited

discussion of principal-agent relations and supervisory relations among the various institutions and central SOEs. In the chapter that follows, a more detailed specific analysis of the SASAC will be presented, dealing with its institutional settings, historical background and the variety of roles it plays in managing, promoting and supervising the central SOEs.

### **3.2. Theoretical Literature Review**

This section aims to provide a comprehensive review of the literature on the principal-agent theory, its origins, development and debates.

#### *What is the principal-agent theory? Definition:*

The principal-agent theory studies the relationship between the principal and the agent with the assumption that each has different goals and preferences (Pollack 2007, 3). The principal-agent relationship has two major characteristics, which are: a conflict of goals, and an information asymmetry, between the principal and the agent. In the principal-agent relationship, the agent has the advantage of more expertise and discretion (Waterman et al. 2004, 66). In this situation, if there is also a conflict of goals between the agent and the principal, a typical principal-agent model presents itself. The information asymmetry and the conflict

of goals certainly create issues in the hierarchy of control, since what is optimal for the principal may not suit the interests of the agent. Meanwhile, the principal is unable to gain full sight of the agent's activities (Moe 1984, 757 and Tallberg 2006, 200). Therefore, there occurs a problem of how to create similar goals so as to incentivize the agent to follow the principal's preferences. The principal-agent theory also suggests that both the principal and the agent are rational actors who seek to maximize their own interests (Waterman and Meier 2004, 20). When the principal delegates power to its agent, it can use various administrative and oversight mechanisms to limit the behavior of its agent. The principal's control mechanisms aim to minimize the ability of the agent to sidestep the principal's goal (Pollack 1997, 108). However, every agent has a certain level of autonomy, since control mechanisms are costly (Tallberg 2006, 201). This degree of discretion allows the agent to be more efficient in the business operation and the decision-making processes. Chen (2016, 92) applies the principal-agent theory in the study of China's central-local relations. His contribution lies in his explanation, using principal-agent theory, of how the central level National Development and Reform Commission (NDRC) supervises its local agent—the provincial level NDRC. Principal-agent theory in this thesis is applied to relations between the government and its central SOEs, which straddle the boundary between the political system and the market.

The application of principal-agent theory in the study of political science:

The principal-agent model was originally generated from the study of economics and management. To begin with, principal-agent relations were discussed in the business environment. In the business context, the manager is the principal, and the employee is the agent. An employee (agent) is presumed to be lazy, passive and always trying to minimize the effort the work requires. The manager (principal) needs to motivate the employee (agent) to work. This theory was later applied in political science, to examine the relations between politicians and bureaucrats. Built on the principal-agent model implemented in the business context, the theory assumes that bureaucrats also are passive and calculating people who try to avoid work. Cook and Wood (1989, 971) point out the shortcomings of this principal-agent assumption. They argue that when principal-agent relations are the subject of bureaucratic policies, they are not the same as in a business context.

According to Kassim and Menon (2003, 122), the application of ‘the new economics of organization’ has had a significant impact in political science research, in particular, when related to rational choice institutionalism. The ‘new economics of organization’ proposed by Moe (1984) provided the toolkit that applied economic thinking to the understanding of institutional activities. This is useful in the study both of how institutions emerge and evolve, and how they interact with each other. Also the new economics of organization contributes to

the study of ‘rent-seeking’ and the transactions that processes bring to institutional operations and development. Hall and Taylor (1996, 10) also noted the impact the “new economics of organization” had on the development of rational choice institutionalism.

The principal-agent theory in political science was further developed with the inclusion of rational choice institutionalism. Under the assumption that actors are all rational actors, rational choice institutionalism is seen as the best way of identifying the interests and motivations of these rational actors within structured institutional settings. Colin Hay (2002, 13) defines rational choice institutionalism as a highly influential hybrid theoretical model that examines “*the extent to which institutions might provide solutions to collective action problems and, more generally, the institutional context-dependence of rationality.*” As a ‘deductive’ theory, it can help users to understand the reasons behind actors’ actions and the likely outcome the actions may lead to within a given institutional incentive structure (Schmidt 2006, 102), as shown by the application of rational choice theory in the study of American congressional behavior. Rational choice institutionalism was developed to aid understanding of US congressional behaviors in the 1970s, and it “*reintroduces institutional factors into formal models of majority voting in the US Congress*” (Pollack 2006, 33). Rational choice institutionalism later became a handy toolkit for the study of political science (Hall and Taylor 1996, 10 and Schmidt 2006, 102). Also, it helps relate the importance of the flow of information to power relations and political

outcomes. Rational choice institutionalism contributes to the study of politics in addressing the most central but often neglected feature of policies—the management of uncertainty in political activities (Hall and Taylor 1996, 18).

The principal-agent model consists of two assumptions: there is goal conflict between the principal and the agent; and there is an asymmetry of information between the two in which the agent has information advantages over the principal (Waterman and Meier 1998, 173). The principal-agent framework can be widely seen at work in studies of: decision-making by the European Commission (Kassim and Menon 2003); American Congressional politics (McCubbins, Noll and Weingast 1987); politician-bureaucrat relations (Waterman and Meier 1998; 2004); and EU member states' implementation of EU law (Jensen 2007, 452). It can also be seen in an analysis of national legislative-executive relations in the making of foreign affairs (Raunio and Wagner 2017). It is believed that the principal-agent theory raises awareness of institutional interdependence in the study of political science.

*The application of principal-agent theory in the analysis of China's management of central SOEs:*

As argued in the previous chapter, China's economic governance strategy towards central SOEs follows a developmental state path that partly adopts market as a tool. The key to China's success in transforming central SOE groups

and making them competitive in the global market is the institution. It is a widely held view that SOEs are “*inefficient, immense bureaucracies—generally beds of corruption and nepotism*” (Deng 2015, 3). Musacchio, Pineda and Garcia (2015, 6) examined state-owned enterprises in Latin America and they attribute the problems they found to two areas—corporate governance and fiscal management. They call for bureaucracies to conduct sufficient oversight of SOEs and clarify the regulations on transfer of funds from government budget to SOEs. How can China’s central state-owned enterprises became successful while SOEs in other developing countries fail, since “*the principal-agent model is often presented (or at least empirically tested) as a top-down political model*” (Waterman, Rouse, Wright and Meier 2004 , 94).

Waterman and Meier (1998, 174) note that “*Principals seek to manipulate and mould the behavior of agents so that they will act in a manner consistent with the principals’ preferences.*” They also point out the differences between the application of the principal-agent model in the field of economics and the application of the model in the field of institutional or regulatory activity. China’s central state assets management blurs the border between the political and the economic, with the principal (SASAC) being located in the political, bureaucratic system, while the agent (central SOEs) is in the competitive market or quasi-oligopolistic market field. The principal-agent relationship between the SASAC and central SOEs should be understood in both political and economic terms. In theory, the principal and the agent clearly have different goals and preferences in

the marketplace, where the principal wants to minimize its service, but the agent wants to maximize its profit, as Waterman and Meier (1998, 185) indicate. However, in the bureaucratic setting, principal and agent may not have goal conflicts over policymaking processes and implementation. It is clear to see that the SASAC (principal) and central SOEs (agent) have similar goals, one of which they agree is the maximization of the central SOEs' profitability. These similar goals have been set by the pilot-agent – the SASAC – under a developmental state plan for making the central SOEs “bigger, stronger and better”. However, at the same time, they have goal conflicts over other issues. For example, the SASAC's (the principal's) priority goal is to prevent a drain on state assets, which means detailed all-round oversight mechanisms and low tolerance of corruption or violating state policies. Central SOEs (the agent), on the other hand, aim for more managerial autonomy and freedom in decision-making in the marketplace. So, after all, goal conflicts exist; but they may not exist equally between principal and agent (Waterman and Meier 2004, 22 and Waterman et al. 2004, 81).

### *From multi-principals to a single principal*

As noted in the earlier section, this chapter limits its discussion to just principal-agent relations, since, in a multi-principal situation, different principals may hold different goals and interests. Also, the principals may fight for a higher degree of influence over the agent. The agent not only faces problems such as a variety of authorization processes, but it also has to choose which principals it should

respond to. The situation may be even more complicated if an agent with an information advantage is able to choose which principal to ally with. Besides, the agent has incentives to respond to different principals in a variety of ways and means (Moe 1987; Waterman and Meier 1998, 181; Waterman and Meier 2004, 35 and Mitnick 1986 in Waterman and Meier 1998, 179; Waterman et al. 2004, 110). The establishment of the SASAC was aimed at solving the multi-principal problem mentioned above, so that the system could rule out any other externalities. The SASAC's establishment was a milestone, and from that time on, the managements of central SOEs have followed a process of “from nine dragons rule to one dragon governs” 从九龙治水到九龙归一 ( BJSASAC/02/2015). This has clarified and simplified principal-agent relations in the management of central state-owned assets and defined the principal-agent relationship between the SASAC and central SOEs.

Obviously, central SOEs have more resources than, and information advantages over, their principal, the SASAC, particularly regarding professional-related issues. This is where a greater level of expertise in the agent occurs, and thus makes the principal hard to control (Waterman et al. 2004,65). This situation has left the SASAC in a dilemma. If the SASAC draws in other ministries to conduct principal-agent supervision of its agents, those other ministries will have a say in the central SOEs' business. The SASAC then will have to face the risk of going back to a multi-principal situation. The SASAC is in a dilemma and struggles to position itself as the only principal in the central state assets management

system. In the case of multi-principal systems, the agent will choose to team up with the most influential principal – the one that can best represent its interests (Waterman 2004, 81). Also, competition among principals may increase the agent's ability and willingness to use asymmetric information to its own advantage (Miller 2005, 211). The post-2003 principal-agent structure has achieved a single principal (the SASAC) and a single agent (the central SOEs). The research fieldwork interviews support the argument that the central SOEs see the SASAC as the most important institution (the principal) that they should respond to. As for the central SOEs, for them, other government institutions, such as the CCDI, the MOF, and the NAO, are supervisors rather than the actual principal.

### **3.3. The dual importance of ex ante and ex post mechanisms**

This section starts with a discussion of the information asymmetry and the goal conflict between the principal and the agent that set the terms of the principal-agent relationship. It then focuses on an analysis of the ex ante and ex post mechanisms that the principal adopts in regulating the agent. For the ex ante analysis, an analysis of 195 SASAC-issued departmental regulations was done to discover what aspect of the central SOEs' operations matters the most. As for the ex post mechanisms, it examines the supervision role carried out by the state

— the SASAC, other central government ministries, and, most interestingly, the market—stock market listing and other market mechanisms.

In order to gain an overview of an agent's activities, *ex-ante* should be introduced as an instrument to define those activities and the decision-making procedures the agent must follow. *Ex-ante* control is usually presented in the form of administrative proceedings (Pollack 1997,108; Kassim and Menon 2003, 124), while an *ex-post* mechanism usually consists of two supervision methods. One is the principal's oversight mechanism, which is used to monitor the agent's behavior in pursuit of a more symmetric information. Apart from the principal's efforts to rebalance any information asymmetry through surveillance, through which the level of agency transparency is increased, another method of *ex-post* control is the imposition of sanctions. As the other central element of oversight strategy, as described by Tallberg (2002, 612), sanctions work as a disincentive by raising the cost of non-compliance for the agent, so that the problem of evasive action by the agent can be improved accordingly.

The principal has the legislative or regulatory power to issue control measures to avoid loss by the agent. The principal's sanctions can include budgetary restrictions, personnel control, exercising the power of veto over the agent's decisions, and so forth (Pollack 1997; Elgie 2002, 189; Tallberg 2006, 200). In practice, the SASAC has issued the Interim Measures for the Liabilities of Central Enterprises for Asset Losses (SASAC 2008 Order No.20), which give detailed

explanations of the various sanction methods against staff whose misconduct has caused the loss of state assets. McCubbins et al. (1989, 481) believe that ex-ante control is generally more efficient than ex-post supervision. Bureaucrats' behavior can be controlled if a procedure is introduced to limit the decision-making process. The ex-post legislative solution, however, is seen as burdensome and inefficient.

Incompetence by the principal in the observation of its agent may cause adverse selection before the contractual relationship has settled, and moral hazard as an ex-post situation after the contractual relationship has settled. Accordingly, "*Moral hazard and adverse selection are general problems whose potential is inherent in all contracting and hierarchical relationships*" (Moe 1984, 754). Moral hazard, in particular, takes a central position in the discussion in the study of political science. The two primary issues that may cause moral hazard are evasive action by the agent and a failure by the agent to deliver which is institutionally induced (Elgie 2002, 188 and McCubbins and Page 1987: 411 in Elgie 2002, 188). The adverse selection problem is associated with hidden information, and the moral hazard problem is related to unseen actions (Shepsle 2006, 29). Adverse selection is caused by asymmetric information before the contract (delegation) has been accepted, which is ex-ante hidden information. As for moral hazard, if the information asymmetry occurs after the contract has been approved, this is ex-post hidden information (Laffont and Martimort 2001, 15-16). According to Pollack (1997, 108), the principal's information deficiency needs to

be made up through all necessary means. Otherwise, the principal will be in a disadvantageous position, which may lead to massive loss by the agent. From the agent's perspective, the bureaucrat's inadequacy in resource allocation, and bureaucratic inefficiency, provide opportunities for the agent to take advantage of bureaucratic inefficiency through its expertise (Waterman et al. 2004, 75).

As noted above, the agent has an information advantage over its principal; so now the discussion moves to the central concern of the principal-agent theory: how can the principal best incentivize its agent to perform according to its preferences? The importance of incentives should not be underestimated: they play a vital role in bringing about an adequate *ex-ante* mechanism. McCubbins, Noll and Weingast (1987, 244) state that "*The best available solution typically consists of a method for altering the incentives of the agent.*" The '*incentive*' should be considered in formulating both *ex-ante* and *ex-post* mechanisms. The agent may not behave in the way its principal would prefer unless proper incentives are given to it, so that it is crucial for the principal to design an effective incentive structure (Moe, 1984, 756).

Gailmard (2014, 92) also comments on the importance of incentives in principal-agent relations, and he looks at the incentive compatibility at the heart of both the moral hazard and adverse selection problems. "*Economic relationships in which one party (the principal) wishes to affect the actions of another (the agent) by means of incentives are ubiquitous*" (Dixit 2002,697). Also, on the overall

structure of how to make the incentive mechanism work, it is worth noting that, in the research on the principal-agent theory, discussions focus not on the authority the principal has but on the incentive the principal imposes on the agents. The principal can reduce agency problems by imposing proper incentives that suit the agent's interests, although moral hazard may limit the principal's capacity to control the situation (Miller 2005, 204). Moe (1984, 756) lists an effective incentive structure, a well-structured oversight system, and mechanisms for encouraging the agent to reveal more information as being the three major solutions to the problems of the principal-agent model.

When the *ex-ante* mechanism is presented in the form of administrative procedures, those procedures regulate the agent's activity and define the procedures the agent must follow. They also provide the legal instruments available to the agent (Tallberg 2006, 201; Pollack 1997, 108). Miller (2005, 214) notes McCubbins et al.'s (1987) contribution in moving the principal-agent question from one of "*congressionally imposed incentive*" to one of "*congressionally imposed procedures*". McCubbins et al. argue that Congress controls the bureaucracy through regulating 'procedures', so that the desirable outcome is likely to be achieved. Consequently, it is worth noting the importance of how the principal regulates the agent's procedures in its activities.

*Ex-ante* mechanisms include the law and administrative rules that can regulate central SOEs' behavior and decision-making procedures in the principal-agent

discussion. For instance, the *Law of the PRC on State-owned Assets of Enterprises* (2009), Article 28, decrees that “*The principal persons in charge of a wholly state-owned enterprise, a wholly state-owned company or a company in which the state has a controlling stake shall accept for their the term of office economic accountability audits conducted according to law.*” Also, there are in total five revisions that have been made since 2003 to enable the SASAC to perform an evaluation of the management performance of senior executives of the central SOEs. The *Interim Measures for Assessment of the Operational Performance of Persons in Charge of Central Enterprises* were adjusted and re-issued four times before the final version of *Measures for Assessment of the Operational Performance of Persons in Charge of Central Enterprises* was issued in 2016. The *Interim Measures for Assessment of the Operational Performance of Persons in Charge of Central Enterprises* were first published in 2003, in SASAC Order No.2; they were later revised in 2006, in SASAC Order No.17; a third version was published in 2009, in SASAC Order No.22; and the fourth version was issued in 2012, in SASAC Order No.33. The Final version of the measures came into effect in December 2016. The two main criteria of these evaluation measures are profit and return on assets. The following part of this chapter will analyze in greater detail the administrative regulations issued by the SASAC from 2003 to 2017 April. Figure 3.2 illustrates the percentages assigned to each category of bureau in the SASAC’s policy papers, with the policy papers divided into 10 types covering nine classifications of bureau: property management; financial supervision and performance evaluation; policy and

regulation; Communist party and publicity; planning and development; enterprise remuneration; enterprise reform and enterprise restructuring; discipline supervision and inspection; and general affairs. The tenth category, ‘other’ consists of policies individually issued by bureaus other than the above ones. The graph shows as a percentage the weight each category contributes to the SASAC’s policymaking strategies. This analysis helps us to understand the SASAC’s work focus. It also indicates the magnitude of each of the SASAC’s many functions.

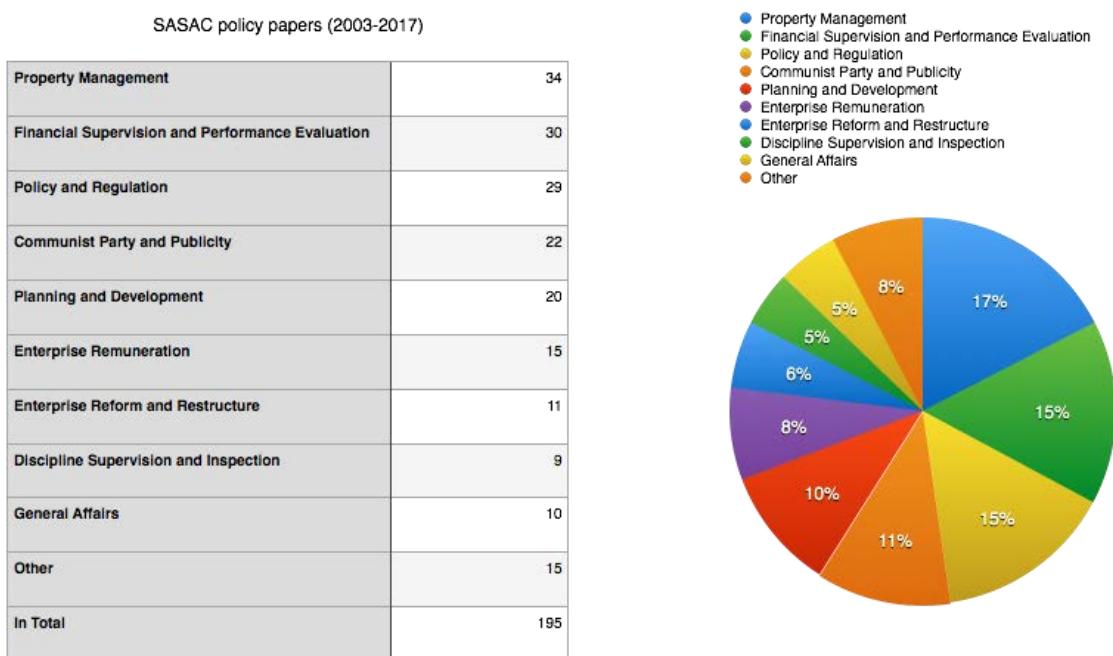


Figure 3.2. Analysis of SASAC Policies (issued 2003-April 2017), organised and classified by the author. Source: policy paper publicity section on the SASAC official website. [online] <http://www.sasac.gov.cn/n85881/n85921/index.html>

The 195 policy papers are divided into ten categories. To begin with, there are 34 policies issued in relation to ‘property management’, which is the largest share of the total number of policies, and represents 17% of the total number. There are 30 policies issued in the ‘financial supervision and performance evaluation’ category and 29 in the ‘policy and regulation’ category, with each contributing 15% of the total number. It can be seen clearly from the pie chart that the three sections add up to 47% of the total number. This indicates that the SASAC’s primary focus is on state assets, financial performance and also on the conducting of regulatory roles. In the *Notice of the State Council on the Establishment of Institutions*, which announced the SASAC’s functions as a ministerial level institution (State Council [2008] No.11), the second clause states that the SASAC is responsible for the value of state assets, supervising the value of the assets through statistical methods. As in the ‘property management’ category, policy papers have mainly related to asset appraisal, the transfer of shares, and dealings on state property. Examples of this are: the Notice on the Supervision of State-owned Property Transfers (SASAC PMB [2005] No.294); the Notice on Strengthening the Appraisal and Management of SOE Assets (SASAC PMB [2006] No.274); and the Interim Measures for Management Buy-out of State-owned Property (SASAC PMB [2005] No.78).

Moving on to the ‘financial supervision and performance evaluation’ section, this accounts for 15% of the total number of policies. The policies in this section are largely about accounting and finance regulations for CSOEs, as well as

evaluation of the operational performance of the enterprises and the persons in charge of them. Examples are the *Interim Measure for the Audit Management of the Economic Liability of Central Enterprises* (SASAC FSEB [2006] No.7) and the series of documents on the assessment of operational performance (both annual and over terms of office) of persons in charge of CSOEs, as noted in the earlier section of this chapter. There are another 29 documents about ‘policy and regulation’ that have been issued by the Bureau of Policies and Regulations, which is in charge of policymaking and revising administrative rules, as well as dealing with issues related to laws on the state asset management system. The ‘Communist party and publicity’ category is in fourth place with 22 policies issued. Apart from policies related to ideological strengthening activities and propaganda, almost half of these policies are about checking whether CSOEs are following correct processes in their business activities, according to regulations, and about working ethics. One such case is the decree on the *Strengthening of Efficiency Supervision for Central Enterprises* (SASAC DC [2004] No.12), which monitors misconduct, non-standard business activities and corruption cases.

Then, there are three categories that consist of: 19 policies issued on planning and development’, 14 on ‘enterprise remuneration’, and 11 on ‘enterprise reform and restructuring’. As for the ‘planning and development’ category, policies are mainly issued on major strategy for the future development of state ownership, as well as to define the main businesses of each central SOE. For example, there is a series of policies announcing the main business of each central SOE—

SASAC Planning and Development Bureau (2005 No.251); (2006 No.49); (2006 No.126) (2007 No.40) and (2007 No.90). The category of ‘enterprise remuneration’ has more to do with salary management and shareholding management for central SOE staff. The policies under ‘Enterprise reform and restructuring’ are mainly about the establishment of modern corporate governance, for instance, the *Interim Measure for Establishing the Board of Directors in a Wholly State-owned Company* (SASAC ERB [2004] No.229). There are many policies on experimental projects and SOE shareholding reform as well. An example of these is the *Opinion on Regulating the Shareholding and Investment Activities of SOE staff* (SASAC ERB [2009] No.49) and the *Notice of the Experimental Project on the Dividend Rights Incentive Mechanism in Some CSOEs* (SASAC ERB [2010] No.148). These three categories indicate the SASAC’s role as a pilot agency that follows the developmental state path. There are 5% of policies on ‘discipline supervision and inspection’ and these include policies related to the activities of the Discipline Committee. The ‘general affairs’ and ‘other’ categories include policies issued by other small SASAC bureaus and contribute 13% of the overall policies. Moving on to the study of the core set of SASAC policies, these consist of only 35 policies which were issued between 2003 and 2017 and were labeled ‘SASAC orders’, as seen in Figure 3.3.

Analysis of 35 SASAC Orders (2003-2017)

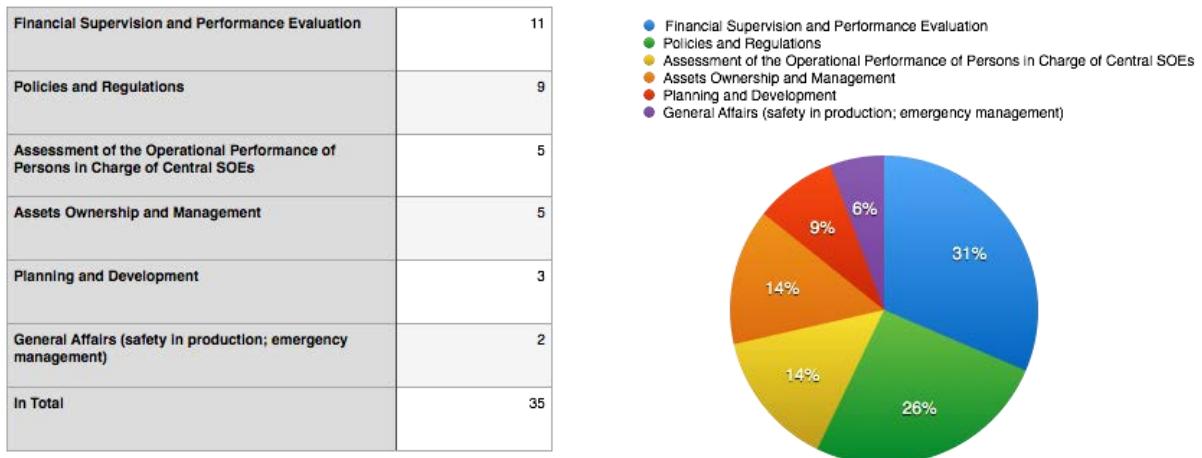


Figure 3.3. Analysis of SASAC Orders (2003-April 2017), organized and classified by the author. Source: policy paper publicity section on the SASAC official website. [online] <http://www.sasac.gov.cn/n85881/n85921/index.html>

Overall, 35 out of the 195 policies are SASAC Orders [in Chinese] “国有资产监督管理委员会令” and these form the core set of policies among all policies issued. There are SASAC Orders only in six categories, with 11 in ‘financial supervision and performance evaluation’, nine in ‘policy and regulation’, five in ‘asset ownership and management’, five in ‘assessment of the operational performance of persons in charge of central SOEs’ (five revisions), three in ‘planning and development’ and two in ‘general affairs’. It can also be seen clearly from figure 3.3 that enterprise operational performance, state assets management, and issuing regulations are at the core of the SASAC’s institutional aim and functions. According to Pollack (1997, 108), “*Such administrative procedures may be more or less restrictive, and they may be altered in response to shirking or slippage,*

*but only at a cost to the flexibility and comprehensiveness of the agent's activities.*" In our exploration of the principal-agent relationship, this shows where the SASAC's *ex-ante* administrative procedures lie. It also shows that the SASAC highlights its function as a principal that employs *ex-post* supervision mechanisms in order to have adequate oversight of its agents' activities and performance.

Thus, the principal puts an effort into making precise *ex-ante* mechanisms to direct the agents to follow the principal's preferences. Miller (2005, 209) offered the idea that "*The threat of ex post sanctions creates ex ante incentives for the bureau to serve a congressional clientele*". However, as McCubbins, Noll and Weingast (1989) argue, in a principal-agent relationship, the principal manipulates the agent to do things that benefit the principal but are costly to the agent. It is impossible for the principal to generate a perfect and costless *ex-ante* to incentivize the agent. In Pollack's (1997, 109) definition, the administrative procedures are the *ex-ante* mechanism, and the oversight procedures are the *ex-post* mechanisms. Due to the information advantage on the agent's side, *ex-post* mechanisms are conducted to help the principal to gain enough insight into agent behavior. The *ex-post* mechanisms include monitoring agents' activities and influencing agent behavior through incentives and sanctions. From the principal's perspective, the oversight mechanisms work best if they are very detailed and intensive, but costless, so that any agency loss can be minimized.

### **3.4. Oversight Mechanism: Police Patrol and Fire Alarm**

The above section discussed the *ex ante* administrative mechanisms in the principal-agent relationship. That is to say, the SASAC as the principal seizes the initiative in the making of *ex-ante* regulations. The discussion here reaches the analysis of *ex-post* mechanisms, which require the principal to be more flexible and adaptable to CSOE activities. This is because the CSOEs are market actors and the marketplace is unpredictable. The principal-agent theory was initially generated in the study of economics and management, and was then adopted as a variant of rational choice institutionalism in its application to political science (Elgie 2002, 187). The principal-agent analysis of this research crosses the blurred line between state and the market, with the principal being the government institution while the agents are market actors. We now turn to the study of the oversight mechanism. Since information asymmetry and goal conflicts exist perpetually between the principal and the agent (Tallberg 2006, 199), the problem is not whether the principal should watch its agent or not. Rather, it lies in the degree of effort devoted to the *ex-post* monitoring of agency behavior and decisions (Bawn 1997, 105). The oversight procedures consist of ‘institutional mechanisms’ for monitoring agency behavior and impose potential sanctions for the agent’s non-compliance (Tallberg 2006, 201). This section now reaches the examination of the two *ex-post* oversight mechanisms: police patrol oversight and fire alarm oversight. It contributes to the understanding of how a government institution conducts sufficient oversight of market actors.

Police patrol oversight is the mechanisms where the principal is directly engaging in detailed, long-term monitoring activities. It can be seen as a centralized method that is expensive and time-consuming for the principal. At the same time, police patrol oversight allows the principal to keep a direct and continuous watch for the hidden message. It is an effective way for the principal to track the agent's actions and procedures. Whereas, the fire alarm mechanism relies on third parties to raise the alarm about agents' misconduct, having taken on the monitoring role based on their interests. It is an indirect way of surveillance and relatively more passive. (McCubbins and Schwartz 1984, 176; Lupia and McCubbins 1994, 97; McCubbins, Noll and Weingast 1987, 244; McCubbins et al. 1987, 244; Kassim and Menon 2003, 124)

Fire-alarm oversight as a decentralized and incentive-based oversight mechanism is much more efficient and less costly than police patrol oversight (McCubbins and Schwartz 1984, 176). The authors further extend the argument to suggest that police patrol oversight is time-consuming, and the principal is only able to cover a very limited sample of subjects. Fire-alarm oversight, on the other hand, may be costly, but at a third party's expense (McCubbins and Schwartz 1984, 168). However, this third party, which shares the principal's costs for supervision mechanisms, may sometimes raise false alarms (Lupia and McCubbins (1994, 97). Bawn (1997, 104) provides a different point of view and argues that fire-alarm oversight does not mean less work needing to be done by

the principal. The principal should also get involved in the fire alarm oversight mechanism, rather than stay outside and wait for the fire alarm to ring. This section illustrates how the Chinese government uses different supervisory institutions to enforce both processes – fire-alarm oversight mechanisms and police patrol oversight mechanisms – in the management of state assets. However, over-reliance on fire alarm mechanisms may cause bias in the principal's decisions taken in relation to those of the agent, and this may not provide an ideal policy outcome. As Hopenhayn and Lohmann (1996, 209) argue in an analysis of political representatives of society as the principal and regulatory agencies as the agent, "*asymmetric fire-alarm signals give rise to asymmetric political control rules that introduce a bias into political decision-making.*"

Oversight mechanisms can be classified into three broad categories. The first type is supervisory teams sent out by the SASAC which include, 1. Members of the Board of Supervisors sent by the SASAC to work in the central SOE headquarters to conduct long-term supervision, and 2. inspection teams dispatched by the SASAC, which occasionally appear as a supervision mechanism. The second category is supervisory teams sent by other central government institutions. This category includes 3. the Central Inspection Team “中央巡视组”, randomly dispatched the Central Commission for Discipline Inspection (CCDI), and 4. an audit team dispatched by the National Audit Office (NAO) to conduct random auditing inspections. The third category involves two

ministries, which are: 5. the Ministry of Finance, which regularly examines accounts, asking the agent (central SOEs) to revise its financial reports, and also evaluates the central SOEs' financial performance and profitability every year, and 6. the Organization Department of the Communist Party of China, which has the ultimate appointment authority for the central SOEs' senior executives. The two ministries in the third category do not directly impose police patrol or fire alarm mechanisms; but their outcome-based control also contributes to supervision efficiency. As Cook and Wood (1989, 974) suggest, "*Principal-agent theory embodies a behavioral perspective that posits explicit stimulus-response relationships.*" When the principal changes its political conduct, status, budgetary distribution or oversight mechanisms, it is very likely that the agent will alter its behavior in the principal-agent relationship as well. It is also possible that the agent will respond to different supervision mechanisms in different ways. All in all, the fundamental point is "all methods of agency control imply costs to the principal and cost trade-off against the benefits from limiting non-compliance" (MaCubbins et al. 1987, 1989) (Kassim and Menon 2003, 124).

### The Board of Supervisors

In order to avoid 'insider control' and potential conflict, members of the Board of Supervisors are chosen by the SASAC. According to the *Law of the PRC on State-owned Assets of Enterprises [Effective]* (2009), also noted in Article 25 "*No director or senior manager shall concurrently serve as a supervisor.*" The SASAC

improved its institutional settings to effectuate the supervision mechanism better. In 2017, there are three newly created supervisory bureaus, enhancing and coordinating supervisory work with the Board of Supervisors. The supervisory board members dispatched to central SOEs are continuously intensifying their supervisory activities on current projects, and providing reports on individual issues that are submitted immediately. In the year 2016, the SASAC submitted 26 reports on supervisory acts to the State Council. The SASAC has also issued, in total, 163 supervision reports, revision notices and reminder letters to the central SOEs (SASAC 2017, 10). However, Wang, Qi and Cao (2013, 70) provide a different understanding of the efficiency of the Supervisory Board. They argue that the external nature of the Board of Supervisors and the potential sanctions it can impose and the negative reports it can send to the SASAC limit its efficiency in oversight activities. An enterprise's board of directors and managerial team can easily form an internal alliance to resist oversight from the Board of supervisors.

*Central inspection teams from the Central Commission for Discipline Inspection (CCDI)*

The Central Commission for Discipline Inspection (CCDI) has become a prominent figure since Xi Jinping took office in 2012. The central inspection system was built on the Audit Ombudsman System “稽查特派员制度”, which was initiated by the Chinese Premier Zhu Rongji in 1998. Under State Council Order

No.246, audit ombudsmen are sent to carry out oversight activities on behalf of the State Council. The central inspection teams are dispatched by the CCDI to local governments and SOEs to conduct inspections of the work of party leaders and party members. The central inspection teams are not law enforcement officers and they do not handle cases directly: problems discovered are transferred to relevant law-enforcement agencies. The CCDI holds a database of central inspection team leaders. Appointment of team leaders is made randomly and is a one-off appointment. The central inspection teams work in a role that uses the fire alarm approach. Their job content includes “dealing with complaints from the general public through letters, telephone and visits”; “questionnaire distribution and collection” and “peer review evaluation of the institution” (CCDI 2017). The detailed working regulations can be seen in the *Provisions of the Chinese Communist Party Regarding On-site Inspections* (CCDI 2015, No.20) The Discipline Committee has been given supervision strategies of “look back”—in Chinese ‘回头看’ – in their examination of local governments and SOEs. The “look back” strategy means a central inspection team conducts its inspection tour of a local government or SOE for a few months, finishes the tour, and leaves the location. Then, without warning, the inspection team makes an unexpected return to the same place. It aims to spot the corrupt officers who thought they were safe when the inspection team first left.

### The National Audit Office (NAO)

There are in total 17 local offices distributed by the NAO across China, each in charge of one or two provinces (NAO 2017). These offices have many responsibilities, including the auditing of central SOEs' local operational branches' assets, liabilities and profits. These local offices report directly back to the NAO, because China's audit system follows a vertical line of administration. According to the Audit Law of the People's Republic of China, which came into force in 1995 (2006 Amendment), the audit office at local level is responsible to both the audit authority at a higher administrative level and to the local government. Since the central SOEs and their operational companies at local level are directly managed by the SASAC, when an audit office at local level conducts an examination of a central SOEs' financial books, it directly reports to the NAO and the SASAC. Moreover, the staff of the National Audit Office, as technocrats, have taken a greater role in the whole political system of China since 2010. In 2010, the *Audit of the Economic Accountability of Party Cadres and SOE Leaders* was issued as an administration order, thus settling the legal ground for the technocrats to be involved in principal-agent relations.

### Organization Department, Nomenklatura System and Dangzu

The *Regulations on the Selection and Appointment of Leading Cadres of the Party and State (2014 version)* state that the selection and management of

cadres must comply with the principle of “*the Party controlling the cadres* 党管干部原则” (Organization Department 2014). Central SOEs have integrated well into the market, and have adopted a corporate governance structure as the SASAC required. Decision-making rights for the personnel system of central SOEs have mostly been granted to individual central SOEs. The party does not want to lose its political control of these business groups on their way to marketization (Brødsgaard 2012, 640). The Central Organization Department is the institution that officially appoints the senior executives of the 53 vice-ministry-level group companies, leaving the executives of the central SOEs that do not belong to the group of 53 for the SASAC to appoint. However, the SASAC retains the power to evaluate the top-level executives of all these enterprises and will provide feedback on their performances to the Organization Department. The Organization Department is the most mysterious institution in China’s political system. It is the largest human resource center operated by the Chinese government and it selects and appoints party cadres. A nomenklatura system established the party’s leadership in China and this is as important in contemporary politics as it was previously, having been consolidated in the post-Tiananmen regime. This research confirms Brødsgaard’s (2010, 28) view that, by bringing the largest SOEs under direct party control through the Organization Department, the state indicated the privileged status of these companies and their CEOs. Brødsgaard uses the term “*integrated fragmentation*” to describe “*the contradictory forces of increasing enterprise autonomy and continued central control that characterise the evolving relationship between business groups and*

*the party-state*" (Brødsgaard 2017, 39). He points out that through the nomenklatura system, the party controls the appointment and promotion of the heads of most SASAC companies. The rotation system allows the transfer of a CEO to another post in a different SOE or to be a senior government officer (Brødsgaard 2017, 52). However, whilst these opportunities have often been given to CEOs in the 53 central SOEs in the strategic sectors, other central SOEs operating in the free market do not have the same importance for the party [and their CEOs do not have the same opportunities].

However, the party's role should not be exaggerated and is often misinterpreted. Discussion on the party's role and the nomenklatura system in the central SOEs tends to neglect an important fact: that is, the state, in promoting managerial autonomy and encouraging central SOEs to be more efficient and productive, aims to re-strengthen state power. Chan (2004, 704) sees the nomenklatura as a key, secretive instrument of the CCP's control of the personnel system in SOEs, which is about using both political and market tools to clear up rent-seeking bureaucracies. It reflects the evolving characteristics of the party-state and shows the party-state's contradictory desire for having "*economic modernization through marketization in combination with continued political control*". Each central SOE has a CCP party committee--the Party Group (党组, *Dangzu* or 党委, *Dangwei*), but the definition of the *dangzu*'s role and function remains vague. Moreover, the party's control over the appointment of SOE executives does not mean that the party can exercise direct control over the decisions, strategies and

operations of these SOEs (Xu 2017, 102). This is important because the boards of directors of SOEs consist of external directors and independent directors, some of whom are professional accountants and lawyers from overseas. Thus, the board members' decisions should not be directly interpreted as the party's will. Further, it is a myth that the executives of SOEs are loyal party members and have to show their loyalty to the party over time. In fact, market indicators are the decisive factors in evaluating these executives' performances. The party's evaluation of these executives in fact reflects an understanding of governing through the market. Wang (2014, 658) sees SOEs as being under a twin governance structure: legal governance, which has learnt about the corporate management and laws of the Western free market economy; and political governance, which remains the party-state in control. Certainly, the party's importance should not to be underestimated, and it is clear that the party continues to strengthen its position on China's path towards a market economy. The tentacles of the party extend into every nook of business entities. There are 1.855 million enterprises with non-public ownership that the party organization has established, and these account for 67.9% of the total number (Organization Department 2017).

As argued in the previous chapter, the SASAC's economic governance of central SOEs follows a developmental state path for which it has partially adopted market mechanisms. Considering the principal-agent perspective, this research argues that the SASAC adopts market practices to conduct supervision of the

central SOEs. The market serves as an oversight mechanism. McCubbins et al. (1989, 434) note that the fire alarm mechanism transfers the monitoring job of the principal (a political institution/officer) to a third party whose interests may be affected by the agent's behavior. Given that the third party's interests may be affected by the agent's misbehavior, the third party will voluntarily monitor the agent's activities and report any non-compliance to the principal.

The listing of Central SOEs' assets on the stock market abroad and/or in the mainland China can be seen as an effort to further enhance SASAC's supervision power in this principal-agent relations. It has two major implications. The first one is that listing can actually accelerate the establishment of modern corporate governance in a central SOE. The board of directors needs to be organized to comply with the requirements of the China Security Regulatory Commission (CSRC). There must be more external directors than internal directors, which can be seen as a way of dealing with the possibility of 'moral hazard' due to insider control. Also, after listing on the stock market, a company needs to comply with both the SASAC's regulations and the CSRC's regulations. Howson (2015, 50) sees the CSRC's role as to "protect minority shareholders against exploitation by the Party-state controlling shareholders." Deng (2015, 19) also notes the CSRC's role in protecting individual investors. This argument was confirmed in my interview with Ma (2015 Interview Beijing-1 CSCEC). Ma agreed that the CSRC's role was to protect minority shareholders and confirmed that, because the China State Construction Engineering Corporation (SHA 601668) is

a company listed on the Shanghai Stock Exchange, the standard of salaries and bonuses issued to its employees has to follow both the SASAC's regulations and those of the CSRC.

Also, the external directors usually have extensive professional experience and/or have worked as senior executives in other central SOEs, so they have the necessary ability to monitor the company's operations. For example, the China State Construction Engineering Corporation has a specific external director to supervise the financial performance of the company — Mr Ruiming Zhong, who is a Hong-Kong-based professional accountant appointed by the SASAC (CSCEC 2017). It can be argued that the listing of central SOEs has created many different 'third parties' – namely the Security Regulatory Commission, the external directors on the board and, most importantly, the general public who bought shares, and these can raise the alarm if needed.

The second major implication has to do with the listing process itself. The central SOEs' listing company chooses internationally renowned investment banks and accounting firms to start the Initial Public Offering (IPO). For example, the China National Building Material's (HK 3323) initial public offering was managed by Morgan Stanley, and the company's appointed accounting firm was Baker Tilly. Hu (2015 Beijing CNBM-9) introduced the listing process and said that before listing on the Hong Kong Stock Exchange (HKEX), around two years were spent stripping the assets and getting hold of all the official documents required by the

HKEX, which included, but were not limited to, financial reports, tax reports, the land certificate of approval, government permission on production, a letter from the Ministry of Environmental Protection and a letter from the State Administration of Work Safety. The asset stripping before listing can be seen as a sorting process that pick out high-performing productive assets from the giant heritage of the planned economy. This change has certainly improved the institutional setting of the central SOEs and made their listing company work as a company in the real sense. The SASAC's emphasis on managerial performance and profitability has made '*how to improve the company's core competence*' [in Chinese: 如何提高核心竞争力] become the central SOEs' most troubling problem (SASAC 2017a). However, Qi and Wang's (2016) research shows a non-listed central SOE is like a 'black box': that is, it has seriously low transparency, and it is likely to have shown no significant improvement since 2012. Deng and Chen (2010) note the positive impact of the comprehensive listing of central SOEs, especially cross-listing in both the A share and H share markets. The SASAC's first director, Mr. Rongrong Li (2004 and 2006), clearly points out two reasons to explain the SASAC's motivation in promoting central SOEs' overseas listing. He states that, "the first motivation is to ensure that the central SOEs have a regulated shareholding system, while the second motivation is to encourage the SOEs to have a higher standard of corporate governance structure." The listing process and the impact it has on both the SASAC and central SOEs will be further discussed in the next few chapters. All in all, the SASAC has adopted

various methods to conduct oversight of the central SOEs and has not hesitated to introduce the market to play a crucial role in this oversight mechanism.

### 3.5. Discussion

The Chinese government has always held an ambiguous attitude towards market mechanisms. China's market reform emphasis on liberal competition in the market sees market competition as an effective mechanism for resource allocation and "survival of the fittest". (Li, Brødsgaard and Jacobsen 2010: 302) However, when crises or difficulties occur, the government's hand visibly returns to the market and manipulates the part played by market functions. The state's capacity in policy implementation is at the heart of making developmental state strategy work. Also, the legitimacy of China's Communist Party has partly been built on the country's fast economic growth. The Chinese government realizes that, in order to confirm the legitimacy of the CCP's rule, better governance needs to be delivered and there needs to be clarification of governmental functions. There are principal-agent problems, such as responsibilities overlapping between ministries and central-local policy implementation differences. However, a study conducted by the Development Research Center of the State Council suggests that 70.7% of the enterprises surveyed in China believe that the core area for the next step in economic system reform is the clarification of government-business relations. Problems enterprises face during

business operations include overlapping policies in different governmental departments. Policy contradictions happen among the various ministries as well as between central and local government (DRC Enterprise Research Institute 2013 No.147).

The government's direct control of its agents is considered to have been successful. Heilmann (2007, 18) explains that during the Asian Financial Crisis in 1997, the central government brought dealings with the Shanghai and Shenzhen stock exchanges back from municipal governments to the central government, making them fit in with SOE restructuring and comply with the government's wishes, so as to achieve national industrial policy. Also, the government's direct state control is getting stronger again, as Breslin (2011, 1331) suggests. The incomplete nature of China's economic liberalization allows the state to support strategic industries through the state-owned banks, thus directing the state sector from the "commanding heights" of the national economy. Heilmann (2009, 450) believes that China's political economy has a high adaptive capacity that combines with its "*extensive policy experimentation with long-term policy prioritization*". He suggests that, instead of observational studies or theoretical analysis, China's policy experimentation follows the idea of "*implementation first and then drafting universal laws and regulations later*" (Heilmann 2007, 4). The central government plays a significant role in the so-called policy experimentation process to coordinate and summarize local experiences, and turns the experiences into laws and regulations. It can also be seen in Breslin (2011) that

the reform strategy is nothing like shock therapy: it follows the gradual way of neo-liberal institutions reform.

Having been used across various political contexts in different countries, the principal-agent theory may be applied to understanding relationships in a state ownership system, especially those among central government institutions and state-owned enterprises in China. Previously, SOEs' inefficiency could be attributed to a lack of incentives and the heavy burden of providing social welfare in the pre-reform era (Li and Brødsgaard 2014). The establishment of the SASAC constituted a most important change in the dynamics of state and market interaction. Some claim that the SASAC is a puppet institution that does not wield real power and that the central SOEs, maintain autonomy in decision making and profit distribution, and are free to make managerial decisions whenever needed. Some believe that the SOEs are more likely to take political orders as their priority, rather than promoting their economic interests. Others believe that the enterprises are rational actors that will act to maximize their interests. How does the principal set up and use regulations and procedures to help agents share their goals with them? "*Through the design of careful selection procedures, principals may succeed in hiring agents who share and so naturally pursue their interests.*" Because it may be uneconomical to solve problems in the principal-agent relationship (Hindmoor 2006b, 135), it is the principal that needs to align the agent's self-interest with its own interests to minimize agency costs (Miller2005, 204).

As Hindmoor (2006a, 87) notes, state intervention creates both economic winners and losers, regardless of which one of the hundreds of forms it takes. When the state's intervention fails, rent-seeking activities occur, causing damage to the economy, because state intervention distorts the market mechanism, so competition is reduced and prices increase. Also, the resources invested in gaining support from the state cannot be converted into resources that bring benefit to consumers. Some scholars argue that the autonomy granted to central SOEs has generated a business interest group. Brødsgaard (2012, 630) describes central SOEs as 'small kingdoms', and argues that "*Rent-seeking takes place when firms or interest groups try to extract special privileges from government.*" The crackdown on the "petroleum gang" in Xi Jinping's anti-corruption campaign triggered a discussion of rent-seeking behavior in state-owned enterprises. Brødsgaard (2012) suggests that the SASAC may have only limited power in the supervision of central SOEs, arguing that the SASAC does not withhold dividends from the SOEs and does not have the power to appoint the senior executives of large companies. However, the increasing degree of control in principal-agent relations between the SASAC and the central SOEs limits the autonomy of the central SOEs regarding business activities and political freedom.

The Central SOEs cannot simply be defined as rent-seeking, because the definition of rent-seeking relies on enterprises' motivation in gaining privileges by

lobbying the government. According to Hindmoor (2006a, 87), rent seeking is “*the investment of resources by firms and pressure groups in the expectation of securing economic privileges*”. Hindmoor (2006) further argues that rent-seeking is damaging the country’s economy, because any forms of state intervention bring unfair competition and also break the normal operation of the market mechanism. Besides, the resources that enterprises invest in gaining support and privileges from the state cannot be used to benefit consumers in other ways. However, it is inaccurate to draw the conclusion that central SOEs have massive privileges, which are granted and protected by the SASAC. This argument will be further extended in the empirical chapters. On the contrary, central SOEs are under close supervision by the SASAC, as demonstrated in the analysis of both *ex-ante* administrative rules and *ex-post* oversight mechanisms in the earlier sections. Besides, as argued in the above section, the central government frequently modifies the measurement in supervision; and assessment of enterprises’ performance can be seen as the most significant character of the principal-agent relationship.

### **3.6 Conclusion:**

This chapter has focused on the analytical theory of this thesis—the principal-agent theory. It began with a theoretical literature review of the evolving process of principal-agent relations. It then moved the discussion to the principal-agent problems that have continuously occurred in the SASAC’s and central SOEs’ relations. The principal-agent theory is built on the assumption that the agent is

likely to avoid its responsibilities. This suggests that the agent is likely to take evasive action, even when no policy disagreement exists. Also, the agent is liable to produce products that are of a lower standard than the principal wants, or to set the production price higher than necessary (Waterman and Meier 1998, 176; Waterman and Meier 2004, 21). In order to direct the agent to follow the principal's preferences, the principal sets up various mechanisms to monitor the agent's activities. The oversight mechanisms include police patrol oversight, which directly monitors the agent's activities, as well as fire alarm oversight, which views the agent's behavior through complaints from a third party. The principal also offers incentives and sanctions to alter the agent's motivation through ex ante and ex post mechanisms.

China's administrative system of central SOEs is structured as a chain of principal-agent relations. The Chinese people are the principal; the State Council is the agent; the State Council is the principal; the SASAC is its newly established agent; the SASAC is the principal; the central SOEs are their agents. The first two principal-agent relationships are based on legal decrees and state power. The latter one is different, and builds on a de facto 'contract': that is, the SASAC grants state assets to be managed by SOE employees. Here, the position and bonuses of employees, namely the executives and managers, will be greatly affected by company performance. Eisenhardt (1989, 60) also addresses the fact that the principal-agent literature focuses discussion on the principal's and the agent's optimal contract, agency behavior and the outcome.

After all, “*the principal-agent model became the dominant framework for examining the difficulties that arise from contracting in any setting*” (Kassim and Menon 2003, 122). Its central focus is the process of the principal structuring incentives for its agents (Gailmard 2014, 91). Apart from the principal’s efforts to create incentives for its agents to follow the principal’s will, what weighs more is the supervision mechanisms.

As argued in the earlier sections, police patrol oversight mechanisms are expensive and time-consuming. It is also very costly for the Chinese government, which even sends inspection teams to the local area to look for fire alarm signals. Direct monitoring and sanctions as oversight mechanisms are expensive. The principal’s economic incentives to the agent are also limited, so that they cannot provide a perfect solution for perpetual principal-agent problems (McCubbins et al. 1987, 273). This may possibly be the reason that China’s “wheel war” style police patrol mechanisms function well in the management of central SOEs, but this experience cannot easily be transferred to local SOEs.

The reason behind the Chinese government’s determination to keep a tight hold on central SOEs and make considerable efforts in the oversight mechanisms has legitimacy and ideological concerns as well, although, as Holbig and Gilley (2010, 400) argue regarding economic performance, neither economic growth nor economic decline would directly challenge the legitimacy of the Chinese government. However, economic growth can be portrayed as beneficial to

citizens' wellbeing. Zeng (2014, 622) echoes this argument and notes that Chinese domestic scholars have already realized the difficulties in basing the government's legitimacy to rule on economic growth alone. It can also be seen from the SASAC's official discourse how state-owned enterprises interlock with the wellbeing of the Chinese people. Central SOEs are seen as the pillar industry of the economy, and as directly affecting people's livelihood. The Guideline for Deepening Reforms of State-owned Enterprises (State Council 2015 No.22) defines state-owned enterprises as being owned by the Chinese people, and as the defining force for achieving modernization and protecting people's common interests.

The developmental state is known to have been criticised as "government selecting winners". Certainly, the state's intervention in market activities can be presented in different forms and will create both winners and losers. Government intervention manipulates and disturbs the operation of the invisible hand, which raises questions as to why this industry, and not another industry; why this company, and not another? Moreover, intervention creates rent-seeking activities that involve state supported privileges being located in the wrong place or in a wrong way (Hindmoor 2006a, 87). This chapter examines the principal-agent relationship between the SASAC and the central SOE, as well as the supervisory roles other central government institutions play in monitoring the performance of central SOEs. It contributes to the argument that, given an adequate oversight mechanism, state-owned enterprises can also be competitive in the market. By

selectively use of market tools to develop the Chinese variant of the developmental state, the state maximizes the possibility of having vibrant market competition, while having the capacity to play a leading role in market activities.

The principal-agent theory is the most appropriate to provide an analysis of the relations between the SASAC and central SOEs. It assists the understanding of the developmental state path China has taken in the management of central state assets. It is also helpful in explaining how central SOEs in China have been able to rise while SOEs in other developing countries have failed. The central SOEs' success should not be solely attributed to the market mechanism and the competition it brings. The state's innovative police patrol oversight mechanisms and the incentives and constraints *ex ante* and *ex post* should also be taken into account. However, the principal-agent relations in China's state asset management are not flawless. Kassim and Menon (2003, 125) raise concerns about the effectiveness of delegation. For the principal, the choice is either to conduct close supervision and try to limit the agents' losses, or to allow the agent more autonomy in the hope of obtaining high performance. China's 'wheel war' of police patrol oversight draws in many different government institutions. It is, of course, expensive and time-consuming for the supervisory institutions. It is time-consuming and troublesome for the agent as well. Although the central SOEs have most of their valuable assets listed on the stock exchange, there is a big part of their assets that is hidden from sight at the group level, which is an obscure area. This is particularly a problem with central SOEs in monopolistic

sectors, where only around 50% of their assets are listed, unlike central SOEs in competitive sectors, most of which list more than 90% of their total assets on the stock exchange.

Although the principal-agent theory is a handy toolkit for examining the contractual relationship between the principal and the agent, it also has limitations. Tallberg (2006, 199) sees that principal-agent problems “*exist inherently*”. The principal-agent theory cannot provide a perfect solution for problems with agents and cannot guarantee an agent’s complete compliance with the principal’s order (McCubbins, Noll and Weingast 1987, 244). Miller (2005, 216) similarly argues that the principal-agent theory “*has been structured as a form of ultimate game, and that this provides a clue to the empirical limitations of principal-agency models. I argue that an awareness of credible commitment problems and moral hazard call for paradoxical reformulations of the PAT*”.

The following chapter focuses the discussion on the SASAC as the key institution in the management of state-owned assets. It starts with a literature review of the SASAC’s historical background and an analysis of its internal institutional arrangements. It then moves to an examination of the relations between the SASAC and central SOEs, but not limited to the supervisory relations between them. It argues that there are many different roles the SASAC plays in its interaction with central SOEs. Their interactions are in the manner of ‘competition and cooperation’. The SASAC’s developmental state model of governance has

facilitated the expansion and growth of central state assets. The SASAC as a pilot agency has achieved its primary aim in maintaining and increasing the value of state assets. However, it also seeks to play different roles in the state assets management system. The next chapter studies the multiple roles the SASAC plays as the investor, a supervisor, a policymaker, a buffer area, a peacemaker and, most importantly, a facilitator.

## **Chapter 4 The State-owned Assets Supervision and Administration Commission (SASAC)**

### **4.1. Introduction**

Thus far, the thesis has examined the macro-theoretical debate on whether China is a developmental state, how the market mechanism facilitates the country's path as a differentiated developmental state, and how the analytical principal-agent theory assists the understanding of relations between the State-owned Assets Supervision and Administration Commission (SASAC) and central SOEs. From this chapter on, the discussion moves to empirical studies, which present a vivid picture of how existing theories meet reality in contemporary China. The empirical work for this thesis consists of a study of the fundamental institution in China's state assets management system—the SASAC, and two case studies of central SOEs under SASAC's administration. It explores the under-researched field of centrally controlled SOEs through extensive interviews with policymakers in the State-owned Assets Supervision and Administration Commission in Beijing, with senior managers in the central SOEs' headquarters in Beijing, and with their operational branches in Shanghai and Hangzhou. Triangulating the information from these sources with a review of laws and SASAC-issued policy papers will contribute rich qualitative data to answer the research questions, while providing a new understanding of centrally controlled SOEs in China.

In the previous chapters, the historical development of state ownership and the state's role in the state ownership reform process were examined through the theoretical lens of the developmental state and its seesaw battle with international market influences. Also, the state's efforts in promoting the development of state-owned enterprises in China, and the contradictions in ideological recognition, have been discussed through the theoretical lenses of the developmental state. As noted, "*The key feature of China's political economy model is the interplay between political and economic (sub-) systems. The two sub-systems have co-evolved, constantly interacting, so that each shapes, and is shaped by, the other,*" (Chen and Naughton 2017,18). That is, the establishment of the SASAC, and the inherent need for modification of its function, role and political position, were shaped by the reform and development of state-owned enterprises. The SASAC's institutional function, internal structure, and the focus of its work also show interaction with market fluctuations and the SOEs' operational performances.

As argued in Chapter 2, China's state assets management system follows a developmental state model and the SASAC works as its pilot agency to promote the reform and development of the central SOEs. The SASAC uses market mechanism as its tools, adopting market criteria for promoting the central SOEs' distinctive role, while rejecting complete marketization of its SOEs. As demonstrated in the principal-agent theory chapter, the government is also the

source of structural change in institutions. The principal-agent analysis, as described in this thesis, presents a different picture, which goes across, and combines, the principal in the political system and the agent in the market sphere. The SASAC, in this situation, is a multi-functional government institution that is the supervisor and the pilot agency, while acting as a facilitator to push the SOEs further towards market competition. Relations between the SASAC and central SOEs cannot be explained by the traditional, straightforward principal-agent theory. The SASAC's role varies from monitor to facilitator, investor, supervisor and more. The SASAC has kept repositioning and adjusting its role as it has ridden the wave of China's market reform, and it has maintained its legitimacy into the present. In this chapter, the discussion will focus on this key institution in China's state ownership system. To be specific, the chapter will provide a detailed analysis based on the SASAC's various roles, such as financer, manager, transmitting body and buffer area in China's state ownership system. Starting with a review of the historical context, roles and functions, and intra-governmental relations among the SASAC and other actors, which include ministries, bureaus, and government at local levels, the chapter will also serve as a bridge to the following two case study chapters in which two central SOEs – one in the free market sector and the other in the monopolistic industry sector – will be analyzed.

An analysis of the SASAC based on the social and economic context of contemporary China helps us to answer the research questions.

1. What is the SASAC? What kind of roles and functions does it play in the state ownership system?
2. How can the SASAC as a new government institution, established at a ministerial level, but not as a formal ministry, monitor the giant SOEs, which have been transformed from ministerial status?
3. To what extent can the SASAC be seen as an important actor, and how does it situate itself among all the other government ministries and institutions regarding the management and supervision of the SOEs' operations?

#### **4.2. An overview of the SASAC**

This section starts with a general look at the social context within which the SASAC and SOEs operate, followed by an introduction of the SASAC's function and its role in China's political system. After this, a detailed analysis will be given of the SASAC's institutional structure.

The legitimacy of state ownership in China is based on the country's *Constitutional Law*. In the first chapter of this, General Principles, Article 7, it is laid down that, "*The state economy is the sector of the socialist economy that is*

*under the ownership of the whole people; it is the leading force in the national economy. The state ensures the consolidation and growth of the state economy.”*

The question is not about the legitimacy of state ownership but about recognizing which government departments represent the ownership of these assets and should take responsibility for the losses and gains related to them, since Kornai (1992, 75 in Xu and Gui 2016, 104) argues, “*State property belongs to all and to none.*” In theory, the state-owned enterprises of China belong to all the people, and the state exerts control on behalf of the people. However, in practice, state-owned enterprises are monitored and owned by the government at both national and local levels (Breslin 2009, 48). The SASAC’s establishment was meant to define clear ownership of state-owned assets. The SASAC was not transformed from a single ministry; instead, it reassembled the responsibilities and duties that had previously rested in many different ministries (Pearson 2007, 305). Figure 4.1 shows that, before 1998, there were nine ministries in the political hierarchy between the State Council and the SOEs. These included the State Planning Commission, the State Economic and Trade Commission, the Ministry of Finance, the Ministry of Labor, the Ministry of Personnel, the Ministry of Foreign Economics and Trade, the Organizational Department of the Communist Party of China, the State Workers’ Union, and other industrial ministries. In the period 1998 to 2003, the number of ministries and government institutions was revised, and the number of ministries between the State Council and the SOEs dropped to five (OECD 2006). This shows that before 2003 there were many government institutions that could give orders and to the SOEs and expect the SOEs to

respond. This multi-principal rule led to the dispersal of responsibility for the investment return on state assets. This system defect made it hard to clarify and locate responsibility within a single ministry (SASAC 2016,85). The complex network of central level ministries and the unclear power relations among the ministries did not provide a favorable internal environment in which the SOEs could operate.



Figure 4.1, Organization of the ownership function within the state administration, as defined in SASAC officer Jia's Speech at the OECD (2006).

Therefore, the State Council simplified the government structure for the management of state-owned assets. The National People's Congress approved

the establishment of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003. Agreement was reached to set up a special ministerial-level institution directly under the State Council's administration to function as the shareholder for 193 central state-owned enterprises (NPC 2003). The SASAC is the institution that “*undertakes investor's responsibilities, supervises and manages the state-owned assets of enterprises under the supervision of the central government (excluding financial enterprises which are controlled by the Ministry of Finance), and enhances the management of the state-owned assets*” (SASAC 2016). Since then, the task of managing state-owned assets has been removed from nine ministries and concentrated in the SASAC. As Jung (2011, 132) suggests, the establishment of the SASAC and the adjustments made in the economic bureaucracy show the state's efforts to build a more efficient mechanism to conduct a more focused method of intervention in state asset management.

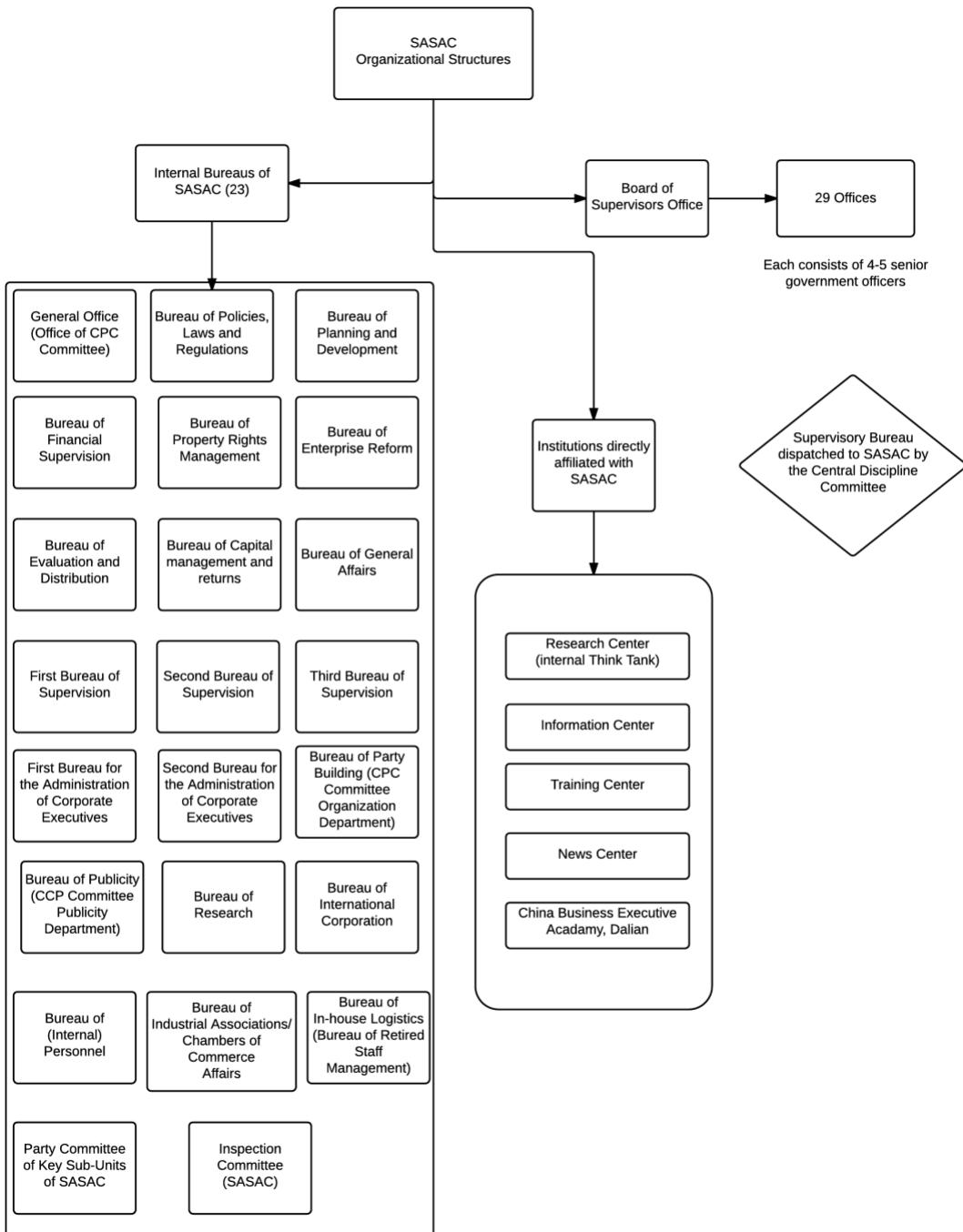


Figure 4.2. SASAC organizational structure. Adapted from SASAC information, modified and augmented by the author in May 2017.

The SASAC's organizational structure follows a typical Chinese government structure rather than a modern enterprise structure. The bureaus and offices inside the SASAC can be divided into three broad categories. As seen from figure 4.2, it has 23 internal bureaus, each with different functions and responsibilities. The Supervisory Bureau, whose members are sent out to enterprises by the Central Discipline Committee, is a permanent bureau inside the SASAC, and though it has not been created by the SASAC, it can be seen as a de-facto bureau in the SASAC system. Each bureau is in charge of one aspect of SOEs' management. There are newly organized bureaus which assist the SASAC's role as a pilot agency in the developmental state framework:, for example, the Bureau of Planning and Development, which sets out grand strategic plans for the central SOEs. The newly formed Bureau of International Cooperation demonstrates the SASAC's role as a pilot agency for leading SOEs to be globally competitive. The Bureau of Industrial Association is designed to work with industrial enterprises. As discussed in the previous chapter, central SOEs are in the leading positions in each industry. Therefore, they are able, in turn, to offer professional advice to the SASAC and other relevant governmental institutions concerning industry standards and difficulties in practice.

Apart from the 29 officers of the Board of Supervisors who are sent to take up permanent positions in central SOEs, three new bureaus of supervision have been established. The adjustment of internal bureaus in this restructuring of the governance system has put an emphasis on the SASAC's role as supervisor.

The three newly created bureaus have been designated the First, Second and Third Bureaus of Supervision. The First Bureau of Supervision is in charge of the work of the members of the Board of Supervisors who are dispatched to central SOEs; the Second Bureau of Supervision is responsible for 52 CSOEs in 10 industries; while the Third Bureau of Supervision is in charge of the other 50 CSOEs in 11 industries (SASAC 2016a). This adjustment shows the SASAC, as the principal, has been strengthening the ex post oversight mechanism. Apart from these two bureaus, there are also the Bureau of Financial Supervision, the Bureau of Evaluation and Distribution, and the Bureau of Capital Management and Returns which assist the SASAC in its oversight role in principal-agent relations.

In the 2016 bureau readjustment, the SASAC also merged bureaus with similar functions. For example, the Bureau of Enterprise Restructure was merged into the Bureau of Enterprise Reform. The new bureau was created to direct and supervise the SOEs' operations in merger and acquisition processes. It also aimed to improve corporate governance structures as well as to direct enterprises to separate their supplementary activities from their main business. The Bureau of International Cooperation is also newly created, and its work exemplifies the SASAC's official discourse about building "*globally competitive enterprises*" and the Chinese government's grand strategy of "*One belt one road*". Regarding the Communist Party's role in the SASAC, it is interesting to see that, although the SASAC's official discourse calls for further "*strengthening of the*

*Party's leadership*", there are only three bureaus whose functions relate to party building and propaganda purposes, namely, the Bureau of Publicity, the Bureau of Party Building and the Party Committee of Key Sub-Units of SASAC, which are key subunits of the SASAC. This fact supports the argument in the theoretical chapter that China is, in fact, "*ideologically light*". This new arrangement also supports the argument in the previous chapter that the SASAC's political discourse of "*strengthening the Party's leadership*" could be understood as a means of serious supervision of the central SOEs. When the SASAC called for stricter party control, and the merging of the two positions of CEO and party secretary so that they were held by one person (SASAC 2017), what the SASAC intended was to further reinforce the principal's control over the agent's activities. This can be seen as a way of preventing evasive conduct by the agent in the principal-agent relationship, because it simplifies the principal's responsibility, thus strengthening the power of the principal.

The second main category in the SASAC organizational structure is the Supervisory Board system. There are 29 supervisory board offices each consisting of around four or five 'supervisors' with high ranking as central governmental officials, most of them being minister-level or vice-minister level officers. Each one of the 29 supervisory board offices oversees around four or five central SOEs. The Supervisory Board sends a team of permanent officers to the central SOEs of which it is in charge. These supervisory officers are permanently based in the headquarters of the SOEs and have the right to audit

every conference and meeting, checking accounting documents or anything else when needed (■ BJCNB/04/2015). There is another set of institutions directly affiliated with the SASAC and these employ officers who support the SASAC's administrative needs. The institutions include a research center (internal think tank), information center, training center, news center and the China Business Executive Academy. The total number of officials is unknown; however, it could reasonably be estimated to stand at around 1000 people.

#### SASAC Directors: career path and term strategies

From 2003 to 2017, the SASAC has had five directors. Li Rongrong, who is seen as the founding father of the SASAC, held the position for the longest term, from 2003 to 2010. After Li, there were Wang Yong, from 2010 to 2013; Jiang Jiemin, from March 2013 to September 2013, Zhang Yi, from 2013 to 2015, and Xiao Yaqing, from 2015 until the present. Their common characteristic was that they had all had extensive experience of working in, and connections with, ministries that dealt with state-owned enterprises. The third director, Jiang Jiemin, had spent most of his career in the oil and petrol industry; but the other four directors had all had rich experience in local level government as well as in parallel central ministries. Their working experience reflected on the strategy each of them adopted when in office. Li Rongrong, the first director of the SASAC, from 2003 to 2010, had had experience of working with both central and local governments. He started his career working for the Planned Economy Committee of Wuxi

Municipal Government, moved to the Planned Economy Committee of Jiangsu Provincial Government, and later went to the National Economic and Trade Commission. He aimed at reducing the number of central SOEs while enlarging the size of the enterprises. His successor, Wang Yong, had had abundant working experience in state-owned enterprises in different industries. Wang had spent his early career in the China Aerospace Corporation, and had then worked in national level ministries, including the Organization Department of the CCP Central Committee and the State Administration of Quality Supervision and Quarantine. Unlike Li, Wang focused on improving the efficiency and productivity of the central SOEs. Jiang Jiemin had previously worked for the Shandong Shengli Oilfield (SLOP), the Qinghai Petroleum Administration Bureau, the Qinghai Provincial Government and Petrol China. However, six months after taking the chair of the SASAC, Jiang was detained by the Central Commission for Discipline Inspection and was put under investigation for corruption. Zhang Yi had followed a traditional career path, starting from working in county level government, then steadily moving up to municipal, provincial and national levels of government. Xiao Yaqing, the current SASAC director, was promoted from his position as CEO of a well-performing central SOE—the Aluminum Corporation of China. All the SASAC directors except Jiang had had abundant working experience in various kinds of government organization, including local authorities, the local levels of central bureaus, and different ministries, which gives them a clear picture of the complex relations and power struggles within China's central-local government structure. Their past careers in SOEs had given

them first-hand experience of the difficult situation of having market competition and government intervention to deal with at the same time.

When the SASAC was established, there were 196 SOEs under its administration. The first director, Li Rongrong, aimed at reducing the number of central SOEs, in order to enlarge the size of the enterprises. As illustrated in figure 4.3, during his administrative term, the number of central SOEs dropped from 196 to 122.

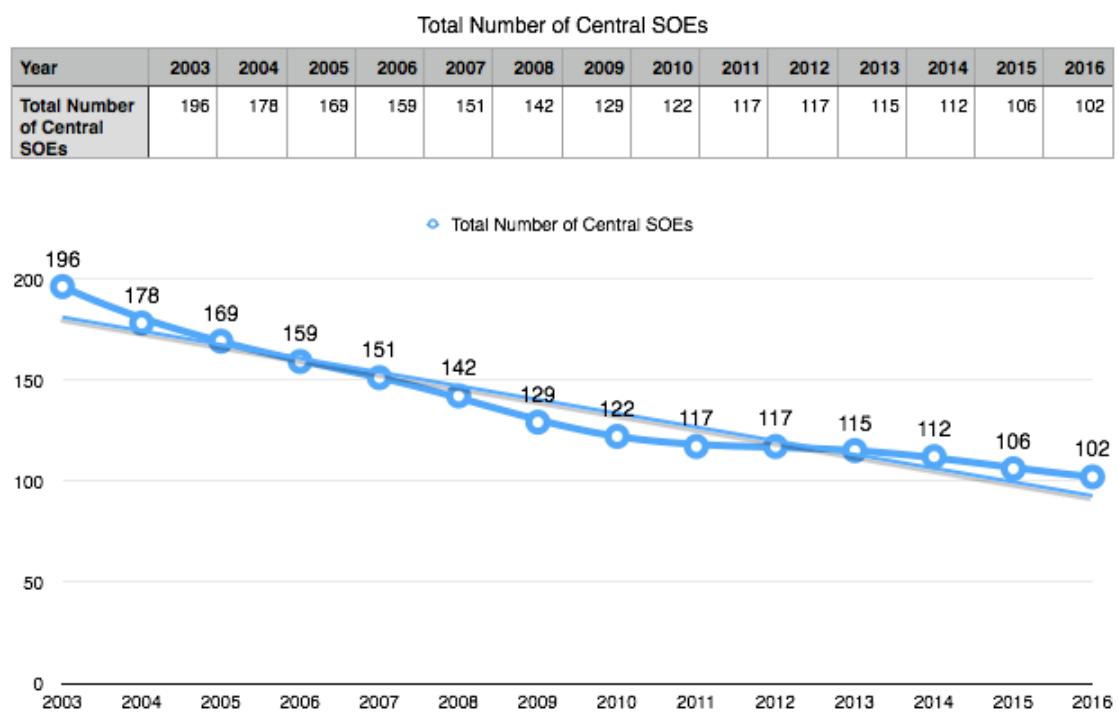


Figure 4.3. Total number of central SOEs under the SASAC's administration, 2003-2016. Adapted from SASAC, modified and augmented by the author in May 2017.

The linear graph in figure 4.3 shows that the number of central SOEs was reduced by 48 percent, from 196 in 2003, when the SASAC was established, to 102 by the end of 2016. The graph reveals that there was a significant fall from 2003 to 2011, followed by a plateau between 2011 and 2014. After that, in 2015 and 2016, the SASAC became actively involved in regrouping and restructuring SOEs again. The target and strategy the SASAC adopted and carried out changed through the development period. When the SASAC was established, the central SOEs were located in various dispersed industries, distribution according to industry was unbalanced, and competition was commonly seen among central SOEs. The first director, Li Rongrong, who held the position of chair of the SASAC from 2003 to 2010, aimed to reduce the number of CSOEs to less than 100 in his term. Although this ambitious target was not fully achieved, the number of central SOEs was significantly reduced, to 122. “*Li aimed at building up the size of the enterprises whereas his successor Wangyong focused more on improving efficiency and productivity*” (█████ BJSASAC/02/2015).

Changes and Adjustments of Central SOEs

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
M&A	18	7	8	8	6	9	6	3	1	2	1	3	3
Reroganisation/ Regrouping	1	2	1		3	2	2	2		1		3	2
Newly establish				1	1		1						1
Bankrupt/ withdraw/				1						1			
Hand-over to other government			1										
Take-over from other government									1				

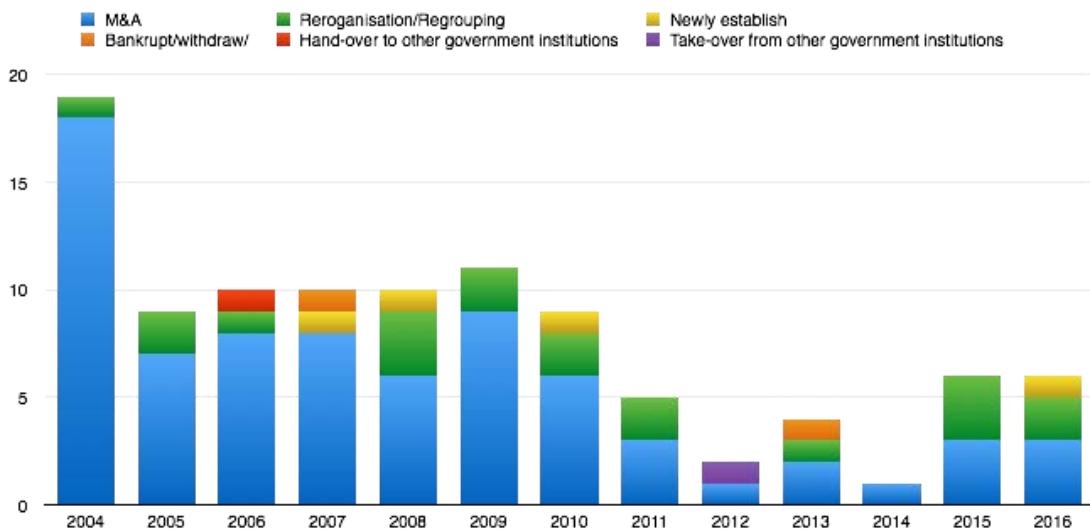


Figure 4.4. Restructuring and reorganization of central SOEs under the SASAC's administration from 2003 to the present. Adapted from SASAC information, modified and augmented by the author in May 2017.

After the SASAC had been founded, in 2003, it began the process of reorganizing and regrouping the central SOEs. Unlike in the 1960s, there were a large number of state-owned enterprises, but each of these had a relatively small scale of production. The SOEs remained relatively isolated from each other, even those within the same industry (Coase and Wang 2013). There were, in total, 102 commercial activities being carried on among central SOEs in the period 2003 to May 2017. Figure 4.4 explains the changes in, and the business activities conducted by, these enterprises from 2003 till the end of 2016. As can be seen from the figure, merger and acquisition were the most common forms of business restructuring among central SOEs during that time, and 75 cases contributed 74 per cent of the enterprise reform activities. Also, there were 19 cases of central SOEs regrouping and reorganizing, and these contributed 19 percent of the companies' reform activities. Four central SOEs were newly created, and two were withdrawn from the list due to bankruptcy. The SASAC handed over one central SOE to the Ministry of Water Resources in 2006 and took over one from the State Council, which was merged into the China National Cereals, Oils and Foodstuffs Corporation (COFCO) in 2013.

SASAC officers continuously encourage and support mergers and regrouping of central SOEs so as to build a stronger group of central SOEs to compete in the global market. There are certain advantages for the SASAC in maintaining a small group of well-performing big businesses. Zhao (2015) argues that the grouping of central SOEs avoids competition between SOEs when it comes to

bidding on overseas projects, which maximizes the interests of the central SOEs. Li (2015) realized that the central bureaucracy's strategy in narrowing the range of direct interventions in SOEs, especially central SOEs, could make the state's control more efficient and focused. He further pointed out that the central government and relevant political institutions could improve their connections with the SOEs and strategic sectors. However, Yu (2014, 182) raised concerns about the central SOEs' monopolistic status being strengthened and inter-industrial mergers consolidating the monopoly power of the newly formed big businesses and the accumulation of their assets and profits under the control of elite members of the CCP system. Sheng (2015) supported Yu's argument and pointed out that the rise of large SOE groups based on the government's preferential policies and loans would upset the domestic market mechanism, thus leaving enterprises with other types of ownership at a disadvantage that would harm the entire market environment in which business was done in China.

### **4.3. The SASAC and central SOEs**

This section will be divided into three parts. It starts with an examination of the SASAC's role as a shareholder and facilitator, which will be discussed based on the developmental state theory this thesis has adopted. This will be followed by an analysis of the SASAC as a transmitting agency that also serves as a buffer in China's partial practice of marketization in guiding the growth of central SOEs in

the market. After this, there will be continued analysis of the SASAC as a supervisor that frequently finds a way to conquer the problem of asymmetric information and to provide better oversight in the principal-agent relationship between itself, central SOEs and their second-tier companies.

#### ***4.3.1 The SASAC as an investor and facilitator***

This section studies the SASAC's role as an investor and facilitator. The SASAC acts as an investor in central SOEs on behalf of all the Chinese people; and it facilitates the growth of central SOEs and, most importantly, facilitates the reform of the state assets management system. As seen in a significant number of official documents, the SASAC defines itself as the investor, and as representing the State Council in the conduct of its duties and obligations (SASAC 2016). Although China has been labelled a communist country for years, its economy takes the form of government-lead economic development rather than a Soviet-style planned economy (Wu 2013:31). From the developmental state perspective, the SASAC is the institution that leads the SOEs' reform and development. It is the central SASAC's duty to push forward the reform and restructuring of SOEs, advance the establishment of a modern enterprise system, improve corporate governance, and promote strategic adjustment of the layout and structure of the state economy (SASAC 2016.). Since the SASAC was established, it has been actively pushing forward and guiding the reform of central SOEs. As illustrated in figure 4.4, there are five main measures the SASAC has adopted in reforming

the SOEs, and through merger and acquisition, and reorganization and/or regrouping, central SOEs have had their size dramatically enlarged within a short period. As a result, the SASAC holds assets with a value of over 10 billion RMB, and “*It aims to achieve the goal of a growth in central SOEs’ annual profits of around 10 percent, which has to be higher than the country’s annual GDP growth*” (██████ BJSASAC/02/2015). The centrally administrated SOEs have reported substantial increases in production rates, profits and taxes paid since 2007.

#### *Integrating the Industrial Chain:*

This chapter argues that the SASAC has a strategic plan and a grand goal for central SOEs, as its position as a pilot agency in a developmental state enables it to do. It focuses mainly on profit, and the returns rate on the assets of the central SOEs, when evaluating the enterprises’ market performance. The SASAC’s project of separating SOEs into different categories based on their functions and main business is a continuation of developmental state thinking in managing SOEs. █████ (BJSASAC/19/2015), director of the SASAC research institute, explains “*We are working on the layout and the structural adjustment of state ownership in the whole economic framework. Horizontally, we encourage the merger of central SOEs with similar businesses; vertically, we promote the integration of the industrial chain.*” The merger of central SOEs in similar businesses is a reflection of the SASAC’s famous slogan about making central SOEs “bigger, better and stronger”. The merger of the China South Locomotive

and Rolling Stock Corporation (CSR Corp) and the China North Locomotive and Rolling Stock Industry Corporation (China CNR) to create the CRRC Corporation Limited can be seen as an example. It shows the SASAC's efforts to merge central SOEs in similar industries to build a stronger national team, while reducing the situation of intra-enterprise competition between the CSOEs. The new CRRC is the largest supplier of rail transit equipment, and is listed on the Shanghai and Hong Kong stock exchanges (CRRC 2017).

The strategy of integrating the industrial chain can be seen in the central SOEs' efforts to acquire small and medium size companies and factories, in order to create for themselves a coherent production chain. Another well-known case of a merger between central SOEs in a strategic sector is the merger of the China National Cotton Reserves Corporation (CNCRC) with SinoGrain in 2016. The regrouping of the CRRC demonstrates the SASAC's aim to have central SOEs that are globally competitive in the free market, since the CSR Corp and the China CNR are in a competitive market and are aiming to do business in the global market; whereas, the merger of the CNCRC into SinoGrain illustrates the SASAC's political role in protecting China's strategic material reserves, since the primary goal for these two companies is not to be profitable in the market but to protect the country's food security and cotton reserves. The merger and acquisition activities of the central SOEs are also subject to constraint. The Bureau of Planning and Development has issued a Notice on Strengthening Supervision Over the Merger and Acquisition Activities of Central Enterprises

(SASACBPD 2004 No.720), and this rules that the merger and acquisition activities of CSOEs must take place according to national industrial policy. For overcapacity industries such as steel, electrolytic aluminum and cement, central SOEs have to report to the SASAC before they merge. Also, the central SOEs should, in principle, conduct merger and acquisition activities in their main business.

The idea of holding state ownership tightly in the hands of the government demonstrates that the SASAC believes in classical developmental state ideas on having the government lead industrialization in order to catch up with the western advanced economy. [redacted] (BJSASAC/02/2015) notes, “*It is important for China to maintain the state ownership system. After all, there is a long way to go for China to catch up with the developed economies.*” Xiang (BJDRC/15/15) echoes Zhao’s ideas and believes that the central SOEs’ existence gives the central government the flexibility and ability to direct the country’s economy growth. Xiang argues that, “*The centralization of resources allows the central government to have high proficiency in completing major national projects, thus achieving its strategic goals.*” The central SOEs controlled by the SASAC include China’s largest three petroleum companies. The petroleum industry is seen as a crucial strategic sector for the national economy. [redacted] (BJSASAC/20/2015) believes that “*The state’s monopoly of the oil industry allows it to adjust and mobilize petrol resources whenever needed. Petrol and other natural resources are essential goods needed for most of the industrial sectors in China.*” He further maintains,

*“Marketisation is the ultimate goal, but some valuable resources are monopolies by nature. The rarer the resources is, the more control will be applied by the central government.”* The above arguments are typical developmental state thoughts which recognize the government’s leading role in achieving industrial growth. Therefore, it can be argued that the SASAC puts an emphasis on the ownership and control of central SOEs so that it can have the power to adjust the national economy when necessary.

### *Grasping the Big, Let go the Small*

There has been an ongoing debate on the privatization of SOEs since the 1980s. At that time, when the Chinese government conducted a state ownership reform plan to maintain government ownership of big SOEs and to privatize small and medium sized SOEs, this was known as a policy of “*grasp the big and let go the small*” (in Chinese: 抓大放小). During the reform period, when China was determined to praise marketization and ask for further reform, the massive privatization of small and medium size enterprises was heavily influenced by the neoliberal trend, whereas such action was rarely seen in the large state-owned enterprises. Huang (2012) and Zhang (2009) supported the privatization measures and argued that could improve efficiency and increase creativity. Huang (2011) suggested that China should adopt a more liberal economic and political environment – one such as Deng Xiaoping sought to create in his “*reform and opening up*” – to further boost economic growth. Mao (2015)

criticized SOEs for using a significant amount of resources, in terms of capital, land resources and other benefits, while having relatively low productivity. He thought the SOEs should leave more market space for other types of ownership to operate in. Although, Holz (2002) argued against the opinion that SOEs were inefficient and unproductive, he held an optimistic view of the future development of Chinese SOEs because statistics showed that SOEs in industrial sectors performed better compared to their privatized counterparts. Sheng (2015) echoed Mao's criticism and pointed out the problems regarding the redundant staff in China's two oligopoly oil companies, the CNPC and Sinopec. He believed that the central SOEs' profit growth was significant, but if the per capital productivity of these central SOEs were calculated, the result would not be ideal. Royal Dutch Shell's per capital productivity is 10.5 times of that of Sinopec and 18.5 times of that of the CNPC.

The SASAC does not conduct a massive program of privatization of central SOEs, and their sub companies have far more complicated reasons for their activities. Apart from the obvious advantage of being owned by the state, central SOEs have shouldered heavy historical burdens and social security burdens that cannot be simply ignored. [redacted] (BJSASAC/20/2015) uses the example of a serious problem of redundant workers in the China National Petroleum Group's sub-company in Jizhong City, Liaoning Province, to explain. It is impossible for the CNPC to conduct a massive layoff of its redundant staff, which is approximately one-third of the employees, because the local government cannot

afford the potential social turmoil, and does not have the ability to solve the problem of unemployment among local residents. It is true that the CNPC's per capita productivity could be improved significantly if it got rid of its superabundance of employees across the country. However, it is unrealistic to do since the government does not have the ability to take responsibility for a high unemployment rate among local residents. Therefore, for national security reasons, a massive layoff of SOE workers cannot easily be accomplished. Also, the government depends on the central SOEs' efforts and investment in disaster relief work as well as in environmental protection projects. When an earthquake happens, the Chinese government can easily give an order to the SOEs to devote themselves to disaster relief work, regardless of the cost. Enterprises with other ownership pay more attention to their shareholders' interests, but SOEs are owned by the state (Zhao BJSASAC/02/15). Clearly, the SASAC is the central SOEs' investor, but it is an investor that is not only keen on economic returns but also on getting central SOEs to take on social responsibilities, since the building of China's social security system is not completed yet.

Apart from that, the central government's interest in fostering large-scale enterprises also lies in making regulatory rules for different industries. "*The SASAC's expectations for central SOEs include having the ability to lay down rules for industry while having a more global impact*" (█ BJSASAC/14/2015). This opinion is echoed by █ (BJSASAC/02/2015), who argues that "*Domestic China is experiencing industrial transformation and updating, and we hope to*

*upgrade industry while exporting our over-capacity products to other countries through the One Belt One Road plan.*" The SASAC encourages the central SOEs to become industry leaders, increasing their size and profitability so that they can be involved in rule-making activities in their industry associations. In implementing China's "*outward-looking policy*", this export of overcapacity products helps to optimize the industrial structure in mainland China. It is conceded that the SASAC not only plays the role of an investor, as part of developmental state thinking, but also works as a facilitator that adopts the market mechanisms to push up standards of efficiency and productivity in the central SOEs.

#### **4.3.2. The SASAC as a transmitting agency and a buffer area**

China's state-owned enterprises have long been subject to constraints. The businesses lack operational autonomy, and are generally subject to the control and restraint of various national institutions and administrative policies. Traditional SOEs were organizations that were created as work units in the planned economy period to serve social and political purposes rather than to achieve economic gains (Hua, Miesing & Li 2006, 403). In the year 1993, amendments to the Constitution of the People's Republic of China were issued. Article 16, which used to say, "*state-owned enterprises, under the unified leadership of the country to obey and fulfil the whole of the national plan, within*

*the limits prescribed by law, have management autonomy*" was amended to say, "state-owned enterprises within the limits prescribed by law have the right to make their own decisions." The phrase "*obey and fulfil the whole of the national plan*" was eliminated, which gave the SOEs more autonomy in business operations. From 1993 onwards, SOEs changed from being business units in a planned economy to being enterprises that could compete in the market economy but retained the basic SOE organizational form (Li and Puttermann 2008). "*The ultimate goal for the SASAC is promoting marketization and the overall listing of the central SOEs. However, what distinguish Chinese SOEs from those of western countries is that the enterprises' motivation comes from the will of the state*" (Zhao BJSASAC/02/15). Even though the constitution was modified to ensure the SOEs' rights and autonomy, the nature of SOEs has not experienced a dramatic change.

From the previous discussion, it can be seen that the debate on SOEs also deals with their profit earning ability. Xu and Gui (2016) point out that the significant growth Chinese SOEs have achieved in recent years can be partly attributed to the Chinese government's marketization strategies. However, the more significant driving force lies in distorted policies that favor SOEs. Pei in Fukuyama (2014: 379) argues that the subunits include giant enterprises — for example, China Telecom and the China National Offshore Oil Corporation — which, during the 2000s, gained in relative power over their private-sector rivals and foreign investors, and have been able to use their political clout to avoid

competitive threats to their position. The impressive performance of SOEs, especially the central SOEs, is due to subsidies and other forms of preferential treatment from the Chinese government (Xu and Gui 2016; Sheng 2015). The above discussion shows one side of the view that SOEs' profitability is primarily based on the nature of their ownership. However, the actual total of subsidies received by central SOEs remains unknown. Wang and Du (BJSASAC/07/2015) partially agree with the idea that central SOEs are recipients of various kinds of subsidies, but they have been unable to obtain an accurate amount for the subsidies central SOEs are given. This is due to a number of government institutions other than the SASAC being involved, for example, banks, industrial organizations and local governments.

China's strong government capacity allows the SASAC to manage and adjust its position in conducting state-ownership reform and the development of central SOEs. Yang and Zhao (2015, 66) argue that China's market-oriented reform does not weaken state intervention in the economy. It combines the two contradictory characteristics and conducts continuous policy experimentation, adjusting subsequent experiments according to the results. Besides, Chinese developmental state bureaucrats have the ability to implement and execute strategic planning without being interrupted by democracy (Zhao 2010, 423). The government's strong state capacity allows it to undertake policy experimentation (Heilmann 2008), making policy shifts, as well as adjusting policy based on previous consequences, both intended and unintended (Yang and Zhao 2010).

This can be described as “*experience first, law later*”. Heilmann, in his most prominent work on policy experimentation (Heilmann 2011, 99), points out that China’s policy experimentation in its economic reform is implemented and institutionalized to a high degree. The SASAC conducts “*experimental items*” also known as “*pilot projects*” [试点]: that is the pilot policy is tried out by selected central SOEs before being issued as a policy that will be applied to all the companies in the state ownership system.

### *Introducing Market Standard to the SOEs*

In the SASAC’s search to create corporate governance in the central SOEs, policy documents of an experimental nature have been issued. As Heilmann (2011, 99) argues, the trialing of policies has helped the government to avoid policy deadlock and to gain experience of policy implementation. An example of this is the *Interim Measures for the Standard Operation of the Board of Directors of a Central Enterprise in the Pilot Program for the Board of Directors* (SASAC reform bureau [2009] No. 45), which regulate the establishment, responsibilities, working procedures, etc. of the Board of Directors. See also the *Administrative Measures for the Full-time External Director of Pilot Central Enterprises for the Work on the Board of Directors* (SASAC SBACE [2009] No. 301) which further emphasize the importance of external directors’ roles in accelerating the creation of standard corporate governance in central SOEs. Another example is the *Interim Measures for the ‘Worker Director’ as a Member of the Board of Directors*

*in Wholly State-owned Companies* (SASACMWB [2006] No. 21), which decree that the board of directors should have a ‘*worker director*’ who is elected by the enterprise workforce. The government also has the autonomy and capacity to free itself from ideological restrictions and interest group politics and to implement new policies when the negative consequences of earlier policies loom large (Yang and Zhao 2015: 68). Hence, the SASAC can supervise the central SOEs and adjust policies when necessary. This is an active example of the way the government deals with the central SOEs’ business operations. On the other hand, the SASAC pushes the central SOEs in market competition, either in non-monopolistic industries or in monopolistic industries, to compete among themselves.

From the time when the SASAC was established, it has adopted an international standard to evaluate its central SOEs’ performance. The first director, Li Rongrong, took the Global Fortune 500 list as the norm for central SOEs from 2003 on. “*Li aimed to have 30-50 central SOEs in the Global Fortune 500. The SASAC adopted the Global Fortune 500 list—a published business listing – very seriously, because it was the international standard for evaluating large enterprises’ performance. This has been helpful when central SOEs have wanted to expand their businesses in the global area. It has also served as a method of external evaluation in monitoring central SOEs’ performances*” (██████ BJSASAC/02/2015). Due to the SASAC’s aim of building global companies, it is supposed to be interested in further marketizing the central SOEs. The market

strategy the SASAC has proposed to improve the efficiency and profitability of central SOEs may sound as though it contradicts the SASAC's primary responsibility and claim: to maintain and increase the value of state assets. However, no market activity is without risk. Mixed ownership requires market activities such as equity transfers and asset sales. Therefore, the Bureau of Property Rights Management of the SASAC has issued a series of policies to regulate activities such as equity exchange, assets appraisal and property disposal. For instance, the *Notice on the Issuing of Guiding Opinions on Actively Introducing Private Investment in the Restructuring and Reorganization of SOEs* (SASACBPRM 2012 No. 80), in which the SASAC encourages the investment of private capital in the SOEs, so as to develop mixed-ownership, building a modern property rights system and further promoting the growth of SOEs. It can be seen from the above discussion that the SASAC and the central SOEs are actively involved in the market and in seeking global competitiveness. As I argued in the theoretical chapters, the SASAC adopts market criteria to improve performance and promote the growth of central SOEs.

#### *[Listing the State Assets on the Stock Exchange](#)*

What does the SASAC expect from the central SOEs according to a globally recognized market standard? The evaluation of central SOEs' performance focuses on the enterprises' economic performance. As noted in the principal-agent chapter, profit and return on assets are the two key aspects of the

evaluation of senior executives. [REDACTED] (BJSASAC/13/2015) notes, “*The current assessment system adopts the Economic Value Added (EVA) index. Not only the revenue is important but also the net profit less the economic cost of the enterprise*”. In the *Measures for the Assessment of the Operational Performance of Persons in Charge of Central SOEs* (SASAC [2016] No. 33), chapter 5 clause 25 decrees that an annual assessment will be conducted every year while a more long-term assessment will be conducted every three years. According to chapter 6 clauses 34 and 35, the salary of the assessed person consists of three parts: one is the guaranteed basic annual salary; but the annual performance wage and the long-term performance bonus are subject to the central SOE’s performance. This system puts pressure on senior executives, since the performance of central SOEs both in the short term and in the long run can immediately affect their personal income. The SASAC’s expectation for central SOEs to be profitable makes it possible for the latter to gain more autonomy in business conduct. [REDACTED] (BJSASAC/19/2015) believes that “*Central SOEs enjoy considerable autonomy in their daily operational business, and are not disturbed by the SASAC. Concerning production and management, the SOEs have a high degree of autonomy. But when it comes to salary and bonuses, the SASAC maintains very tight control over these. Total wages, including the payment of executives, need to be reviewed and approved by the SASAC*”. [REDACTED] (SHPDSASAC/33/2015) agrees with this comment and says that “*The SASAC tends to make sensible regulations, at the same time granting more autonomy to the SOEs in order to increase enterprise vitality. After all, the enterprise’s market*

*performance matters*". Hence, the SASAC performs a supportive role in making central SOEs profitable. From the principal-agent perspective, the goal of conflict can be understood as being that the SASAC needs more control while the central SOEs need more autonomy, but they share the same interest, which is the sound performance of the enterprises.

In order to push central SOEs forward in market competition, the SASAC started the process of listing central SOEs on the stock exchange. This requires a process of selecting well-performing assets from the central SOE group of companies and forming them into new stock companies. There are many benefits that listing can bring to both the SASAC and the SOEs. The listing of a company can be seen as a way to improve the SASAC's supervision mechanism and to reduce the degree of insider control. Also, by involving more productive private ownership, SOEs can increasingly adapt to market activities (██████ SHPDSASAC/32/2015). Chen (SHPDSASAAC/33/2015) agrees with Wang, and further suggests that public listing is a very decisive action for both the SASAC and the enterprises. There are many benefits that public listing has brought to the SOEs, such as the possibility of raising capital, market value appreciation and increased mobility. When companies are listed on the stock exchange, the Security Regulatory Committee becomes another principal to regulate and monitor the SOEs in the market. Also, more attention will be paid by the general public and the media. As argued in the previous chapter, in the principal-agent relationship, the principal (SASAC) introduces third parties to monitor the agents'

behavior and this can reduce the level of information asymmetry so to avoid evasive action by the agent. However, the SASAC does not give an order for the listing of an SOE on the stock exchange. This is done on the SOEs' own initiative.

■ (SHPDSASAC/33/2015) further notes, “*The SASAC does not force the SOEs to list themselves on the stock exchange but it does encourage them to do so. There are many SOEs submitting applications to the Shanghai stock exchange, and there is always a long queue.*”

The asset-stripping process cannot avoid dealing with historical burdens. From 1995 to 2005, two-thirds of SOEs were downsized and privatized. Unlike what happened in Eastern European socialist states, the privatization process did not lead to political turmoil but to the earning of profit. However, a large number of small and medium size firms were transformed into fully private entities and ‘management buy-outs’ resulted in the creation of rich capitalists and the corruption of local government officers. The experience raised the government’s confidence in corporate reform and restructuring, and it did not increase the unemployment rate significantly. Harvey (2005) sees China’s significant economic development after the 1980s as an “*unintended consequence of the neoliberal turn in the advanced capitalist world.*” The Chinese government made great efforts to minimize layoffs and unemployment, and to make sure there was no link between its actions and a layoff of SOE workers. Oi (2010:11) explains that 75 percent of Chinese SOEs were reconstructed without layoffs. It is argued that, although reforms were carried out in the state ownership system, the state

kept control of the major state-owned enterprises because of the complex social network and variety of interests involved (Heilmann 2008, Zhao 2006; Wang et al. 2011). “*The state ownership system left many burdens from the planned economy system. These are hard to eliminate, but further steps need to be made.*” (█ BJDRC/16/2015). The central SOEs, as a large group of companies, planned to get together their valuable assets to be listed on their behalf, and to have the kindergartens, schools, hospitals and other social functions they were previously responsible for eliminated or maintained by the group as a whole. The asset shedding process also varied, due to the complexity of these central SOEs’ local branches in local areas. █ (BJSASAC/14/2015) notes that “*some SOEs divested the kindergarten and hospital from the enterprise, but the local county did not have a well-functioning education system, so this made employees' lives harder than before. Some of these SOEs' tax contributions to local government were higher than 95 percent of the local annual taxation; and these practical issues needed to be considered before action was taken.*”

The centralization of state-owned assets and the more rigorous requirement for profit-delivery started after 2010. Yu (2013) sees it as strengthening the state’s monopoly in strategic industries and as leading to the resurgence of the state in China. The SASAC started to push the CSOEs from partial listing to overall listing from 2010 on. In 2011, the SASAC named 11 central SOEs to become overall listed companies for both *A* and *H* shares (SASAC 2011). *A* shares are issued in mainland China, *H* shares are issued on the Hong Kong Stock

Exchange. In the past, the state has had a strong hand in deciding which part of the group will be a spin-off for the IPO. Usually, the strongest part of a company will be listed on the stock market, while any loss-making or heavily indebted part of the assets will remain unknown (Wang et al. 2011: 257). There is also a place for discussion of relations between the group company and its stock company.

█████ (BJDRC/15/2015) believes that if the group parent company level were eliminated, the market mechanism might work even better. But the government and the central SOEs both need this level to deal with some political responsibilities during the reform period. █████ (SHPDSASAC/32/2015) offers a similar argument: that the listed company should be separate from the group company. Otherwise, some of the group company's activities can damage the interests of public shareholders. The group company conducts government functions while the stock company is a market player. Therefore, it can be seen from the above that the central SOEs as the group company have a heritage of post-soviet state assets and at the same time the listed company is a profit-earning company in the global market. Discussion of the relationship between the group company and its stock company will be further dealt with in the following chapter. Nevertheless, the central SOEs should be understood as a combination of the old system and a new system, which sometimes takes on government functions, but most of the time acts as a modern enterprise in the market.

#### *4.3.3. The SASAC as the Supervisor (Principal-Agent)*

The institutional reform of the 2000s clarified and specified the duties and responsibilities of the SASAC. It reassembled responsibilities that were previously assigned to other ministries, for example, the Ministry of Industry and Information Technology, the Ministry of Industry, and so on (Pearson 2007: 305). As was mentioned in the previous chapter, the central government created an active principal and supervised its agents carefully, as can also be seen from the government's efforts in recentralizing political power. In order to minimize the negative influence of asymmetric information in the relationship between the SASAC and central SOEs, the SASAC conducted different types of supervision and evaluation methods.

Decision-making rights for the personnel system of the central SOEs have mostly been granted to individual central SOEs. The SASAC maintains the power to appoint and evaluate the top-level senior executives of enterprises, while leaving the appointment of middle-level managers and the rest of the employees to the company itself. In the SASAC, there are two bureaus in charge of personnel, namely the First Bureau of Personnel and the Second Bureau of Personnel. The two bureaus have different functions and are in charge of different sets of central SOEs. The First Bureau of Personnel is responsible for appointing all the senior executives of the 53 vice-ministry-level group companies and has the right to evaluate recommendations for the post of CEO of the group companies.

Candidates for the post of CEO of the group company will then be discussed and appointed by the Central Organization Department of the Communist Party of China. The Second Bureau of Personnel is in charge of appointing the senior executives of central SOEs which are not on the 53 vice-ministry-level list (██████ BJSASAC/02/2015). Thus, it can be seen from these working procedures that although the Central Organization Department is the institution that officially appoints the senior executives of the 53 vice-ministry-level group companies, the SASAC's First Bureau of Personnel has equal importance, because the candidates are nominated by the First Bureau of Personnel and the Bureau is also in charge of the future evaluation of the senior executives' operational performance. The SASAC's Second Bureau of Personnel, on the other hand, has full power over the personnel systems of the rest of the central SOEs. Even so, a report needs to be sent to the Central Organization Department for approval.

The SASAC, as the main principal of the state ownership system, in its evaluation of central SOEs operations, emphasizes on the financial perspective. In the tenure of office of Zhu Rongji (Chinese Premier 1998-2003), an audit ombudsman system was set up. According to State Council Order No. 246, the audit ombudsman would be sent by the State Council to carry out oversight powers on behalf of the State Council. The audit ombudsman would be a ministry level or vice-ministry level government officer (State Council 1998). According to █████ (BJSASAC/02/2015), the audit ombudsman system was then transformed into the supervisory office system of the SASAC. Each supervisory office has

central government bureau-level status, and each is in charge of five to six central SOEs. The supervisors on the supervisory committee also have senior central government officer status, from minister to vice-minister, and bureau-level to department level, with deputy department level as the lowest. Sending out senior officers with minister-level rank allows the supervisory committee to exert its power in examining central SOEs. The ombudsman system thus represented the starting point for the government to identify and try to conquer the principal-agent problems occurring between themselves and state-owned enterprises. It later evolved to become the current system of the Supervisory Board of the SASAC whose members are dispatched to central SOE headquarters.

Central SOEs also consistently receive supervision and inspection from other ministries apart from the SASAC. The Central Discipline Committee is an outside supervisory institution, and the SASAC's former director, Mr Jiang Jiemin, six months after taking office, came under investigation by this committee for corruption during his time at the China National Petroleum Company. After that, the inspection team went to different central SOEs and their sub-companies for extensive inspection work. The SASAC's supervisory committee focuses on the supervision of SOEs' operations and performance, while the Central Discipline Inspection Committee pays attention to individual officers' corrupt behavior or misconduct. *"As seen in the media, there are many corruption cases occurring at different levels of the central SOEs, as a consequence of the years during which the SASAC delegated powers to them. The higher degree of marketisation leads*

*to a higher level of autonomy for the SOEs. Consequently, the SASAC increasingly tightens its supervision over central SOEs to prevent the loss of state-owned assets*” (█ BJSASAC/19/2015). As discussed in the previous chapter, the SASAC’s new strategy of using a ‘*wheel war*’ police patrol oversight mechanism and the dual procedures of ‘*resident inspectors on-site*’ and ‘*short-term inspection tours*’ serve as different means of oversight.

### SASAC’s Political Status and Capacity in Governing the CSOEs

We shall move on now to discuss the SASAC’s political status in the Chinese government system and its power to issue government regulations and policies, as well as the extent to which these policies are important. According to *Constitutional Law Article 90*, “*The ministries and commissions issue orders, directives and regulations within the jurisdiction of their respective departments and in accordance with the laws, the administrative rules and regulations, the decisions and the orders issued by the State Council*”. Article 71 of the Law of the People’s Republic of China reads “*The various ministries, commissions, the People’s Bank of China, the Audit Agency, and a body directly under the State Council exercising regulatory functions, may enact administrative rules within the scope of their authority in accordance with national law and administrative regulations, as well as the decisions and orders of the State Council*”. The SASAC, as a ministry-level commission directly under the State Council, can issue administrative rulings, such as opinions and measures, to regulate SOEs.

Therefore, it can impose both positive and negative incentives on central SOEs. As explained in the previous chapter, that there were in total five revisions of the Measures for Assessment of the Operational Performance of Persons in charge of Central Enterprises between 2003 and 2016. There are also Interim Measures for the Administration of Comprehensive Performance Evaluation of Central Enterprises (SASAC 2006) to evaluate the economic performance of enterprises and adjust the salary of the executives accordingly. ■■■ (BJSASAC/20/2015) agrees with the argument that profit is seen as the most important indicator in the evaluation of SOE performance, because profit is measurable. The SASAC also imposes negative incentives on central SOEs. It is the SASAC's duty to reduce the amount of corruption taking place in central SOEs. "*Central SOEs are involved in business activities which provide opportunities for the managers to become involved in corruption and tradeoffs of money and power*" ■■■ (BJSASAC/02/2015). For this reason, apart from being a facilitator, the SASAC also pays attention to increasing the effectiveness of its supervisory activities.

There are two important external supervisory powers that need to be analyzed: the Central Discipline Committee, as mentioned in the previous section, and the National Bureau of Statistics, which conducts audits of central SOEs and their local branches. The SASAC is continuously working to classify SOEs into different categories and evaluate them accordingly. The SOEs are divided into two main categories—the commercial category and the public welfare category. The commercial category sees the financial performance of the SOEs as their

primary responsibility, whereas the public welfare category's main aim is to provide public goods and promote public welfare (SASACRC 2015 No.170). The categorization can not only help to clarify different strategies and development goals for different SOEs, but also helps the SASAC to improve its supervision mechanism by tailoring detailed assessment to suit both types of SOE (SASACRC 2015). However, in practice, it is not easy to categorize the central SOEs because they can belong to both categories or neither at the same time.

(BJSASAC/20/2015) further notes that "*In fact, most of the central SOEs have a mixed operational status. Take the China National Petroleum Corporation, for example. Its oil concession business is in a monopoly industry, but the refinery enterprise and gas station business can be categorized as being in competitive industry.*"

It is a myth that as long as the managers of the SOEs do not hold shares, they lack the incentive to run the SOEs well. Hart and Moore (in Xu and Gui 2016, 104) argue that bureaucrats who control enterprises and other assets have no incentive to make good decisions because their personal income and wealth is not connected with the revenue and profit of the SOE they manage. In other words, there is a "*mismatch between residual claims and residual control*". The ownership school of scholars believes that SOEs are intrinsically inefficient because the government is the owner and incompetent in running SOEs, due to the multiple objectives they have, such as social efficiency and social welfare, taxation, and unemployment rate control. Thus, the ownership school believes

that privatization is the best way to solve SOEs' problems, making the enterprise free from bureaucratic control and political influence. However, the SASAC's presence and the effective developmental state model it applies suggest that SOEs can be efficient as long as a proper principal-agent mechanism is set.

According to Li and Wu (2002b, 95), there is no clear evidence that there are any crossover-effects of autonomy and profit incentives on SOEs. Their quantitative research has shown that strategies of management reform, including granting autonomy to the enterprises and profit incentives, cannot guarantee a positive effect on enterprise performance. Puttermann and Dong (2000) argues that the official definition of SOEs means they are '*owned by the whole people*', that is, there is control by state jurisdiction. The increasing autonomy of local authorities, and the managerial autonomy granted to SOE managers, have made them a '*de facto private companies*', with declining discipline as well as increasing corruption. Using profit-sharing and linking bonuses to the financial performance of the enterprise as an incentive works better than granting autonomy to the managers. According to [redacted] (BJSASAC/13/2015) "*From 2003 onwards, the evaluation system was changed about three or four times. It has become stricter but also more customized. Senior executives of central SOEs will be examined annually, and their long-term evaluation will be of equal importance.*" By stretching the time frame, central SOEs' executives have to focus on the long-term performance of their enterprise rather than seeking to promote their short-term interests. Wang and Zhang (BJSASAC/20.21/15) both note that the SASAC is working on how to

impose a long-term incentive awards system. Methods of deferred payment for senior executives and awards of stocks and shares to raise staffs' motivation have been discussed. This comment is echoed by [REDACTED] (SHPDSASAC/33/2015) and [REDACTED] (SHCG/29/2015), who note that an evaluation of enterprises will be conducted every year. Increasing attention is paid to long-term performance rather than annual financial results. As seen from the above interview, the SASAC's evaluation of central SOEs' work has moved from focusing on the ability to earn short-term profits to the ability to ensure long-term development of the company.

Lin (2010) sees both the economic and the political aspects of SOE managers' motivation. He believes that SOE managers' motivation for creating a better economic performance by their company is to obtain a higher position in China's political system. Profitability is the main criterion for the SASAC's supervision of central SOEs, however, and more constraints and rules are imposed for this reason. The SASAC, in 2009, regulated the main businesses that each central SOE operated in. [REDACTED] (BJSASAC/20/2015) further notes "*Each central SOE has its own main businesses, and the SASAC has the responsibility to ensure the central SOEs operate within their businesses and industries. For example, even if it is highly profitable for an aviation company to invest in real estate development, that is not allowed.*" From 2004 to 2007, the SASAC Bureau of Planning and Development issued seven administrative rules dealing with the regulation of the main businesses of the central SOEs: SASACBPD 2004 No.

324; SASACBPD 2005 No. 80; SASACBPD 2005 No. 251; SASACBPD 2006 No. 49; SASACBPD 2006 No.126; SASACBPD 2007 No. 40 and SASACBPD 2007 No. 90.

Thus far, this thesis has argued that the SASAC can be seen as a powerful principal that has the ability to conduct adequate supervision of central SOEs. Central SOEs' headquarter have to maintain their position as wholly state-owned enterprises, because the SASAC holds nearly 100 percent of the shares of the central SOEs' group companies (Chu 2014). Central SOEs set up their joint-stock companies primarily to provide a high return to shareholders. The SASAC confirmed and approved the reform plan for state-owned enterprises because it was in its interests to further the reform of SOEs. Apart from its economic interests, the SASAC sees the Security Regulatory Committee and the general public shareholders as external principals for the central SOEs, due to the asymmetric information problem that inherently exists. [REDACTED] (BJSASAC/20/2015) notes that "*the SASAC's capability does not allow us to monitor every detail of SOEs. After all, we are outsiders.*" This argument is echoed by [REDACTED] (SHPDSASAC/32/2015), who says that it is very difficult for the SASAC to figure out everything that happens inside SOEs because they are distributed across different industries. Moreover, it is impossible for the SASAC to be an expert in every sector and monitor every detail of the enterprise's operation closely. As a result, the SASAC has introduced corporate governance and delegated managerial power to the board of directors. It can also be argued that the

SASAC's efforts in transforming SOEs into market-oriented corporations is to further enhance the state's strength in the management of state-owned assets. Through being listed on the stock market while carrying out merger and acquisition projects, the central SOEs expand in size and increase their total assets and revenues. The SASAC has institutionalized the supervision and direction of central SOEs to increase the state's capacity in economic activities. This empirical study argues against Brødsgaard (2012, 626), who labels the SASAC an institute that has lost control of central SOEs and sees central SOEs as small kingdoms that operate according to their own will and keep the profits in their pockets. The CEOs hold ministerial or vice-ministerial status so that the central SOEs can work on their own and contact relevant ministries directly without passing the message through the SASAC. This chapter argues that the SASAC is the most important principal for central SOEs. The SASAC carries out multiple roles in promoting the growth of central SOEs as an investor, supervisor and facilitator, and sometimes also works as a transmitting body and buffer area for central SOEs.

#### 4.4. Organizational Interactions between the SASAC and other Ministries/Local Government Institutions

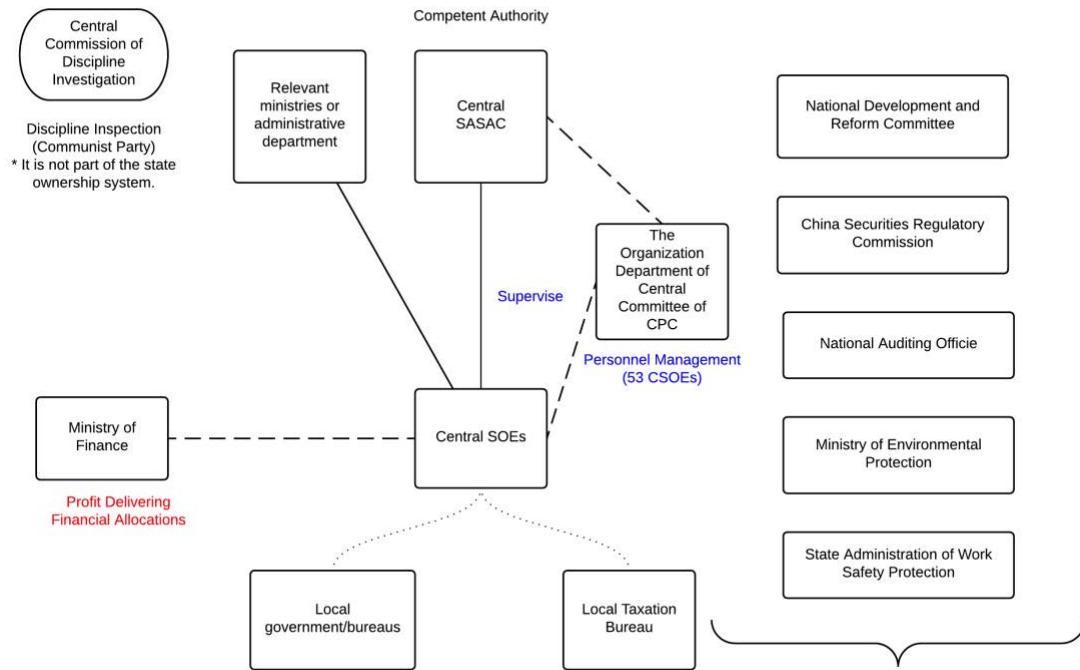


Figure 4.5. Interactions among the SASAC, central SOEs and relevant government institutions. Source: created by the author in 2017.

Although the structure of state ownership becomes more straightforward and clear after 2003, in practice there are still many institutions and ministries involved in the activities of central SOEs. According to Pearson (2010), the authorities placed over China's state firms are highly fragmented. In other words, the state-owned enterprises need to negotiate and report to many different government institutions other than the SASAC. Tsai's (2014) research in the

electricity industry shows that electricity producers need to deal with various ministries, local government bodies and sometimes the National People's Congress as well as the State Electricity Regulatory Committee (SERC). Admittedly, there are many different governmental institutions that are involved in the actual business operation. As stated earlier, the Organization Department of the Communist Party of China is involved in the appointment of the senior executives of central SOEs; it is the Ministry of Finance to which central SOEs have to deliver profits; it is the National Development and Reform Committee which is in charge of developing new projects; and there are also inspections conducted by the Discipline Committee and the National Audit Office.

We shall now turn to the discussion of two vital central agencies that are related to the personnel and money of the CSOEs—the Organization Department of the Communist Party of China and the Ministry of Finance (MoF). It seems that Brødsgaard's (2012, 630) argument about the SASAC's limited power over central SOEs is problematic. As he understands it, the SASAC neither receives dividends from the SOEs nor does it have the right to appoint their CEOs and top senior managers; so its control over the CSOEs is restricted. Xu (2012, 10) also notes that it is the Organization Department that has the right to appoint top SOE managers, not the SASAC. However, this understanding of the SASAC's role is flawed, because it only focuses on the seal on the appointment letter. It makes no attempt to acknowledge the nomination and negotiation processes before the appointment, as well as all performance assessment after the appointment. Apart

from that, there are differences between the 53 CSOEs in the strategic sector and the rest of the CSOEs in fully competitive industries. Even for CSOEs in the strategic sector, the Organization Department usually appoints the top three positions in the company, namely, chairman of the board, party secretary and the general manager, leaving the rest for the SASAC (■ BJCSCC/01/2015).

For Central SOEs in fully competitive sectors, the Organization Department's role is less significant. ■ (BJCNBM/08/2015) notes that the Organization Department of the CCP works more closely with the 53 CSOEs in the strategic sector. Although the CNBM's size and its total assets are larger than those of some of the 53 CSOEs, the Organization Department does not usually contact it directly. ■ (BJCNBM/03/2015) is also of the view that the Organization Department of the CCP is rarely seen in the CNBM. The senior executives in the rest of the CSOEs are nominated, appointed and evaluated by the SASAC. Although the Organization Department gives these appointments the final stamp of approval, it does not regularly participate in the process. During the fieldwork interviews for this research, we found that the Organization Department of the CCP was an important power in the appointment of the senior executives of the 53 CSOEs in the strategic sector. However, it does not follow from this that the SASAC's work in this area is less significant. The SASAC's First Bureau for the Administration of Corporate Executives is in charge of the senior managers of the 53 COSEs, while its Second Bureau for the Management of Corporate Executives is in charge of the senior managers of the rest of the CSOEs. The

SASAC is also responsible for the assessment of both the annual and the long-term (three-year) performance of CSOE senior executives, granting rewards or imposing penalties (SASAC 2016 No. 33). All in all, the SASAC can be seen as the crucial actor that take charge of personnel matters in the CSOEs, because it participates in the full process of selection and assessment.

The role of the Ministry of Finance (MoF) in CSOE-related issues is also widely discussed. The MoF is the ministry in charge of the operating budget for state capital and the collection of dividends from SOEs. This is decreed in the *Measures for the Administration of the Collection of Proceeds from the State-owned Capital of Central Enterprises* (MOFAMB 2016 No. 32), which also notes the MoF's right, in its supervisory function, to compile, verify and hand in reports. Besides, the MoF and local-level financial departments are responsible for the utilization of the state capital operating budget (State Council 2007 No. 26). The Ministry of Finance also issues some policy documents to give professional guidance to the CSOEs. For example, the Notice on the Auditing of Firms, which covers the final accounting and auditing work for central SOEs (MoF Audit Bureau [2011] No. 24), gives the instruction that CSOEs have to change their auditors after hiring the same company for ten consecutive years. If the MoF is involved in the finance-related activities of CSOEs, then can we take it that this ministry occupies what would otherwise be a crucial role for the SASAC in the management of state asset, thus leaving the SASAC in a position of reduced authority?

The MoF should be seen as providing professional guidance and serving as a regulator in a broader sense, while the SASAC is the principal that is involved in very specific activities in the CSOEs' financial supervision. For instance, the MoF's Implementation of the Central State Capital Operating Budget is issued as a regulatory document to not only the 102 CSOEs under the SASAC's administration, but also to enterprises overseen by other ministries (MoF Budget Bureau 2017), while the SASAC's regulatory publications are more detailed and are focused on CSOEs. The *Interim Measures for the Management of Financial Budgets of Central Enterprises* have 50 clauses that give detailed instruction to CSOEs on how to report on their budgets to the SASAC (SASAC 2007 No.18). This comparison is supported by empirical evidence. According to [redacted] (BJCNBM/08/2015), the CNBM group consults the MoF when dealing with finance-related technical work; but the SASAC is the body that oversees the detailed financial activities of CSOEs. [redacted] (BJCNBM/10/2015) agrees with Xu and refers to the SASAC's supervision of the CNBM's financial report as intense and strict. In summary, the SASAC holds the principal's responsibility in closely monitoring CSOEs' financial activities, while the MoF provides general professional guidance on the use of state capital in the broad sense.

Nevertheless, the overlapping of government functions is less likely to happen now. The competent administrative department of the SASAC carries out its role as the main principal, while other parallel relevant administrative departments

and line ministries are in charge of fragmented technical issues. (BJSASAC/19/2015) uses an example to explain the relations among central governmental institutions. “*For example, a major industrial production accident happens in one of the central SOE’s factories. The State Administration of Work Safety is there to handle the accident, clarify the liabilities and report to the public. Based on the report provided by the Administration of Work Safety, the SASAC will impose a penalty on the central SOE. The penalty might include, but is not limited to, downgrading the enterprise in the annual performance review. The direct consequence is that the salary bonus for the senior executives of the CSOE will be eliminated*”. It can be seen from the above fieldwork interview material that although other ministries are involved in dealing with technical issues in relation to the central SOEs’ operation, the competent authority that holds the principal responsibility for CSOEs is the SASAC. Likewise, the Ministry of Finance is important in the state ownership system, but is mainly concerned about central SOEs’ reports on their operating budgets and delivery of profits. It is not involved in central SOEs’ operations. The Central Discipline Committee sends inspection teams to SOEs regularly, but will not maintain a permanent presence in the enterprises, unlike the supervisory committee sent by the SASAC. It is the SASAC that holds the main control of central SOE-related issues. All in all, for central SOEs, SASAC is the most substantial competent authority.

Also, listing central SOEs not only introduces more regulators, like the Security Regulatory committee, but also leads to problems such as businesses that overlap between the group level and the listed company. The SASAC issues *Advice on Pushing Forward the Adjustment of State-owned Assets and the Reorganization of State-owned Enterprises* (State Council [2006] No. 97). In Section 2, Major Policy Guidance Article 4 clearly states that the SASAC should firmly press ahead with shareholding reform of state-owned enterprises. All large SOEs, excluding SOEs in national security industries, should be institutionalized step-by-step into diversified shareholding companies. The government's support for SOEs to be on the stock exchange can also be seen in Article 5, which states that it should vigorously advance the reform and the listing on the stock market of SOEs, raising the quality of listed companies. However, the SASAC's intention in supporting SOEs in seeking listing on the stock exchange, and encouraging already listed SOEs to transfer their main business funds into their listed company, may produce problems of conflict of interests, which will be discussed in detail in the next two chapters.

#### **4.5 Summary and Discussion**

This chapter redefines the SASAC's role in China's political and economic system by arguing that it is not just the financier and the facilitator but also acts as a transmitting body and a buffer area for central SOEs. The SASAC, as a pilot

agent in the developmental state context, adopts a market mechanism to promote the growth of central SOEs. In return, these central SOEs can further strengthen and push forward the growth of a functional developmental state model.

In theory, the SASAC is the government institution that central SOEs relate to; but in practice, there are other ministries and institutions involved as well. The Commission has to apply for approval for new start-up projects from the National Development and Reform Committee, to apply for research funding from the Ministry of Science and Technology, to report tax to the State Administration of Taxation, to apply for stock market entrance permits from the Security Regulatory Committee, and so on. Its autonomy and the rule that central SOEs' daily business should not be interfered with allow central SOEs flexibility in their enterprises' operation. This situation puts the SASAC in a dilemma, because allowing SOEs more autonomy not only decreases its own capacity in the principal-agent game but also reduces its power and lowers its status in China's political system, thus making it an institution that is not indispensable. However, it is also not feasible for the SASAC to monitor and control central SOEs too closely.

This thesis argues that China's development processes in the management of state-owned assets follow a developmental state path but use large central-government-owned SOEs instead of supporting an oligopoly of private

enterprises based on Japan's and Korea's previous development experiences.

*"The Chinese government and the Chinese tradition of centralized rule have never disappeared"* (Fukuyama 2014, 356). The SASAC is the important institution that motivates and promotes the processes, although it is not as powerful as the Ministry of International Trade and Information in Japan's developmental state period. The SASAC plays multiple roles, as the financier, coordinator and supervisor, and also serves as a transmitting body and a buffer area that adjust policies in ways that will promote the growth of state assets. In other words, it is the main facilitator of SOEs' development. It is the crucial government institution because it is the financier and supervisor of central SOEs, which can conduct inspections, examinations, and annual evaluations of central SOEs' performance. It can also regulate the total wage bills of individual central SOEs. Members of the Board of Supervisors are permanently resident in the central SOEs and audit any meetings and discussions, allowing the SASAC to keep itself informed. Fukuyama (2014,335) notes that there are two polarized interpretations of the region's successes. One side stresses the importance of market-friendly policies; the other side attributes success to state intervention and functional industrial policies. The SASAC, as the institution that provides state intervention to promote China's economic growth, also has limitations. Although it holds control over personnel matters, the Central Organization Department retains approval power. The SASAC also has the right to audit each central SOE's financial performance at any time, but the Ministry of Finance retains the ultimate control over state-owned capital operation budgets and

delivery of profits. The SASAC is the authority that approves major business mergers and acquisitions. However, it does not have the right to issue licenses, a right for which responsibility lies with the National Development and Reform Committee. Central SOEs have autonomy in dealing with most of their business, while other ministries and government institutions are in charge of functional problems. Central SOEs have to deal not only with the SASAC but also with different functional departments in charge of matters such as issuing licenses and giving permissions. However, the complexity of the administrative formalities in a way lowers the efficiency of the SOEs. Zhang (2010) points out that in a free market world, enterprises have to face the uncertain turbulence of the market, which promotes innovation. In China, enterprises have to deal with the frequent and unpredictable policy adjustments made by the Chinese government, which is a waste of time and efficiency. The complexity of administrative formalities also leaves plenty of space for the SOEs to play among different institutions, thus creating more asymmetric information.

The SASAC's latest 2016 version of *Measures for Assessment of the Operational Performance of Persons in Charge of Central Enterprises* presents the SASAC's requirements for central SOEs. Chapter 1, General Principles, Article 3 appeared for the first time in the latest version of the measures of SASAC Order No. 33 in 2016. It lists four principals the assessment has to follow. The first principle is to comply with the laws and regulations strictly. The second principal is to adhere to market reform, based on the requirements of the market economy. This supports

the argument of this thesis that market criteria have been adopted in the promotion of central SOEs' development. The third principle calls for the combination of incentives and constraints in assessment, which means that it is reasonable to study SASAC-central-SOE relations through the theoretical lens of principal-agent theory. The fourth principle emphasizes both short-term goals and long-term development plans, taking into consideration international standards and industrial standards. This principle takes into account both '*long-term development*' and '*international standards*'. It shows the developmental state logic in the SASAC's management of central SOEs.

In conclusion, the SASAC's presence in China's state ownership reform shows the government's determination to further strengthen its control over strategic sectors and key enterprises, while leaving marketplaces for private enterprise. As Breslin (2012:29) notes, "*China retains control of key industries and resources and thus shapes the nature of the market that non-state actors operate in.*" The Chinese government's visible hand in market activities promotes the economic growth of the country. It has selectively adopted the market mechanism in managing state-owned assets, and it not only motivates SOEs to be profitable but also consolidates the assets and power of the state. However, the state ownership reform process is constrained by historical developments as well as social stability pressures. Walder (2010: 6) believes that "*China's reform remains trapped by the fundamental contradictions between market liberalization and single-party dictatorship*". The contradictions have hindered the state ownership

reform process and prevented central SOEs from developing their market potential unfettered by political and historical burdens and pressures. Nevertheless, central SOEs have a degree of autonomy, and listing on the stock exchange separates the stock company from the group company and further strengthens their role as a market actor. The following two case study chapters will provide a detailed analysis of two central SOEs, one in a fully competitive industry and another that has monopoly status. The SOE reform has been driven, and will be driven, by institutional change. All in all, as the SASAC's first director, Mr Rongrong Li (2004), argues, "*We are moving from 'promoting the reform of the state asset management system through SOE reform' to 'promoting SOE reform through the reform of the state asset management system.'*" The SASAC will continue to play a crucial role in the state's strategy of governing through the market, and to lead forward the reform of central SOEs along a developmental state path by partially adopting market tools.

## Chapter 5 The China National Building Material Group Corporation—Three Layers of Organizational Power

### 5.1. Introduction

So far, this thesis has discussed the use of developmental state theory and market tools to assist growth. Our analysis of principal-agent theory has supported the argument that, with proper oversight mechanisms, state-owned enterprises can be efficient and competitive. In the previous chapter, the SASAC's role, function and responsibility in managing central SOEs were analyzed through the lenses of developmental state theory and principal-agent theory. The chapter argued that the SASAC was a pilot agency for the promotion of a developmental state model in the management of state assets. It also suggested that the SASAC played multiple roles in its relationship with central SOEs, a relationship that is both pragmatic and flexible. The SASAC chapter provided an understanding of the situation from the principal's side. The two case study chapters will give views from the agent's side. This thesis straddles the boundary between the political system and the market environment in China. The principal, the SASAC, has to regulate and oversee not sub-level government entities but enterprises that are involved in global market activities. As for the agents, the central SOEs, they have to confront market fluctuations while responding to their largest shareholder—the government.

The SASAC has roughly categorized central SOEs into two categories based on personnel management thinking: there are 53 central SOEs in the strategic sector whose senior executives have been approved by the Organization Department of the CCP; and there are the rest of the central SOEs – those in the competitive sector – whose senior executives are managed by the SASAC. Although the SASAC and the MoF (2016 No. 252) had issued policy customizing the assessment of central SOEs into three categories – commercial central SOEs in fully competitive industries; central SOEs in the strategic sector; and central SOEs in public welfare and public services – until 2017, the work of positioning central SOEs in precisely detailed categories had not been finished. So this thesis follows the current SASAC arrangement and chooses two of the central SOEs under the SASAC's administration as cases for analysis: the China National Building Material Group Corporation (CNBM), in a fully competitive industry; and the China National Petroleum Corporation (CNPC), in a monopolistic industry.

Drawing on first-hand interview data, the companies' annual reports, government regulations and stock exchange reports, this chapter provides a comprehensive understanding of the operation of central SOEs. Furthermore, this chapter focuses on discussion of this thesis's research question: How can enterprises in competitive industry operate in the free market while being owned by the state? Can SOEs be profitable without privatization? This chapter adopts the CNBM as the main case, with supplementary material from other central SOEs in a

competitive industry to support the argument. It provides an empirically based understanding of modern central SOEs and their interaction with the SASAC, as well as with other government institutions. The empirical chapters aim to answer the following sub-questions of the research.

1. How do central SOEs in a fully competitive industry work? Are they market actors, or arms of the government, or both?
2. Why does the SASAC encourage central SOEs to get listed on the stock exchange? Why is listing important?
3. How do central SOEs maintain state ownership while presenting excellent market performance? How do they operate as an enterprise while being constrained by the SASAC?

This chapter begins with an introduction to the China National Building Material Corporation and its listed company, the China National Building Material Co., Ltd. This will be followed by a discussion of this company's interaction with the SASAC and other relevant government institutions. The three layers of the CNBM's operating structure will then be discussed, as well as the difficulties and dilemmas it faces as a central SOE. In this chapter, the parent company, the China National Building Material Corporation, is abbreviated to 'the CNBM group' and its listed company, the China National Building Material Co., Ltd, is

abbreviated to ‘the CNBM listed company’. The findings of this chapter suggest that the state takes a back seat in terms of its role as manager. However, the state takes an active role as the principal that uses market mechanisms to supervise central SOEs in competitive industries. The Party focuses its role as the supervisor in the principal-agent relationship on conducting oversight and, at the same time, maintaining its ideological influence. This chapter also suggests that the three layers of the CSOE group structure tactically block government administrative-related work at the group level, leaving the listed company to focus on business practices, which is the key to answering the question of how Chinese central SOEs can be efficient and successful in the market while being owned by the state.

## **5.2. The China National Building Material Group Corporation (CNBM)**

### ***5.2.1. Company Overview***

The China National Building Material Group Corporation was established in 1984, with the leadership and approval of the State Council. Its main products include cement, lightweight building materials, glass fiber, flame resistant (FR) products, and engineering services. In 2003, it became one of the central SOEs under the SASAC’s administration. It has been assigned and committed to following the market path since its establishment. After the CNBM was created, the growth of

the group corporation was over 40 percent per year for ten consecutive years. The assets of the group corporation total 410 billion RMB, and it has 180,000 employees (CNBM group 2014). The CNBM group company was reformed and transformed into the largest building materials producer in China, with 17 wholly-owned subsidiaries and six listed companies, of which two are listed on an overseas stock market. The CNBM listed company is the group company's listed company. It was established on 28 March 2005 and was listed on the Hong Kong Stock Exchange on 23 March 2006, under the stock code HK 3323 (CNBM Co. Ltd., 2017). It was listed in the Morgan Stanley Index as constituent stock, in the Hang Seng Index as constituent stock, and in the Dow Jones China Offshore 50 Price Index. Concerning the market status of the company, by the end of 2014, the CNBM was the largest cement producer, the largest commercial concrete producer, the largest gypsum board producer and the largest rotor blade producer in the world (CNBM 2016 Annual Report).

The CNBM group is the type of traditional SOE under the government's direct control that does not issue financial reports or reveal its operational performance to the general public. However, the CNBM listed company issues an annual report according to the requirement of the Hong Kong Stock Exchange. The listed company is the business operational company, earning a profit based on market share and brand development. According to the SASAC Bureau of Planning and Development, the CNBM's main businesses are 1. Manufacture of building materials and equipment; 2. Relevant engineering and technological

research and services; 3. Trade in building materials and logistics. The SASAC urges CSOEs to adjust their development strategy to focus on their businesses, according to the regulations. The CSOEs should aim to make their main businesses, as overseen by the SASAC, stronger and bigger (SASACBPD [2005] No. 251). So the CNBM chose its best-performing assets to be listed on the stock exchange, so that the company could receive financing from the capital market. It can be seen from the above analysis that the CNBM group is a central SOE that, whilst owned by the SASAC, has its listed firm, the CNBM, on the Hong Kong stock exchange. The listed company aims for profit and market competitiveness; but at the same time, it has to conduct production activities in its three main business areas, as regulated by the SASAC. The structure of the CNBM group is set out below (CNBM 2016 annual report):

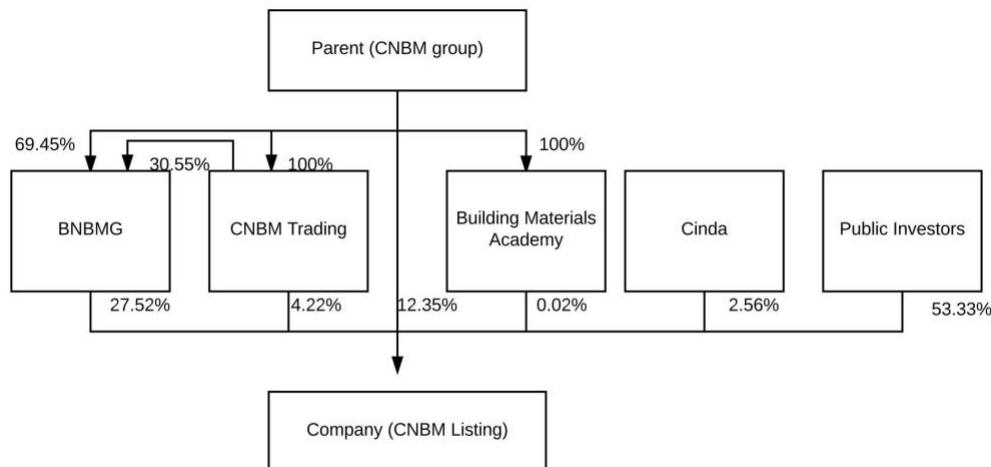


Figure 5.1 CNBM shareholding structure. Source: The China National Building Material Company Limited Annual Report, 2016. Note: percentages are rounded to two decimal places.

The above figure shows the shareholding structure of the CNBM Company Limited. The cross-boundary shareholding structure can be understood as the CNBM group operates 100 percent of CNBM Trading, and it also holds 69.45 percent of the Beijing New Building Materials Group Company (BNBMG). The China National Building Material Import and Export Company (CNBM Trading) holds another 30.55% of the BNBMG. BNBMG and CNBM Trading hold 27.52% and 4.22% of the CNBM listed company respectively. The CNBM group holds 100 percent of the China Building Materials Academy (Building Materials Academy) and the Building Materials Academy holds 0.02% of the CNBM listed company. The CNBM group directly holds 12.35% of the CNBM listed company. In brief, the figure can be interpreted as showing that 44.11% of CNBM listing is held by the CNBM Group through cross-shareholding. The other 2.56% of shares come from the China Cinda Asset Management Co., Ltd. Cinda was the first financial asset management company approved by the State Council, when it was established in 1999. Its responsibilities include defusing financial risk, maintaining the stability of the financial system, and promoting the reform and development of state-owned banks and enterprises. In 2010, the China Cinda Asset Management Co., Ltd was transformed into a joint-stock company listed on the Hong Kong Stock Exchange (Cinda 2017). The largest group of shareholders

of the CNBM listed company are the public investors who purchased shares on the Hong Kong Stock Exchange. Public investors hold over half (53.33%) of shares in the CNBM listed company.

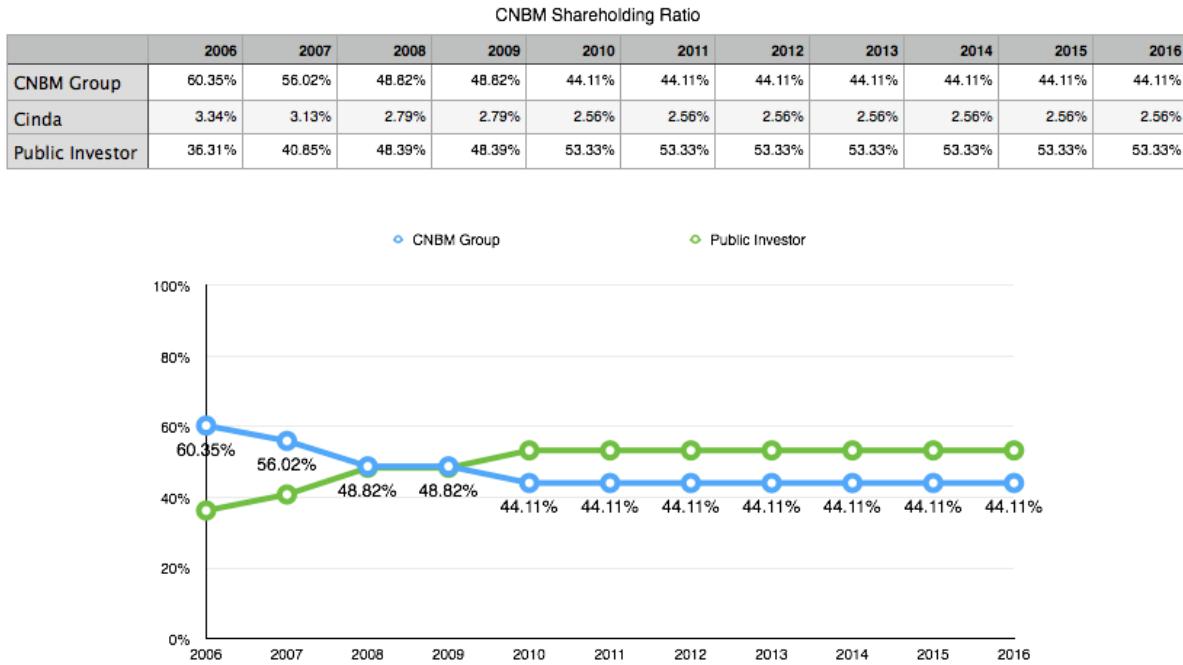


Figure 5.2. CNBM Shareholding Ratios from 2006-2016. Source: China National Building Material Company Limited Annual Report 2006-2016. Analyzed and presented by the author.

The above figure shows the evolving stream of shareholding ratios since the company was listed on the stock exchange in 2006. In the Interim Measures for the Management of State-owned Stocks in Limited Liability Companies (NABSP 1994[81]), Clause 11 decrees that state-owned shareholdings should include ‘absolute holdings’ and ‘relative holdings’. Absolute shareholdings refers to a

ratio of state-owned shares above 50%; while relative shareholdings refers to a ratio of state-owned shares between 30% and 50%. Due to the decentralization of stocks, the state retains the controlling power in the company. Although the above interim measures have expired, the definition of state-owned shareholding remains valid and can be found in the documents of the National Statistics Bureau (2003 No. 44). In this sense, the CNBM listed company can be defined as a state-owned enterprise in which the CNBM group has a relative shareholding.

There has been a marked change in the shareholding ratio for the company over the years. The CNBM group's share in the CNBM company dropped from 60.35% to 44.11% between the years 2006 and 2010. From 2010, it remained at 44.11% until 2016. The Cinda investment company, as a financial company affiliated to the State Council, slightly decreased its share in the CNBM company from 3.34% to 2.56% between 2006 and 2010, and has since kept its share at this level. By contrast, non-states investors, in other words, the general public and companies with other types of ownership that purchased the shares of the CNBM company on the Hong Kong stock exchange, increased their share from 36.31% to 53.33% between 2006 and 2010 – a ratio that also remained the same until 2016. The graph shows that there was a marked increase in the percentage of shares released to the general public between 2006 and 2010. This coincides with the early years of the SASAC's operation and shows the state's capacity for carrying out its reform plan for the marketization of central SOEs.

After our discussion of the shareholding structure of the CNBM listed company, we turn now to an analysis of the company's financial performance over the years since it was listed in 2006. Drawing on the 2006-2016 annual reports for the CNBM Co., Ltd, the next section will present a detailed analysis of the financial performance of the company over the years.

Currency: CNY ¥ Unit of measurement: 1000.

Exchange Rate: 1 GBP = 8.9 CNY (2016)

#### CNBM Company Limited: Financial Performance

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Assets	9,712,499	13,990,314	29,879,987	58,904,191	77,009,037	111,516,350	158,395,218	246,433,547	291,631,175	316,481,826	329,818,831	340,754,174
Revenue	4,726,544	6,451,830	10,514,411	26,365,159	33,297,363	51,987,763	80,058,470	87,217,629	117,687,840	122,011,222	100,362,429	101,546,783
Profit after Tax	492,119	489,160	1,148,733	1,873,356	3,077,893	4,743,040	10,745,739	7,736,986	8,311,870	8,671,647	2,792,762	2,822,244

Figure 5.3 CNBM total assets, revenue and profit after tax. Source: China National Building Material, Annual Reports from 2005-2016. Analyzed and presented by the author.

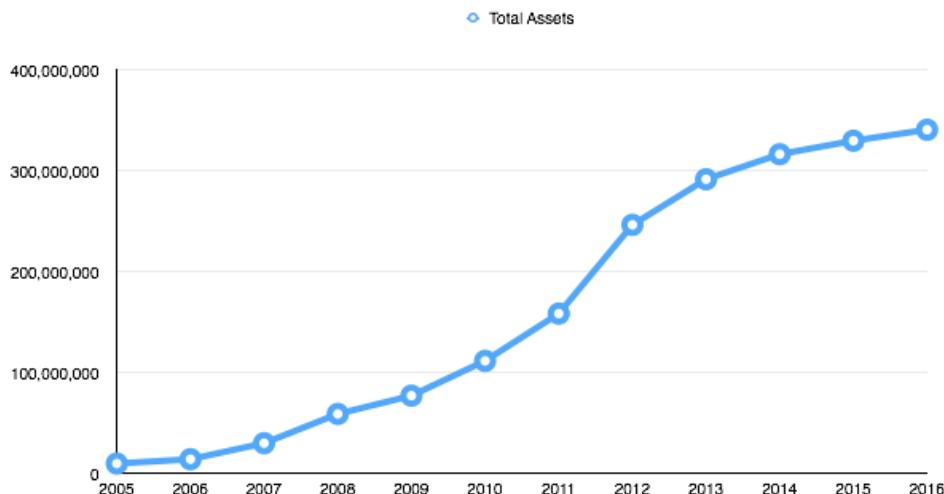


Figure 5.4 CNBM total assets from 2005-2016. Source: China National Building Material Company Limited, Annual Reports 2006-2016. Analyzed and presented by the Author.

Figure 5.4 shows that the total assets of the CNBM company increased steadily from 2007 and have risen dramatically since 2010. There are two main reasons that might explain the significant increase in the total assets of the CNBM. The company's listing on the Hong Kong Stock Exchange generated a large volume of funds, and this money enabled the CNBM to undertake a series of restructuring and reorganization initiatives, while thousands of private enterprises have been merged into the CNBM group since then. According to State Council Document No. 97 (SCGO 2006), Section 2 Article 5, the SASAC is expected to "Vigorously promote the organization by transforming and listing.....Encourage listed SOE firms to inject all their main business assets into the listed firm through methods like increasing capital and accumulating shares, acquisition of

assets, etc.” Section 2 Article 8 of the State Council document instructs the SASAC to “accelerate the restructuring and regrouping of large SOEs.....promoting the combination of powerful large SOEs..... forming reasonable industrial concentrations, cultivating giant group corporations that have global competitiveness.” This policy guidance, driven by developmental state logic, has encouraged and supported the remarkable growth of the CNBM company’s total assets from ¥13.99 billion in 2006 to ¥158.40 billion in 2011, the latter figure being more than 11 times of the original assets. The company has since doubled its assets to ¥340.75 billion in 2016.

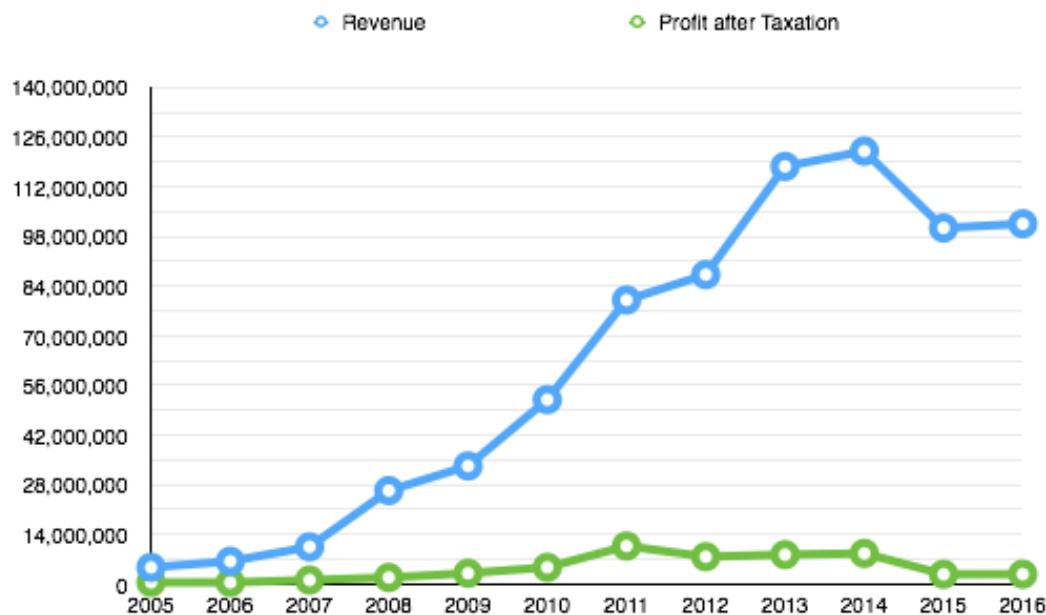


Figure 5.5 CNBM total revenue and profit after taxation, from 2005 to 2016.  
Source: China National Building Material Company Limited Annual Reports 2006-2016. Analyzed and presented by the Author.

The comparison of the total revenue and profit after taxation in figure 5.5 shows the operational performance of the company. The revenue is important not only because it shows the amount of money the CNBM received from its business every year, but also because the SASAC sees the Fortune 500 ranking as an indicator of central SOEs' global competitiveness, and the Fortune 500 listing ranks enterprises based on their revenue. Profit after taxation is also crucial to an understanding of a company's achievement in its business. The total revenue of the CNBM rose sharply from ¥6.45 billion in 2006 to ¥122.01 billion in 2014. However, it showed a drop to ¥100.36 billion in 2015, though there was a slight return to growth, with ¥101.55 billion, in 2016. Profit after taxation, on the other hand, does not seem to be positive. It showed a dramatic growth from 2006 on, and reached a peak, at ¥10.75 billion, in 2011; but this was followed by a decline to ¥7.74 billion in 2012. After further steady growth to ¥8.67 billion in 2014, it experienced a steep fall to ¥2.79 billion in 2015. Finally, there was a slight increase to ¥2.82 billion in 2016, but this was still lower than the ¥3.08 billion in 2009, and profit after taxation remains poor.

The above data shows that the CNBM's total assets increased gradually, year by year, while the revenue rose as well, until it started to drop in 2014. Profit after taxation, however, has not been ideal since 2011. These data demonstrate that the company's profitability was excellent from 2006 until 2011; but starting from 2011, the company grew in size and revenue but not profit. Even though the total assets doubled from 2011 to 2016, there was a sharp drop in the profit. A

possible explanation is that the building materials industry was in recession after 2011. In particular, the cement industry suffered from excess capacity. This probably offers an explanation for the CNBM's acquisition of the China National Materials Group (Sinoma), which was announced by the SASAC, and later approved by the Ministry of Commerce Anti-monopoly Bureau, in 2017. This acquisition case is a reflection of developmental state thinking, as discussed in the policy document issued by the State Council and the SASAC (SCGO 2016 No. 56). In chapter 3, section 3, it rules that some CSOEs should be regrouped to "promote the combining of CSOEs.....through the centralization of resources, reduce the disruption of competition.....and effectively deal with the excess capacity of related industries such as construction, steel, building materials....." If Fligstein and Zhang (2010, 47) are correct in arguing that China's development is not through a bottom-up approach, but rather shows the continuing presence of the country's all powerful government as a coordinator, then does this lead to the conclusion that the strong position of the Chinese state can ensure that the developmental state model can be enforced properly without being disrupted by any other political or economic factors? The previous chapter presented the perspective of the principal—the SASAC. Drawing on fieldwork interview data, SASAC policies, and regulations issued by other regulatory agencies, the following section gives the view of the agent—the CSOE. In practice, how does the CNBM deal with a developmental state type of bureaucratic control while competing in both domestic and international market?

### *5.2.2 The CNBM's Interaction with Government Institutions*

The unusual characteristic of the Chinese economy is the state's powerful and assertive presence in the market economy, in which it owns a substantial number of assets in large-scale companies in strategic industries (Naughton 2017, 5). The SASAC, as the largest shareholder, has an interest in making the CNBM profitable. As the principal, it issues ex ante administrative policies to regulate the CNBM and also operates an ex post oversight mechanism by sending members of the Supervisory Board to the head office of the CNBM to monitor meetings and financial performance. It also worked with company to get it listed on the stock exchange and has cooperated with inspection teams sent by the Central Discipline Committee and the National Audit Office. So, from the perspective of the agent, the CNBM, is the SASAC a powerful principal? Or it is just a government institution that gives formal validity to the company's existence? Are there other government institutions that are equally or even more important than the SASAC? With which other government departments do central SOEs have frequent contact?

As we have seen, the agent holds more information than the principal in any principal-agent relationship. This puts the principal at a disadvantage in finding out about and supervising performance (Pollack 1997, 108). Miller (2005, 204) further extends Max Weber's identification of the asymmetric relationship in politics in which authority is located on one side and an information advantage on

the other. The asymmetric distribution of information between the principal and the agent may lead to evasive behavior and the incurring of extra cost by the agent. In the context of this research, the SASAC is the principal that is assumed to be disadvantaged in terms of information when compared with its agents, the central SOEs. Chapters 3 and 4 examined the SASAC's way of solving the problem of its information disadvantage and we analyzed both police patrol oversight and fire alarm oversight. As can be seen from Jensen's (2007, 454) argument, the police patrol strategy is a top-down supervision mechanism which puts more emphasis on administrative means, while the fire alarm oversight depends more on bottom-up information-sharing based on mutual interests and requires cooperation among the various actors.

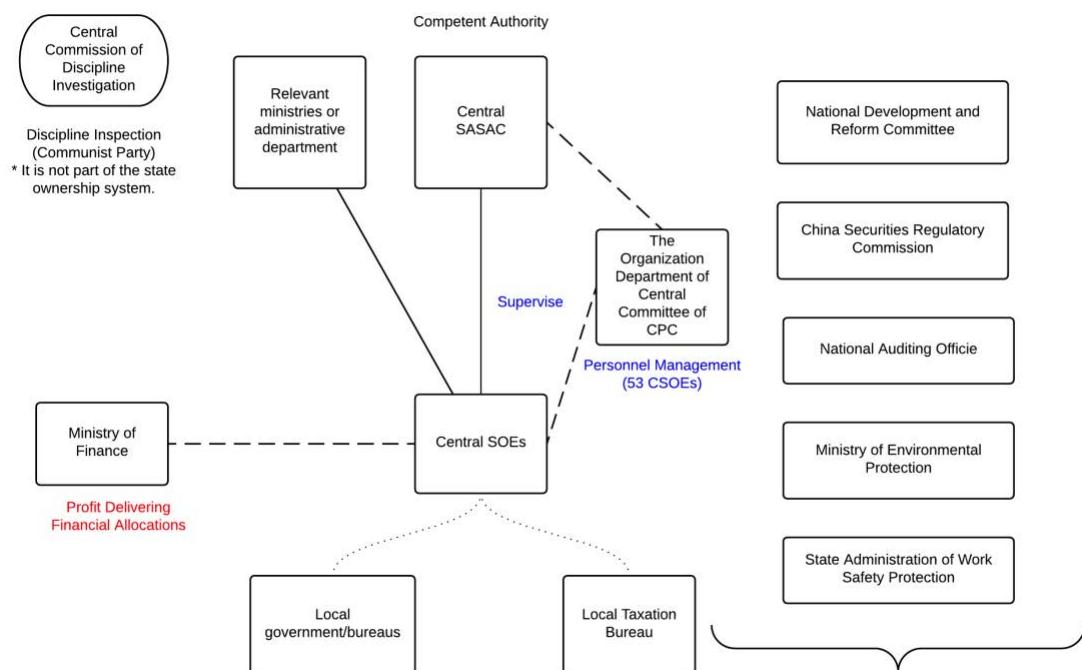


Figure 4.5 Interactions among the SASAC, central SOEs and relevant governmental institutions. Note: Created by the author in 2017. (The same figure is presented in chapter 4.)

The fieldwork interviews confirmed the argument that the SASAC is the primary and the only principal that all central SOEs have dealings with. However, other government institutions have an equal importance in different areas of business. This section will be divided into two parts: it starts with the perspective of the CNBM group, a group that is a traditional SOE still influenced by its planned-economy past, and we shall look at its interactions with the SASAC and other ministries. It then moves to discussion of the CNBM listed company, which is the operating company of the CNBM group, and which has new corporate governance and all the other characteristics that fit the standards of the Hong Kong Stock Exchange.

The CNBM group was established in 1984 under the leadership of the State Council. The group, as the head office, does not itself conduct business. Instead, it works as the strategic center of the business. [REDACTED] (BJCNBM/08/2015), former vice-president and board member of the CNBM group, notes that the government department he contacted most frequently was the SASAC, which conducted general supervision and oversight of the details of the group's operations and performance. [REDACTED] (BJCNBM/12/2015) agrees with Xu, and he describes the group's work as acting as a coordinating center that reports to

government institutions while relaying the government's guidance and regulations down to the operational branches. [ ] (BJCNBM/10/2015) provides a similar view. She sees the SASAC as a very strict supervisor that examines every detail of the group's annual financial report and asks for revisions, while the ministry of finance only asks for the main forms. Accordingly, the SASAC is the principal of the CNBM group. Are there any other ministries or institutions relevant to the operation of the CNBM group?

Based on the empirical evidence given by staff interviewed, as seen in figure 4.5, for CSOEs, after the SASAC, the Ministry of Finance and the Organization Department of the CCP are the two of the most important central agencies. The Organization Department of the CCP controls appointments to the 53 CSOEs in strategic industries. The Ministry of Finance is another influential organization and it is in charge of delivering profit from the CSOEs to the state and allocating finance to the CSOEs. There are also other ministries that are essential to the CNBM group's work. Which are the relevant ministries or administrative departments for a CSOE depends on which is its competent operational authority, and this varies for the different industries. For example, the China State Construction Engineering Corporation (CSCEC) is a construction CSOE, which reports to the SASAC as its boss, while the Ministry of Housing and Urban-Rural Development (MOHURD) is its competent operational authority, because the MOHURD is in charge of issuing qualifications, national construction standards and so on ([ ] BJCSCCEC/01/2015). As for the CNBM, it reports to the Ministry of

Industry and Information Technology (MIIT) as its competent operational authority.

The five government institutions and regulatory committees, as seen on the right side of figure 5.4, are the most frequently contacted government entities for the CSOEs, as was learned from the fieldwork data. The first institution is the National Development and Reform Commission (NDRC), which is known, because of its powerful position in the government system, as the “mini-state council”. Its core functions range from monitoring macroeconomic trends to issuing licenses and regulating oil price. It was described as the ministry that CSOEs contacted very frequently. Members of the National Audit Office (NAO) are sent to CSOEs as an oversight mechanism, and the CSOEs do not take the initiative and approach the NAO. The China Security Regulatory Committee (CSRC) is an important actor because most of the CSOEs are listed companies. The Ministry of Environmental Protection and the State Administration of Work Safety Protection have to do with the technical issues during the business operation of the CSOEs.

As noted in the previous chapters, in theory, the SASAC, as the principal, is involved in all activities related to CSOEs. In practice, the SASAC’s internal bureaus are connected to the CNBM’s functional departments in relation to issues such as financial supervision, planning and development, work safety, party related activities, etc. In practice, how do we understand the overlapping of

responsibilities among the SASAC and other functional ministries? (BJCNBM/12/2015) uses an example to explain the different roles these government institutions play in CSOE businesses. In this example, in one of a CSOE's factories an industrial accident takes place. The State Administration of Work Safety will be on site to handle and investigate the accident while clarifying responsibilities. The SASAC will issue a penalty to the enterprise and lower the grade of the senior executives in their annual performance review (SASAC 2008 No. 21). It is easy to clarify the relationship between the SASAC and the technical-issue-related ministries. The SASAC acts as the investor to supervise the SOEs, while the relevant government department serves as a professional administrative authority in dealing with particular issues.

#### Assessing the Performances based on a Market Standard

As the principal that conducts all-round supervision of CSOEs, the SASAC uses various ex ante administrative regulations and ex post oversight mechanisms. It also has a coordinating role, with the Organization Department of the CCP, in personnel management, and with the Ministry of Finance in the supervision of financial activities. The Board of Supervisors, which is unique to China's state assets management system, carries out on-site monitoring of the agents, the CSOEs. Members of the Board of Supervisors are sent by the SASAC to permanent positions in companies and keep a regular watch on the enterprises' management (BJCNBM/08/2015). These supervisors attend monthly

meetings and have the right to review all company documents. They provide their annual examination report to the SASAC based on their observation of the CSOE (█ BJCNBM/03/2015). The Supervisory Board is under pressure to make sure CSOEs' activities are following the SASAC's regulations. As █ (BJSASAC/13/2015) notes, the SASAC increasingly raises its standard for CSOEs' information disclosure, drawing on Sweden's experience. The SASAC's ex ante administrative rules do guarantee the correct process is followed by its agent, but at the same time, they lower the efficiency of business activities. The SASAC sometimes oversteps its authority as the largest investor in the company and involves itself and the CSOEs in tedious administrative work.

So far, this section has focused on interaction with the government at the CNBM group level. The following section will move on to the CNBM listed company. As we asked in an earlier chapter, what does the SASAC expect from CSOEs in competitive industries? The answer is revenue, profit and return on assets. CSOEs in competitive sectors, as listed companies, put their highperforming assets on the stock exchange. After that, the listed company becomes the 'normal' enterprise and seeks to conduct its business profitably. The CNBM listed company's profit contributes more than 90% of the CNBM group's overall profit (the precise figure is not publically available) (█ BJCNBM/08/2015). The SASAC aims to restructure all the operating companies into transparent and focused joint-stock corporations in the long run. By doing so, the SOEs will be able to operate without being disturbed by the semi-bureaucratic and opaque

holding companies (Naughton 2008,25). The CNBM listed company has as its primary goal the guaranteeing of shareholders' equity, which indicates profit. Thus, the goal of the CNBM listed company suits the SASAC's requirement for CSOEs in competitive sectors.

As a listed company, the CNBM's primary goal is to make a profit. By earning enough profit, the CNBM listed company can guarantee shareholders' return on equity, as well as employees' bonuses and welfare. However, as a listed company, the CNBM still has to comply with SASAC regulations, because the SASAC holds 44.11% of shares and is the largest shareholder in the listed company. The SASAC's evaluation of the company's performance not only pays attention to profit and social responsibility but also to work safety. The SASAC's attention to work safety can be seen in its annual evaluation of CSOE senior executives, which rules that the company is not qualified to be selected as one of the "advanced units" if any serious work accident has happened (SASAC 2016 No. 33).

The SASAC's assessment of central SOEs ranks them at ABC and D levels and this affects the salary standards of senior executives, but not those of ordinary staff. The SASAC (2016) also discloses the annual salaries of the top executives of all CSOEs, so that these can be viewed by the general public; and the wage levels of the whole group, including ordinary staff, have to be adjusted according to the SASAC's regulations. ■■■ (BJCNBM/07/2015) notes that the SASAC

regulates the gross payroll of the whole company. The total payroll fluctuates alongside the company's yearly profit. For example, if the profits of the company increase by 10% from the previous year, the growth of the gross payroll has to be lower than 10%, at around 7% to 8%. The SASAC is in charge of examining and approving the CSOEs' gross payroll. It (SASACBED 2005 No. 303) sees creating a link between gross payroll and economic benefit as the state's main tool in adjusting total wages and growth in pay levels in the CSOEs.

Apart from money, the SASAC also has other expectations of the CNBM listed company. The company is also in contact with the SASAC and other relevant ministries, working as a megaphone that passes on information about the difficulties of the industry it operates in. [REDACTED] (BJCNBM/04/2015) notes that the CNBM listed company works with the Ministry of Industry and Information Technology in closing down outdated production facilities. Communication between central SOEs and the government works very well. The CNBM listed company's technology department sends staff to work and be based at the MIIT; and it facilitates the exchange of information between central SOEs and the government. The company also sends teams to government-held meetings with industrial associations to discuss the creation of industrial standards, and to seminars to discuss how to control excess production capacity. The CNBM listed company not only attends the meetings held by different ministries and industrial associations, but it also holds meetings that invite relevant ministries to participate. [REDACTED] (BJCNBM/03/2015) notes that when the CNBM held meetings to

discuss its grand strategy for the merger and acquisition of businesses, the MoF, the State Administration of Taxation, the People's Bank of China, and the Banking Regulatory Committee were invited to discuss the extension of loans.

To conclude, both the CNBM group and the CNBM listed company see the SASAC as their principal. They do interact with other relevant ministries for professional guidance and cooperation; but the SASAC's comprehensive supervision of them remains strong.

## 5.3 Surviving the Market

### 5.3.1. *Competing in the free market*

The accession of China to the WTO in 2001 made it impossible for the Chinese state to avoid opening up more of its market to companies with private and foreign ownership. However, the companies that are in the strategic sector remain in a state monopoly. The government has opened some parts of the industrial chain for private and foreign investment; but the key resources and licenses are held by Chinese CSOEs. This means that central SOEs usually get hold of the most profitable business areas, which guarantee their monopolistic market status. As Chen and Li (2015, 6) point out in their discussion of the thermal power industry, the coal retail business and entrance to the energy

market are open to public investors, while access to electricity generation and the electricity network are to some extent restricted. Therefore, although a large number of non-SOEs in the thermal power industry have been closed down, profitability in the electric power industry remains high for SOEs. As noted in an earlier section, the CNBM is doing business in a fully competitive industry. It does not enjoy privileges in terms of natural resources, licensing or market protection policies. Jacques (2012, 229) notes the hybrid nature of Chinese SOEs, which combines characteristics from both private and state enterprises. The CNBM is, in fact, like any other company in the world in seeking business, revenue and – most importantly—profit.

As noted in the principal-agent theory chapter, the SASAC's requirement for CSOEs lies in profit and return on assets. The latest version of Assessment of CSOEs further clarifies that, for CSOEs in competitive industries, the primary requirement is the maintenance and growth of state assets, which focuses assessment on Economic Value Added (EVA) and profit, taking mid- to long-term growth capacity into consideration. The CSOEs are encouraged to accept social responsibilities on the premise that this fits with the rules of the market economy (SASAC and MoF 2016 No. 252). How does the CNBM, as a CSOE in a competitive industry, see its primary goal and target? In practice, [redacted] (BJCNBM/08/2015) agrees that the most important goal for the CNBM is profit. Firstly, this is because being profitable is the major part of the SASAC's requirement for the CNBM. Apart from the profitability of the company as an

essential criterion, the total revenue is equally important, because the Global Fortune 500 list is based on an evaluation of the annual revenue of a company. It can be seen from the interview that the CNBM (both at group and listed company level) takes profit and revenue as its primary goals. By linking the salary levels of senior executives with the total payroll of the entire company, the SASAC successfully incentivizes CSOEs to follow the SASAC's goal: that is to be profitable and competitive in the market. ■ (BJCNBM/07/2015) agrees with Xu that the CNBM's primary goal is to make a profit. Unlike CSOEs in monopoly industries, which accept a government function, but at the same time hold natural resources or rare operational permits, the CNBM is a CSOE in name, but the government barely allocates any resources to the company. The building material industry is fully competitive, so that the business has to survive the market by itself.

Having discussed the CNBM as a market actor that takes profit and revenue as its primary goals, in accordance with the SASAC's requirement, we turn to look at how the CNBM achieves these profoundly market standard goals while dealing with government-related administrative work at the same time. The findings of this case-study chapter suggest that the CNBM has a relatively high level of autonomy in its business operation. The SASAC is more like an authority that makes a grand framework for state assets management, as well as regulating working procedures. After all, it is the CNBM, not the SASAC, that is the expert in building material industries. ■ (BJCNBM/08/2015) notes that before he retired

from his position as vice-president of the CNBM group, most of his time at work was spent dealing with the government. There used to be countless meetings on supervisions, inspections and reports. After Xi Jinping had taken office, in 2012, the number of government meetings, conferences and reports was reduced significantly. Xu also points to the SASAC's efforts in simplifying administrative procedures and delegating more power to CSOEs in the competitive market.

In summary, the CSOEs in fully competitive industries are becoming more like market actors, aiming to increase of their profitability and competitiveness rather than behaving as a governmental bureau. This trend suits the SASAC's goal and the requirement for CSOEs in a competitive market as well; so that the problem has become: what makes the transformation of Chinese CSOEs from a soviet planned economy legacy to modern corporations go smoothly and well? The most likely explanation is the SASAC's reform plan for listing the CSOEs' best-performing assets on the stock exchange. After an asset-stripping process, the CSOE listed companies can get rid of their junk assets and social welfare burdens and finally become modern corporations like their foreign counterparts.

### ***5.3.2. Becoming a listed company***

The SASAC supports the reform and overall listing of SOEs and promotes the growth of competitiveness among listed companies (SASACBPR 2009 No. 123). It also encourages the SOEs that are already listed on the stock market to transfer their central business funds from the group to the listed company (SCGO [2006] No. 97). In particular, the SASAC encourages the CSOEs to become listed on foreign stock exchanges to meet international standards. As Li (2004) adds, “We (SASAC) want the central SOEs to have a normative corporate governance structure and to follow the right path in the joint-stock system from the very beginning”. As noted earlier in the principal-agent discussion, apart from the SASAC’s various kinds of oversight activities based on its own internal bureaucratic system as well as on working with other ministries, the SASAC has also introduced the Security Regulatory Committee and the stock exchanges as external supervision agents to monitor the CSOEs’ performances.

Under the SASAC’s guidance, the CNBM, as a central SOE in the fully competitive market, established its listed company in 2004 and was on the Hong Kong Stock Exchange in 2005. The listing of CSOEs is something that needs to be approved by the China Security Regulatory Commission (HKEX 2017 HKEX-GL55-13). In order to support Chinese enterprises (including SOEs) in raising capital on the international market, the CSRC (1999 No. 83) issued the *Notice on Relevant Issues Relating to Enterprises Applying for Overseas Listing*, which

noted that SOEs could be reformed into joint stock companies and apply for overseas listing. In 2012, the CSRC (2012 No. 45) issued the new version of the above 1999 No. 83 notice, which simplified the application process and shortened the review procedure.

By listing the CNBM's quality assets on the stock exchange, the SASAC created the same goal for the CNBM listed company as its public shareholders had for it: that of being profitable in the marketplace. Wang, Guthrie and Xiao's (2012, 253) research suggests that the SASAC and concentration of the ownership of SOEs has had a positive impact on companies' performance. ■■■ (BJCNBM/04/2015) notes that the SASAC's assessment and evaluation of the CNBM group focuses on key performance indicators (KPIs) like total revenue and total profit. The CNBM listed company is on the stock exchange, which means it takes the interests of the shareholders as its top priority. Since the SASAC is the largest shareholder, it shares this goal with the CNBM listed company. Zeng further points out that the CNBM listed company enjoys a high level of autonomy concerning business activities. After all, it is the CNBM that best understands the business and the market situation.

Recognizing the failure of shock therapy that advances political reform before economic reform, the Chinese government took the opposite route. China sees a stable political environment as a precondition for economic development (Li, Brødsgaard and Jacobsen 2010, 305). Listing CSOEs' best-performing assets on

the stock exchange can bring many benefits. The listed company can focus on meeting market competition, while leaving historical burdens, like issues related to redundant staff, to the group level. The listing of central SOEs helps the government to avoid discussions of ownership and privatization. Consequently, the government can advance its reform through changes to competition and incentives within the structure of the state ownership system (Xu 2000,94). This argument is supported by Yang and Zhao (2014, 67), who correctly state that “China’s market-oriented reform does not weaken state intervention in the economy but only changes the form of intervention.” Indeed, as argued in the previous chapters, the Chinese state’s strong capacity in economic activities allows it to adjust its policies when needed. China is ideologically free in making policies for economic development purposes.

The CNBM was listed on the Hong Kong Stock Exchange on 23 March 2006 under the stock code HK 3323 (CNBM Co. Ltd., 2017). The process included cooperation with professional accounting and legal firms and a firm of consultants, as well as intermediary organizations. ■■■ (BJCNBM/10/2015) disagrees with Wang, Guthrie and Xiao’s (2012, 257) view, and argues that it is not the state that has a strong hand in deciding which parts of a group’s assets should be on the stock exchange. It was the CNBM preparation team that made the decisions and reported to the SASAC for final approval. ■■■ (BJCNBM/09/2015) notes that the listing process was managed in accordance with the HKEX regulations, and it was the CNBM preparation team that decided

which parts of the firm's assets should be stripped. The company produced a "mock financial statement" for a three-year term as part of the preparation process before the final listing in 2007. The strongest performing assets in the CNBM were selected to be included in the listed company because shareholders valued the return on their investment the most.

The shareholding structure of the CNBM was in the form of a cross holding by three of the CNBM group's subsidiaries. Two of the group's subsidiaries, namely the Beijing New Building Material (Group) Co., Ltd (SHE: 000786) and the Luoyang Glass Co., Ltd (SHA: 600876) were already listed. ■■■ (BJCNBM/09/2015) notes that the asset stripping process was carried out again in the CNBM listing preparation. The required documents for listing also had to be obtained from the Ministry of Environmental Protection and the State Administration of Work Safety. The central government's stringent requirements on matters related to environmental protection led to an increasing cost to this CSOE. The cost to the CNBM of environmental protection activities is high, due to its five cement subsidiaries' annual spending on the purchase of carbon emission credits, which in total exceeds more than 90 million RMB (9.2 million GBP). The CNBM listed company drew on the cooperation of firms of consultants in Hong Kong for suggestions such as which businesses were more popular on the stock market. The CNBM worked with about 12 companies that had expertise in accounting, assets appraisal, the law and so on. The CNBM listing took around one to two years from the asset stripping to the stock listing.

Apart from having to get a large number of documents approved by different central ministries, the company also had to interact with many different local government departments for various kinds of proof: for instance, local land resource bureaus for land warrants and local taxation offices for proof of tax paid. The CNBM's operating companies and building materials factories are located in different provinces. China started its system of tax division between central and local governments in 1994 (State Council 1993 No. 85). According to Bardhan and Mookherjee (2016, 25), decentralization in China lies in the administrative and economic field, and was the central government's tool in motivating local governments to develop the economy actively. Under this system, even though the CNBM's headquarters building is located in Beijing, it does not pay income tax or tax on its turnover to the local authorities in Beijing, only a small amount of business tax. The CNBM's operating subsidiaries' taxation is incurred by its business operations and has to be handed to the local governments where the operating companies or factories are registered.

This section explains the listing process of the CNBM, which supports the argument of this thesis that through having their assets listed on the stock exchange, the CSOE listed companies become market actors that are set up to take their shareholders' interests as their top priority. This profit-oriented marketization of central SOEs in competitive industries suits the SASAC's market criteria in assessing the central SOEs' performance. The listing also assists

supervision by the principal—the SASAC – of its agents’—the central SOEs’ – performance. As argued in an earlier chapter, the SASAC’s developmental state model of governance lies in the creation of a broad framework and the regulating of work processes. As part of SOE reform, the SASAC is the institution that promotes the moving of CSOEs onto the stock exchange. This leads to the question of how CSOEs can be market actors while dealing with countless reports and supervision inspections from central ministries and, even more importantly, being asked to provide public goods and achieve political goals. If the SASAC is going to grant more autonomy to these enterprises through strengthening its overall supervision of CSOE groups, while leaving their subsidiaries to be directed by the groups (State Council 2015 No. 63), what will be the nature of the interaction between the group and the listed companies? The following section presents the pyramidal operational structure found inside the CSOEs. It explains the functions, roles and interactions of the CNBM group, the CNBM listed company, and the CNBM subsidiaries.

### 5.3.3. The three layers of the CNBM group corporation

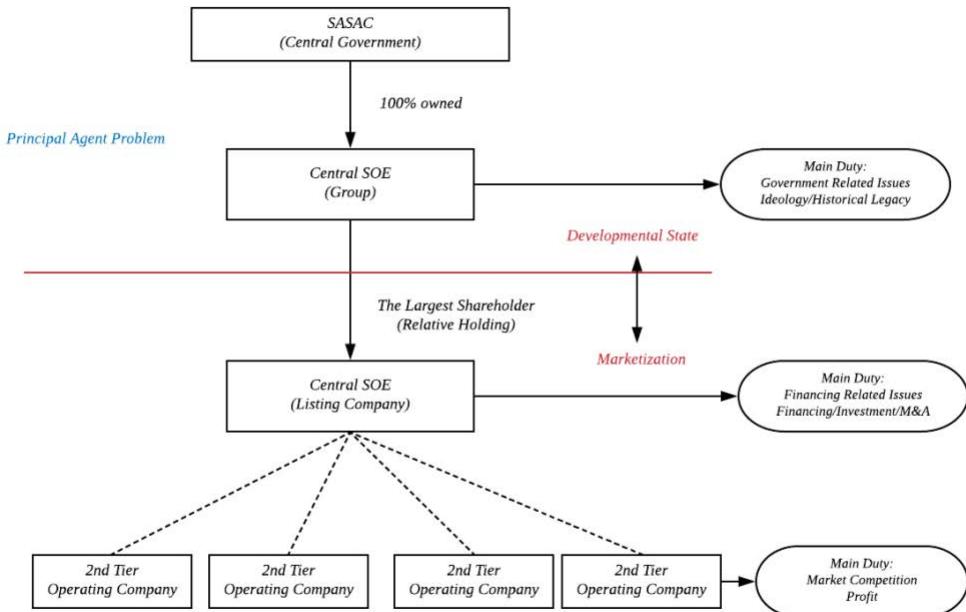


Figure 5.6: The three layers of the organizational structure of a CSOE. Drawn up by the author (May 2017).

The company has, maybe unconsciously, generated three layers of operation inside the group corporation, which presents a certain form of ‘division of labor’. In the CNBM group corporation, there is the highest level—the CNBM group corporation as the parent company, which is 100% (no publicly available data) owned by the SASAC. In the second level is the CNBM listed company, which is listed on the Hong Kong Stock Exchange and has more than 90% of the group’s

best-performing assets. The third level is made up of the CNBM listed company's second-tier operating companies, such as China United Cement (100%), South Cement (80%), CNBM Investment (100%), etc. The CNBM group, as the parent company, works as a strategic center that cooperates closely with the SASAC and other relevant ministries. The CNBM listed company's main duties include financing, capital raising and investing. The second-tier companies, as the operating subsidiaries, are business entities that compete in the market. The 'division of labor' among these three layers means that each is in charge of different kinds of work that guarantee the company's efficiency and profitability.

This draws on Sutherland and Ning's (2015, 231) analysis of the pyramidal form of enterprise structure used in China's state-controlled business groups. However, this thesis only half agrees with Sutherland and Ning's argument that the capacity of large SOE groups may undermine the party state's broader objectives in building global competitive firms, as some groups have developed pyramidal structures that are driven by the interests of managers. The complex structure of the SOE group may indeed increase the problem of insider control and their personal benefits. The complex inside structure of the company, in particular the second-tier companies and their subsidiaries, makes it difficult for the state to conduct effective oversight. However, the three layers of operation also help to increase CSOEs' efficiency.

In this research, the CNBM group, the CNBM listed company and the second tier subsidiaries form a pyramidal division of labor. The CNBM group takes the administrative roles and leaves the listed company to focus on the business operation relatively free from administrative activity. ■■■ (BJCNBM/10/2015) shared her working experience of the CNBM group, where her daily work was to write reports to the SASAC and the Ministry of Finance, and frequently to revise the group's financial reports according to the SASAC's advice. The SASAC's supervision of the CNBM group was very strict and detailed. After moving to a position in the CNBM listed company, she usually interacted with tax offices, banks, and the security regulatory committee when issues of refinancing occurred. Pei further notes that the SASAC held many meetings to examine meticulously the details of every accounting statement of the group. The group spent lots of energy and time on SASAC-administrative-related jobs. The members of the Board of Supervisors located in the CNBM group by the SASAC also examined and checked the work often. The SASAC has very detailed and strict regulations for the central SOEs. ■■■ (BJCNBM/11/2015) sees the CNBM group's work as, on the one hand, dealing with most of the administrative jobs and leaving the CNBM listed company to focus on profit earning, and on the other, helping the CNBM listed company to apply for more support, like research funding and other preferential treatment from the government. It can be seen from the above that the SASAC conducts strict supervision at the group level. As for the listed company, the SASAC introduces professional regulators, such as members of the Security Regulatory Committee and personnel from the Hong

Kong Stock Exchange, as well as public shareholders, to conduct supervisory roles. The three layers of the business operation structure and the division of labor make the listed company and its subsidiaries more efficient, but in a way, it also blocks the SASAC's oversight at the group level, because members of the Board of Supervisors (from the SASAC) are in the CNBM group.

This section presents the three layers of operational structure and shows that this structure brings more good than bad to the management of CSOEs in competitive industries, based on the understanding that the SASAC's assessment of CSOEs in competitive industries focuses mainly on revenue, profit and return on assets. These evaluation criteria can easily be passed down through the layers from the listed company to second, third and fourth tier businesses and the factories of each. Since the CNBM is located in a competitive industry, unlike CSOEs in petroleum or electricity, it follows a vertical line of administration. The CNBM subsidiaries do not need to report to, or listen to, the local SASAC. However, the downside of this is that the many layers inside the group decrease the efficiency of the company and make it difficult for the principal—the SASAC – to monitor the operations of the lower end of the enterprise's operations. Moreover, is it necessary to have the group level if the listed company is efficient enough to direct the business of running of the entire group? The China State Construction Engineering Corporation (CSCEC) is a wholly listed CSOE in which the group and the listed company are the same company and are managed by the same team. The CSOE group-level reform is

the toughest part of China's state assets reform. The SASAC has tried to pass its reform plan on to the group level. The central authority's latest guide for deepening the reform of SOEs suggests that, for all commercial SOEs in fully competitive industries, reform should be undertaken by introducing a corporate and shareholding system to the company..... to further promote the reform and listing of the SOEs..... and the aim is to have overall listing of the entire group of companies (CCP and State Council 2015).

#### **5.4. The Fictitious Crown as a Central SOE**

What does the title of CSOE bring to the CNBM? How does it benefit from being owned by the state? Does it have any subsidies, preferential loans and development funds from the government? What about the historical burdens handed down from its planned economy past? As Walder (2010, 34) suggests, ownership has been highly diversified in China's large-scale corporate sector. The CNBM's competitors in the building materials industry include not only other SOEs but also private and foreign enterprises. The CNBM operates a fully competitive company, which means the government is unlikely to invest more funds in it. The CNBM rarely has any, or has very little, subsidy from the government (Pei BJCNBM/10/205). ■ (BJCNBM/08/2015) sees the CNBM's advantages as coming not from state subsidies but from the company's large number of professional managers and technical experts. The company has been

in the building materials industry for a long time, so it can better understand and analyze industrial development in this area. The SASAC works on reducing administrative procedures and delegating more power to central SOEs. ■■■

(BJCNBM/08/2015) notes that in the past, the administrative power was highly centralized, which made the company less flexible than now. ■■■

(BJCNBM/12/2015) agrees, and points out that, in the past, the SASAC had very detailed regulations stipulating what could and should be done. After years of reform, the SASAC published a 'negative list' to regulate CSOEs and this stated what could not be done. This change significantly increased the company's autonomy in its business activities.

However, central SOEs and SOEs in general are, at the same time, bound by historical legacies inherited from the period of planned economy. Li and Brødsgaard (2013, 56) assert that SOEs' inefficiency can be attributed to two major factors: the lack of incentives for the SOEs' workforce; and the heavy social burdens SOEs used to carry. Since 1979, the State Council and the Ministry of Finance have issued a series of policy papers to create incentives for the SOE workforce. These started with the reform that allowed the SOE to retain part of its profit as funds for the company's development (State Council 1979, State Council 1983 No. 75; MoF 1984). These policies were issued to provide economic incentives for the managers and the staff to work hard for better progress. After 30 years of letting SOEs retain their profit, the Ministry of Finance

and the SASAC (2007 No. 309) recentralized the power and requested that the CSOEs hand - their proceeds back to the central state.

The social burdens, including overstaffing, were due to the SOEs' incapacity to lay off redundant workers, in case they upset social stability. This was due to the social functions the SOEs (mostly local government owned SOEs and some local branches of Central SOEs) inherited from the planned-economy past. The problem of overstaffing can be widely seen in the northeastern provinces, which used to be the center of heavy industry in China. According to Wen and Song (2015, 13), there are a number of bankrupt local SOEs with outstanding debts. Therefore, they are unable to put their retired employees through a retirement procedure that would give them a pension and medical insurance. Apart from that, the local government controlled SOEs have a historical responsibility for paying water bills, electricity bills, gas bills and housing management fees for current and retired employees. The financial cost of solving the "*three bills and one fee* 三供一业" problem based on the relevant regulation (SCGO 2016 No. 45) is very high. For the three northeastern provinces alone the cost is around 19.5 billion RMB (1.95 billion GBP).

So, the reforms brought huge costs, and both the SOEs and the local governments are unable to pay these. Chan (2009, 46) points out that the social burdens SOEs carry run counter to the primary goals – to be competitive and profitable. ■ (BJCNBM/03/2015) notes that the government effectively

subsidizes the central SOEs by releasing them from the social burdens they carried. In the past, SOE workers were paid relatively low wages but were allocated areas of housing and had their water, gas and electricity bills linked to and paid by the factory. The reform process includes separating welfare from factory operation, and for this, government subsidies are needed. It is also correct for Chan (2009, 53) to argue that the governance structure of SOEs can bring various agency problems. The SOEs' problems – like price distortion, policy-induced profit or loss, and policy-driven welfare burdens – have provided enough excuse for the SOEs to ask for soft budget constraints, state subsidies and many other examples of adverse selection and moral hazard.

The CNBM, as the leading company in the building materials industry, is involved in creating quality standards for the industry. This can be seen as a benefit of the SASAC's developmental state model of governance for CSOEs. This thesis suggests that the CSOEs can, therefore, work with the relevant ministries in the making of a more executable industrial policy that suits the market condition of the industry. By holding seminars with CSOEs, the SASAC can have a more in-depth understanding of the development, challenges and difficulties of the industries its CSOEs operate in. This may also be a possible explanation of why the SASAC does not eliminate the CSOEs and create a fully competitive industry.

The CNBM's interaction and cooperation with relevant government institutions are positive and frequent. The government often receives reports and

suggestions regarding policy implementation and industrial development from the CNBM. [ ] (BJCNBM/03/2015) notes that the government consults the CNBM when making policies related to building materials industries. The CNBM also has the chance to provide feedback on difficulties and problems during policy implementation. For example, the CNBM and the China Building Materials Federation (industrial association) jointly proposed to the MIIT that the production of ordinary Portland cement 32.5 (PC 32.5) should be stopped, and this suggestion was approved in 2015. The CNBM believed that the removal of the low-end PC 32.5 cement could raise the quality of building and would be beneficial for the industry's future development, even though the rise in quality might not be beneficial to the CNBM, which was the largest cement producer ([ ] BJCNB/04/2015). In summary, the CNBM as a central SOE in a competitive industry does not enjoy many policy favors and subsidies directly from the government; but its large size and years of experiences give it an advantageous position in the building materials industry as a whole. As a CSOE in a leading position in the industry, the company has better opportunities than its competitors to interact with the government in terms of policy making and consultation about quality standards.

Thus far, this chapter has examined the business performance, shareholding structure, operational structure, listing process and government relations of the CNBM. It argues that although the CNBM, as a market actor, works through the three layers of a pyramidal structure, its listed company and its operating

companies and factories are capable of engaging in market competition that prioritizes profitability and competitiveness. And for the CNBM as a CSOE, where is the Party in all this? The Party maintains a high-profile presence among CSOEs for two main reasons. One is that, as argued in the previous chapters, the Party Organization Committee and the Party Discipline Committee in the CSOE serve as an oversight mechanism in the supervision of the CSOE. The other is more important: the Party seeks to maintain its ideological influence and to remind the marketed CSOEs repeatedly of the Party's leading role.

As for the Party's disciplinary work in strengthening the oversight mechanism in the principal-agent relationship, the SASAC Discipline Committee conducts annual performance checks on the CSOEs as part of the Commission's supervisory role. Its main responsibilities include supervising the implementation of laws, policies and regulations in CSOEs and also undertaking corruption investigations of individual CSOE staff (SASACDC 2004 No. 12). A more detailed list of measures can be seen in SASACDC 2006 No. 139. Apart from the annual inspection, the SASAC Discipline Committee also issues special measures targeted at different business activities. For example, the SASAC (SASACDC 2006 No. 46) issued a special implementation plan for the control of bribery during property transactions undertaken by CSOEs.

How can the Party achieve its goals without sacrificing the efficiency of CSOEs? As Chen and Li (2015, 5) argue, party organization follows a vertical line of

administration, but each SOE has different characteristics. Party organization emphasizes the importance of political ideology control, while a CSOE's board of directors focuses on the profitability of the company. These contrary goals leave the Party in a dilemma. It refuses to settle for a less important position; so it has to defeat the neoliberal ideology that the market and global capitalism are bringing into the CSOEs. At the same time, it is not interested in interfering too much in CSOEs and lowering the efficiency of the business operation.

It is hard to define the role of the Party in the CSOEs, since each CSOE is required to be an independently operated market entity. Furthermore, in general, CSOE board members and senior managers are members of the party committee of the company; and the SASAC's assessment focuses on quantifiable outcomes, as shown in the company's financial report, rather than on the abstract concept of party building. Therefore, we can make the assumption that for the senior executive of a CSOE, their managerial role is much more important than any formal position as party secretary that he or she might hold. The Party understands the dilemma; but it has issued a regulation that states, "the party secretary and the chairman of the board positions should be held by one person (SCGO 2017)," as a reminder to CSOEs that the Party is still in control. Taken together, these observations suggest that the party compromises and blends its role as ideological guardian into the CSOEs' marketization.

All in all, it is important to distinguish the Party as a broad concept from the Party as an individual organization located inside the company. The Party as a broad concept has been intangibly involved in all aspects of central SOEs' development at every historical stage. A company's discipline committee is a party organization. The Central Discipline Inspection Committee and the SASAC Discipline Committee are both part of the administrative system of the Communist Party. In this sense, the Party's importance can never be over-emphasized. However, when it comes to discussion of an individual party organization inside the company, the practical influence of party ideology is seeing a diminishing trend. The Party's ideological control is not emphasized at the expense of market efficiency and an enterprise's efficient operation.

## 5.5. Conclusion

In the previous chapter, we looked at the SASAC's role and power in managing central SOEs as the principal in a principal-agent relationship. In this chapter, we have looked at the relationship from the point of view of the agent. Central SOEs in competitive industry take profitability and total revenue as their priority, while central SOEs in monopolistic industry put more emphasis on policy implementation. However, the two categories have many characteristics and goals in common: for example, to prove the superiority of the state ownership system, make profits, maintain a socialist ideology, boost economic growth and

lead the development of their industry in China, while competing with other giant enterprises in the global market. Drawing on the annual reports of the CNBM listed company from 2006 to 2016, relevant policy documents and extensive fieldwork interviews, this chapter has argued that central SOEs can be competitive and successful in the market while having the state as their largest shareholder.

This chapter was organized to analyze four key themes: first, the three layers of the operational structure of central SOEs; second, the importance of getting state-owned assets listed; third, details of the oversight conducted by different ministries; and finally, the Party's role in central SOEs, which included discussion of social burdens. Starting from the three layers of the operational structure inside the CNBM – that is, the CNBM group, the CNBM listed company, and the second-tier operating companies – we saw that most of the administrative government-related work was taken care of at group level. Historical burdens and loss-making assets were dealt with at group level as well. The group level interacts with its principal, the SASAC, most often; but it also has frequent contact with the Ministry of Finance in matters of state capital management (State Council [2007] No. 26). Listing high-performing assets to establish the CNBM listed company puts the listed company in a flexible position that enables it to focus its efforts on market competition. The CNBM listed company can operate the high-quality assets of the entire group, at the same time minimizing the time spent on government-related administrative work. The subsidiaries,

namely the subsidiaries under the CNBM listed company, are thus focused on businesses and production. Through the three layers of its operational structure, the CNBM manages to find a balanced area between being owned by the state and based on the developmental state model, while surviving in a market based on market criteria. The CNBM listed company is the area that sits between the developmental state and the market.

CSOEs in competitive industry have a high percentage of their total assets listed on the stock market in China; and there are wholly listed CSOEs like the China State Construction Engineering Corporation (CSCEC) that are listed overseas. Capitalism's demand for profit has turned CSOEs into market actors that prioritize the profitability of the company. As Chang (2007, 120) notes, the three keys to improving SOE performance without privatization are: clarifying priorities among the multiple goals SOEs take on; improving the monitoring system; and increasing competition, whether in the domestic market with private counterparts or in the international market. This thesis shows that the SASAC sets good business performance and market competitiveness as its primary goals for central SOEs in a competitive industry. The listing of these central SOEs on stock exchanges illustrates the government's intention to clarify the main goal of CSOEs as profitability. Therefore, the government expects central SOEs to achieve multiple goals; but only if they achieve the target of being competitive can central SOEs be mobilized by the government to achieve other goals, and the profit can be put to good use by the government. Certainly, when we see

central SOEs which are the leading enterprises in each industry agitating for a free market and advocating a global market and fewer trade barriers, it is important to remember that their competitiveness and the necessary capital they were supplied with came from the SASAC's years of policy support to make central SOEs bigger, better and stronger. It can seem ironic that central SOEs call for a free market since they grew under a developmental state model.

As we have seen in this chapter, the government's influence on companies' business operations certainly exists. The members of the Board of Supervisors dispatched by the SASAC and based in the CNBM headquarter will check if the CSOEs' merger and acquisition activities comply with national industrial policy and the state's macroeconomic plan, and whether these activities fit in with the CSOEs' main business areas, as regulated by the SASAC (SASACBPD [2004] No. 720; SASASCBPD [2004] No. 63). The SASAC's ex ante administrative rules set frames for CSOEs' business activities, from the main business areas the CSOEs should operate in to overseas investment plans. The CSOEs also have to respond to a rotating multi-team police patrol oversight mechanism that comes from a dual-track application of both "resident on-site" and "short-term inspection tours". The Party's role can never be over emphasized, but it is present more in an intangible way than as obvious direct control.

Consequently, this chapter has suggested that central SOEs in fully competitive sectors have been given great autonomy and freedom to operate as market

actors. Drawing on the principal-agent understanding, this chapter has confirmed the circumstances in which the SASAC is the principal that central SOEs refer to, and there is no clear sign of a multi-principal situation in the Chinese state's governance of central state assets, although central SOEs do need to interact and communicate with many different government offices, including functional ministries and various local government institutions. We have seen that the government's role in competitive CSOEs is not very disruptive, because the regulations that define the SASAC's responsibility are not clear, and the delineation of the SASAC's authority is quite blurred. Consequently, the SASAC, in order to be responsible to its principal—the State Council – worries about its responsibility as the guardian of the value of state-owned assets. However, more regulations from the SASAC will lead to more constraints and less flexibility in CSOEs' market activities. The uncertainties and unpredictable nature of a market leave no place for more control of CSOEs.

This leads to the main argument of the chapter: that central SOEs can be efficient and profitable, while being owned by the state. This thesis disagrees with the argument that central SOEs are not market actors and cannot be competitive in the market without state support. After all, central SOEs are found either in competitive industries where they face serious market challenges; or they are in monopolistic industries where they compete with their central SOE counterparts. It is impossible to have a central SOE that is completely isolated from all kinds of market competition, even for central SOEs in the defense

industry that produce munitions. For example, the China Electronics Technology Group Corporation (CETC 2017), apart from its military products, also engages in various kinds of engineering and construction of civil information technology and electronic products. Although it is not a listed firm, eight of its sub-companies are listed.

In conclusion, this chapter suggests the Chinese central government, in its management of CSOEs, follows a developmental state model that uses the SASAC as its pilot agency. The Chinese government has a high state capacity to impose methods of control as a principal. In 2015, the government had direct and indirect control of around 38% of the GDP, which enabled it to stress collective goals and give top-down orders (Naughton 2017, 7). The State Council serves as a coordination center that mobilizes and coordinates different ministries and financial institutions to provide help to the SASAC, so that the SASAC can implement its strategy to enlarge CSOEs in terms of total assets. It is the government's goal to use successful central SOEs to maximize the capacity of the state, so as to achieve the Party's legitimacy and social harmony (Chan 2009, 53). It also relies on central SOEs to be a major actor in the global market, especially in sectors that relate to natural resources, to fuel economic growth. In order to create a successful developmental state, the SASAC assesses CSOEs based on a market standard. Therefore, both the SASAC and the CSOEs are continuously adjusting their functions and positions to find a balance between the

seemingly contradictory concept of having a developmental state model of governance and winning in the face of competition in the global market.

In the next chapter, the discussion will move to central SOEs in monopoly sectors or, more accurately, those which have oligopoly status. The China National Petroleum Corporation (CNPC) will be examined as a case of a CSOE in a strategic area that is the backbone of the national economy. This will suggest that, when we compare them with the CNBM in the fully competitive market, we shall see that CSOEs in strategic sectors have more goals to fulfill than just being profitable in the market.

*Final Remark:*

26 August 2016. It is announced that the China National Building Material Group Corporation (CNBM) and the China National Materials Corporation (Sinoma) are being merged into a new China National Building Materials Group Corporation.

27 February 2017. The Ministry of Commerce of the People's Republic of China Anti-Monopoly Bureau issues a Notice on Decisions (MoCAMB 2017 No. 10) which approves the CNBM's acquisition of Sinoma.

## **Chapter 6. Case Study: China National Petroleum Corporation—CSOEs in Monopolistic Industries**

### **6.1. Introduction**

Now that we have discussed the one-party-state's developmental state governance model, and the principal-agent relationship between the SASAC and those central SOEs that are in competitive industries, this chapter moves on to an analysis of the China National Petroleum Corporation (CNPC) and its listed company, PetroChina, which are situated in the state-monopolized petroleum industry. The CNPC is one of 53 CSOEs in the strategic sector and is the biggest National Oil Company (NOC) in China and in the world. In looking at this company, we shall discuss two important themes, the first of which is the importance of the stock market. Even though the CNPC is a strategic SOE in the monopolistic sector of the Chinese economy, where the state holds more than 85% of shares in enterprises, the importance of the stock market to the enterprise should not be underestimated. Although the securitization of the CNPC is relatively low, the process has brought more transparency to this party-controlled old-style SOE. Secondly, its monopolistic status brings the CNPC more constraints than other central SOEs, because of the strength of the state's visible and invisible hand in the energy sector. Examples of this range from state-regulation of the refined petroleum price to the demands of social justice, and of

a massive workforce left to it by the old structure. Furthermore, the Party is under real pressure: on the one hand, it must manipulate the CNPC to achieve state goals; and on the other, it must make the CNPC profitable and competitive in the global market. It also has difficulties in overcoming the asymmetric information problem and conducting an adequate principal-agent relationship with the CNPC.

Drawing on CNPC group annual reports, PetroChina annual reports, government regulations, and interviews, this chapter presents the results of research into how monopolistic CSOEs operate in the market and their interactions with the state. Being seen as shouldering more social responsibilities, and as a market actor that holds a quasi-governmental role, the CNPC and its listed company, PetroChina, play various and contradictory roles. They are pursuing business interests and profit maximization to suit the interests of their shareholders on the stock exchange; but at the same time they must prioritize political and social aims to suit the state's expectations. And we shall extend this discussion to look at the interaction between Chinese central SOEs and the global energy market. How do central SOEs fit into the global market; and how does the global oil market affect the performance of Chinese central SOEs and the development of China's economy? These discussions will answer the following sub-questions of the research.

1. Is a central SOE in a monopolistic industry a ministry or a company? How and to what extent can a CSOE in a monopolistic sector be seen as a modern corporation?
2. How and to what extent can the SASAC exert its administrative power in monitoring and directing monopolistic central SOEs? How do the latter compete while co-operating with their state-owned counterparts?
3. How does the global energy market affect the operation of central SOEs, and how do central SOEs' international business activities affect the global market?

This chapter begins with a discussion of China's petroleum industry, and the three Chinese NOCs, which are all central SOEs operating on the global oil market under the SASAC's supervision. It then provides a comparison of the business performance of China's three NOCs with that of their international counterparts Shell, Exxon and British Petroleum. This is followed by a look at the CNPC's listed company, PetroChina, with an examination of the company's financial performance and shareholding structure. We shall also look at the visible and the invisible hand the government takes in the supervision of the petroleum industry. We shall conclude with a comparison of the CNPC and PetroChina in the monopolistic category with the CNBM group and the CNBM listed company in the competitive category.

## 6.2. Petroleum Industry Overview

China's big three national oil companies (NOCs) are the China National Petroleum Corporation (CNPC), the China Petroleum and Chemical Corporation (Sinopec), and the China National Offshore Oil Corporation (CNOOC). The CNPC is China's largest oil and gas producer and supplier, and is 100% owned by the Chinese government. It produces 52% of China's total crude oil and 71% of China's total natural gas (CNPC 2017). The CNPC holds 86.17% of its listed company, PetroChina, which is listed in New York (PTR), Hong Kong (857) and Shanghai (601857) (PetroChina 2016; PetroChina 2017). Like all the other central SOEs under the SASAC's administration, these NOCs have to comply with the SASAC's regulation governing the three main sectors in which their businesses operate. According to the SASACBPD (2004 No. 324), the CNPC, Sinopec and the CNOOC can operate in three main businesses: 1. the exploration and development of crude oil and natural gas; 2. petroleum refining; petrochemicals, and the production of other chemical products; reserve maintenance; and the pipeline transportation of, and trade in, oil and natural gas; 3. relevant engineering technology research and services. There is another CSOE – the Sinochem Group – that has its main business in the petroleum refining industry and conducts trade and other retail activities in petrol, crude oil and fuel oil. It can conduct oil exploration and the development of oil and gas overseas (SASACBPD 2005 No. 80).

From a historical perspective, the monopolistic central SOEs shouldered many different kinds of responsibility from the past planned-economy system. Tracing their histories back to the planned economy era, the CNPC was transformed from the former Ministry of Petroleum, while Sinopec was transformed from the Ministry for Chemical Industries. The huge assets and vague subsidies, as well as the strong government influences they have inherited and carry with them, have made the three NOCs' function and business performance the subject of debate. The petrol price is adjusted according to the NDRC's guidance, and the petrol price and GDP growth have an effect on each other. The CNPC has to guarantee oil supply, and at a government regulated price, to support economic growth. Compared with central SOEs in competitive industry, the CNPC must undertake more government functions alongside its monopolistic status. It has a responsibility for maintaining a stable oil supply to assist the continuous growth of GDP. [REDACTED] (ZJCNPC/30/2015) see central SOEs' priority as the maintenance of social stability and energy supply. Zhejiang province is one of the top five tax contributors in mainland China. From 2007 to 2008, Zhejiang's GDP growth was higher than 10%, which required an enormous supply of refined oil. PetroChina had to maintain a stable supply of oil products despite high prices on the international oil market.

Figure 6.1 shows China's oil production and consumption from 1993 to 2016. Production increased slightly during these years, but consumption rose significantly, and oil production in China is not currently sufficient to satisfy

domestic demand. According to a British Petroleum report (2016), China has remained the world's largest growth market for energy for 15 consecutive years. In 2016, China's increase in demand of 6.3% was the largest of any net oil importing country. In that year, the CNPC and its listed company, PetroChina, accounted for an estimated 54% and 77% of China's crude oil and natural gas production (FACTS Global Energy in EIA 2015). Figure 6.2 shows China's energy consumption structure by fuel type in 2012. Coal occupied 66% of China's total primary energy consumption and oil occupied 20%, with natural gas occupying only 5% of energy consumption (EIA 2015). China's forecast primary energy structure for 2020 shows that consumption of natural gas will rise to 8.6%, and petroleum consumption will account for 16.8% of consumption. Non-petrochemical energy will rise to 15%, while the use of coal will go down to 59.6% (PetroChina 2016/04/28). China's energy consumption mainly relies on coal, but coal is highly polluting, and has been widely decentralized to small-sized private enterprises. The oil industry, as the second largest supplier of fuel for energy generation, is dominated by CSOEs.

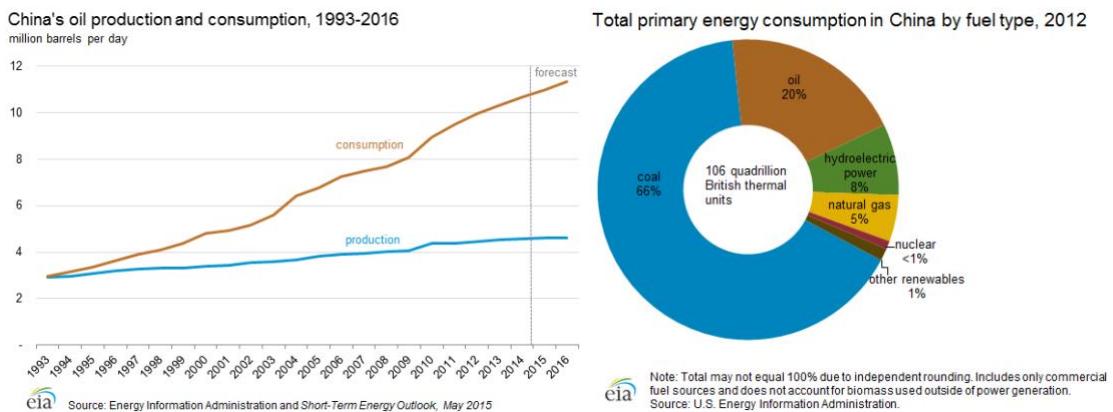


Figure 6.1. (left) China's Oil Production and Consumption, 1993-2016. Source: EIA report 2015.

Figure 6.2. (right) Total Primary Energy Consumption in China by Fuel Types, 2012. Source: EIA report 2015

The Chinese government's search for energy has both an economic aspect and a security aspect. The country needs energy resources to maintain its economic growth. As Chen and Lees (2016, 6) argue, "China focuses on deploying state-owned enterprises as the gatekeepers of energy security". For this reason, the Chinese government also assists the NOCs to acquire more natural resources overseas. So as to secure an adequate energy supply for the country, the Chinese government uses foreign aid and financial loans to consolidate the NOCs' status in their globalization processes (Gao 2017, 318). In 2012, Chinese NOCs' investment contributed more than half of the total investment in oil fields in Central Asia, the Middle East and Africa. China's foreign affairs strategies follow the interests of energy security. Chinese diplomats have taken advantage of China's position in international organizations to promote energy cooperation with resource-rich countries. Zhao (2008, 210) defines this as a state-centered approach to energy security leading to a mercantilist strategy.

Caceres and Ear (2013, 7%) discuss the Chinese government's global hunt for strategic resources to secure energy and materials in a peaceful and non-

hegemonic way. However, China is not very dependent on imported oil, though it continues to raise its consumption. China's state-led promotion of renewable energy development also contributes to the reduction of the country's reliance on oil and oil imports (Lai 2007, 533). Chinese NOCs' global quest for energy, and the Chinese government's political and diplomatic strategy, influence each other (Gao 2017, 313). Chinese NOCs have gone into oil-rich countries from which IOCs have retreated for high-risk reasons. Sudan is China's largest overseas oil production base. The CNPC's massive investment in the Sudan oilfield was made in conjunction with a commitment to improving the lives of local communities, including making donations for education and providing drinking water, free medical services and so on. The civil war in Sudan did not lead to the CNPC pulling out. Instead, it not only continued its production but also helped with post-conflict management from the UN by building a refugee camp for the homeless in 2014 (CNPC 2010 and 2014). Therefore, the government supports the NOCs' global expansion through diplomatic methods aimed at guaranteeing a sufficient supply of energy. Apart from indicating China's energy security concerns, the NOCS' market activities in resource-rich countries are also highly oriented towards China's economic interests.

The CNPC and Sinopec have dominated onshore oil exploration, while the CNOOC has been in charge of Chinese offshore oilfields. The Ministry for Fuel Industries, created in 1949, was the predecessor of both the CNPC and Sinopec (Sinopec 2017). In the 1980s, responsibilities for upstream operations and

downstream operations were divided. Upstream operations were dominated by the predecessor of the CNPC—the China Petroleum Corporation (CPC) – under the administration of the Ministry for Petroleum Industries. Sinopec dominated downstream operations under the Ministry for Chemical Industries (Kambara and Howe 2007, 46). In 1983, Sinopec was established, and later, in 1988, the government restructured the CNPC and Sinopec into vertically integrated firms that operated both upstream and downstream in the onshore oil industry. The CNOOC was responsible for offshore oil and gas exploration and production. It has been actively expanding its business influence overseas and has also started to step into the downstream of the petroleum market by selling refinery oil on the domestic market. The CNOOC is seen as a growing competitor of the CNPC and Sinopec (EIA 2015).

	Asset (million \$)	Revenue (million \$)	Revenue Change	Profit (million \$)	Profit change	Number of Employee s	Owership	Location	Industry	Global Fortune 500	Profit as % of Assets	Profit as % of Revenue
CNPC	621,242	299,271	-30.2%	7,091	-56.7%	1,589,508	NOC	China	Petroleum Refining	3	1.1%	2.4%
SinoPec Group	317,006	294,344	-34.1%	3,595	-30.6%	810,538	NOC	China	Petroleum Refining	4	1.1%	1.2%
China National Offshore Oil	179,044	67,799	-31.7%	4,608	-46.4%	110,200	NOC	China	Mining, Crude-Oil Production	109	2.6%	6.8%
Royal Dutch Shell	340,157	272,156	-36.9%	1,939	-87.0%	90,000	IOC	Netherlan ds	Petroleum Refining	5	0.6%	0.7%
Exxon Mobil	336,758	246,204	-35.6%	16,150	-50.3%	75,600	IOC	U.S.	Petroleum Refining	6	4.8%	6.6%
British Petroleum	261,832	225,982	-37.0%	-6,482	-271.5%	79,800	IOC	Britain	Petroleum Refining	10	-2.5%	-2.9%

Figure 6.3. Comparison of the Key Indicators of the Top Oil Companies in the World. Source: Global Fortune 500, 2016. Analyzed by the Author.

Figure 6.3 compares the key indicators of China's three NOCs with those of the world's three largest IOCs. Drawing on the Global Fortune 500 list for 2016, there were five companies in the petroleum industry in the top 10. China's largest oil company—the China National Petroleum Corporation (CNPC) – was in third place, while the country's second largest oil company—the Sinopec Group – was in fourth place. Royal Dutch Shell, Exxon Mobil and British Petroleum were ranked at fifth, sixth and tenth place, respectively. China's third largest oil company—the China National Offshore Oil Corporation (CNOOC), which is also in mining and crude oil production – was ranked at 109. In 2016, these six enterprises in the oil industry all experienced a significant drop in both revenue and profit. Among them, British Petroleum presented the worst performance, with a 37% drop in its revenue and a 271.5% drop in its profit. Sinopec only experienced a 30.6% decrease in its profit, but the CNPC's profit fell by more than half compared to the previous year and the CNOOC also had a 46.4% decline in profit. According to the CNPC's listed company, PetroChina (2016/03/29), low oil prices in the international oil market largely affected the performances of both PetroChina and Sinopec. PetroChina's main business lies upstream in the oil industry, with outstanding advantages in exploration and production, so that the profit that should have accumulated through exploration and production was severely reduced by the low oil price. On the other hand, Sinopec's main business lies downstream in the oil industry, with a focus on oil refining and chemical engineering, as well as the sale of refined oil products, and

so it still had a certain profit margin in this climate. The average OPEC crude oil price experienced a dramatic decline from \$96.29 per barrel in 2014 to \$49.49 per barrel in 2015 and then dropped slightly to \$40.68 per barrel in 2016. Both the CNPC and the CNOOC had their focus upstream in the oil industry, and so their business performance was easily affected by the low international oil price.

It can be seen from Figure 6.3 that, in terms of number of employees, Sinopec has 810,537 while the CNOOC, as China's third largest NOC, has only 110,200, showing little difference when compared with Shell, Exxon and BP. The CNPC has 1,589,508 employees, which is a much higher figure than the total numbers of employees of the other five companies added together. However, it would be unfair to draw the conclusion that the CNPC has low efficiency and abundant employees. According to the CNPC group's annual report, employees aged 56 and above were slightly over one-third of the total number, at 35.84%, and the age group 46-55 represented 28.49% of the total employees (CNPC 2016, 19). China's retirement age is 60 for male and 55 for female cadres, and 50 for women workers, which means more than half of the CNPC's employees will retire or be close to retiring in the next few years. The data helps to indicate the CNPC's inability to lay off any of its redundant employees, more than half of whom were initially employed under a planned economy background.

We shall now turn to an analysis of the business performance of China's three NOCs. Profit as a percentage of assets is also known as the return on assets,

and shows a company's profitability. The CNPC and Sinopec achieve the same return on assets of 1.1%, while the CNOOC reaches 2.6%. It can also be seen from the figure that the CNOOC has the highest profit as a percentage of revenue, at 6.8%, the CNPC has 2.4%, and Sinopec only has 1.2%. This shows that although, in 2016, the international oil price was at its lowest point since 2005, upstream in the oil industry was more profitable than downstream. It also indicates that the CNOOC did well in 2016 compared to its domestic and international counterparts. The CNPC and Sinopec, although both experienced a dramatic decrease in revenue and profit, fared better than Shell and BP.

### **6.3. Son of the Communist State—From Ministry to Central SOE**

#### ***6.3.1. The China National Petroleum Corporation***

Since the market reforms of 1978, China has experienced rapid social changes and economic development. It has maintained GDP growth at an average of 10% a year, which is the fastest sustainable growth in history (World Bank 2016). China's energy consumption has increased significantly to support this economic growth. It is the fourth largest petroleum-producing country and the largest consumer of oil products. Petroleum, as the key energy source, has been categorized as a pillar industry of the national economy. The SASAC has promoted the growth of state assets in the strategic sector and in major

industries in order to enhance the controlling power of the state over assets and exercise a leading role in the economy (SCGO 2006 No.97). The state maintains absolute holdings in seven pillar industries that are at the core of national security and are also seen as the lifeline of the national economy: military Armaments, electricity and the electricity grid, petroleum and petrochemicals, telecoms, coal, civil aviation, and shipping (Xinhua News Agency 2006). Chinese central SOEs in the strategic sector are often portrayed, in an extremist interpretation, as being the arms of the Communist Party of China and its bureaucratic structure, and their business activities as being highly politically oriented.

Among these CSOEs, the three National Oil Companies, namely the China National Petroleum Corporation (CNPC), the Sinopec Group (Sinopec) and the China National Offshore Oil Corporation (CNOOC) are often criticized as being profitable due to their monopolistic status. China's three NOCs', with their monopolistic status, have an annual profit that is estimated at 637.6-689.3 billion Yuan (Zhou, Xie and Huang 2015, 199). It is further argued that the National Development and Reform Committee's (NDRC's) refined oil price-control mechanism maintains a monopoly of the petrol refinery stage, but fails to keep the NOCs's prices down due to the latter's monopolistic status in the upstream activities of exploration and production. As illustrated in Figure 6.1, China's petroleum consumption increased significantly from 1980 to 2015 and this trend is thought likely to continue. There is no doubt that China's three NOCS are

crucial central SOEs in the pillar industries, being responsible for the country's energy supply and, at the same time, profitable.

The China National Petroleum Corporation (CNPC) was founded in 1998 and is China's largest oil and gas producer and supplier, with a presence in 70 other countries (CNPC 2016). Its business activities include petroleum exploration and production, natural gas and pipeline construction, refining and marketing, oilfield services, engineering construction, petroleum equipment manufacturing, new energy development, capital management, and finance and insurance services (CNPC 2014). The CNPC was is a conventional NOC, prioritizing government functions over business functions and putting the interests of the country first (Jiang 2012, 380). The CNPC's annual taxation paid in domestic China was 407.8 billion Yuan in 2013, and 407 billion Yuan and 338.1 billion Yuan in 2014 and 2015, respectively (CNPC 2015). The company's predecessor was the Ministry for Petroleum Industries in China, which was founded in 1955 and was restructured in 1998. When the CNPC was established, it inherited part of the old Ministry for Petroleum Industries' responsibilities, mainly in terms of taking charge of oil and gas upstream operations. The CNPC was a ministerial-level corporation with certain government administrative functions operating directly under the State Council when it was established in 1988. It has 87 different units, including the country's flagship oilfields. like Daqing and Shengli (CNPC 2017; Meidan 2016, 14). It defines itself as "*a state oil company endowed with certain government administrative functions*" (CNPC 2016). In 1999, the CNPC founded

its listed company, PetroChina, under Company Law and this was listed on the New York, Hong Kong and Shanghai Stock Exchanges.

### *6.3.2. The CNPC and its Listed Company, PetroChina*

The CNPC separated its core assets and reconstituted them as branch companies, later transferring these assets to its listed company, PetroChina (Jiang 2012, 392). The CNPC held 86.17% of the shares of PetroChina. The PetroChina Company Limited (“PetroChina”) is the largest oil and gas producer and distributor, holding a dominant role in the oil and gas industry in China. It is not only one of the companies with the biggest sales revenue in China, but also one of the largest oil companies in the world. Unlike the CNPC, PetroChina puts more emphasis on its business role by adopting a standard corporate governance structure, following the relevant laws and regulations, including China’s Company Law and the Articles of Association of Companies Seeking a Listing outside the PRC Prerequisite Clause (CSRC 1994 No. 21). It provides annual reports and semi-annual reports and holds meetings to report to its shareholders (PetroChina 2016). Unlike what happens with central SOEs in the competitive sector, which have more than 50% of their shares listed on the stock market and available to public investors, the CNPC holds a high percentage of the shares of PetroChina, and its shareholding has only decreasing slightly over time: from 90% when PetroChina was listed in 2000, to 86.17% in 2015. As

explained in chapter 5, the group company and the listed company have different functions, and seek to achieve different aims and objectives, through the division of labor among the three layers of operation. In the CNBM, the CNBM group works as a strategic and coordinating center, while the CNBM listed company and its subsidiaries conduct the real business. However, in the CNPC, both the CNPC group and the CNPC listed company, PetroChina, conduct business activities. The problem of having no clear line between the CNPC and PetroChina (Jiang 2012, 402) leads to some overlap in businesses areas and the conflict of competition. There has also occurred a potential conflict of interests between these two operational entities.

This section describes the different functions of the CNPC and PetroChina. It also explains what the CNPC does to avoid competition with its listed company. This is important because the listed company has to consider the interests of minority shareholders. The CNPC has the power to select the board of directors of PetroChina and is also the largest supplier and purchaser of products from PetroChina, providing technical services and sometimes an exchange of assets when necessary. In 2000, to support PetroChina's business, the CNPC and PetroChina signed the Agreement on Avoiding Competition and Pre-emption Rights. This confirmed PetroChina's rights and priority in acquiring the CNPC's overseas oil and gas assets (PetroChina L2014-018). The controlling shareholder, the CNPC, has to inform the listed company, PetroChina, of any of its business that might cause competition with PetroChina's primary business.

PetroChina also has priority in acquiring the CNPC's assets and shares (PetroChina L2014-001).

The CNPC's support for its listed company, PetroChina, can also be seen in the case of overseas investment in oilfields. For instance, if overseas investment is in a relatively stable oil market, or a market where the CNPC has already had considerable investment experience, and if the time for exploration does not take too long and the business can be profitable in the short-term, investment will be done by the listed company, PetroChina. However, investment in new markets, or in markets where, for political reasons, the country involved does not allow the listed company to invest, will be covered by the group company, the CNPC. When these investment projects undertaken by the CNPC became profitable, they are transferred to the listed company, PetroChina. The CNPC plays the role of business incubator for PetroChina (PetroChina 2014/05/21). The CNPC can be seen as a post-reform Ministry for Petroleum Industries, which has highly politically-oriented goals, such as to guarantee a stable supply of energy while its listed company, PetroChina, focuses more on business performance. Like the CNBM listed company, PetroChina takes shareholders' interests as its priority. The difference is that the largest shareholder in the CNBM listed company is the "public investor", who holds 53.33% of shares in the CNBM listed company; but the largest shareholder in PetroChina is the CNPC, which owns 86.17% of the shares. Unlike central SOEs in competitive industries, the CNPC takes the

responsibility for guaranteeing the energy supply for the country as its priority rather than purely commercial interests.

PetroChina can be seen as a company that is no different from other international oil companies. It has taken on western-style corporate governance and has a precise definition for the roles each department plays in its business activities. The primary goal for the CNPC is providing employment, paying taxes and ensuring energy security. It holds more of a government function than a business function. PetroChina was created to be an internationalized oil company and is listed on stock exchanges so as to attract investors. The “taxation generated in mainland China” is presented as one of the core pieces of data in the annual report of the group company, CNPC, but is not seen in any of PetroChina’s annual reports or semi-annual reports. PetroChina’s annual report focuses more on the company’s market performance, corporate governance and transparency as a company. Therefore, it can be argued that the CNPC’s report takes the SASAC as its primary reader, along with other central government departments, while PetroChina’s report aims to show compliance with stock markets’ regulations and targets shareholder’s interests, so as to attract more capital. Furthermore, it is interesting to notice that, although the SASAC holds 100% of the CNPC group and the CNPC holds 86.17% of PetroChina, the SASAC still chose to put PetroChina on the stock market. Apart from generating capital to lessen pressure on the state’s finances, the listing should be seen, more importantly, as a method adopted by the SASAC to push forward the

reform of the giant ex-ministry CSOEs. As argued in the previous chapters, listing of CSOEs can significantly increase the SASAC's ability in conducting a principal's control of its agents.

Acknowledging the CNPC's privileged political background and authority to access natural resources, an assumption can easily be made that, because the CNPC has a stable income from operations upstream in the oil industry, this becomes a political 'cloud' and means the company is exempted from the SASAC's supervision. The estimated fiscal subsidies granted by the state to SOEs were around 314.3 Billion yuan in the period 2001 to 2009 (Yu 2014, 16). However, the absence of official data giving the actual number of subsidies, and the sources of direct and indirect subsidies, makes it problematic to assess the level of support central SOEs have from the government (██████████ BJSASAC/13/2015). Can the CNPC and PetroChina fulfill the government's political requirement to keep petrol price low, while making profits to hand over to the SASAC? As a public arm of the CNPC, PetroChina outperforms many other NOCs around the world. Its total assets rose from 432 billion RMB in 2000 to 2,394 billion in 2015. And it has maintained a stable growth despite the fluctuation of international crude oil prices.

### *6.3.3. PetroChina—The Hybrid Model of a Modern Corporation*

The petroleum industry in China has monopoly status, like all the post-structured vertically integrated NOCs; and the NOCs have all listed part of their best-performing assets on various stock exchanges around the world. The analysis now moves to a study of PetroChina. Unlike the cross-holding structure of the CNBM listed company, PetroChina's shareholding structure is simple. From 2000 to 2004, the CNPC held 90% of shares in PetroChina. It then slightly reduced its shares to 88.21% in 2005. After that, the CNPC reduced the number of its shares very slightly every year, until it reached 86.507% in 2011. The shareholding percentage was then kept the same for four consecutive years until, in 2016, it dropped slightly to 86.17%. Unlike the CNBM listed company, which released a large number of its shares to public investors, the CNPC held strictly to a very high percentage of shares in PetroChina.

PetroChina Company Limited Financial Performance (2000-2016)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>Total Assets</b>	432,0	477,	500,	557,	643,	785,	880,	1,069,	1,196,	1,450,	1,656,	1,917,	2,168,	2,342,	2,405,	2,393,	2,396,
<b>Revenue</b>	46	566	811	023	641	409	287	611	235	288	487	586	896	110	473	844	651
<b>Total Revenue</b>	245,2	245,	249,	310,	397,	554,	691,	837,5	1,072,	1,019,	1,465,	2,003,	2,195,	2,258,	2,282,	1,725,	1,616,
<b>After-tax Profit</b>	79	536	386	431	812	063	448	42	604	275	415	843	296	124	962	428	903
<b>Profit</b>	54,64	45,4	47,3	71,8	108,	140,	150,	155,3	126,8	106,5	150,79	145,9	130,6	142,2	119,0	42,08	29,37
	5	13	74	97	108	156	187	37	02	59	2	59	20	74	28	92	

Figure 6.4. Source: PetroChina Company Limited Annual Reports from 2000-2016. Currency: CNY ¥ Unit of Measurement: million. Analyzed and presented by the Author.

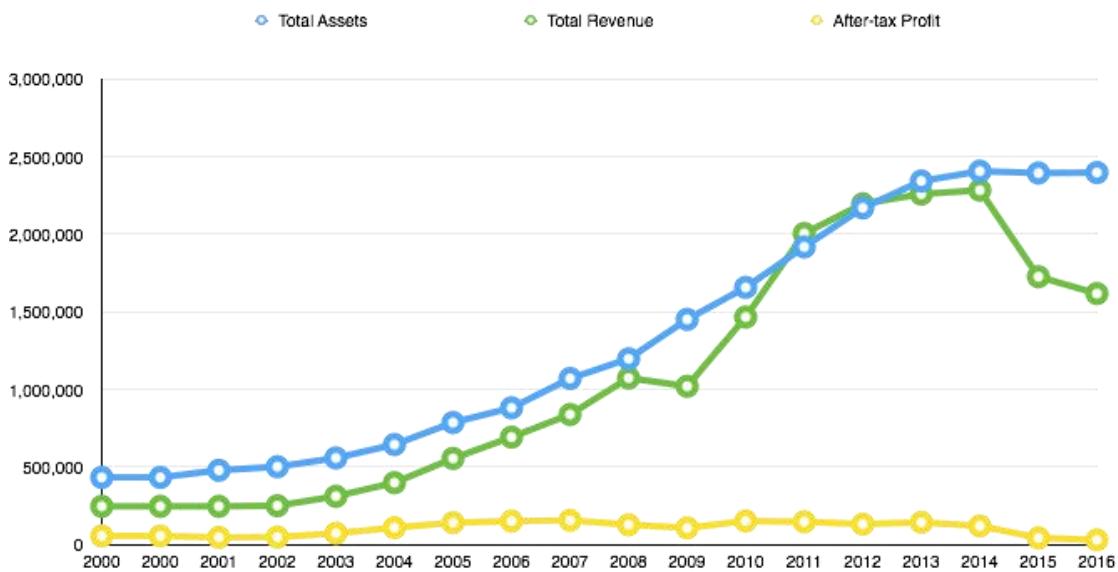


Figure 6.5. Total Assets, Total Revenue and After-tax Profit from 2000-2016. Source: PetroChina Company Limited Annual Reports from 2000-2016. Analyzed by the Author.

Figure 6.4 and Figure 6.5 show the total assets, total revenue and after-tax profit from PetroChina from 2000 to the latest available annual report, that of 2016. They indicate that PetroChina's total assets experienced a gradual growth from 432 billion RMB in 2000 to 643,641 RMB in 2004, and then rose significantly to

2,405 billion RMB in 2014. There was then a continued, steady growth to 2,397 billion RMB in 2016. Unlike the stable and sustained growth of total assets, total revenue showed more obvious fluctuations. From 2008 to 2009, revenue dropped slightly, from 1,073 billion RMB to 1,019 billion RMB. It then grew again until 2014, but suffered a remarkable decrease, from 2,283 billion RMB in 2014 to 1,725 billion RMB in 2015; and then down again to 1,617 billion RMB in 2016. The figures also demonstrate that, compared to the gradual growth of total assets and total revenue, the net profit remained low. For instance, in 2005, total assets were 785 billion RMB, while profit after taxation was 140 billion RMB. In 2013, net profit was 142 billion RMB, but total assets were 2,342 billion RMB, which was three times more than those for the year 2005.



Figure 6.6. (left) Average Annual OPEC Crude Oil Price 2000-2016. Source: [www.statista.com](http://www.statista.com) (in US dollars per barrel). Analyzed and presented by the author.

Figure 6.7. (right) After-tax Profit of the PetroChina Company Limited 2000-2016.

Source: PetroChina Company Limited Annual Reports from 2000-2016. Analyzed and presented by the author.

What are the likely explanations for a situation in which PetroChina's total assets and total revenue all show significant growth while net profits fluctuate? Figure 6.6 shows the average OPEC crude oil price, while Figure 6.7 shows that the net profit earned by PetroChina experienced huge fluctuations between 2000 and 2016. The average annual OPEC crude oil price rose significantly from 23.12 USD per barrel in 2001 to 94.1 USD per barrel in 2008. In the same period, PetroChina's net profit also increased from 45 billion RMB in 2001 to 155 billion RMB in 2007. The OPEC price suddenly dropped in 2009 to 60.86 USD per barrel, but soon went back to a rising trend. PetroChina's net profit also experienced an upturn, from 107 billion RMB in 2009 to 151 billion RMB in 2010. The OPEC crude oil price reached a peak at 109.45 USD per barrel in 2012. The oil price then decreased dramatically from 96.29 USD per barrel in 2014 to 40.68 USD per barrel in 2016. PetroChina's net profit showed a similar drop from 142 billion RMB in 2013 to 29 billion RMB in 2016.

As discussed in the earlier section of this chapter, China's volume of oil consumption is bigger than the volume of its domestic production, so that its oil supplies depend significantly on imports from the global oil market. To secure oil supplies, the Chinese NOCs have increased their investment in domestic and

overseas oil exploration (IEA 2014). The two figures have shown very similar waves. Taken together, these results suggest that the steady increase in PetroChina's total assets and total revenue reflect China's growing demand for energy, whereas its net profit relies heavily on the rise and fall of crude oil prices on the international oil market. This is the reason why China's National Energy Administration (NEA), as part of the National Development and Reform Commission (NDRC), regulates and issues the retail oil price every ten working days, according to the oil price on the international market. The CNPC and PetroChina focus on upstream activities, and draw profit from oil exploration and associated operations. Therefore, the government-regulated oil price has a significant impact on the company's net profit.

## 6.4. Too Big to be Watched

### 6.4.1. *Government's Visible Hand in the Petroleum Industry*

Before 2008, China was a country that had been without a ministerial-level agency to supervise the country's energy development policies since 1993, when the Ministry of Energy was dissolved (Zha 2006, 186). Therefore, China's national energy policy system was fragmented and disorganized. The absence of a national government agency to coordinate and make energy development policies made China's energy policies disjointed, and sometimes they had contradictory objectives (Xu 2006, 273). The SASAC was the investor that

monitored the business performance of the three NOCs. However, it was unable to make energy development policies or comment constructively on energy security plans. However, in 2008, the National Energy Administration (NEA) was created under the NDRC, and was put in charge of energy policies for coal, electricity, oil and gas, and renewable energy. The NDRC (including its sub-bureau, the NEA) and the SASAC became the visible hand that the central administration presented to the petroleum industry.

The Chinese government launched a fuel tax and reform of the domestic oil pricing mechanism in 2009. The NDRC conducted a trial implementation of oil price control in which it set the highest retail price for each province (NDRC Price 2009 No. 1198). This reform was designed to ensure better profit margins for refiners, who had to sell fuel at regulated prices so as to reduce the intense energy usage that resulted from lower consumer prices and higher demand. The oil product pricing system adopted in 2009 allowed the NDRC to adjust the retail price when the average price of imported crude oil moved outside an established 4% price range for 22 consecutive working days for diesel and gasoline. Despite the price reform, international crude oil prices increased at a faster rate than the revisions made by the NDRC to retail fuel prices, causing refiners to incur losses on their downstream businesses and increase their fuel product exports. To promote greater market transparency and to cope with global changes, the NDRC revised the pricing mechanism in March 2013 by shortening the retail fuel price adjustment period to every ten working days, when prices would

automatically be adjusted to international crude price fluctuations greater than 50 RMB per metric ton (about \$1.10/barrel). However, the NDRC did not identify the crude oil types that it used for price determination. When international oil prices began falling in the middle of 2014, the NDRC approved 12 downward price changes. When the benchmark crude oil prices recovered slightly at the beginning of 2015, the NDRC raised the retail prices twice (EIA 2015).

The NDRC set the highest price at 130 USD and the lowest price at 40 USD per barrel. In article 6 of *Measures of Petroleum Pricing* (2016, No. 64), the NDRC Price Bureau ruled that when the crude oil price was lower than 40 USD per barrel, the refined oil price should be calculated based on USD 40 per barrel as the cost. When the crude oil price was higher than 130 USD per barrel, taking into consideration the interests of the producers and consumers, and the principle of maintaining national economic stability, the government should have in place adequate fiscal and monetary policy to guarantee the production and supply of refined oil, with the aim of not raising, or only slightly raising, the price of diesel. The history of the government's oil price control can be traced back to 1998, when the old Ministry of Petroleum Industries was transformed into the CNPC. In 1998, the NDRC's predecessor, the State Planning Committee, issued a Notice of Crude Oil and Refined Oil Price Mechanism Reform (1998 No. 52). In section 2, article 3 of this notice, it was stated that the price for refined oil would be adjusted and set by the State Planning Committee, based on the crude oil price on the Singapore market. The State Planning Committee regulated the

retail price of gasoline and diesel in each province. The two oil companies, the China National Petroleum Corporation and the China Petrochemical Corporation, could adjust the retail price within 5% of the price on the Singapore market. Recently, the NDRC's refined oil price has varied from one province to another, due to the unbalanced local economic development situation. For example, in a notice on decreasing the refined oil price for the domestic market, the NDRC (2014 No. 246) ruled that the highest retail price for gasoline and diesel in each province would be set subject to the crude oil price on the international market, with Beijing paying the highest price at 9400 RMB for gasoline and 8655 RMB for diesel, while Xinjiang Province had the lowest-priced supply, at 8975 RMB for gasoline and 7985 RMB for diesel.

In considering price mechanisms, it is worth noting that despite having oil price control as an objective, the NDRC, in a document on refined oil price mechanisms (2016 No. 64), set the importance of sufficient market supply as its priority. In chapter 3 article 1 of this document, the NDRC rules that the big three NOCs, namely the CNPC, Sinopec and the CNOOC, must continue using adequate mechanisms to coordinate the interests of the upstream and the downstream aspects of the group's work: that is, they must coordinate the production and transportation of crude oil and refinery oil, maintain sizable stocks, enhance the comprehensive coordination and scheduling of emergency resources, and ensure market supply. The NDRC, as the government's visible hand, issues energy policies and price guidance, and directs the NOCs in their

efforts to maintain energy supplies adequate for national economic stability. We shall now look at the other visible hand of the government—the SASAC.

One theme of this thesis is that the SASAC is constantly improving its supervision system to play the role of the principal better, and to monitor more effectively the operation of its agents, the CSOEs, through both ex ante and ex post mechanisms. Leaving aside the supervision mechanisms discussed in the previous chapters, which are applied to the CNPC as they are applied to any other CSOE, this section focuses its analysis on the SASAC's supervision of CSOEs' work overseas. The SASAC set as one of its goals the significant improvement of the international competitiveness of CSOEs. Since CSOEs were increasingly involved in the global market, the SASAC issued more detailed regulations to enhance its regulatory power through ex ante mechanisms.

SASAC orders No. 26, 27 and No. 35 (previously No. 28) set out the supervision system for the management of CSOE's assets overseas. The SASAC revised the Measures for the Supervision and Administration of Investment by Central Enterprises (SASAC 2017 No. 34) and the Measures for the Supervision and Administration of Overseas Investment by Central Enterprises (SASAC 2017 No. 35) to replace previous interim measures in orders No. 16 and No. 28, respectively. The revised measures showed the method of regulating these enterprises' working processes as the ex-ante mechanism in the principal-agent theory. Both measures, as discussed in chapter 2, rule that the SASAC will

require CSOEs to create an administrative system to supervise their investments in both the domestic market and overseas. Also, these regulations cover the entire working process: pre-investment evaluation, control of the investment process, and management after investment (SASAC order 2017 No. 34 and No. 35). The SASAC also applies the police patrol mechanism and fire alarm mechanism as ex post mechanisms in the supervision of CSOEs' management of their overseas assets. It grants CSOEs' headquarters a certain degree of autonomy in the supervision of their overseas assets; but it will conduct random checks and inspection tours of their subsidiaries (SASAC 2011 No. 27). The performance of overseas assets will also be taken into consideration in the assessment and evaluation of CSOEs' performance; and the economic accountability reports of those in charge of CSOEs' overseas branches will be evaluated by the SASAC accordingly (SASAC 2011 No.26).

The Chinese government's ability to control the NOCs in the situation just described has been questioned, due to the fragmented nature of its energy sector. China's decentralization and liberalization of the energy sector led to a situation where the state-owned energy companies took over power and resources from the government. The NOCs enjoyed greater autonomy, leaving the government very limited ability to monitor and direct these energy firms' activities (Downs 2007, 53 and Zhang 2015, 261). Kennedy (2010, 139) too notes the central government's difficulties in controlling the NOCs, suggesting that the NOCs sometimes hijacked China's foreign policy, their investment in the

overseas oilfields pulling the government closer to states that were international pariahs. However, I support the view that the NOCs should not be seen as arms of the government. The NOC's investment activities overseas were not motivated solely by the government's concern for energy security, but also by their own economic interests (Downs 2010, 96). Nevertheless, the companies' greater autonomy in making business decisions should not be seen as a sign of the government's diminishing power. Rather, the SASAC played the supervisory role in a principal-agent relationship with the CSOEs as they pursued their business activities. Also, the NDRCs' regulated oil price mechanism gave the state indirect control of the companies' finances (Meidan 2016, 15).

This chapter suggests that the state has been able to closely supervise the NOCs at the same time as it has retreated from direct interference in the companies' daily market operations, choosing to rely on market standards to assess their performance. Although the NOCs have been involved in the global oil market, they have never gained full autonomy from the one-party state. The oil and gas industry have remained as the strategic assets of the government for the maintenance of stable energy supply (Meidan 2016, 55). Taylor (2012, 75) provides a similar view, and sees the one-party state's efforts to strengthen its political authority in the strategic sector and its capacity to apply top-down policies to influence the operation of the NOCs. In order to understand the principal-agent relationship between the SASAC and the CSOEs, it is also important to examine the personnel system inside the CSOEs. Lin (2015, 125)

examines the career pathway of the CEOs of Chinese SOEs, pointing out that these CEOs usually spent their entire career in the same group corporation. Also, she is correct in arguing that the personnel systems of industrial SOEs are to a high degree of closed-off, which favors insiders over outsiders. In the Chinese government, the “*top-tier of satisfactions in politics and economics are synchronized*” (Lin 2011, 73). The interviewees for this thesis suggested that the people who work at a managerial level in a CSOE start their career as ordinary employees in one of the companies/factories of their CSOE’s group. A possible explanation might be that one of the criteria for being promoted to CNBM senior positions is a clear and complete understanding of the company system, with experience of frontline work. This can be helpful for solving principal-agent problems inside the corporate group, since the latter is a large enterprise. Therefore, it is also reasonable to argue that managers in the CNBM system are promoted based on their performance at work rather than their political connections. The incentives for staff in central SOEs can be both promotion to a higher political position or material rewards.

There are two views as to whether the CCP, as an institution, is in progressive decline as regards its control over, and influence on, the political, economic and social life of the nation (Shambaugh 2010, 3), or whether the Chinese governments’ total involvement of the state in the economy and “*complete synchronization of a party-government-military-economy regime*” is a distinctive feature that differentiates it from a traditional developmental state (Lin 2010, 70).

This chapter argues that the CCP's way of control is less direct but more versatile. As Chen and Lees (2016, 9) argue, the Chinese government is determined to maintain bureaucratic system-monitoring mechanisms and remain actively involved in the developmental state model of governance. It disagrees with Li (2012, 613), who believes China has "weak government, strong interest groups" and accepts the central government's declining capacity in the effective control of key SOEs. As argued in Chapter 4, the SASAC has adopted market criteria as a method of exerting effective oversight of CSOEs, so as to achieve the goals of a developmental state. It is the SASAC's mission to maximize the value of state holdings, combined with achieving the government's strategic goals, especially in the major industrial sectors (Naughton 2006, 3).

China's global quest for energy is highly focused on domestic demand. Since the country needs a peaceful world environment to continue its economic growth, it is unlikely to pursue an aggressive foreign policy to disturb global politics (Xu 2006, 267). It is an oversimplification to define the state's capacity to control as meaning government intervention in every single decision-making process. The state's capacity to control should be understood through the theoretical lens of principal-agent theory and is about the *ex ante* administrative policies that ensure correct processes in NOC activities. It is also about the *ex post* supervision mechanisms of rotating police patrol and fire alarm oversight.

The central government's strategy for reducing insecurity in oil-supply is to internationalize the petroleum industry (Jaffe and Lewis 2002, 122). China's political-economic strategies have become the government's way of re-enrolling in the global economy. The Chinese SOEs are now inextricably linked with the western economies, which apply capitalist logic to their global expansion (Lim 2010, 680). This thesis suggests that the Chinese government has adopted market tools in promoting the growth of the country as a developmental state. It is an oversimplification to come to the conclusion that the government is unable to control the CSOEs because the CSOEs pursue their own economic interests or compete among themselves for overseas resources and market share. There is no causal relationship between the NOCs' pursuit of their economic interests and the state's capacity to control. Nevertheless, it is important to limit the state's visible hand in the petroleum industry, since it is in the state's interest to have the NOCs as market actors that are profitable in the global market. Besides, PetroChina is a listed company, and since the CNPC is the largest shareholder, the state's role in PetroChina has become even more ambiguous.

#### ***6.4.2. Regulating the Government's Invisible Hand in the Petroleum***

##### ***Industry***

The Chinese government's primary interest in its dealings with the NOCs is to secure its energy supply for economic development. The SASAC's primary requirement for the NOCs is for them to be profitable, which suits the SASAC's core responsibility of maintaining and raising the value of state-owned assets. The Economic Value Added (EVA) was adopted as an essential indicator for the evaluation of enterprise managers' performance in the management of capital, and for the assessment of the value they generated for shareholders (SASACBGA 2014 No .8). After being promoted to ministerial level in 1996, and gaining more autonomy afterwards, the three NOCs were put in a position where they were neither government puppets nor completely independent corporations (Xu 2006,272). It was hard to draw a line that would limit the scope of government intervention. It was also unclear how to define the responsibilities and roles of the different governmental agencies that were involved in the NOCs' group businesses.

Therefore, it is crucial to limit the CSOE group's potential for intervening in its listed company, and to limit the government's intervention at the group level, leaving the listed company to play its role as a market actor. Particularly for those CSOEs in strategic sectors, where the group holds an absolute majority of the shares, the SASAC values the CSOEs' listed companies as the pioneers of state

ownership reform, building modern corporate governance and increasing the transparency of companies' finances. PetroChina created the nomination committee for its board of directors, in 2015, according to the standards laid down in Hong Kong's guidelines for corporate governance (PetroChina 2016/01/08). The State Council (2016 No.19) issued guidance to central SOEs to close down their old production facilities, so as to improve production efficiency. It also expected central SOEs to reduce the managerial levels from the current 5-9 levels down to 3-4 levels, so as to increase efficiency and to accelerate decision-making processes.

The SASAC sets the boundary that limits the extent to which the group company can take an invisible hand in its listed company. The participation of state shareholders should ensure the independence of the listed company regarding personnel, assets, finance and businesses. The state shareholders should promote the interests of the entire company, while improving the core competitiveness of the listed company (SASACBPRM 2009 No. 123). This measure shows that the SASAC assumes that the state, as the largest shareholder, especially in the major sectors, has full control of, or at least a high impact on, the listed company, as is the case with the CNPC, which holds 86.17% of PetroChina. It is crucial to distinguish the listed company's goal and business activities from that of the group, and not to mix the concepts of CSOEs and CSOEs' listed companies. The listed company has to run under corporate

governance, taking the shareholders' interests as its priority, and comply with the regulations of overseas stock exchanges.

The Chinese government has resisted the pressure to privatize the commanding heights of its economy. On the contrary, it has attempted to build a group of giant SOEs which are globally competitive in order to catch up and compete with the high-income countries. These large SOEs, although they went through a long reform process of institutional restructuring and technological upgrading, remain bound up with the government and the domestic economy (Nolan 2012, 21). The SASAC's goals consisted not only of improving corporate governance and instituting enterprise reform, but also of restructuring the firms so that they would be able to adjust the sectorial composition of government-owned assets (Naughton 2003, 5). Nolan (2012, 59) points out that developing countries that opened their markets to neoliberalism had their economies dominated by oligopolistic firms. China's standard-bearing firms were located in strategic industries which were broadly the same as those in which the developed countries established their standard bearers during their post-war reconstruction. China's large state-owned enterprises not only occupy the pillar industries but also have extensive government support. For this reason, market's high-profile entry into China met strong resistance from the domestic market, especially those of the major state-owned enterprises. As this thesis has suggested, China adopted the tools of marketization to promote the growth of its developmental state model, while refusing to decrease state power in the market. Nolan (2012,

64) further adds that China's standard-bearing firms focus more on long-term gains than on short-term returns. These SOEs also benefit from cooperation and support among themselves. China's large SOEs, therefore, are able to make technological advances based on enormous domestic consumption. This orientation towards the domestic market distinguishes China from the classical developmental states, which focused on developing an export-oriented economy (Zheng 2011, 141). The CNPC, as illustrated above, like other central SOEs, is highly vertically integrated, including large numbers of research institutions attached to the group company which strengthen the company's development in production and technology.

The listing processes, and the continuous need to respond to the regulations of the stock exchanges of New York, Hong Kong and Shanghai, serve as a form of external supervision to further improve the company's working transparency. Even if the CNPC holds over 86% of shares of PetroChina, the securitization of the company did help in promoting its transparency. In 2007, the China National Petroleum Corporation released a further 1.92% of its shares in PetroChina on the stock exchange. The CNP's shareholding dropped from 88.21% to 86.29% of shares (PetroChina 2007a, 1-2-5). On the one hand, this assisted the central SOEs in attracting finance and acquiring cash flows. Jiang (2012, 394) observes that the listing of PetroChina was a way of attracting finance which aimed at lifting pressure from the state-owned banks. On the other hand, most importantly,

the securitization of central SOEs' high-performing assets facilitated the SASAC's supervision and examination of central SOEs.

The listing of the CSOEs on the Hong Kong stock exchange has required greater financial transparency, better corporate governance and higher pressure on profitability, which suits the SASAC's interest in the principal-agent relationship. Also, listing has pushed the central SOEs to face hard-nosed investors and respond to their criticisms and questions every year. In order to qualify as a listed company, the CSOEs have to follow the regulations of the Hong Kong Exchange. Concerning financial transparency, the company has to produce an annual report and semi-annual report that comply with international accounting report standards. Listing also requires a company to provide general information about board members, stock issuers and their families, according to article 12.2 HKEx (2016 a., A16-8). It requires that buying and selling shares be prohibited to board members at all times, since these people have information advantages (HKEx b. 2016, 4). In the continuing obligation section, it requires that there must be at least three independent non-executive members of the board of directors, which accounts for more than one-third of board membership (HKEx 2010). According to the PetroChina 2014 and 2015 Annual Reports, there were ten board members, nine supervisory board members and nine senior managers, none of whom held shares in the listed company. So, the listing of the CSOEs inevitably assisted the SASAC in pushing forward the reform of the CSOEs. As this thesis has suggested, the SASAC adopted market criteria in the evaluation of the

CSOEs so that the CSOEs could abandon their outdated managerial habits from the planned-economy past.

#### ***6.4.3. Social Burdens (Group/Listed Company)***

As discussed in the previous chapter, CSOEs in competitive industries have listed their best-performing assets on the stock exchange through establishing listed companies. The problems of the separation of valuable assets from burdensome responsibilities is more commonly seen, and harder to solve, in the monopolistic sectors. If we analyze the group company CNPC and its listed arm, PetroChina, through the three layers of their corporate structure, we can see clearly that the group and the listed company have different aims and objectives. The CNPC was reorganized into an integrated oil company in 1998, during the years of China's reform of its oil and gas industry. Most of its operation on the domestic market is conducted via PetroChina. Unlike PetroChina or Sinopec, the CNPC is under no great pressure to boost efficiency and maximize profits (Verma 2016, 41). As Naughton (2006, 4) points out, the CSOEs in the petroleum industry have valuable oil and gas products, and the refinery firms have the money-losing services, and the welfare legacies that were put into the "left-behind firms" which took over the burden from the communist past. Naughton explains this by using the example of the CNOOC, whose listed firm

has 1000 employees and is highly profitable, while the left-behind firms have more than 10 times as many employees and are big loss-makers.

The central government has issued policies and measures to support the stripping of social functions from the SOEs since 1995. After the “*pilot projects*” conducted in the CNPC and other two CSOEs, 74 SOEs started the reform in 2005 (MoF Bureau of Enterprises 2005 No. 62). The intense market competition has further prompted the government to accelerate the process of stripping their social functions from the SOEs. This activity aims to solve the problems left by history, so that the SOEs can participate on equal terms in a competitive market. The SOEs are expected to have centralized their resources to develop their main businesses. They should no longer undertake any public service responsibilities that are not compatible with the direction their main business is taking (State Council 2016 No. 19). The guidelines on stripping social functions from SOEs that were co-issued by the SASAC and three other ministries set a completion date of the end of 2017 for finishing the work of transferring municipal administration and community management arrangements from the SOEs to the relevant local government departments by the end of 2017 (SASACBER 2017 No. 85).

The CNPC’s other main responsibility is as an employer. It has around 1.6 million employees, and problems of over-staffing can be found in many of its local branches. For example, in Jizhong city, the CNPC has over 30% redundant staff,

but massive lay-offs are impossible because they could lead to serious social stability problems for the local government (██████ BJSASAC/20/2015). Also, █████ (BJSASAC/13/2015) and █████ (BJSASAC/14/2015) point out another concern that arises with stripping the social welfare responsibilities of the central SOEs. They explain that, for historical reasons, the CNPC's factories employ a large percentage of local residents in oil fields far away from the developed areas, and these locations do not have adequate social facilities, such as hospitals and educational institutions. In order to provide a reasonable standard of life for employees, social facilities like hospitals and schools cannot be stripped from the companies' assets. The dilemma caused by this situation has meant that the reform process has gone slowly. Despite these difficulties, however, the SASAC urges SOEs to separate themselves from their social burdens and reduce their responsibilities so that they can compete in the market more freely.

## 6.5. Competing in the Market – From Brothers to Competitors

The SASAC's evaluation of CSOEs' performance emphasizes financial performance, and also the petroleum industry is dominated by CSOEs. This circumstance has given rise to oligopolistic competition among CSOEs. Yeo (2009, 1015) asserts that, "*The SASAC is a quasi-ownership agency and exerts real control over the market and the players,*" which suggests the SASAC can not only regulate the players but also the market itself. This section studies the

oligopolistic competition among CSOEs in the same industry. These CSOEs have moved from being brothers in the planned-economy era to competitors in the market.

From the *Tuolasi* (corporate trust) in the 1960s to the *zonggongsi* (general corporation) in the 1980s, China has continued its collective political and economic thinking, which aims to make the SOEs into business-oriented organizations that combine government leadership with business management. China's "*large corporations, large business groups*" strategy in the mid-1990s did not come to an end after the Asian Financial Crisis and the country's entry into the WTO (Li 2016, 4). On the contrary, China integrated modern corporate governance and market ideas on market competition into its state assets management system. China was not keen to replicate the mistakes of the Soviet Union, but rather it drew on the latter's experience of failure. The Soviet Union had failed in many aspects of economic governance, including being unable to integrate its enterprises into international trade and financial systems, allowing inefficiencies in its central planning, having too much party intervention, and failing to develop adequate market mechanisms (Shambaugh 2010,26). So as to avoid Soviet-style economic stagnation, which eventually caused the collapse of the entire Soviet regime, the Chinese government selectively adopted market tools for economic governance and opened the country up to the international market. In the petroleum industry, the Chinese government pursued an approach similar to that of the Taiwanese developmental state, which focused its "state

*influence on relatively large-scale firms in the upstream industries, while leaving the downstream smaller-scale firms much freer*" (Wade's 1990,73).

The government's reform of the management of CSOEs aimed at improving the efficiency of political institutional control of these enterprises, rather than retreating from the game (Li 2015, 56%). It sought to embed the Chinese state's bureaucratic legacy along with the new organizational concepts of modern western corporations. In this process, as the conception and boundaries of the firm were redefined, the format of central bureaucratic control was remodeled as well. The starting point of the reform of SOEs into modern corporations was in 1993. The Third Plenary Session of the Fourteenth CCP Central Committee approved the Decision of the Central Committee of the CCP on Some Issues Concerning the Establishment of a Socialist Market Economy (CCP 1993). It noted that "*public ownership will be the mainstay and multiple forms of ownership will develop side by side..... to transform the operating mechanism of SOEs and to build modern corporate governance that suits the needs of a market economy*". The Fifth Plenary Session of the Eighth Standing Committee of the National People's Congress approved the Company Law of the People's Republic of China (1993). The move from the *Law of the PRC on Industrial Enterprises Owned by the Whole People* (1988) to *Company Law* (1993) marked a change in the relationship between the state and the SOEs. In the *Enterprise Law* (1988), it was stated that the business of the SOEs "... shall be operated and managed by the enterprise with the authorization of the state...". This showed the relationship

between the state and the SOEs was one of trusted management, while Company Law (1993) defined it as investment relationship. The SASAC's first Director, Li Rongrong (2005), notes that the majority of CSOEs under the SASAC's administration were registered under Enterprise Law, not Company Law. The SASAC has been working to build corporate governance and establish the board of directors according to Company Law.

The Central SOEs are not necessarily achieving the same goals as their governmental supervisor-SASAC let alone other relevant regulatory agencies. As Xu (2017,123-127) points out that in overseeing State Grid Corporation, the goals aimed at vary among different central governmental agencies. For example, central government institutions such as the NDRC and the NEA aim to build a more regulated energy market, while the SASAC aims to raise the value of state assets; and local governments are keen on securing a sufficient petroleum supply for local economic development. However, despite the various interests held by different levels of government, the Chinese central state's ability to regulate its Central SOEs maintains relatively strong. In the petroleum industry as Yeo (2009, 1014) argues, the competition between the two Central SOEs- CNPC and Sinopec over "structuring for competition (regulation for competition)" is bound up with the central government's ability to steer the economy.

Relations between the Chinese government and the NOCs can be described as "love-hate", as the two are mutually dependent but have different priorities

(Mechling, Kong and Madan 2015, 1168). Nolan and Wang (1999) note Chinese bureaucrats' active role in the institutional reconstruction and modernization of large SOEs. China's experience suggests that, rather than destroying a bureaucracy, reform and improvement can be a better way. However, Downs (2008) believes that the NOCs' increasingly strong power and position in China, and senior managers' promotion in the administrative ranks, give the NOCs more bargaining chips in energy policy-making and politics. The SASAC's first director, Li Rongrong (2006), provided the blueprint for central SOEs' economic plan by arguing that the government should maintain complete control over the national oil companies' upstream business while pushing forward the reform of these NOCs' downstream business, to bring investment from other owners and diversify ownership. For PetroChina, the upstream of the petroleum industry was concentrated in the hands of three NOCs. However, downstream businesses were relatively more open to other types of ownership. For central SOEs in monopolistic industries, the government intentionally created competition among them in the upstream area of industry and introduced companies with other types of ownership to compete with them in the downstream area of industry. In this way, the central government expected market competition to improve the efficiency of these CSOEs.

By conventional definition, NOCs hold the majority of petroleum reserves and produce the majority of the world's supply of crude oil. NOCs usually hold exclusive rights to the exploration and operation of petroleum resources within

their home country. The Chinese public enterprises are not competitive in the market, due to their obligation to implement the government's orders and strategic choices (Chan 2009, 53). Chinese NOCs' close ties with the government allow them a certain leeway to not operate strictly by market principles. Their government role of job creation and tax generation often runs contrary to their market role of profit maximization (Pirog 2007). Neoliberals believe that extensive state intervention can encourage large-scale rent seeking, as economic agents engage in lobbying activities and request more government subsidies than agents actively involved in market competition (Payne and Phillips 2014, 90). Therefore, the SASAC encourages oligopolistic competition among CSOEs.

The SASAC uses economic interest to motivate the NOCs to improve efficiency (Liou 2009, 677). [REDACTED] (ZJCNPC/30/2015) consider that PetroChina's main competitors in refined oil products and sales are Sinopec, the CNOOC and ChemChina (China National Chemical Corporation). Private enterprises are not strong competitors, due to the concentration of oil resources in the hands of the SASAC's national team. The competition is basically an internal one among the central SOEs. The SASAC, as the coordinator, often works to mediate conflicts between NOCs, or even influence the results. Liou (2009, 684) examines an instance of participation by the CNPC and Sinopec in a bidding competition over a Sudanese oil field. It was in the Chinese central government's interest to have the CNPC and Sinopec cooperate during the

bidding, thus maximizing the government's access to energy resources. [redacted]

[redacted] (ZJCNPC/30/2015) echo the idea of the government facilitating cooperation between PetroChina and Sinopec to shorten and ease the processes of generating oil products. However, cooperation is very difficult to arrange, due to the restrictions set by anti-monopoly law, although the Anti-Monopoly Law of the People's Republic of China (2008) makes an exception of SOEs and legitimizes their monopolistic status. Article 7 of the law reads: "With respect to the industries controlled by the state-owned economy and concerned with the lifelines of the national economy and national security or the industries lawfully enjoying exclusive production and sales, the State shall protect these lawful business operations conducted by the business operators therein, and shall supervise and control these business operations and the prices of the commodities and services provided by these business operators, so as to protect consumer interests and facilitate technological advancement." However, the SASAC is unwilling to concentrate three NOCs into one large company group because it believes market competition can increase efficiency, thus raising the value of state assets.

It is expected that central SOE managers' high administrative rank and their relationships within the bureaucracy can somehow help them clear a path through bureaucratic affairs to pursue their firms' financial interests. Liou (2009, 678) prefers to view China's NOCs as market actors, despite their political roles. She argues that the global listing of China's NOCs reveals their corporate

performance, whilst their economic performance is more easily observed and subject to routine evaluation. A CSOE's overseas investment should not always be seen as representing an act of the state (Liou 2013, 228). A Chinese NOC's bidding on an overseas oil field is more driven by its economic interest than by any political interest (Mechling, Kong and Madan 2015, 1161). NOCs should not be seen as agents of the state with political motivation, though no political risk (Alon, Leung and Simpson 2015). China's three NOCs have privileges in mining rights, refined oil imports, crude oil imports and the right to sell in the domestic market. Through controlling refined oil import rights, the three NOCs exclude rivals in the domestic market. Also, China has failed to fulfill its promise, as part of its WTO agreement, to relax its control of crude and refined oil production by the end of 2006 (Zhou, Xie and Huang 2015, 110). Despite this, the CSOEs have to face competition among themselves. As noted in the earlier sections, the SASAC introduced EVA as one of the core indicators to evaluate central SOEs' annual performance and their senior managers' performance (SASAC 2014 No. 8). In addition to this, in order to meet the requirement of the stock exchanges they are listed on, the NOCs' listed companies employ some of the leading accounting firms in the world to examine their financial situation, which not only helps the stock exchanges and public shareholders to have a clear understanding of the firms' performance, but also helps the SASAC to oversee the financial results and to solve the asymmetric information problem in the principal-agent relationship.

Admittedly, the government's hand in the petroleum industry has not faded away easily. According to PetroChina's 2014 annual report, the gross profit margin on oil exploration and production was 30%, compared with 3.1% on oil retailing and 2.1% on refining and chemical engineering. This shows that the company's oil exploration and production are highly profitable, due to the monopolistic status it holds in China. The retail price is set by the NDRC's energy bureau, which limits the income of the CNPC and PetroChina's retail branches. Jiang (2012, 406) argues that the government's cross-subsidies to the CNPC downstream in the refining and retail sections keep the prices of oil products lower than the full market cost. In exchange, the government taxes the upstream of the oil industry heavily. From this perspective, the CNPC and other CSOEs in monopolistic industries are different from the CSOEs in competitive sectors. The competitive CSOEs do not have any privileged access to resources or preferential policies; but at the same time they are free from the government's direct orders and interventions in their business activities. The CSOEs with monopolistic status enjoy privileges in their monopolistic status in the market and preferential loans from state-owned banks; but at the same time, they are constrained by government regulations and directions.

## 6.7. Conclusion

This chapter started with an overview of the petroleum industry in China and then moved to a study of the three largest NOCs in China, which are also CSOEs in strategic industries under the SASAC's administration. This was followed by a comparative analysis of the NOCs and their international counterparts. After that, a review of the CNPC's background and PetroChina's business performances were provided. The discussion then moved to understanding the different roles of the central government in supervising the CNPC and the other two NOCs. In addition, this chapter also noted the importance of regulating the invisible hand the government takes in the NOCs, as well as lifting the social burdens these companies carry from the planned-economy past. Since these CSOEs operate in industries that are state monopolies, their competition is mainly among themselves. The chapter then discussed market competition among the CSOEs, and influences on their corporate governance.

The CSOEs in competitive industries have a clear understanding of their role as companies, according to both the government's definition and their own self-recognition. The CSOEs in strategic sectors have to deal with more complicated relations, and also have a greater economic, political and sociological impact on the country as a whole; but at the same time, there are more actors involved in their business activities, such as regulatory committee and local government. This complex network involves actors with various interests and leads to a more

complicated, interdependent relationship among the CSOEs, the SASAC, the relevant ministries, the regulatory committee and local governments. This chapter has used China's controversial central SOE, the China National Petroleum Corporation and its listed company, Sinopec, as an example to provide a comprehensive picture of the operation and development of central SOEs that have a monopolistic status. It has argued that central SOEs in monopoly industries are significant in terms of their total assets and high production capability: the oligopolistic competition among the national teams guarantees a certain efficiency and profitability that market competition is supposed to achieve. Nevertheless, unlike their peer companies that were granted more autonomy and less responsibility, and which compete in the market for economic success measured mainly by market criteria, this category of central SOEs has shouldered more burdens, while enjoying more benefits, based on their status as the scions of a communist state. However, the problem of asymmetric information, supervision insufficiency due to multi-level organizational structure, moral hazard and adverse selection are more prominent in the monopolistic CSOEs than in other industrial CSOEs in competitive sectors. The monopolistic CSOEs have to cooperate while competing with each other, at the same time as they coordinate their interests with those of various government agencies at both central and local levels.

The principal-agent problem between the SASAC and central SOEs can be seen as a seesaw battle. The principal, the SASAC, holds the responsibility for

conducting efficient supervision of the value of state-owned assets. This thesis disagrees with the argument that the SASAC and central SOEs have teamed up to form a new interest group and that the CSOEs can reject or distort policies that have been set or implemented. Admittedly, the SASAC and central SOEs share more interests with each other than they share with any other institution. The SASAC's legitimacy is supported by the central SOEs' performance. Central SOEs' close links with the SASAC also legitimize their superior status in the market, their policy preferences and their bargaining power with banks and local government authorities. The CSOEs are evenly distributed across most of the industrial sectors in China, and each industry has a different regulatory framework and market situation. For example, the central government has been able to create competition among the CSOEs in the petroleum industry, as discussed in this chapter. However, it is unlikely that the same thing will happen in the electricity sector. In the State Grid Corporation of China, the CSOE that controls over 90% of China's transmission networks, the border between the administrative role and the business part is even more blurred (Xu 2012, 148). The establishment of the State Electricity Regulatory Commission (SERC) was seen as a milestone in the Chinese state's efforts to build a modern regulatory system. The SASAC was the body to which the State Grid Corporation belonged, but the SERC took over responsibility as the regulator (Tsai 2014, 460). However, the SERC was dismissed and merged into the National Energy Administration in 2013.

“The SASAC is thus the ally and the adversary of the central enterprises” (Naughton 2008, 8). As this thesis argued in chapter 4, the SASAC has multiple roles as investor, supervisor, facilitator, policy-maker, buffer area and peacemaker in the state assets management system. The roles the SASAC plays and the goals CSOEs aim at illustrate their mutual influences under the developmental state model of economic governance and market competition. When we consider the old-style CSOEs with their abundant employees, we should take into consideration the welfare burdens they took over from the collective ownership past and not just their corporate profits. Given the multiple and sometimes contradictory objectives the CSOEs have, it is important to draw a clear line between group and listed company by having the three layers of operation of the CSOEs. Certainly, future reforms will primarily center on the group level. After all, through listing their high-performing assets, the SASAC successfully turned the listed companies into modern corporations with greater transparency and efficiency; but the group level, which embraced the loss-making assets, the over-abundant employees and similar historical legacies, needs more support and reform pressure from the government. However, these difficulties and obstacles will not stop the trajectory of CSOEs moving towards marketization. Market competition among monopolistic CSOEs, which has been structured by the government under developmental state logic, aims to raise the competitiveness of CSOEs. This argument supports the theoretical debate of this thesis: that the Chinese government has partially adopted market mechanisms to promote the growth of CSOEs. If this strategy is continued, principal-agent

problems can be further reduced. As a result, holding a vast amount of state assets will further enhance the state's power. Also, the state's capacity will be maintained and even improved with the promotion of industrial upgrading.

## **Chapter 7 Conclusion – Beyond the state and market debate, towards a hybrid model of state assets management**

The debate on what has made China's economy keep growing over the past 40 years lies between praising market norms of free trade and the decrease in government control, and recognizing the power of the state in promoting growth. Academic research on China's state-owned enterprises has focused on the massive state-owned assets all around China, and has discovered problems such as low-efficiency, soft budget constraints and insider-control, and developments such as the privatization that has taken place in small and medium size SOEs in a gradual, non-shock-therapy, way. The above debate, although very useful for the understanding of China's political economy, nevertheless misses a pivotal grouping in China's governance of state-owned enterprises—the central SOEs, led by a pilot agency, the SASAC. This study has adopted a hybrid theoretical framework to give a novel interpretation of China's economic governance of central SOEs in the post-WTO era.

State-owned enterprises are one of the most problematic issues in understanding China's political economy in the twenty-first century. For the domestic policy-makers, the SOEs are both an indispensable representation of the government's ideological slogan of "socialism with Chinese characteristics" and a key infrastructural power in promoting economic growth. The contemporary understanding of state-owned enterprises, which is trapped in the stereotype of

SOEs, is not as market actors; thus, their presence in the market has led to the disruption of the market. China's continuing economic growth and the country's steadily deepening integration into the global market show the country's cooperation with, and embracing of the global market. However, at the same time, the Chinese government tenaciously holds onto a large number of SOEs. In particular, the central government of China holds onto the largest SOEs in the country, known as the national team of central SOEs. These companies have kept growing in size, assets and profits, and are playing an increasingly significant role in the domestic market and internationally. It is important to understand why the Chinese state insists on owning the central SOEs at the central government level, and how these companies can be owned by the state at the same time as being a market actor. To analyze this puzzle, the thesis studied the interactions of the government, the central SOEs and the market through the theoretical lenses of the developmental state with the principal-agent theory as the analytical theory.

The central research questions are, from the state perspective: "Why and how does the Chinese government supervise and regulate the central SOEs"; and from the enterprises' perspective: "How can the central SOEs be owned by the state while being a market actor that achieves a fairly good business performance in the market". As the Chinese government's requirements in assessing the enterprises, and the way it promotes the growth of these central SOEs, are highly market oriented, the SASAC, as the largest shareholder,

examines the assets, revenue and profit of the central SOEs. This process easily translates into the rise of market and the decrease of state power in China. However, in fact, China's embrace of the market is with limitations. The power of the central government is strongly maintained, and the pillar industries are still largely dominated by SOEs. The closest model with which China can be matched is that of the developmental state. Conceptualizing China's model of governance as a developmental state has helped the discipline of political economy to have a deeper and more precise understanding of the country, instead of distinguishing China from any other political, economic model in the world. Ultimately, the purpose of this thesis is to generate useful knowledge in answering the question of how state-owned enterprises can be made efficient and productive.

In the first part of this thesis, the questions of why the Chinese central government holds the group of central SOEs at the central government level, and how it regulates and supervises these enterprises, were explored. China is a variant of a developmental state. Market competition was brought in as a toolkit to help the Chinese state to govern the SOEs effectively. Instead of massive privatization of the SOEs, as happened in the post-Soviet-Union states, the Chinese state chose to maintain complete control of the SOEs while using market criteria to assess their performance and market mechanisms to motivate their business activities. This thesis is not about a debate between the merits of state or market; it is about how the state uses the market to exercise control and

achieve objectives through the market. It suggests that the state can strengthen its control through an arms-length strategy by giving some control to the market.

What the operation of the central SOEs since the introduction of the SASAC has brought sharply into focus is the dual pressures – from state and market – that have effectively made the central SOEs' operation into a durable construction. Instead of rejecting the global market firmly by isolating the SOEs from market influences, or embracing marketization comprehensively by privatizing the SOEs in a short period, the Chinese government chose a third road, by managing the central SOEs in a developmental state fashion while partially adopting market forces to accelerate its growth. The SASAC adopted market criteria in the assessment of the companies' performance and used the Global Fortune 500 magazine's ranking of global companies as an international standard to evaluate the global competitiveness of central SOEs. The logic behind the Global Fortune 500 list is also evident in the SASAC's ambition to push the central SOEs to have a global impact that can expand their business into the international market.

Marketization methods can also be seen in the listing of central SOEs on overseas stock exchanges. As noted in the empirical chapters, 5 and 6, the central SOEs have selectively listed their most valuable assets on stock exchanges around the world. The listing was initiated, encouraged and supported by the SASAC as a mean of bringing the corporate governance of the companies up to international standards and to have the global capital market as a major

source of financing. The asset-stripping processes needed for this allowed both the SASAC and the central SOEs to elucidate the real financial condition of the companies. The listing on foreign stock exchanges also forced the central SOEs to sort out their confused working procedures and to be more regulated and professional in the international market. Finally, the listing allowed these central SOEs to generate a large amount of wealth from the capital market and this released the pressure on the previous funder—the Chinese state. The Chinese state now no longer provides funds for central SOEs in the competitive industries, and gives only limited support to those in the monopolistic industries. Besides, the central SOEs are not keen on government funding because changes in the shareholding ratio may be troublesome. As discussed in the empirical chapters, five and six, central SOEs, as listed companies, must report to the stock exchanges where they are listed any adjustment of the shareholding ratio. By getting the central SOEs listed, the Chinese government has significantly reduced the problem of low-efficiency, soft budget constraint and insider-control.

## 7.1. The Return of the State

The “grasping the big, letting go the small” strategy of privatizing small and medium size SOEs has been categorized as a big step towards marketization, with the Chinese state retreating from the market. However, the selectively adopted market criteria were set by a developmental-state-driven plan, the market competition was driven by a developmental mindset, and the benefits that

market brought were contributed to the developmental state. In fact, the Chinese state has never left the commanding heights of the economy. As noted in chapter 2, neoliberalism as an ideology has been resisted by the Chinese state, but the marketization the global market brings have been used as a tool to help the SOEs regenerate themselves and become modern corporations. The result has been that the central SOEs have become profitable and productive, due to market mechanisms that have reinforced the state's capacity to adequately direct a large amount of state assets. The market tool not only allows the government to authorize the profitable central SOEs to play a social welfare role, but it also further strengthens the government's legitimacy. One of the principal arguments made throughout this thesis is that the Chinese state has been able to keep finding a balancing point between state-led economic governance and the market-led growth. On the one hand, the government is not willing to lose its control of this 'red capital', which would lead to potential threats to its capacity to govern the economy. On the other, the government has realized its inability to supervise these giant groups of central SOEs, because the insiders always have an information advantage over the outsiders. It has come up with the solution of using the market as a means of promoting the efficiency of central SOEs and the stock exchange as a means of supervising and regulating their business performances: both crucial methods of solving the problem of asymmetric information. Also, the government has kept adjusting its policies, and the degree to which its hand is visible, in order to achieve a pragmatic balance between the state and the market principles.

Chapter two presented the macro-theoretical debate underlying the thesis, starting with a discussion of the many different political and economic models of China, and argued that the developmental state was the most appropriate one for studying China. It suggested that it was too vague to define the entire country as a developmental state. In fact, China's political and economic models differ from one industrial sector to another and from one province to another. The chapter then outlined the relationship between the state and the market. This pragmatic strategy of governing through the market allows the state to use marketcriteria to assess the performance of the central SOEs, which are managed under the developmental state model. Apart from the way in which the developmental state and marketization influences reinforce each other in making China's central SOEs profitable, another significant effect – on the state's supervision and administration of SOEs – should not be ignored. Chapter three studied the analytical theory of this thesis—principal-agent theory. SOEs were often criticized as belonging to all, but belonging to none. To tackle the problem of the lack of a principal, the state created an institution called the SASAC as the principal, to conduct supervision and administration of the enterprises. Drawing on document analysis of 195 SASAC policy documents, the chapter looked at the SASAC's ex ante administrative procedures and categorized them into different sections. It then provided a novel understanding of police patrol and fire alarm ex post oversight mechanisms by examining multi-police patrol and rotating police patrol strategies.

The crucial point for the success of a developmental state lies in having an efficiency-promoting institution as a pilot agency to lead growth; so, Chapter 4 devoted the entire chapter to looking at this pilot agency – the SASAC – and its role in the governance of central SOEs. The chapter provided a comprehensive overview of this ministry-level institution, from its organizational structure to its interactions with central SOEs. From 2003 to the end of 2016, the number of central SOEs dropped from 196 to 102. Half of all central SOEs were merged and restructured with other central SOEs, to become giant company groups. The chapter focused on the SASAC's multiple roles as investor, facilitator, supervisor, policy maker, buffer area and peacemaker. Chapters five and six presented the empirical case study undertaken for the thesis. Chapter five examined the China National Building Materials Group Corporation (CNBM) as a central SOE in the competitive industries sector, beginning with a discussion of the CNBM's cross-shareholding structure, which has meant rising percentages of shares released to the general public on the stock exchange by the state. The core of the study was an investigation of the division of labor among the CNBM group company, the listed company and the subsidiary companies. This three-layer governance structure for the enterprise group was formed unintentionally, but became the key to understanding the operation of central SOEs. The listed company was particularly effective as the middle layer that blocked the developmental state above it at the group level, while leaving itself and the operating companies free to focus on the competition in the market. Chapter six followed a similar structure

to that of chapter five, presenting an analysis of the China National Petroleum Corporation (CNPC) as a central SOE in the state monopolistic industry sector. Items that came with the CNPC's monopolistic status were state regulated petroleum prices, social burdens, and a massive superabundance of employees. Compared to the CNBM, the CNPC has more government-related issues to deal with, and its interactions with the government are far more complicated. The chapter then went on to draw out the way in which the international market has shifted the dynamic of the relationship between the SASAC and the central SOE, and how the one-party state controls central SOEs and thus changes the current political and economic status of the world.

## 7.2. Long Live State-owned Enterprises? Moving Forward the Debate on the Future of the Chinese state, Chinese SOEs and the Global Market

The SOEs are the vital forces for building up China's overall strength to protect the people's interests. We have to make the SOEs stronger, better and bigger, with great confidence. We shall also continuously increase the vitality, influence and risk resistance capacity of the SOEs.

Chinese President: Xi Jinping 2016-07-04

The problem with all of this is that no matter how marketized the Chinese central SOEs are, and no matter what the degree of their integration into the global

political economic system, state-owned enterprises are unavoidably political. The Chinese government keeps tight control of its SOEs in “commanding height” industries through its shareholdings in these companies, and it appoints the senior executives through Nomenklatura system and uses the SASAC to monitor their performance carefully. As discussed in the earlier chapter, although the Chinese NOCs participate in the international oil market and operate in foreign countries, China’s domestic petroleum industry is largely dominated by them. And the NDRC’s petrol price control mechanism has built a firewall that separates China from the global energy market. Lin (2013, 99) defines the government’s intervention in the promotion of industrial growth as the best-kept secret in any country. Indeed, government intervention was widely used in many of the developed economies in the early years of their economic growth, from nineteenth century Germany and Japan to post-war France, Norway, Finland, Austria, Korea and Singapore. However, there has been little analysis done to explain how these countries have successfully used government intervention to support sustainable growth, increase employment opportunities and push forward structural transformation (Chang 2007 and 2008).

It was the ambition of the SASAC’s first director, Li Rongrong, to build world-leading multinational companies to follow latecomer industrializing countries’ developmental path (Nolan 2005). Also, industrial and technological skills were the key to economic development, which required the government’s support in forms such as proper import protection, subsidies and institution building (Chang

2006). Lin (2013, 99) echoes Chang's assertion and suggests that sustainable economic development is based on cooperation between the public and private sectors. This collaboration can lead to a continuous industrial and technological upgrading of the country. The Chinese government's determination to keep control of the 102 CSOs, especially the 52 enterprises in the pillar industries, is unchanging. As argued in the theoretical chapter, the Chinese government uses the developmental state model of economic governance in the management of central SOEs. It uses market strategy to oversight these companies while losing the state's power in the market control. Aivazian, Ge and Qiu (2005, 795) suggest that corporatization, not privatization, can bring sustainable improvement in the performance of China's state-owned enterprises. They argue that the growth in productivity in Chinese SOEs is due in large part to the increase in incentives, competition and better factor allocation. The former Chinese premier, Zhu Rongji (term in office: 1998-2003), who conducted in-depth reform of state ownership in the 1990s, during his meeting with George Bush, disagreed with the idea of seeing China's corporatization of SOEs as a western style privatization and argued that "*China is corporatizing its large state assets, which is just another way of realizing state ownership*" (McGregor 2010, 43).

Certainly, compared to central SOEs in competitive industries, which are granted more freedom in investment decisions and freedom from other business activities, the 53 enterprises are faced with more government intervention, political orders and strict regulations. After all, their primary goals are not limited to meeting the

market criteria of being competitive and profitable. As Jiang (2012, 413) argues, the CNPC offers evidence of a rough transition from a planned economy to a market economy, but its operation is maintained within the framework created for a planned economy. Despite the SASAC and the CNPC's effort to portray PetroChina as a modern corporation that can compete with any international oil company, PetroChina was, and still is, best described in the words of the Goldman Sachs economist Paul Schapira (2010, 61): "*the best way to describe PetroChina as it was then, was the Ministry of Petroleum*". However, like the CSOEs in competitive industries, the CNPC and other NOCs in monopolistic industries have considerable autonomy in their business activities, although the government maintains tight control of the selection of financial and other personnel (the senior management team). Taylor (2012, 75) argues that the relationship between the Chinese government and the NOCs can be seen as "*collaboration governed by hierarchy*". The two cases provide two totally different pictures of China's central SOEs.

What kind of experiences can be drawn from China's development path that can be beneficial to the other developing countries in the world? If state ownership of enterprises is unavoidably political, then how does the government play a useful role rather than being a troublesome bureaucracy? The success of Chinese central SOEs lies not only in governing through their market strategy but also in the principal-agent mechanism. Both the SASAC's ex ante and ex post supervision mechanisms have an impact on the activities and business

performance of central SOEs. This thesis argues that ownership is not the decisive factor in an enterprise's success or failure, but rather the principal-agent relationship is. Since central SOEs operate in many different industries, and each of the central SOEs has multiple organizational layers and massive numbers of employees, in addition to interactions among central SOEs and various government agencies at different levels, future research could study the impact these central SOEs have on the government's industrial policy making. The growing significance of industrial associations would also be worth analyzing: for example, the relationship between central SOEs and industrial associations, and what impact this network has on the making of industrial policy. These interactions are crucial to an analysis of state ownership, and have great importance in helping us make sense of the wider state and market debate in China.

The high-performing central SOEs have functioned as an engine of China's rise as a developmental state, following the adoption of selective market forces as a tool for the development of state-owned assets. The market indicators were adopted, as was the listing of the central SOEs, not purely for financial reason, but in order to push forward the reform of these SOEs: to give them international standards of corporate governance, to increase the transparency of their financial performance, and, most importantly, to have the international market and public shareholders as external supervision entities. It is a painful struggle for the Chinese government to justify to itself the strategy of using market criteria to

strengthen state capacity. The government has used overseas listing to revitalize and activate the Leninist legacy. Obviously, it is embarrassing and difficult for the state to explain this to the Chinese people. Difficulties are also posed by resistance from workers in the SOEs to the enterprises' transition towards a profit-oriented market mechanism, because political ideology and political propaganda had portrayed SOEs as representing the superiority of the Socialist system and as a major source of the CCP's legitimacy. The Chinese state has maintained its vital role in conducting incremental institutional reform to achieve compatibility with capitalism (Jung 2011, 121). However, this transition to integration into the global market has never been easy: apart from pressure from the government, there has also been resistance from the workers. It is the market, not the state or state-directed resource allocation, that defines today's labor relations inside the SOEs. Resistance from workers was widely seen in the transition towards a market economy (Jia 2016, 9-14). The official discourse in 2003 was that the central SOEs were becoming bigger, stronger and better; but at that time, SOEs, in general, were loss-making, inefficient entities with unpaid loans. The process of China's promotion of SOEs was full of self-contradictory strategies. Using market mechanism to reactivate the legacy of the Leninist system, adopting market criteria to assess and supervise SOEs that the state was unable to evaluate and run by itself, this meant a period of distrust, self-adjustment and resurgence.

This is significant because it represents a policy paradox: to some degree, it runs contrary to the stereotypical image we have of Chinese SOEs, particularly when we compare them with the SOEs of Latin America and most other developing countries. The Chinese government has exercised entirely different strategies from the ones used in these countries. Its cautious and gradual way of adopting a supervision system builds on a market standard has been part of its pragmatic governance. When we look at China, we see that the market mechanism has had a significant influence on the government, which has used a cautious, gradual way to learn the supervision mechanisms of the market world. China's well-thought-out supervision of its central SOEs presents an entirely different picture of what SOEs are like. The problem of state-owned enterprises has never been an issue of what ownership the company comes under, but rather one of the state's inadequacy in monitoring the performances of these enterprises. Compared to the massive regulatory lacunae in the supervision of public enterprises in other developing countries, such as that of Petrobras in Brazil, the Chinese government's assiduous efforts to improve the supervision and administration of its central SOEs is aimed at minimizing loopholes in the system. Therefore, it is sufficient to argue that, for developing countries, it is worth considering that SOEs can be a possible solution to stimulating economic growth and can be seen as a positive factor in leading the country's development, at least in the earlier stages.

When we discuss China's state-owned enterprises, we tend to fall into an analysis of the Chinese state behind them. The Chinese state plays a significant role in international political economy, and so do Chinese central state-owned enterprises. Chapter 6 looked at the China National Petroleum Corporation, and extended the discussion of China's central SOEs to the international stage by looking into this corporation's engagement in the global market, and how this affects the petroleum industry in China. As Linda Weiss (2003, 317) points out, yes, the state has been transformed by global markets and international competition, but this has happened in unexpected ways. Instead of weakening state capacity, globalization has enhanced the national state's power in the market.

This thesis has shed light on China's state ownership system, looking at the complexity and various shades of thinking behind every step of reform. Future research could study the central SOEs' local operations, to see how these have developed, and what happens when the vertical line of administration studied by this thesis meets horizontal administrative arrangements. How can central SOEs work across the complex vertical and horizontal interconnections, and balance the interests of all parties, as they expand their business? Although the thesis provided discussion on Chinese central SOEs' overseas business in chapter six, more could be done. Questions worth pursuing in future research could be expanded to engage with China's domestic political economy, for instance, looking at the extent to which the central state's supervision of central SOEs

could be duplicated to cover SOEs at local levels. How does the listing of central SOEs on stock exchanges improve the general reform situation of SOEs, and what are the implications of building a more regulated market in China? Research could be extended to engage with the discipline of international political economy, to see how China's developmental state model of economic governance impacts on international political economy. From the perspective of the state, the rise of state capitalism represents the realization by third world countries that they must protect their resources from exploitation by the industrialized countries through international corporations and under the cover of neoliberal ideology (Lin 2010, 92). What does the rise of China's central SOEs and their ambitious global expansion mean to the world market? Are central SOEs investment bargaining chips or burdens for the Chinese government in international negotiations? How do the Chinese government's global investment strategies such as "one belt one road" facilitate the growth of Chinese Central SOEs and vice versa?

### **7.3. Towards a hybrid model of economic governance**

China should not be examined as an individual unit. Instead, it should be seen as a collection of different political economic models which vary among regions, provinces and industries. China is a variant of the developmental state that has different developmental states across the country. If China can embrace market,

why shouldn't the neoliberal western economies consider embracing state-owned enterprises? China's experience suggests that state-owned enterprises can be competitive in the market, and that SOEs can support the government in leading the country's industrial growth, thus contributing to the development of the country. It may be a solution to the problem of what a government can do to raise its country out of poverty in a short period. Chinese central SOEs will continue to be a significant player in the market, as there are more responsibilities to be taken and more problems waiting to be solved. The rise of China's central SOEs challenges the preconception that state-owned enterprises are a drain on the state and have intrinsically low efficiency. This thesis started with a macro theoretical debate on China's developmental state model and its selective use of marketization. It argued that although the two theories seem contradictory, they can coexist to promote economic development in the Chinese context. The Chinese government is pragmatic and ideologically relaxed about the economic models that it has adopted to encourage the growth of the economy. When we discuss the SOEs, we are not discussing what ownership means, but what ownership can do and how that influences the market. Instead of shoehorning neoliberalism into developing countries, a better way would be to rethink and readjust the different developmental models that suit different local conditions. In fact, as Lin (2012, 241) points out, the government has played a major role in helping individual firms to overcome coordination and externality problems in their transformation during the country's development. The key to success is not *whether* the government should interfere in, and thus facilitate, the growth of

industry, but *how*. This thesis suggests that managing SOEs in a developmental state can be a way of taking the first step towards prosperity.

Discussion of SOEs should not just be limited to research into government's support for them: the role of the market is equally important. The core reason for Chinese central SOEs performing better and growing stronger lies in the principal-agent relationship. The innovative *ex ante* and *ex post* supervision mechanisms adopted have enabled the key principal, the SASAC, to maximize its ability to overcome asymmetric information. Given China's magpie behavior in economic policy making, the Chinese government will continue to push forward market reform in China and to become better integrated into the global market. It is political realism, dynamic activity and minimal ideological constraints that have contributed to China's industrial success.

Future reforms should be focused on the group level of central SOEs. This does not necessarily mean that the group level should be eliminated, or that the importance of the group level should be reduced. In fact, the group is the fundamental level that has stabilized the structure of this hybrid governance system. This important level of the system needs to be reorganized, and its functions need to be further clarified so that it operates better as a coordinating center that interlinks the developmental state and marketization. Espousing a "governing through the market" strategy has significantly reduced the problems of the state ownership system, but more effort needs to be made in the promotion

of listing the entire group and stripping out the loss-making assets that have piled up in the past years.

All in all, as Breslin (2012, 29) puts it, “*Despite the rise of the private sector, the Chinese state retains control of key industries and resources and thus shapes the nature of the market that non-state actors operate in.*” From governing the market to governing *through* the market, the Chinese state has adopted an adaptive, flexible, pragmatic style of economic governance. The central SOEs, as part of this governance strategy, will extend their influence into the international market, as China plays an increasingly crucial role in global governance. At the time when this thesis was completed, another two central SOEs-- China Guodian Corporation and China Shenhua were being restructured and combined into a giant business corporation-- State Energy Investment Corporation (*国家能源投资集团*), so that the total number of central SOEs was reduced to 98. This research only represents a beginning. It is clear that it is now time to rethink China, the Chinese state-owned enterprises and, most importantly, the state’s strategy of governing through the market.

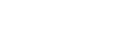
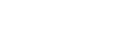
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Code	Interviewee	Institution	Position	Category
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BJSASAC/02/2015	[REDACTED] [REDACTED]	SASAC	[REDACTED] [REDACTED]	SASAC officer/policy maker
BJCNBM/03/2015	[REDACTED]	China National Building Material Co.ltd	[REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED]	Central SOE
BJCNBM/04/2015	[REDACTED] [REDACTED]	China National Building Material Co.ltd	[REDACTED] [REDACTED] [REDACTED] [REDACTED]	Central SOE
BJDCSASAC/05/2015	[REDACTED] [REDACTED]	Dongcheng SASAC, Beijing	[REDACTED]	Local SASAC
BJEFC/06/2015	[REDACTED]	Beijing Enamel Factory co.ltd	[REDACTED] [REDACTED]	Local SOE
BCJNB/07/2015	[REDACTED] [REDACTED]	China National Building Material	[REDACTED] [REDACTED] [REDACTED] [REDACTED]	Central SOE

BJCNBM/08/2015		China Enterprise Reform and Development Research Institute	  	Official Think Tank/Centr al SOE
BJCNBM/09/2015		China National Building Material	  	Central SOE
BJCNBM/10/2015	 	China National Building Material	   	Central SOE
BJCNBM/11/2015		China National Building Material	  	Central SOE
BJCNBM/12/2015	 	China National Building Material	   	Central SOE
BJSASAC/13/2015	 	SASAC Research Dept.	 	Policy- maker
BJSASAC/14/2015		SASAC Research Dept.	 	Policy- maker
BJDRC/15/2015	 	Development research center of the state council	  	Policy- maker/ official think tank
BJDRC/16/2015		Development research center of the state council	 	Policy- maker/ official think tank
BJCSIC/17/2015	Anonymous	China Shipbuilding Industry Corporation	 	Central SOE

BJCEC/18/2015	Anonymous	China Electronics Corporation	 	Central SOE
BJSASAC/19/2015	 	SASAC Research Center	 	SASAC officer/policy maker
BJSASAC/20/2015	 	SASAC	  	SASAC officer/policy maker
BJSASAC/21/2015	 	SASAC Research Center	  	SASAC officer/policy maker
ZJCNBM/22/2015	 	CNBM South Cement	  	Central SOE
ZJCNBM/23/2015	 	CNBM South Cement Zhejiang	 	Central SOE
SHCSCEC/24/2015	 	CSCEC 8 <sup>th</sup> Bureau	 	Central SOE
SHCSCEC/25/2015	 	CSCEC 8 <sup>th</sup> Bureau	 	Central SOE
SHBR/26/2015	 	Business Review	  	External Observer
SHEG/27/2015	 	Shanghai Electric Group	    	Local SOE
SHCGR/28/2015	Anonymous	China Grain Reserve (Sinograin)	 	Central SOE
SHCG/29/2015	 	Shanghai Construction Group	    	Local SOE
ZJCNPC/30/2015		China National Petroleum Corporation (PetroChina) Zhejiang	    	Central SOE
ZJCNPC/31/2015	 	China National	 	Central SOE

		Petroleum Corporation (PetroChina) Zhejiang		
SHPDSASAC/32/2015	 	Shanghai Pudong SASAC	 	Local SASAC/policy maker
SHPDSASAC/33/2015		Shanghai Pudong SASAC	   	Local SASAC/policy maker
SHPDPG/34/2015	 	Shanghai Pudong Properties Group Co.ltd	   	Local SOE
SHZJT/35/2015	 	Shanghai Zhangjiang Technology	  	Local SOE
SHBFG/36/2015		Shanghai Bright Food Group. Wusi co., ltd	 	Local SOE
SHBFG/37/2015		Shanghai Bright Food Group. Wusi co.,ltd	  	Local SOE
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