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The Chinese state-owned enterprises' reform: an overview

NELSON DOS SANTOS ANTÓNIO

"Ask what has been the most stunning economic event of the past century, and many people might cite the case of China in the two decades since it opened up. In that time the economy has grown more than fivefold, incomes have quadrupled, and 270m Chinese have been lifted out of absolutely poverty." The Economist, March 10th - 16th 2001.

"When China awakes, the world will tremble", warned Napoleon. In the last two decades, China has awakened and the interest about what is happening in this country has unmistakably increased. China's manufacturing is getting more sophisticated and employing more capital. Some Chinese officials argue that even as it moves up the manufacturing chain (e.g, to semiconductors and information-technology hardware, of which it is the world's third biggest producer), China will not lose its advantage in cheap, labour-intensive areas such as toys, textiles and shoes. This possibility has a profound shock to China's neighbours, most of whom have built a development strategy over the past two decades around export-led growth. It is also a shock outside the region, to exporters in India and Mexico, who thought themselves far removed from the Chinese threat. The world did not tremble, but is watching China very carefully.

Since 1978, the Chinese economy has had an open-door policy, characterized by the substitution of the central planned economy with the free market economy system. The policy, sometimes called Deng Xiaping's Chinese Socialism (or Socialism with Chinese characteristics) claimed to externally open the economy to the world market.

Simultaneously others transitions are occurring in China; transition from a rural society to an industrial society and a transition from an industrial society to a post

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industrial society. In the implementation process of these transitions the SOEs played a crucial role.

In order to introduce market competition, in the very early stages of transition reformers began to experiment with reforms that allowed firms to retain at first a small and then increasingly a larger proportion of their profits. Not only did decentralized transactions slowly become acceptable, but state reformers encouraged them as a way to make firms and their managers more responsible for production and other aspects of plant operations. In the early days of reform, enterprise autonomy intended to allow planners to direct enterprises as they deemed appropriate. After the mid-1980s, a series of additional measures aimed at increasing enterprise autonomy pushed reform even further. Most enterprises gradually adopted the factory manager responsibility system - comprising manager authority to determine productions plans, the linking of wages to profits, and long-term contracting of profit remittances between factories and their superiors.

Starting in the mid-1980s reformers also began to allow, and in some cases to encourage, mergers and acquisitions. Likewise, they allowed new organizational forms to emerge and thrive. Both moves signaled an acknowledgement that a proliferation of organizational forms was desirable, and was a reasonable target of industrial reform, because it might lead to more efficient means of resource allocation and management. Mergers and acquisitions were designed to revitalize large-and- medium firms by further transferring control and decision making to managers. The idea behind this reform measure was to let state-owned enterprises merge voluntarily, or to allow better SOEs, collective enterprises, private enterprises, or foreign firms to acquire failing or weak SOEs. This measure was intended to aid SOEs that were performing well to acquire the resources, technologies, and other capabilities that they needed. Relatively complex ownership and control structure tended to characterize the new organizational forms, simultaneously challenging old notions about ownership and pushing China towards privatization.

From the firm's perspective, these changes meant increased freedom to determine how to conduct business, and with whom. From methods of production to decisions about hiring and firing workers, Chinese business organizations gradually started to depend less on central authority in most areas of plant management. Managers quickly became responsible for finding productive inputs, for determining appropriate production and inventory levels, for finding markets for their products, and for ensuring long-term growth and survival. In the process, managers began to focus on profitability and efficiency.

The increasing realities of firm failure and unemployment fuelled concern about

long-term outcomes. Prior to reform, bankruptcy was unheard of, and employers guaranteed workers lifetime employment. State-owned factories might have reorganized or merged, with all workers assured of positions in the new factory or given a comparable position in another factory, but the closure of a plant was extremely rare. Reform gradually introduced provisions allowing firms to close entirely and leave all employees unemployed.

By the late 1980s, rules regarding employment had changed even more dramatically, and firms were encouraged to "re-optimize" their labour forces, cutting down on redundant employees. Local governments established programmes to retrain and place workers who found themselves unemployed, but the number of jobless, particularly in large urban areas increased steadily up to the late 1990s. In 1997 the State Council developed a task force to oversee and enforce bankruptcies and other closures. The task force was responsible for identifying unprofitable state-owned firms, determining the long-term prospects of the enterprise, and, where there was a negative prognosis, auctioning their assets. As a result, bankruptcy (and thus unemployment) increased dramatically, demonstrating to managers that poor financial performance could result in failure for a firm, and unemployment for the firm's managers and workers alike. The closures primarily affected small and medium-sized enterprises, as the state continued to protect larger firms in the hope of stabilizing the economy.

Under a combined attack from Foreign Investment Enterprises (FIE) and Township and Village Enterprises (TVE), SOEs have plenty to be worried about. But how do the SOEs themselves perceive their situation?

They complain about the "social security" burdens. The cost of providing housing, medical care, education and the like accounts for 15-20 percent of the total investment of most enterprises. Subsidized housing and medical care is an important benefit for employees. But the "cradle-to-grave" policy of providing housing to retired employees until death, and the policy of providing retirees the same level of medical care that current workers receive, is a heavy burden. With respect to employees, apart from there being some 30 percent too many workers, the SOEs is paying personnel costs for retired former cadres and retired workers, who constitute another 25 percent of the total workforce. Converted to wages cost, the wages paid to workers actually engaged in production roughly equal the payments made to excess and retired personnel.

According to some SOEs managers, the "social security" burdens act as a constraint. They do not allow them to become more competitive. As matter of fact, for

the SOEs is becoming more and more difficult to attract young employees. Although, the "dream" of the new generation is to be employed by a Multinational Company, the competition among the MNC is becoming more and more strong. For these companies it is not only difficult to recruit qualified workers but also difficult to retain them.

In this competitive environment it is crucial for the SOEs to pay attention to the Human Resources. The success of the reforms depends on their capacity to attract and retain qualified workers.

In the Chinese economy the SOEs are still important and the government is willing to reform them. According to a 1995 census, in terms of number of enterprise, SOEs accounted for only 1.6 percent; in terms of employment and output value they constituted something more than 30 percent. And of some 88,000 SOEs, some 30,000 were loss-makers. As we said, since the beginning of the "open door", the reform of the SOEs constitutes priority number one, and its malfunctioning has effects in others sectors of the Chinese economy, for example, the state bank's loans are a symptom of a deeper malaise among the China's state-owned enterprises. Some four-fifths of the banks loans are to such enterprises (nearly 30 per cent of the Bank of China's loan book is non-performing and it is the least bad of the four), and lending is still driven as much by politics as by credit considerations.

Now we will divide the SOE's reform process in some phases and describe each one.

STATE-OWNED ENTERPRISES REFORM: SOME PHASES

Since China opened up 23 years ago, the State-Owned Enterprises (SOEs) have been under reform, that means that, China's groping for a way to reform SOEs was a concomitant of the Deng Xiaoping era and began at the same time. On July 13, 1979, the State Council handed down its "Decision Concerning the Expansion of Autonomy for State-Owned Enterprises".

The lack of efficiency endemic to SOEs was first noted in the early 1960s, and the reforms that first attempted to deal with this problem could be dated back to that time. Until the end of 1978, however, the SOE reform had been bogged down by the pendulum that swung between administrative decentralization and re-centralization, i.e., the re-division of economic management rights between ministries and local governments by the related wax-and-wane cycle of the administrative organizations. These made the reforms fail to tackle with the deep-rooted problems in the traditional economy. The reform in the late 1978 transcended the cycle of administrative

decentralization and re-centralization and drove deeper into increasing autonomy and improving incentives for enterprises. It gradually led to the objective of establishing modern enterprises institutions in the market economic system. Profound political, economic and social changes had set-up the background for this series of deep-going reforms. The specific changes in situation that set the stage for the SOE reform are as follows.

First, the traditional development strategy and the corresponding economic system were increasingly unsustainable. The consequences of the heavy-industry-oriented development strategy, which had been in effect for many years, had led to severe distortions in the economic structure and serious shortage of industrial consumer products that people needed on a daily basis.

Second, the widening of the economic gap between China and the developed countries and the remarkable economic development in China's neighbouring countries and regions created pressures and a sense of urgency for change.

Third, the desire to "catch up" with the Western countries by "leaping forward", based on import of equipments, once again pushed the traditional development strategy to the extreme, which further revealed its shortcomings.

Finally, the leadership with Deng Xiaoping at the helm adopted the theory that "practice is the only yardstick for testing the truth" during the Third Plenary Session of the Eleventh Party Congress, the leadership carefully rethought the traditional system. The authority of the new generation of leadership would be rested on the acceleration of economic growth and development and rapid improvement of people's living standards.

Phase One - Economic Responsibility System (1979-1984)

This phase began with the "Decision Concerning the Expansion of Autonomy for State-Owned Enterprises" and extended to the introduction of the system of "converting profits to taxes". The principal theme of this period was to "let go of authority and give up profits", which meant devolving authority to enterprises and allowing enterprises to retain profits.

The main purpose of this phase was to enlarge enterprises autonomy and expand the role of financial incentives within the context of traditional planning system. The primary feature was the implementation of a system of "profit sharing", in other words, instead of the original system in which the state received all revenues from the enterprises and was responsible for all expenses, the new system allowed the enter-

prises to retain a share of their own profits according to a fixed percentage.

Granting SOEs enterprise autonomy meant offering the enterprises the opportunity to encroach upon the rights, interests and assets of the state. From the perspective of governance structure, the traditional SOE management system was an integrated entity. When the rights and interests of the owners or the autonomy of operators were changed, the problems of information asymmetry and incentive incompatibility will emerge. In particular, when competition did not exist, the market was immature and losses or profits of enterprises did not reflect their genuine operation performance, increasing enterprise autonomy opened the way for enterprise staff to appropriate more of the enterprise revenues, which in turn affected the amount of profits turned to the state.

In response to this problem, in the early 1980s, Shandong province took the lead to change profit retention into profit contracting. The enterprises in Shandong were first to turn over a certain required percentage of profits to the state, after which they would retain the rest or divide it between the state and the enterprise according to a certain ratio. The state quickly gave consent to this so-called industrial responsibility system, and the system spread rapidly throughout the nation. It is worth pointing out that, from the beginning, increasing the level of autonomy and improving incentives led to the contradiction between the enterprises and the state in terms of interest allocation. The purpose of the state was to raise asset income and fiscal income while granting enterprises autonomy and independent interest.

The "Economic Responsibility System" is no more than the transfer of what was done in the agriculture to the industry, but without success. The pioneering reform in China, initiated with the policy of the "Family Responsibility System" is *de facto* ownership reform (and this was not the case with the "Economic Responsibility System"). The government does not send a penny to peasants but allots a piece of land for one family to farm on. This ownership reform in agriculture is based on family ownership and it has worked. But for the industry only in 1997 the problem of ownership was more or less clarified.

Phase Two - Tax for Profit System (1984-1986)

Was the transition period "converting profits to taxes", which meant converting from a system where all enterprise profits were remitted to the supervising state authority to one of taxing profits.

In this phase, the emphasis of enterprise reform shifted to increase the role of economic instruments and substitution of profit remittance by income taxes, in other

words, where the enterprises used to remit their profits to the state, they now had to pay income taxes according to the stipulations of the law.

The main purpose of replacing profit remittance with taxes was to demarcate government fiscal income from the disposable income of the enterprises (and increase the amount collected by the state), such that the state's fiscal revenue would be linked with taxes and enterprise income to profit.

We can divide this phase in two stages. Under this system, in the first stage, large-and medium-sized enterprises were obliged to pay an enterprises income tax of 55 percent. Any remaining profits were divided into an amount payable to the state and an amount that could be retained by the enterprises. The small sized state-owned enterprises were levied according to 8 levels of progressive taxes (from 7 percent to 55 percent).

The second stage commenced in September 1984. It put into effect a single tax regime, which included improvement in the income tax and added a capital tax, a city maintenance and construction tax, property tax, land-use tax and vehicle-use tax. It also established a product tax, value-added tax, business tax and salt tax. The second stage was initially successful. However, the problem was that since the economic accounting and auditing system was unsound, enterprises could figure out all kinds of ways to avoid paying taxes while increasing profits.

Phase Three - Contract Responsibility System (1987-1991)

The initial reforms, which emphasized the distribution of profits, came to the end, since they were not able to solve the problem of low-efficiency in state-owned enterprises. Therefore the attention of the reforms shifted to internal problems like operational mechanisms and individuals, especially to managers. In this period (the period of the "contract responsibility system") the enterprise guaranteed a fixed amount of profit remittance to the state and was allowed to retain whatever remained. The principal theme of this phase was "separation of government and enterprises, separation of ownership and operation".

The "Contract Responsibility System" was an attempt to clarify the authority and responsibility of the enterprises and their supervisory bureau. The main purpose of these measures is to reduce government intervention in the management of SOEs and to make them financially independent and to introduce profit rather than plan fulfillment as the indicator of enterprises performance.

By making managers responsible for meeting output and profit targets, production improvements targets, and other goals, in exchange for greater managerial latitude

and profit retention, this system decentralized management control. Increases in autonomy were intended to give enterprises the flexibility and incentives needed to respond to market forces and for the first time the managers were responsible for defining and implementing a strategy.

The objectives of the "contract responsibility system" were to provide the mangers with more authority to deal with the business problems and to standardize the behaviour of both the enterprise and the government. In this system, a manager or an enterprise, as a contractor, signs a contract with the state about mutual responsibilities, rights and benefits. Based on the contract, managers have the right to manage the production of the enterprise, including the whole process from supply, to production and marketing, and are supposed to be responsible to the profits and losses of the operation.

The "Contract Responsibility System" was widely implemented in 1988. It covers about 70 percent of all state-owned enterprises by August 1988. Under the system the amount of profit taxes and in some cases the amount of indirect taxes were negotiated as part of the contract. Such a system not only undermined the tax system and offers substantial tax concessions but also leads to extensive bargaining before and after the contract.

Under the "Contract Responsibility System", contract terms were formed on the basis of one-on-one negotiation between the state and enterprises. To some extent, this could take the interests of both the enterprises and the state into consideration. However, in a deeper analysis, in the absence of a simple and cost-effective information indicator to fully reflect enterprise performance, there were still information asymmetry and incentive incompatibility. Besides, the contract terms still could not prevent operators from infringing upon owner's rights and interests by using their enterprise autonomy. People generally attributed the failure of preserving or increasing the value of the state assets in the reform to the vague delineation of property rights. Therefore, in 1990s, there has been an integration of two schools of thought, namely, treating property rights reform as the core of the SOEs reform, and increasing autonomy and improving incentives.

Phase Four - Modern Enterprise System (1992-1997)

This phase dates from July 23, 1992, when the State Council promulgated its "Regulations on the Conversion of Operational System of Industrial Enterprises Owned by the Whole People". This was actually a concrete manifestation of the party Central Document No 4, drafted by then-vice premier Zhu Rongji on the basis of Deng Xiaoping's remarks during his southern excursion. The principal themes of this

phase were "Transforming the system of operation" and "establishing a modern enterprise system".

After so many tentative the Chinese authorities realize that the crux of the problem regarding the SOEs does not have to do with the questions of profit sharing or distribution between the state and the enterprises, but has more to do with the fact that the operational and managerial mechanisms were not rational. Therefore, reform needed to be grounded in switching to a different set of mechanisms in these enterprises and to push the enterprises toward the market.

The program called for the transformation of SOEs into limited liability companies or limited liability share-holding companies whose equity belonged to diversified owners. The basic goal was to reorganize the existing SOEs into wholly state-owned enterprises groups, and transform administrative bureaus into wholly state-owned holding companies. The detailed measures included enlarging assets and reducing debts, that is, converting part of the enterprise debts owed to the state into state investment. The programme was conducted in eighteen cities designated for experimentation. According to some authors, a "modern enterprise system", one that fits the needs of a market economy, requires a set of regulations and an appropriate institutional environment. Regulations should cover property rights, organization, leadership, financial accounting, human resources, while the institutional environment involves the social security system, the transformation of the functions of the government and the relations between the government and the enterprises. It also includes codes of conduct governing the relations between enterprises and the stakeholders (government, stockholders, society, employees). The establishment of a "modern enterprise system" is not the responsibility of the enterprises alone; it involves the reform of a number of institutions, the creation and improvement of a legal system relating enterprises, as well as the transformation of government's functions.

It was in this phase (1994) that the corporatization of the Chinese state-owned enterprises started. The reform has been aiming at reconstructing the SOEs in the way of the western style public corporation in order to transform the SOEs into incorporated companies with definite investors or representatives of the ownership as well as an effective corporate governance structure. Based on the initial design of the expected corporate governance structure, the distribution of power among shareholders, board of directors, board of monitors and managers could effectively restrain the discretion behaviour of managers and reduce the cost of agency. It should be recognized that the above ideas to reform SOEs are based on the reasoning that the western style public corporation run efficiently thanks to its distinct property rights, thus

the only way to reform Chinese SOEs should be to make the state ownership being as distinct as the private ownership is through an ingenious design of multiple-level agency. It is this reasoning that meets with great difficulties in the reform of the Chinese SOEs.

Phase Five - Legitimization of the Joint-Stock Company System

This phase followed the Fifteenth Party Congress in 1997, which adopted Jiang Zemin's government work report. Previous experiments were validated, and SOE reform was positioned to advance to a higher level. Most remarkable was the complete legitimization of joint-stock company system.

Table on page 93 presents a rough summary of the issues raised in Jiang Zemin's report. Chinese enterprises had already been listed on such foreign stock exchanges as Hong Kong, New York and London, and in China securities exchanges had been established in Shanghai and Shenzhen. In order to support the development and enlargement of China's better companies, which in most cases are small by international standards, a key policy was instituted to "nurture enterprises groups". Yet for small-and medium-sized SOEs, the new prescription included bankruptcy or merger or the adoption of a cooperative shareholding system (meaning share ownership by workers). The strategy is to nurture a "company mentality" among workers by making employees shareholders. This is a realistic strategy, since there is little chance that small-and medium-sized enterprises will be listed on the stock exchanges.

Jiang Zemin's report to the 15th Chinese Communist Party Congress has broken the ideological shackles and represents a breakthrough after one decade of reforms directed by Deng Xiaoping The ownership reform scenario of which he gave a detailed description holds a key to the further and continuous reform in China. According to his report, China will stick to public ownership but with a different definition: the public ownership can and should take diversified forms. The public sector includes not only the state-owned and collective sectors, but also the state and collectively owned elements in the sector of mixed ownership, including the joint ventures between Chinese and foreign enterprises. According to the report; "China should see the full meaning of the public sector of the economy. The public sector includes not only the state-and collectively-owned sectors, but also the state-and collectively-owned elements in the sector of mixed ownership. The dominant position of public ownership should manifest itself mainly as follows: public assets dominate in the total assets in society and the state-owned sector controls the life-blood of the national economy and plays a leading role in economic development". Jiang Zemin also gave a positive explanation of the stock system. According to him: "China should strive to seek various forms for materializing public ownership that can greatly promote the growth of the productive forces. The joint stock system is a form of capital organization of modern enterprises, which is favourable for separating ownership from management and raising the efficiency of the operation of enterprises and capital. It can be used both under capitalism and under socialism".

TABLE

Direction and Strategy for State-Owned Enterprises Reform

Direction
• Specify ownership rights, clarify authority and responsibility, separate government administration from enterprises, institute scientific management." Establish the modern enterprise system. • Corporatizing SOEs: Reform large and medium-sized enterprises into corporations... Establish legal person entities capable of competing in the market. • Separating Government and SOEs: The state will enjoy ownership rights in accordance with the amount of capital invested in enterprises; the state's liability for the debts of the enterprise will be limited. Enterprises will by law have autonomy in operations and will be solely responsible for their profits and losses.
Strategy
• Form large enterprises groups: Form large enterprises groups with large competitive strength and operations that transverse regions, sectors, ownership forms, and countries. • Freeing and Vitalizing small SOEs: Speed up liberalization and vitalization of small SOEs through reorganization, forming associations, mergers, leasing out facilities. Contracting facilities to operators, converting to cooperative shareholding companies, or outright sales.
Related Forms
• Dealing with Bankruptcy and Unemployment: Provide incentives for mergers; apply standards for bankruptcy. While raising enterprise performance by temporarily laying off or transferring personnel, implement reemployment programs. • Protecting State Assets: Preserve and increase the value of state-owned assets; prevent state assets flowing or being drained away. • Establish a Society Security System: Institute an old-age and medical security insurance system, establish unemployment insurance and a social welfare system. Provide for the most basic societal needs.

Source: Jiang Zemin, "Political Work Report at the Fifteenth CCP Congress," People's Daily, September 22, 1997.

SOME MAJORS DEVELOPMENTS

The Framework of Public Ownership and Joint Stock Companies

Jiang Zemin's report offered the possibility that SOE reform could take many forms, but it was emphasized that any reform should support and not undermine

"public ownership". Thus, if a socialist market economic system was to remain worthy of the name "socialism", nothing should be allowed to develop too far outside the framework of "public ownership". For sectors with a strong public interest, operations are placed in the hands of public enterprises, even in capitalist countries. This would become policy in China. In the countryside, however, the collective economy would combine collective ownership with private ownership.

In the "surnamed capitalism or surnamed socialism" ideological debate, the corporate share system presents a particular problem. Is a limited-stock company privately owned or publicly owned? Chinese ideologues have managed to place share ownership in the publicly owned category by employing two artifices: first, they have endeavored to greatly broaden the category of public ownership; second, they have greatly narrowed the category of private ownership, which is theoretically two sides of the same coin.

In the first case, the focus has been placed on the owner or the controller of the shares. If the owner is not an individual, then it is not considered private ownership. On this theoretical basis, the shares of Japanese and U.S. companies owned by institutions would belong in the category of collective ownership. An example of the second case is the share cooperative system, in which the ownership of shares is with individuals, both investors and workers. In this case, private ownership of shares can be placed in the category of public ownership.

Formation of Large Group Companies

In 1991 the State Council put out its "Notice Concerning Selection and Implementation on an Experimental Basis of Some Large Scale enterprise Groups" (State Council Notice No 71). This launched a policy to form one hundred large-scale enterprise groups. In April 1995 the State Council produced its "Temporary Regulations Concerning Formation and Management of Enterprises Groups", which elucidated the definition of enterprise groups. An **Enterprise group** was now defined as "a united economic entity comprising many enterprises and businesses tied together through investment and production operations", or an enterprise group with a core enterprise as well as subsidiary enterprises. Subsidiary enterprises under the umbrella of the core enterprise would have corporate status; the enterprise group itself, however, would not be a corporate person.

As business groups began to emerge rapidly in China in the 1990s, more than one organizational form that could technically be called a business group developed. Generally, however, the Chinese business groups could be divided into two categories. The first were small groups of small, often private firms that resembled the

guanxi qiye of Taiwan. The second were the *qiye jituan*, groups of large, primarily state-owned firms that resembled Korea *Chaebols* (just before the Asian financial crisis, China was exploring the South Korean *Chaebol* as a possible model of corporate governance).

The small groups formed voluntarily among businesses that were typically family-based or run by individuals with some other form of social connection, e.g. school ties. The small, private business groups developed in all industries, but tended, because of their size to be more predominant in industries with high proportion of private and start-up firms, that is, the groups were most common in low-tech and light industrial sectors. In addition, the small groups were most often found in the more marketized regions of China, including cities such as Shanghai, Xiamen, and Guangzhou. Relations among firms in the small business groups included financing relations, personnel exchanges, trade relations, ownership relations, and agreements to engage in joint production. Interfirm relations in these groups, however, tended to be informal; and the groups, because of their size, generally lacked a formal-wide management system.

In contrast, the *qiye jituan*, groups of large state-owned firms, were deliberately formed by the state and were throughout China. The *qye jituan* were extremely large, usually the largest firms, by order of magnitude, in China.

Like the small business groups, the large groups developed in all industries and all geographic regions (including provinces, municipalities directly under the jurisdiction of the central government, and autonomous regions). Relations among firms in the large business groups were more expansive than those in the small groups, including financing relations, personnel exchanges, trade relations, ownership relations, and agreements to engage in joint production, as well as interlocking directorates, equity ties, ties for political lobbying and other interfirm contacts.

The basic principles of an enterprise group are as follows:

1. The group should be in conformity with the state's economic development strategy and industrial policy, having an important position in a sector's production or exports.
2. Enterprise groups should pursue fair competition across regional and administrative barriers.
3. Enterprise groups should implement the policy of "separating government and the enterprise".
4. In forming an enterprise group, the decision making independence of invested enterprises should be upheld, subject to the leadership of the state.

The main features of enterprises groups are as follows:

a. The enterprise scale of the core enterprise should attain the standard for large-scale enterprise set by the state or have a registered capital of RMB 1000 million or more.
b. The core enterprise should have at least five subsidiary enterprises.
c. The group should require that members of the group jointly observe and follow group standards and regulations, which include the group name, core enterprise name, address and operations location, form of association between member enterprises, specifics as to requirements for consultation and decision making for group related business activities, and registration of the core enterprise with the government administrative agencies.

Subsidiaries would be included in the following three cases:

1. Membership through shareholding occurs where the core enterprise owns more than 50 percent of the subsidiary company's shares and where the accounts of both companies must be consolidated in financial statements.
2. Membership through share participation: the core company does not own more than 50 percent of the subsidiary company, but membership in the group has been approved in the group's articles and regulations.
3. Cooperative membership: designated member due to long and stable production, operation, or technical cooperation association with the core enterprise and approved in the group's articles and regulations.

In June 1997 the so-called State Experimental Enterprise Group work meeting was convened in Beijing. The development of large-scale enterprise groups was deemed a "task having strategic significance" for China's economic reform. Since the first designation the power of enterprise groups had been greatly strengthened. The performance of many groups in economic development and structural adjustment was highly praised. Regarding future development, six issues were raised:

- Adopting the modern enterprise system;
- Adapting to the market economy;
- Promoting the development of enterprise groups in the context of structural adjustment; also, raising enterprise efficiency, avoiding duplicate investment within the group, and coordinating on new projects;
- Strengthening the group's internal management system;
- Strengthening management ranks;
- Continuing to promote reforms necessary to build the group.

These 120 groups now constitute the "backbone" of the national economy. Compared with assets, sales, and profits before tax of all independent accounting unit

enterprises nationwide, these 120 constitute about one-fourth in each category and more than half of after-tax profits (Premier Li Peng, 1997).

For many authors, the most important recommendation for the Chinese authorities is a change in the role of government from controller and producer to architect of a more self-regulating and self-adjusting type of system. This sounds straightforward but is far from it. The government is deeply involved in business. The Beijing municipality, for example, has stakes in about 16,000 local businesses. The finance ministry owns 100 per cent of the 'big four' state banks. The telecommunications regulator is the main shareholder in China Telecom and China Mobile and the television regulator owns China Central Television, the state TV company. It is often hard to disentangle the government's commercial interests from its roles as industry regulator, paymaster for courts, tax collector and economic policymaker.