Opinions on Several Major Issues on the Reform of State-owned Enterprises

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In the *Decision of the CCCPC on Some Major Issues Concerning Comprehensively Deepening the Reform*[[1]](#endnote-1) (hereinafter the “Decision”) adopted three years ago at the Third Plenary Session of the 18th CPC Central Committee, the state laid out a grand blueprint for a new round of reform of state-owned enterprises (SOEs)[[2]](#endnote-2). The Decision serves as the top-level design of SOE reform, and it consists of a series of major decisions, including developing mixed ownership, transforming state-owned assets management from asset management to capital management, and sticking to the separation of government and capital, and separation of government and enterprise. It was well received by the public, and the whole nation had great expectations toward the new round of SOE reform.

Since then, the State Council and other relevant state departments have released 1+N documents, such as *Guidelines on Deepening the Reform of SOEs*, and *Guidelines on Defining and Classifying Functions of SOEs*. As the Decision serves as the overall plan and top-level design, the 1+N documents serve as construction plans and drawing designs of the reform.

However, after the release of 1+N documents, the reform has only been visible within the government, leaving the general public and enterprises indifferent and unaffected. Such grand reform is stagnated at the stage of construction plans and drawing designs, and the ground-breaking day seems to be far away. We believe that the following factors have led to this situation. SOEs have been reactive rather than proactive towards the reform; most local governments have taken a wait-and-see attitude to those documents; private enterprises have not been very much interested in participating in the reform; and the general public has been indifferent to those documents.

Lack in both methodology and theory has contributed to the stagnation of SOE reform. Methodologically speaking, the way of designing the reform plan is divorced from the reality. **Relevant state departments failed to solicit valuable opinions or advice from SOEs, local governments or the general public. The documents released are obviously based on their own interests, and are unlikely to be fully carried out or well received by the public.** As to the theory, the drawing design itself falls below the mark. **When it comes to major issues on the SOE reform, 1+N documents fail to present the core value of the top-level design, as there is no clear approach or measure to bring the design into reality. And the experience of SOE reform in the past decades, especially in the last decade, is not well summarized.** Therefore, even if the documents are well implemented, it is difficult to achieve the goal set in the top-level design.

Shenzhen Special Economic Zone, established at the beginning of the Reform and Opening up, has witnessed a lot of exploration of SOE reform during its development, and stands ready to offer its lessons to other cities in China. SOEs in Shenzhen are leading the pack in many aspects, such as the system, mechanism and economic benefits, which is well recognized by the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council. I am very privileged to have been involved in the whole process of the reform of SOEs in Shenzhen, especially from 2003 to 2010, during which time I led and promoted a range of reforms, including enterprise restructuring, distribution adjustment, institutional transition, recapitalization, making industrial groups bigger, stronger and better, and transforming enterprises owned by Party and government institutions. The successes and failures have led to reflections on both the theory and practice of SOE reform. Based on that, I would like to share my opinions on several major issues on the reform, and I am open to your comments and suggestions.

**I. Is the direction and objective of SOE reform to make SOEs bigger, stronger and better, or to improve the vitality, impact and dominance of the state-owned sector?[[3]](#endnote-3)**

In the top-level design of SOE reform, the *Decision of the CCCPC on Some Major Issues Concerning Comprehensively Deepening the Reform* adopted at the Third Plenary Session of the 18th CPC Central Committee, the direction and objective of SOE reform is specified as to “give full play to the leading role of the state-owned sector, and continuously improve its vitality, impact and dominance”[[4]](#endnote-4). However, in the 1+N documents followed, the direction and objective is redefined as “to center on economic development, stick to the problem-oriented principle, advance SOE reform, remove institutional obstacles, and unswervingly make SOEs bigger, stronger and better”. The redefinition has shifted the focus from the macro-level state sector to micro-level SOEs; from “to improve the vitality, impact and dominance of the state-owned sector” to “to make SOEs bigger, stronger and better”.

As for SOEs in critical industries closely related to national security, welfare and the well-being of its people, it makes sense to make those SOEs bigger, stronger and better, and it will sure do. But I don’t think it is appropriate to take this as the direction and objective of SOE reform, and I believe it is impossible to make all SOEs bigger, stronger and better.

The last three decades have seen continuously deepening understanding of the direction and objective of SOE reform, and also increasing knowledge about the law of development of SOEs and the market economy.

Before the 1990s, we believed that the main problem faced with SOEs was the mismatch between the internal management and operation, and the socialist market economy. Therefore, the direction and objective of SOE reform at that time was to strengthen business administration and to transform the internal operation mechanism. Practices showed that, without clear ownership and the separation of government and enterprise, it was impossible to transform the internal operation mechanism. Therefore, in the *Decision on Some Issues on the Establishment of Socialist Market Economic System*, the direction and objective of SOE reform was specified as “to form a modern corporate system with clearly established ownership, well defined power and responsibility, separation of enterprise from government, and scientific management”. Then, many people believed that, with a modern corporate system, we were able to make all SOEs bigger, stronger and better.

However, rapid economic growth in the 1990s ended the period of undersupply in China, and the seller’s market was turned into the buyer’s market. External market conditions faced with SOEs changed significantly. Meanwhile, as the Reform and Opening up deepened, private enterprises saw rapid growth, and foreign capital flowed in, which made the market increasingly competitive for SOEs. Due to the inflexible mechanism and heavy debt, a lot of SOEs, especially small-and medium-sized SOEs in competitive industries, ran into difficulties in production and operation, and had trouble with paying debts and wages. All these facts brought us new thoughts in SOE reform, and a consensus was reached that it was unrealistic to rely on the modern corporate system to make all SOEs bigger, stronger and better.

The Central Committee of CPC had new insights into SOE reform around 1998, and adopted *Decision of the CPPCC on Some Major Issues Concerning the Reform and Development of State-owned Enterprises[[5]](#endnote-5)* at the fourth Plenary Session of the 15th CPC Central Committee in 1999. It says that SOE reform means to emancipate the mind, seek truth from facts, focus on improving the state-owned sector, and restructure SOEs. Strategic adjustments to the industry distribution of SOEs is needed to improve the vitality, impact and dominance of SOEs, which means that disadvantaged SOEs in competitive industries should be closed so as to steer state-owned capital to industries closely related to national security and welfare. The 2010 objective of SOE reform prescribed in the Decision is to complete strategic adjustments and restructuring, form a suitable distribution of SOEs, and establish a sophisticated modern corporate system, so that the state-owned sector is better positioned to lead the national economy. The objective of SOE reform has shifted from “to establish a modern corporate system and make SOEs bigger, stronger and better” to “to make strategic adjustments and refresh the whole state-owned sector”. It is a strategic shift made by the Central Committee based on reflection on years of SOE reform. Practices then showed that the Central Committee made the right decision.

In the *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform* adopted in 2013 at the Third Plenary Session of the 18th CPC Central Committee, the direction and objective of SOE reform and development is elaborated. It says that we need to vigorously develop a mixed ownership economy, stick to the separation of government and capital, and separation of government and enterprise，transform state-owned assets management from asset management to capital management. State-owned assets should be used to serve national strategic goals, and should be mainly invested in critical industries closely related to national security and lifelines of the national economy, such as providing public services, promoting strategic industries, protecting eco-environment, supporting technological progress, and safeguarding national security[[6]](#endnote-6). Such elaboration on the direction, objective and principle of SOE reform is in line with that of the *Decision of the CCCPC on Some Major Issues Concerning the Reform and Development of State-owned Enterprises* adopted at the fourth Plenary Session of the 15th CPC Central Committee in 1999.

It is worth noting that, in the guidelines and implementation plans on SOE reform released by state departments last year, the direction and objective of the reform is adjusted to focus on making SOEs bigger, stronger and better, rather than improving the vitality, impact and dominance of the state-owned sector through restructuring and better distribution.

In theory, there is a big difference between these two interpretations of the direction and objective. While “making SOEs bigger, stronger and better” underlines each one of SOEs, “improving the vitality, impact and dominance of the state-owned sector” underlines the whole state-owned sector; while the former focuses on improving every SOE, the latter focuses on restructuring and better distribution; while the former aims at achieving the absolute predominance of the state-owned sector, the latter aims at leading the national economy.

In particular, it is not only about the difference in theory, it is closely related to practices. When it comes to carrying out the supply-side reform, and policies of “de-capacity, destocking and deleveraging”, we have to decide whether to focus on improving the whole state-owned sector, restructuring industry distribution, closing down disadvantaged SOEs in competitive industries, especially those “zombie companies” with debts they could not repay, or, to focus on making SOEs bigger, stronger and better, supporting those “zombie companies” in the supply-side reform.

SOE reform in the past decades has proved that it is unrealistic to make each one of SOEs bigger, stronger and better. In theory, it goes against the law of development of SOEs and the market economy. In practice, it is simply impossible to realize the goal.

There are three theoretical approaches to explain why SOEs are not competitive in the market. **First, the nature of state-owned assets calls for multi-level entrustment, supervision and regulation**, which means that the major decision-making process of SOEs is not as efficient as that of private enterprises. In private enterprises, the boss has the final say, and the decision-making process is efficient enough to grasp business opportunities in the ever-changing market, which is a must to survive in a competitive industry. However, in SOEs, tons of regulations and processes cramp the operation, and inefficient operation leads to misses of opportunities, which makes SOEs inferior to private enterprises.

**Second, the nature of SOEs makes its internal incentives less attractive than private enterprises.** In private enterprises, the clearly established ownership and well defined power and responsibility makes entrepreneurs highly motivated to make a fortune. However, in SOEs, although executives are trying to establish a good incentive system, the reality is far from satisfactory. Based on the current system, no matter how much the revenue is, SOE managers get the same payment. Naturally, managers are not motivated to make more profit.

**Third, private enterprises have been growing with the Chinese market since the Reform and Opening up, and their internal operation system is flexible enough to ride the tide of the market when it comes to decide whether to hire or fire employees, promote or demote managers, and** **raise or cut salaries.** However, SOEs undertake a lot of political and social responsibilities. Recent years has seen reform of labor, human resources and distribution systems, but it is difficult for SOEs to fully embrace the market.

The above-mentioned three reasons explain why few SOEs are made bigger, stronger and better in competitive industries. Most SOEs are struggling to survive in the competitive market, let alone to become bigger, stronger and better.

The SOE reform in Shenzhen offers both experience and lessons for the national SOE reform in terms of the direction and objective. In the early 1990s, a lot of experiments were conducted in establishing a three-level state-owned asset management system and a modern corporate system inside SOEs in Shenzhen, which generated some salutary experience.

However, from the late 1990s to the early 2000s, Shenzhen government failed to fully understand the direction and objective of SOE reform prescribed by the Central Committee. It failed to introduce measures in time to adjust the industry distribution of SOEs, and blindly believed that it could make all SOEs better by establishing a modern corporate system.

Based on that false belief, it set a series of targets of making SOEs in competitive industries bigger, stronger and better, including targets such as to produce six ten-billion group corps in the construction material industry and light industries; to set up Sogo Shoshas or general trading companies[[7]](#endnote-7) like those in Japan and Korea in trading and circulation industries; to promote the “Dragon Project”[[8]](#endnote-8) in the real estate industry. In the early 2000s, except for Shenzhen Energy Corp.[[9]](#endnote-9), most large SOEs in competitive industries were struggling to survive. However, some SOEs not included into those targets experienced rapid growth thanks to urbanization and economic growth in Shenzhen. They were mainly municipal SOEs in public utilities and infrastructure, such as airport, fuel gas and water supply. It fully embodied a Chinese saying – “the flower one grew and cared withers, while the seed one threw away flourishes.”

The experience and lessons drawn from SOE reform in Shenzhen demonstrated some basic rules of SOE development in a market economy. That is, SOEs must put themselves in the right position, identify their advantages and disadvantages, and tap into their own potential. We have to admit that it is unrealistic to make all SOEs in all industries bigger, stronger and better.

After 2002, as requested by the Central Committee, SOE reform in Shenzhen shifted its focus to large-scale restructuring and distribution adjustment. Disadvantaged SOEs in competitive industries such as manufacturing, trading, construction and services were transformed into ECOSs (Enterprises of Composite-Ownership System) through ESOP (employee stock ownership plans)[[10]](#endnote-10) and restructuring, thus state-owned assets successfully exited. About 20 SOEs left untouched were mainly providing public services and infrastructure. During the past decade, most of them experienced rapid growth, playing a significant role in critical industries closely related to national welfare and the well-being of people, such as water supply, gas supply, transportation and energy sector. They ensured sustainable economic growth in Shenzhen. Besides, most of them had grown into powerful and influential group corps, leading in economic performance, quality, vitality, competitiveness and influence. In a word, these SOEs were really made bigger, stronger and better.

**II. Can the establishment of capital investment and operation companies transform state-owned assets management from asset management to capital management?**

There is a general consensus that it is the right direction to transform state-owned assets management system from asset management to capital management. The question is what kind of reform is needed to accomplish such a transformation.

According to *Guidelines on Deepening the Reform of SOEs*, the key is to set up state-owned capital investment and operation companies, and to establish a two-level investors system through authorized operation. That is to say, the supervisor of state-owned assets is the investor of the state-owned capital investment and operation company, and the latter is the investor of companies it invested in. This new state-owed assets management system featuring three-level, namely supervisors of state-owned assets, capital investment and operation companies, and companies they invested in, facilitates the transformation from asset management to capital management.

Such a three-level system of course needs to be test out. And we still have to solve a lot of theoretical and practical problems to see whether such a system will work.

Shenzhen Special Economic Zone has been trying out reforms of state-owned assets management system since the 1980s, and other cities in China may draw lessons from its successes and failures. The first investment and management company was set up in Shenzhen in the 1980s, and then Shenzhen Municipal State-owned Assets Administration Office (SSAAO)[[11]](#endnote-11) and three asset operation companies were set up in the 1990s. Those three asset operation companies invested in and managed over 100 state-controlled enterprises, thus a state-owed assets management system featuring three-level, namely the SSAAO, asset operation companies and SOEs, was in place. As for the SSAAO, separation of government and capital was realized. State-owned capital management was separated from the social and economic management of the government. As for state-owned asset operation companies, separation of supervision and operation of state-owned capital was realized. As for wholly state-owned or state-controlled companies, separation of state-owned capital operation and SOE operation was realized.

This three-level system in Shenzhen had contributed to strengthening supervision and management of state-owned assets, and exploring appropriate method and system based on ownership management. But in general, the three-level system was not so successful because of various reasons, and it certainly had not realized the transformation from asset management to capital management.

Therefore, in 2003, Shenzhen government adjusted the state-owned capital management system based on problems it had identified and the *Interim Regulations on the Supervision and Administration of State-owned Assets of Enterprises[[12]](#endnote-12)* released by the State Council. It shut down those three asset operation companies and made the SASAC the direct investor of municipal SOEs. In this way, the three-level system, namely the SSAAO, asset operation companies and SOEs, was adjusted to a two-level system, namely the SASAC, and wholly state-owned or state-controlled companies. As for the SASAC, separation of government and capital, and government and enterprise was realized. Making the SASAC as the investor of municipal SOEs integrated the management of people, events and capital. Years of practices in Shenzhen showed that, the two-level system was better than the three-level one.

The reform of state-owned asset management system in Shenzhen offers important lessons for the current reform in China both theoretically and practically.

Theoretically, there is an intrinsic defect in the three-level system. The SASAC and the asset operation company are both investors of state-owned capital in this case. Although investor’s rights can be exercised through entrustment, ultimately these rights belong to only one entity. It is unrealistic to divide investor’s rights into those for the SASAC and those for asset operation companies by “clearly defining the right of ownership and the right of management”, because the right of management itself is an essential part of the right of ownership. The one who enjoys the right of ownership will decide to what extent to authorize or entrust the right of operation, and when to adjust the entrustment according to the nature of enterprises or various needs in different periods. It is impossible to clearly define these two rights.

Practically, a lot of problems exist in the three-level system when it comes to how to divide rights and obligations between the SASAC and asset operation companies. These problems hinder the reform, adjustment, restructuring and development of SOEs. For example, it is hard to decide which investor should be responsible for the preservation and appreciation of state-owned assets, and which should prevent the loss of state-owned assets. The SASAC and asset operation companies are constantly arguing with each other over how to exercise rights of the investor when managing people, events and assets of wholly state-owned or state-controlled enterprises. When state-owned assets are going through restructuring or merger, once it goes against its own interests, the asset operation company stops and blames the SASAC’s intervention. Then it will be very hard for the SASAC to push forward the restructuring or merger. In the process of SOE restructuring, adjustment and exit, the asset operation company is often unwilling to exit SOEs under its management because of its own vested interests. Therefore, for wholly state-owned enterprises, the three-level system with two investors is like to put two bosses in charge, which is clumsy and inefficient.

Based on Shenzhen’s experience, I believe that the key to transform state-owned assets management from asset management to capital management is not setting up capital investment and operation companies, nor reforming the authorized operation system itself. The key lies in the ability to carry out fundamental reform in the following three aspects.

**First, SOEs should enter the market unconditionally.** Capital management involves capital operation, distribution, appreciation and security, and no micro-level management of employees, property and items, or investment in profitable companies is involved. Therefore, pushing SOEs into the market is an essential prerequisite for the transformation to capital management. SOEs should follow the law of market to manage employees, property and items. Without this prerequisite, it is impossible to transform from asset management to capital management, no matter how many management systems are introduced and how many investment and operation companies are set up.

One major reason for the failure of the three-level system in Shenzhen is that it failed to push SOEs into the market. Their executives were under the management of Organization Department of the Municipal Party Committee. Their major projects had to be reviewed and approved by the investment and operation company and the SASAC. Their salary systems had to be approved by the Municipal Bureau of Labor. Their loans were often coordinated or even guaranteed by the SASAC or the investment and operation company. So the SASAC and the investment and operation company were some kind of managers to SOEs, which was far away from the concept of capital management.

**Second, capital and enterprise should be thoroughly separated from the government**. It is the guideline on the reform of SOEs and state-owned assets management system set by the Central Committee. Recent years has seen real progress in this regard but it still falls short of the goal. Some state departments are still exercising the investor’s rights directly over SOEs. For example, financial departments are direct investors of financial SOEs; publicity departments are direct investors of cultural SOEs. What’s more, SOEs under the state-owned assets management system are not thoroughly separated from the government. The government put SOEs under its protection and also interferes in operation. Some Party and government officials even make SOEs employ their friends or relatives, abusing power for personal benefits. Besides, for some SOEs, prices are still set by local Development and Reform Commission; executives are under the management of local Organization Department; salary systems for executives and employees are made according to standards set by Human Resources Department; development plans and major projects need to be approved by relevant state departments; and some “zombie companies” protected by the government enjoy long life without making any profit. Based on these facts, do you think it is possible to transform from asset management to capital management by setting up several investment and operation companies?

**Third, after the completion of previous two steps, the government should look to the Temasek’s model to adjust the functions of existing SASACs at every administrative level, and transform the SASAC into a capital investment and operation company directly. The SASAC will then be the Temasek in China, and no capital investment and operation companies are needed.**

The SASAC, as the Temasek in China, will exercise the investor’s rights directly over companies it invested in, including industrial groups, comprehensive investment companies and fund companies. It will select qualified persons from the market and appoint them as directors in companies it invested in. In this way, the SASAC is mainly focused on capital operation. The micro-level management of employees, property, items, and assets will simply follow the law of market. As for SOEs closely related to public welfare or national security, the SASAC will exit, and those SOEs will be transformed into statutory organizations of the government. They will be like public institutions, not state departments or for-profit companies.

As such a transformation of the SASAC is completed, the head of it can be appointed directly by the government. Then, financial departments at all levels will be the ultimate investors of SOEs and state-owned assets. They will only enjoy the right of receiving dividends and investment returns, and will not intervene in the SASAC’s operation.

**III. Can the SOEs dedicated to public welfare but struggling to profit provide better public services?**

One major measure of this new round of SOE reform is to sort SOEs into two categories, one for business and the other for public welfare, to which different management and performance assessment will be applied. The performance of SOEs for public welfare will be assessed based on the quality and efficiency of services and goods they provide, not on their economic benefits or investment returns. I believe this measure is well intended. It underlines the social responsibility and social benefits of SOEs, and aims at providing better public goods and services. But it might backfire, leaving economic benefits and social benefits of SOEs untouched, and no better public services or goods will be in place.

Here are two reasons. First, all SOEs are players in the market economy, so not only SOEs for public welfare, but also those for business, have to fulfill their social responsibilities to survive and grow in the market economy. Especially SOEs producing consumer goods, if they fail to provide goods at low cost and of high quality, and satisfactory services to customers, then they will not be able to grow or even survive in the competitive market. For a healthy enterprise, economic benefits and social benefits are compatible with each other.

Second, it is impractical to define which SOEs are purely for public welfare. Are SOEs in industries providing public goods, services and infrastructure, such as water supply, power supply, gas supply, transportation and airport, purely for public welfare? Are SOEs in industries closely related to the well-being of people, such as food striate and management, real estate development, shopping basket program[[13]](#endnote-13), and produce market, purely for public welfare? If all those SOEs are sorted into the category of “public welfare” enterprises, and their revenue and profit are not included into the performance assessment, then they would be like SOEs in the planned economy.

“Pubic welfare” enterprises are, above all, independent players in the market economy. They should have proper profit and investment return, which is the internal motivation for them to improve management, drive down costs, provide better services, and achieve sustainable development. If they are not after profit and investment return, then they will lack the impetus and ability to be competitive. Private capital will not flow into such “public welfare” enterprises when they seek joint-stock system. In the long run, it will do harm to consumers and the general public. We have seen a lot of living examples and hard-learned lessons in this regard.

In Shenzhen, before the 1990s, most public goods and services, including public transportation, coal gas and tap water, were provided by wholly state-owned enterprises. There were no other competitors in the market, and prices were kept low. Those SOEs did not have proper profit and return, and were mainly dependent on the government’s support to run the business and provide low-level services. They were not motivated to provide better services for the public, or to pursuit sustainable development. The government, general public and other enterprises were all dissatisfied with such low-level services.

After the 1990s, SOE reform was carried out in Shenzhen to diversify the shareholding system of enterprises providing public goods. Strategic investors were introduced to transform wholly state-owned enterprises into ECOSs. For example, the Bus Group[[14]](#endnote-14) brought in the Kowloon Motor Bus Co.[[15]](#endnote-15) of Hong Kong; the Gas Group[[16]](#endnote-16) brought in the Towngas[[17]](#endnote-17) of Hong Kong; and the Water Group[[18]](#endnote-18) brought in Veolia[[19]](#endnote-19), a French company.

Public goods and services are closely related to daily life of the public, so the prices must be kept low. Enterprises in these markets could not get proper return from utility bills paid citizens, and some even could not maintain daily operation. Thus the Shenzhen government formulated *Regulations of Shenzhen Municipality on Concession for Public Utilities*[[20]](#endnote-20), specifying the pricing, cost control, proper profit and investment return rate of industries concerning infrastructure and public services. Based on the Regulations and performance assessment of those SOEs, the government then compensates them through price adjustment, fiscal subsidy, tenancy discount, etc. In this way, the SOEs can get proper investment return, and are motivated to scale up, provide better services, and pursuit sustainable growth.

Recent years has seen great improvement in the quality of public services and goods provided by relevant municipal SOEs. It has laid a solid foundation for the city’s development, and citizens have been enjoying more and more public services. Shenzhen SOEs in industries such as bus, subway, water supply and gas supply are in the leading position in China in terms of service quality. What’s more, these SOEs have enjoyed better development. Most of them are now providing services outside Shenzhen, leading the industry with strong competitiveness, high efficiency and good benefits. They have become the main force of Shenzhen SOEs, and demonstrated how economic benefits and social benefits can be integrated.

In conclusion, I believe that for SOEs providing infrastructure, public goods and services, the way to motivate them to deliver better social benefits is not putting them into the category of “public welfare” enterprises, and assessing their performance without looking at their profitability. The following three measures should be taken instead.

**First, for a few central SOEs closely related to national strategy and security, such as military and aerospace, they are not concerned with domestic market competition or proper investment return. They should be transformed into statutory organizations of the government, which are different from both state departments and for-profit enterprises. The government should manage them directly following the rules similar to those of public institutions.**

**Second, for SOEs providing public goods and services, they should diversify their ownership system and be transformed into ECOSs.** In general, ECOSs are able to provide better public services than wholly state-owned enterprises. Therefore, the state does not have to be the sole shareholder or the control shareholder of such enterprises, which is contrary to our traditional belief. In fact, the key to best protect interests of the country and consumers lies in supervision, not proportion or nature of the ownership. Without proper supervision from the government, even wholly state-owned enterprises may fail to serve consumers’ interests and safeguard national economy. We have seen a lot of living examples of such enterprises.

Third, those state-owned enterprises dedicated to public welfare should be fairly rewarded so that they could be better positioned to improve their services and motivated to pursue sustainability. They cannot set prices too high as people rely on their products and services to meet basic needs. The prices determined by the government, however, cannot even cover the costs, let alone generate profits for these enterprises.

Under such circumstances, the government should compensate enterprises in the forms of financial support, land or tax revenue and establish a compensation mechanism that is reliable, just and transparent so that these enterprises can profit. There are various ways of compensation. In Shenzhen, we have seen direct fiscal subsidy: a cost-based rate of return was determined for public transport enterprises; concessional land prices: discounts for lands used by the water group for its main business; compensation packages: a compensation package for the metro group for “rail+property ” development.

Fourth, relevant government authorities should strengthen their supervision and regulation of SOEs in these fields according to laws and regulations. To ensure that these enterprises provide better public services and products, the best solution is not the evaluation by state-owned assets supervisory authorities in accordance with the “Guidelines on Defining and Classifying the functions of State-owned Enterprises” developed by relevant state departments, of indicators such as cost control, operational efficiency and provision capability. It lies in enhanced regulation of government departments at various levels on these SOEs under laws and regulations. SOEs should follow the requirements of the government departments for each sector, implement laws and regulations, accept supervision from the government and the public and fulfill their social responsibility.

Four: What is the key to improving the governance structure of SOEs?

Establishing and improving the governance structure is the most vital and difficult challenge confronting SOEs to establish a modern enterprise system that fits the market economy. Over the past three decades, certain progress has been made after exploring the leadership system and the governance structure of SOEs. However, we have not found a successful model for the governance structure of SOEs theoretically or practically. The current governance structure is not fully compatible with the market economy. Nor does it keep up with relevant laws and regulations.

Therefore, the “Guidelines” incorporates the improvement of corporate governance structure as an important part of SOE reform. It also proposes the following advice: giving full play to the role of the board of directors as a decision maker and the management as the manager of operation; enhancing check and balance within the board of directors; setting up a multi-level administrative system of SOE executives. These measures are expected to have positive effects and are necessary at present.

The measures proposed by the “Guidelines”, however, fail to address the critical problems in the current SOE governance structure. Based on the past decades of SOE reform in Shenzhen, these measures have limited effect. Relying on the measures alone is unlikely to solve the fundamental problems in the corporate governance structure. A more open mind and bolder explorations are required to make greater breakthroughs.

The first reason is that building the board of directors of SOEs is neither a purely technical nor theoretical challenge. The “Guidelines” mentions the proportion of the board structure, a voting system, the evaluation of directors and other specific improvements that have been realized in Shenzhen several years ago. But these measures only addressed the symptoms of the problem.

Second, the idea of addressing the problem between the board and the management by ensuring the management has its say in operation does not hold water either theoretically or practically. Theoretically, the management is not supposed to enjoy independent power in operation. The board speaks for the interests of the shareholders and is appointed by the shareholders to appoint the management. The management is then authorized by the board to engage in operation. The board of directors will offer and adjust at any time the extent of power of the management according to different circumstances and stages of development. Therefore, it does not make sense to clarify and ensure the independent power of the management. Since the 1990s, efforts have been made to draw a line between the powers of the board and the management under the current corporate governance system to address the problem, almost all of which failed to deliver desired results.

Third, the “guidelines” suggests a multi-level administrative sytem of corporate executives: to choose and employ executives through multiple methods including selection, appointment and recruitment. This relatively moderate measure requires dual- or multi-track systems of executive selection, appointment and compensation management. The complicated implementation is likely to cause various problems within enterprises and discourage the entire management.

Based on Shenzhen’s SOE reform in the past decades, I believe those simple problems have been solved and most measures at the technical level have been adopted in improving corporate governance structure. The next step is to boldly reform the administrative system of corporate executives. The key lies in the market-oriented reform of corporate executives.

Nowadays, most factors of production in SOEs are market-based and basically fit the market economy. But the most important one: managers of SOEs are yet to become market-based.

The board of directors is not entitled to select managers. It cannot select and appoint managers from the market to meet the needs of enterprises and gradually establish a system of professional managers. Nor can it implement a performance-related compensation system for professional managers based on the market value. Instead, relevant departments employ adnistrative methods to select and appoint managers internally following the standards and procedures for government and Party leaders, which constitutes the root cause for a series of problems in the corporate governance structure.

If the general manager of an enterprise is selected and appointed by the board of directors, will the managers exercise internal control while boards of directors enjoy practically no power? Will there still be so many disputes between the chairman of the board and the general manager as well as between the board and the management? Will we still need to take great trouble to define respective powers of the board and the management?

The market-oriented reform of corporate managers requires correct understanding and bold exploration of practical ways to realize Party supervision on corporate executives. This kind of supervision should be combined with the legitimate rights of organizations at higher levels and the board of directors to select managers.

According to the Party’s standards and requirements for SOE executives, I believe the prime way is for the board of directors to independently select and appoint qualified managers from the talent market. In this way, we can ensure SOEs prosper in compliance with the path and policies of the Party as well as laws and regulations of the state and the government.

To realize Party supervision of corporate executives, Party organizations at higher levels do not have to evaluate, select and supervise every corporate executive by themselves. It is indeed far riskier to select mangers in this way than for the board of directors to select from the market. Over the years, we have seen too many cases where SOE executives obtain their positions and power through unjust means and corrupt executives get promoted. Lessons should be drawn from these cases.

Foreign-funded enterprises and private enterprises can select and appoint qualified managers from the talent market. So can the board of directors of SOEs. But there is certainly a possibility for the board to choose the wrong person. Hence, Party organizations and corporates at higher levels should strengthen board building by selecting a competent chairman, determining the standards and procedures for manager selection and enhancing their supervision in the process. To say the least, if the board of directors is found to have seriously violated the standards and procedures speculated by the Party organization during the process, Party organizations and corporates at higher levels may very well correct the problem by adjusting or reorganizing the board.

Since the reform and opening-up, Shenzhen has made a huge amount of explorations in building leadership in city SOEs and improving the corporate governance structure. As early as in the 1990s, according the “Company Law”, Shenzhen took the lead in introducing regulations such as the “Provisional Regulations on Boards of Directors of Enterprises in Shenzhen” and the “Provisional Regulations on Corporate Managers”, contributing to the standard regulation of the corporate governance structure.

Since 2003, the Shenzhen SASAC has recuited a huge number of outside directors who constitute a majority in the boards of directors of those enterprises that have diversified their ownership. In addition, it made great efforts to promote the market-oriented reform of managers by openly recuiting general managers and vice general managers of major SOEs and have done a lot in the internal building of boards of directors.

Around 2010, the Shenzhen SASAC delegated the power of selecting and appointing vice general managers of local SOEs to their boards of directors. When the measure was first announced, some people had their doubts and concerns. But over the years, a group of outstanding managers were selected from the market, which also set a good example for talent employment in SOEs.

**Going forward, if the power to select general managers from the market could also be delegated to the board, we can expect major problems in improving the governance structure of SOEs to be completely solved.**

**5. Can the executives of state-owned enterprises be motivated by a ceiling annual salary of 600,000 RMB?**

The reform of the compensation system is the core part in deepening SOE reform. In particular, the compensation system for enterprise executives constitutes the basic driving force for enterprise development. Under the planned economy, SOEs followed egalitarianism in internal profit distribution. As SOEs gradually fit into the market economy, fundamental changes have taken place in the distribution system within enterprises. Salaries of employees began to relate to the labor market and that of executives began to be connected with the market of senior managers and enterprise performance. A sustainable incentive mechanism is also under exploration to link executives to the long-term development of enterprises.

But for various reasons, some executives of SOEs, especially those of state-owned financial enterprises that are not checked by higher-level organizations, went out of control with their salaries. Some senior executives have an annual salary up to millions or even tens of millions of RMB, a far departure from the market level, our national conditions as well as the general public, which aroused strong public grievance. Under such circumstances, relevant state departments introduced the “Opinions on Deepening Reform of the Compensation System of SOE Executives”, which was followed by many local versions of reform opinions.

According to the national and local “Opinions”, the compensation of an executive consists of three parts: 1. Basic salary: no more than twice the average salary of the employees of the enterprise; 2. Performance-based salary: no more than twice the annual salary; 3. Bonus salary: no more than 30% of the total annual salary. According to this scheme, the ceiling annual salary of SOE executives is around 600,000 RMB. The introduction of these reform documents provoked great repercussions in SOEs.

While this regulation is necessary to prevent exessively high annual salaries in a few enterprises, especially financial enterprises, it is not recognized by most SOE executives and is not fully-received by the public. Since the “Opinions” were introduced, centrally-administered and local SOEs, the management teams and elites of enterprises became very unstable. Meanwhile, some private enterprises took advantage of the opportunity to poach talents from SOEs. Some talents have left, which discouraged many SOE executives and dampened the long-term development of SOEs. Relevant state departments should pay special attention to this phenomenon.

Given the nature of SOEs and their social implications, the salary of SOE executives may not reach the market level, not to mention the execessisly high salary of some executives of financial enterprises in the past. As an interest group, SOE executives shoulder the historical responsibility of reforming and developing SOEs. Quite a few executives are well educated and experienced. They constitute a major part of the elite class of the society. They deserve their legitimate rights and interests and have their just pursuit of material benefits. In addition, they are also burdened with high living costs.

A few of them may be driven by their polical beliefs, noble qualities and social responsibility and do not care about rewards or material intersets. But to fully motivate most SOE executives without reasonable salaries, material benefits and an incentive mechanism is not only unrealistic, but also against the basic principle of Maxism on material intersts.

I think the current Opinions on the compensation system reform issued nationally and locally have three serious flaws:

**First, the basis on which salaries are determined is not solid and does not meet the requirement of the law of the socialist market economy.** Under the market economy, salaries of employees are mainly determined, affected and adjusted by the labor market and are linked with the average salary of the society. The salaries of enterprise executives should be affected and adjusted by the talent market and be linked with the average salary in the market. Meanwhile, given the special role of managers, their salaries should also be related to the performance of the enterprises.

In this regard, as early as in 1999, the party central committee clearly stipulated in its “Decisions on Several Major Problems in Reforming and Developing State-owned Enterprises” that “A profit distribution system compatible with the modern corporate system should be established; Guided by state policies, the board of director and the management should be rewarded based on their respective duties and contributions; The salary of employees should be determined by enterprises according to average local salaries and the economic efficiency of the enterprise. Within an enterprise, profits should be distributed according to performance and properly differentiated. Capital, technology and other factors of production are allowed and encouraged to be part of the profits for distribution.

The current “Opinions” stipulates that the salaries of SOE executives are not linked with the talent market or enterprise performance, but with the average salary of the employees of the enterprises they work for. It points out that the basic salary of SOE executives should be no more than twice the average of the enterprise and their performance-based salary no more than four times the average. It may lead to excessively low salaries for SOE executives or executives raising the average salary of the employees to increase their own salaries.

**Second, the salary calculated on this basis is much lower than the actual market level, severely harming the legitimate rights and interests as well as just rewards of managers and discouraging corporate executives.** According to the current stipulation, the salary of executives of centrally administered enterprises include basic and performance-based salary ranging from 56,000 to 64,000 RMB. Performance-based salary will not be paid until evaluation results come out at the end of a year, which means executes only receive a basic salary from 7000 to 8000 RMB every month.

Currently, the housing price in Shenzhen is over tens of thousands of yuan per square meter. Housekeepers and babysitters earn about 4000 RMB every month. Postgraduates get a monthly salary of about 7000 RMB. For those uncorrupted executives without savings, they cannot even afford a house mortgage in a big city relying on a basic salary of 8000 RMB. How can they be motivated if even a decent life is unattainable? It is only natural that talents are leaving SOEs.

At the same time, the salaries of SOE executives basically have nothing to do with enterprise performance. They get the same annual salaries regardless of the profits. There is no incentive for them to create more profits. An incentive system and a disciplinary system are complementary. Without a proper incentive mechanism, there can be no real disciplinary system. A disciplinary system relying on administrative measures alone is impossible to last. Executives of SOEs, especially of major centrally administered enterprises manage assets of maybe billions of RMB. But they only receive a monthly basic salary of 8000 yuan. They are unlikely to feel content with the treatment. Such a system cannot guarantee that they remain uncorrupt for a long time.

**Third, the “Opinions” suggests differentiated salaries for executives appointed in different ways, that is, the salaries of executives selected from the market are market-based while that of executives appointed by the organizations are calculated according to internal regulations. This system may work at the moment but cannot serve as a long-term compensation system.**

To begin with, the salaries of corporate executives should be linked with their positions, capabilities, performance and the market level. The way and procedures of appointment should not be a major factor. A competent executive that has delivered great performance for the company deserves market-based compensation even if he is appointed by an organization at a higher level. While there should be differentiated salaries for different members of the management, the difference should be based on their positions, performance and contribution to the enterprise instead of ways of appointment. According to the current regulation, however hard those executives appointed by the SASAC work, regardless of their performance and contribution, they can never receive higher salaries than their coworkers selected from the market. It is certainly unfair and dampens their enthusiasm in the long term.

Second, different ways of appointment and different compensation systems will give rise to huge salary gaps and many unfair and unreasonable phenomenon. In particular, under the differentiated compensation system, the salaries of the board chairman and the general manager, the most important positions in enterprises, are often much lower than that of the vice-chairman and vice general manager selected from the market or even that of mid-level division executives. This often leads to a lot of internal problems. It can neither motivate individuals nor boost the performance of the entire team.

In a nutshell, the opinions on reforming the compensation system for SOE executives issued by relevant state departments and local governments have proved to be unreasonable theoretically. It has exerted negative implications in practice and is not consistent with the policies of SOE reform over the years. The following two solutions are suggested to improve the situation:

**The first solution is to halt the implementation of the current “Opinions”.** Afterwards, the power of compensation distribution for corporate executives will be transferred to the board of directors or organizations at higher levels. They will decide on the compensation structure and level taking into account the market level, the economic efficiency of the enterprise and performance evaluation of executives. The new and improved distribution system will basically meet the law of the market economy and manifest the features of SOEs. It will provide both incentives and restraints by linking compensation to the economic efficiency of enterprises.

Will the distribution system run out of control? I think it is very unlikely. After decades of reform, the central and local sate asset supervisory authorities have made lots of explorations in reforming the enterprise compensation system, accumulated many experiences and developed some good systems. In some parts of the country such as Shenzhen, the compensation reform is basically in line with the market economy. There is little possibility of losing control.

A few enterprises regulated by government departments, especially those financial enterprises regulated by the fiscal authority, need special attention. If the separation of government and enterprise and the separation of government and capital can be realized in these enterprises and if they are to be incorporated into the state-owned assets supervision and administration system, the situation where some financial enterprises went out of control with their compensation management is unlikely to repeat.

**The second solution lies in revising the “Opinions”.** It requires the resolution to correct those unreasonable regulations and to continue deepening the reform of the distribution system in SOEs following the direction set by the “Opinions on Reforming and Developing SOEs” issued in the Fourth Plenary Session of the 15th Party Central Committee. A sound SOE profit distribution system compatible with the socialist market economy and the modern system should be established to motivate managers and employees and promote the sound and stable development of SOEs.

**6. The reform of local state-owned enterprises can only imitate the reform of centrally-administered enterprises?**

Since the reform and opening-up, guided by the overall policies of the central authorities, the reform of centrally-administered enterprises and local state-owned enterprises have always been carried out according to their investment structure and ownership in two separate systems. Relevant departments of the state council and local governments are in charge of the reform and have their respective responsibilities.

In China, there are a huge number of SOEs of large sizes and complicated problems. This two-tiered reform acknowledges the actual profits of government investment in enterprises, motivates local governments in SOE reforms, encourages local explorations and innovations and provides experiences for the reform of centrally-administered enterprises. Meanwhile, it underlines the responsibility of local governments to reform SOEs. Clear division of responsibilities helped avoid instability during the process.

But changes have taken place in the two-tiered SOE reform in recent years. Since the “1+N” documents on deepening SOE reforms were released by the state and relevant departments, every specific reform scheme and opinion is required to be followed by their local versions.

For instance, local governments are also required to classify SOEs, set up, invest in and manage enterprises and to introduce reform schemes of the compensation system for SOE executives. Timelines are often given for the introduction and implementation of these schemes. This practice harms creativity in local SOE reform and is against the principle of the two-tiered reform of differentiated measures in line with local situations.

I believe guided by the overall policies of SOE reform developed by the third plenary session of the 18th Party central committee, local governments should have the power to carry out SOE reform rather independently instead of imitating reform schemes and methods adopted by centrally-administered enterprises. The reasons are as follows:

**First, according to relevant laws and regulations and the principle of separating government and capital, as to the investment of state-owned assets, the state council and local governments execute the right as capital contributors. As capital contributors of local SOEs, local governments are supposed to dominate their reform. Relevant departments of the state council and local governments only provide guidance in managing state-owned assets. Otherwise, the relation between the state and the enterprise may return to what it was like under the planned economy.**

**Second, centrally-administered enterprises and local SOEs have very different structures. Most local SOEs have withdrawn from competitive sectors. The few remaining SOEs are small in size and mainly deal with public services and infrastructure.** Therefore, their reform should be carried out by local governments independently. It is allowed to be different from the reform of centrally administered enterprises.

For instance, given that basically no local SOEs are large enterprises concerned with national security and strategies, there is no need to categorize them into enterprises for public welfare and that for profit. Moreover, since local SOEs are small in size and number, local state-owned assets supervisory authorities can directly execute their rights as the capital contributors. There is no need to establish a capital investment operation company. In recent years, local SOEs have developed supervisory and administrative systems for SOEs that fit local situations and the market economy. There is no need to change the systems just to imitate centrally-administered enterprises.

**Third, local SOEs are undergoing different reform and have different development goals compared with centrally administered enterprises.** After years of restructuring and adjustments, most local SOEs are dedicated to infrastructure and public services. Therefore, their goal is not to grow bigger and stronger, not even to exert control and influence on local economic development, but to boost vigor and provision capability.

Maintaining vigor means accelerating the transformation of the mechanisms within SOEs to be better adapted to the fierce competition in the market economy. Boosting provision capability requires these SOEs dedicated to infrastructure and public services to fulfill their social responsibility while gaining proper profits, to improve their service quality and propel the economy and the society of a city or a region forward.

**While the central authorities should delegate powers to local governments, local governments should take proactive measures. They cannot just imitate the practices of centrally-administered enterprises in SOE reform. What they should do is to boldly explore and innovate based on the realities under the overall requirements of central authorities.**

Local SOEs have small sizes and flexible mechanisms. They may very well make some breakthroughs and provide lessons for the reform of centrally-administered enterprises. Over the years, Shenzhen has set an example of SOE reform and has developed systems and mechanisms for state-owned asset management and SOE development that fit local situations. **But Shenzhen cannot be content with past successes. It should look to Temasek model to transform the functions of the SASAC from assets management to capital management, thus offering lessons for all SOEs and making new contributions.**

**7. Do we need so many pilot areas to push forward SOE reforms?**

Currently, the central authorities have decided the overall policies of SOE reform. It is an arduous and urgent task of the supply-side structural reform. Our people are expecting bolder strides. But the plan on deepening SOE reform and “ten reform pilots” announced by relevant departments of the state council mentioned almost all important aspects of SOE reform. It is an incremental roadmap in which a new policy has to be testified first, and then extended to other parts of the country. This slow approach is rather unpopular among the public.

It has been decades since SOE reform was initiated and over a decade since the SASAC was established. A lot of explorations have been made and experiences have been accumulated. Except a few pilot reform projects, we should follow the requirements of the central authority and make bold efforts based on past successes. It is also essential to make breakthroughs in key projects so that the designated reform tasks set by the central authority can be fulfilled, and produce desired results as soon as possible. It is a waste of time to launch so many pilots and promote the projects years later.

**Relieving enterprises of social services and addressing problems left over by history**

This reform has been ongoing for almost two decades. SOEs were restructured on a large scale in the end of last century. The focus was on the restructuring of major enterprises and minor ones were left to fend for themselves . A wealth of experiences was accumulated and a series of policies, systems and specific measures were developed. With some adjustments and improvements based on the new situation, they can be promoted widely. There is no need for pilots.

**Functions and powers of boards of directors**

Around 2005, the SASAC selected several enterprise pilots and issued opinions and schemes for them. Now there are dozens of pilot enterprises, many of which have accumulated plenty of experiences. Once institutionalized, some practices may very well be promoted among centrally administered enterprises. There seems no need to select another two to three pilots.

**Mergers and reorganization of centrally-administered enterprises**

Over more than a decade, we have seen many cases of mergers and reorganization among centrally administered enterprises. Their number has shrunk from over 130 to about 100. For those enterprises that need merger and reorganization, we only need implementation. Pilots are not necessary.

**Market-based selection and appointment of managers**

Over more than a decade, the SASAC has publicly recruited senior managers for large enterprises around the world for several times. Is the pilot still necessary?

**Mixed ownership**

In the past 30 years of reform and opening-up, mixed ownership has basically become the main organizational form of our economy. Except that some centrally administered enterprises are still wholy state-owned, a lot of centrally administered enterprises and most local SOEs have completed joint-stock reform and implemented mixed ownership. With strong resolution, mixed ownership can also be realized in the sectors of power, civil aviation and telecommunications without pilots.

**Information disclosure of SOEs**

Centrally-administered enterprises and local SOEs have thousands of state-holding public companies at home and abroad. Following the requirements of relevant regulatory departments of the State Council, these public companies are already disclosing a huge amount of their information and financial data.

**8. Can the supply-side structural reform succeed without breakthroughs in the reform of state-owned enterprises?**

The central authority made strategic adjustments recently on the direction of the macro-economic policy and the priorities of the reform of the economic system. In the past, policies to stimulate demand and the supply side management to drive economic development were the main measures. Now the focus is on the supply-side structural reform. Through restructuring and transformation of growth models of enterprises, the sustained development of the national economy will enjoy comprehensive support. The supply-side structural reform is going to be the priority and key task for the reform of the economic system during the 13th five-year period or for a long period to come. A series of major reform measures such as cutting over-capacity, de-stocking, de-leveraging, reducing cost and shoring up weak spots have been announced. I think this is a wise decision.

Data show that currently the eight industries plagued with serious over-capacity and over-inventory are mainly SOEs. Only a few of them are private enterprises. The majority of “zombie enterprises” are also SOEs. What are the causes for this situation? The world market is under reshaping. The reform of government functions is yet to be completed. The market-based competitive mechanism is not sound enough. Despite these problems, I think the root cause is the stagnation or even recession of SOE reform in recent years.

Over the past three decades of reform and opening-up, the Party Central Committee and the State Council have always positioned SOE reform at the center of the reform of the economic system. Several rounds of major reform have been carried out targeting problems in SOEs and the state-owned economy in different stages. In the 1980s, it was proposed to transform the operational mechanism of enterprises. In the early 90s, the establishment of a modern enterprise system was the main task. In the late 90s, the priority was to restructure of major large SOEs and concentrate SOEs to those key industries and fields that concern the national economic bloodline. Around 2000, the government set about reforming the administrative system of state-owned assets. A series of reform were carried out, such as the separation of government and capital, separation of government and enterprise and adjustments to the administrative systems within enterprises.

These years of reform, especially the economic restructuring and restructuring of large SOEs at the turn of the century, has enhanced the influence and stability of the state-owned economy and created broader prospects for the development of the private economy. It played a decisive role in delivering over a decade’s high-speed growth of the national economy and realizing our position as the world’s second largest economy. After years of deepening reform, the administrative and operational systems of SOEs have undergone profound changes. They gradually fit into the market economy and become the major players in market competition. A group of large key enterprises have made great contributions to the development of the national economy.

We enjoyed the benefits brought by the high-speed growth over the past decade. SOE reform was progressing by leaps and bounds. SOEs solved many of their problems and began to develop rapidly. However, we seem to have forgotten these problems and our goals. We did not continue to deepen reform following the direction and policies determined by the central authority. SOE reform has basically come to a halt and has even gone backwards in some aspects.

For instance, in recent years, SOEs, especially those under central administration, fail to follow the central mandate to restructure the state-owned economy and prioritize their operations. Instead of situating themselves primarily in the critical industries closely related to national welfare, they flood into almost all industries, including many competitive industries. As SOEs expand into steel and iron, coal, cement, glass, iron ore, non-ferrous metal, real estate and other industries, the state-owned economy become less focused, leading to low overall quality and poor resource distribution.

Moreover, the decision-making in SOEs is not adaptable to the changing market demand. A great deal of overcapacity cannot be reduced, adjusted, or transformed in time, which becomes a heavy burden for the companies. The SOEs and the Chinese economy at large have paid a heavy price for it.

In addition, the exit mechanism has not yet been established for SOEs that are outcompeted, and the shift of internal mechanisms in those companies has not been completed. As a result, many of them are overstaffed, inefficient and uncompetitive. Some become ‘zombie companies’ – companies that suffer heavy losses for excessive capacity and unsold products but still scrape by on government support and bank loans.

One important reason for the above-mentioned problems is inadequate government reform. In recent years, some local governments established investment vehicles as a tool of obtaining bank loans, despite the reform targets of ‘two separations’ – separation of government and capital and separation of government and enterprises. This increases the financial and debt risks of local governments. Some relevant state departments and local governments set the threshold for non-state-owned capital, or use administrative methods to disrupt fair market competition, under various excuses and pretexts, in order to protect the state-owned monopolies. Many of the overcapacity projects are put together by state departments with the approach of command economy.

Over the years, stagnation and even regression of the reform of SOEs is pervasive throughout the country, even in Shenzhen, a pioneering city for such a reform. For instance, the Shenzhen municipal government sets up companies like Shenzhen SEZ Construction and Development Group, whose investment, projects and top executives are directly managed by the government, despite the principle of ‘two separations’. Shenzhen Qianhai Administration Bureau set up so-called share-holding groups involving finance, services and infrastructure development under various pretexts, violating the central government’s ban of party and government organs from running businesses. It took Shenzhen over a decade to reorganize the enterprises controlled by district governments and withdraw district capital from those enterprises. However, in recent years, the district governments again set up so-called investment companies or development and construction companies. These companies are not incorporated into the state-asset management system for standardized management. As a result, they involve considerable potential risks.

Therefore, to implement the decision of structural reform at the supply side, it is important to stick to the right direction of the SOE reform, to accelerate the reform process, and to carry out institutional restructuring. This will help address the root cause of the current situation – overcapacity, heavy stockpile, excessive inventory and structural imbalance. By deepening reform and accelerating economic restructuring, disadvantaged SOEs will be able to withdraw from competitive industries in a fast, steady and orderly manner. This will eliminate the root cause of zombie companies, as poorly managed SOEs are allowed to go bankrupt and capitals are allowed withdraw from them. Meanwhile, SOEs should speed up the reform of their decision-making and operation mechanisms. This will help reduce their production costs, boost their vitality, and allow them to adapt better to market competition. It will also enable the national economy to realize coordinated, sound and orderly development on a new foundation and ensure the success of structural reforms at the supply side.

If the supply-side reform fails not make breakthroughs in the reform of SOEs, the deep-seated causes of overcapacity will remain. Even if the government eases structural imbalance and curbs excessive demands with subsidies, preferential policies or other administrative measures, through merger and acquisition and reorganization, it will only relieve the symptoms on a temporary basis. In the long run, it might pose grave risks for China’s economic development, which will have to be addressed by another supply-side reform.

**Translator’s Notes**

1. 《中共中央关于全面深化改革若干重大问题的决定》：Decision of the CCCPC on Some Major Issues Concerning Comprehensively Deepening the Reform （CCCPC: Central Committee of the Communist Party of China）

   （Source: <http://www.china.org.cn/chinese/2014-01/17/content_31226494.htm>） [↑](#endnote-ref-1)
2. “对新一轮国有企业改革做出了总体规划和顶层设计，为国有企业改革绘出了一幅宏伟的蓝图”，该处两小句意思表达类似，翻译简洁处理。 [↑](#endnote-ref-2)
3. “国企改革的方向和目标是做强做优做大国有企业，还是提高国有经济的活力、影响力和控制力？”

   精炼版英文翻译：Is the direction and objective of SOE reform to make SOEs bigger, stronger and better, or to improve the vitality, impact and dominance in critical industries?对“国有企业”和“国有经济”两个关键概念没有区分，所以本文译文在参照精炼版英文翻译基础上做了修改。 [↑](#endnote-ref-3)
4. 即“发挥国有经济主导作用，不断增强国有经济活力、控制力、影响力”。译文参考《中共中央关于全面深化改革若干重大问题的决定》的中英对照版：

   中：必须毫不动摇巩固和发展公有制经济，坚持公有制主体地位，发挥国有经济主导作用，不断增强国有经济活力、控制力、影响力。

   英：We must unswervingly consolidate and develop the public economy, persist in the dominant position of public ownership, give full play to the leading role of the state owned sector, and continuously increase its vitality, controlling force and influence.

   其中“国有经济活力、控制力、影响力”与小标题中的“国有经济的活力、影响力和控制力”顺序有差异，请作者考虑是否统一顺序。该三个词的译文选取了客户提供的精炼版英文翻译its vitality, impact and dominance，顺序按照小标题顺序，避免调换顺序引起读者不必要的疑问。 [↑](#endnote-ref-4)
5. 原文“《关于国有企业改革和发展若干重大问题的**规定**》” 疑有误，1999年9月22日 中共十五届四中全会审议通过的是《中共中央关于国有企业改革和发展若干重大问题的**决定**》，是“决定”而非“规定”。译文按照“决定”翻。

   （参考：<http://www.people.com.cn/GB/historic/0922/4812.html>） [↑](#endnote-ref-5)
6. 原文“保障国有安全”疑有误，译文按照“保障国家安全”翻。 [↑](#endnote-ref-6)
7. 综合商社：Sogo shosha (総合商社, or general trading companies) are Japanese companies that trade in a wide range of products and materials.

   （参考：<https://en.wikipedia.org/wiki/Sogo_shosha>） [↑](#endnote-ref-7)
8. “组龙工程”暂未查到相关具体说明和对应英文名。 [↑](#endnote-ref-8)
9. “能源集团”，译文参考“深圳能源集团股份有限公司”官网。（参考：<http://www.sec.com.cn/Abouts.aspx>） [↑](#endnote-ref-9)
10. “员工持股” ESOP ( employee stock ownership plan )

    （参考：<https://en.wikipedia.org/wiki/Employee_stock_ownership_plan>；<http://www.esop.org/>） [↑](#endnote-ref-10)
11. “市国有资产管理委员会（国资办）” Shenzhen Municipal State-owned Assets Administration Office (SSAAO)

    （参考：<http://english.mofcom.gov.cn/article/lawsdata/chineselaw/200211/20021100053446.shtml>） [↑](#endnote-ref-11)
12. 《企业国有资产监督管理暂行条例》Interim Regulations on the Supervision and Administration of State-Owned Assets of Enterprises

    （参考：<http://www.chinadaily.com.cn/beijing/2012-12/18/content_16028303.htm>） [↑](#endnote-ref-12)
13. 菜篮子工程 shopping basket program

    （参考：<http://baike.baidu.com/link?url=dQCmdS81ZcE0m_jNi9XxV9eOCuHUU9_CV-TIb48Ic0t7jfY_o138PROAojifPVNH3GFZcwhSC6E9GuQ5cmfchvYdZk30rPVLFwVaiBaExaL--AT1-s-RFV08VpTmN5URNoNtKfYnostHkdxvYz3SXK>） [↑](#endnote-ref-13)
14. “巴士集团”现为“深圳巴士集团股份有限公司”，译为Bus Group。

    （参考：<http://www.szbus.com.cn/>） [↑](#endnote-ref-14)
15. “九龙巴士” The Kowloon Motor Bus Co.

    （参考：<http://www.kmb.hk/tc/news/faq.html>） [↑](#endnote-ref-15)
16. “燃气集团”现为“深圳市燃气集团股份有限公司”，译为Gas Group。

    （参考：<http://www.szgas.com.cn/>） [↑](#endnote-ref-16)
17. “中华煤气”即“香港中華煤氣有限公司(煤氣公司)”，英文全称The Hong Kong and China Gas Company Limited (Towngas)

    （参考：<http://www.towngas.com/Chi/Cust/index.aspx>） [↑](#endnote-ref-17)
18. “水务集团”现为“深圳市水务（集团）有限公司”，译为Water Group。

    （参考：<http://www.sz-water.com.cn/>） [↑](#endnote-ref-18)
19. “威立雅”即总部位于法国的威立雅集团。英文Veolia Group。

    （参考：<http://www.veolia.com/en/veolia-group/profile>） [↑](#endnote-ref-19)
20. “城市特许经营条列”原文“列”字请修改。本条例全称：深圳市公用事业特许经营条例。

    （参考：<http://www.cnnsr.com.cn/jtym/fgk/2005/20051228000000104672.shtml>） [↑](#endnote-ref-20)