CHINA’S STATE CAPITALIST TURN:
POLITICAL ECONOMY OF THE ADVANCING STATE

by

Sarah Eaton

A thesis submitted in conformity with the requirements for the degree of Doctor of Philosophy
Graduate Department of Political Science
University of Toronto

© Copyright by Sarah Eaton (2011)
The thesis explores puzzling change in Chinese state sector over the past two decades. China’s debt-ridden state-owned enterprises (SOEs) were long seen as the most thorny reform dilemma; however, in the past decade, the surging profitability of large SOEs in the so-called “monopoly sectors” (longduan hangye 垄断行业) have made them lynchpins of an emerging state capitalist system. The main argument is that the state sector’s apparent reversal of fortunes is, in large measure, a legacy of the brief period of neoconservative rule (1989-1992) following the Tiananmen uprising in spring 1989. The fleeting ascendance of Chen Yun’s neoconservative faction provided them the opportunity to redirect the reform course set by Deng Xiaoping and embed a market vision which saw SOEs as pillars of the economy. The neoconservative leadership laid the normative and institutional foundations of a robust SOE-directed industrial policy regime which has gained momentum through the 1990s and into the last decade.

The study also sheds lights on the political and economic drivers of China’s unfolding market order through analysis of the industry foundations of China’s emerging state capitalist system. In recent years, state ownership has concentrated in some industries and largely retreated from others. What is driving this process of what Pei (2006) terms the “selective withdrawal” of the state from the economy? To address this question, the nature of ownership change across Chinese industry in recent years is first analyzed. Focus then shifts to comparative analysis of the
reform pathway of two industries in which state ownership remains dominant: telecommunications and airlines. Combining insights from the partial reform equilibrium model and historical institutionalism, the study argues that both the particularist interests of “short-term winners” in industry and the neoconservative policy legacy have left an imprint on the process of selective withdrawal.
Acknowledgments

It is truly a pleasure to thank to those individuals and organizations who made this thesis possible.

First and foremost, I am grateful for excellent supervision. Louis Pauly and Joe Wong were a great advisory team. Generous encouragement and incisive questioning as well as a thousand acts of kindness made the tailwind that pushed me through to completion of this project. Richard Stubbs has been a mentor since my time at McMaster and his wisdom and generosity continue to inspire. Todd Hall’s contributions toward the end of this project helped to sharpen the thesis and have set the task for future elaborations of this work. I drew from Victor Shih’s deep knowledge about Chinese politics and economics at several points in the research process and was fortunate to have his invaluable feedback on the final draft.

I’m thankful, too, for a lot of help from my friends and classmates. At the University of Toronto, I was lucky to be surrounded by a brilliant and merry band of fellow travelers on the dissertation road, especially Mike Mastroeni, Wendy Hicks, Seth Jaffe, Bill Flanik, Steve Trott, Andy Paras, Charmaine Stanley, Caroline Shenaz Hossein and Jenn Wallner. Special thanks go to the incomparable Alanna Krolikowski whose wit, intelligence and friendship have been a sustaining force for me. Friends made in China also helped to make this a process of discovery and growth, particularly Chen Shu, He Weimin, Cigdem Gül and Andrée Chenard. Trinh Thuy Hang taught me a lot about life, putonghua and the wonders of fish sauce—I’ll always be grateful that she took me into her world.

Many people contributed in one way or another directly to my thesis findings. Unnamed interview subjects generously shared their insights with me and allowed me to get a toehold on complex issues. Gao Haihong and Zhang Ming were greatly helpful during my time as a Visiting Scholar at the Chinese Academy of Social Sciences. At various points, exchanges with the following people helped to save me from wrong turns and generally kept me in a (roughly) forward motion: Kay Shimizu, Jennifer Choo, Margaret Boittin, Matt Ferchen, Sandra Heep and members of ‘The Vineyard’ Wednesday night group. I also benefited from talks with Carl Walter, Kan Kaili, Yukyung Yeo and Rosie Hsueh.
A dissertation is a slow-moving process and these people were especially important influences before the formal project ever came into view. Marilyn McCullough’s student exchange trip to Hangzhou in summer 1998 was nothing less than life-changing for me as it was for several others. She is missed and fondly remembered. Another of Marilyn’s students, Susan Andrews is a wonderful person who I am better for knowing. The same goes for her family.

My last year of writing was a juggling act and I was fortunate to have been surrounded by kind, smart and hilarious people at a challenging time. Thanks especially to the ladies of the Asia Pacific Foundation of Canada for good times at ‘Moose’s Downunder’, soccer pitches and other spots in town: Heather Kincaide, Lia Cosco, Trang Nguyen, Erin Williams and Alexandra Ho. Yuen Pau Woo and Jill Price were hugely supportive and understanding. Hillary Bullock and other old friends were also great companions.

Without research funding from a number of sources, this thesis would not have been written. I am grateful to the Social Sciences and Humanities Research Council of Canada, the Canada-China Scholars’ Exchange Program, the Chiang Ching Kuo Foundation, the China Times Cultural Foundation, the Dr. David Chu Scholarship Fund for Asia Pacific Studies and the Department of Political Science at the University of Toronto.

Finally, I owe deepest thanks to my nearest and dearest. My parents, Diane and Curtis Eaton, are my role models, guides and best friends. Annual visits to see them in the Crowsnest Pass were and are the highlights of my calendar. Brett and Isabelle Eaton and their brood took a crazy Ellie husky into their busy lives while I was living in China—they are true mensches, not to mention brilliant. I thank Genia Kostka for all the joy she has brought into my life. She helped this thesis along in more ways than I can recall, most of all with incisive comments, understanding and a steady stream of good cheer.

While many people contributed to this thesis, all errors and omissions are mine and mine alone.
Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>TABLE OF CONTENTS</td>
<td>VI</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>X</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>XI</td>
</tr>
<tr>
<td>LIST OF APPENDICES</td>
<td>XIII</td>
</tr>
<tr>
<td>LIST OF ABBREVIATIONS</td>
<td>XIV</td>
</tr>
<tr>
<td>1  INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>1.1 Research Questions</td>
<td>1</td>
</tr>
<tr>
<td>1.2 Contributions</td>
<td>5</td>
</tr>
<tr>
<td>1.3 Thesis Structure and Summary of Findings</td>
<td>6</td>
</tr>
<tr>
<td>2  SELECTIVE WITHDRAWAL: AN ANALYTICAL FRAMEWORK</td>
<td>10</td>
</tr>
<tr>
<td>2.1 Introduction</td>
<td>10</td>
</tr>
<tr>
<td>2.2 The Politics of Postcommunist Transitions</td>
<td>12</td>
</tr>
<tr>
<td>2.2.1 Przeworski vs. Hellman</td>
<td>12</td>
</tr>
<tr>
<td>2.2.2 The China Transition Debate</td>
<td>16</td>
</tr>
<tr>
<td>2.2.3 A Critique of the Partial Reform Equilibrium Model</td>
<td>18</td>
</tr>
<tr>
<td>2.2.4 A Historical Institutionalist View</td>
<td>20</td>
</tr>
<tr>
<td>2.3 A Critical Juncture in China’s Economic Transition: Tiananmen and</td>
<td>23</td>
</tr>
<tr>
<td>Everything After</td>
<td></td>
</tr>
<tr>
<td>2.3.1 The Neoconservatives’ Economic Legacy</td>
<td>23</td>
</tr>
<tr>
<td>2.3.2 The Shifting Tides of Elite Politics</td>
<td>28</td>
</tr>
<tr>
<td>2.3.3 The Growing Clout of SOEs in the Crucible of Regulatory Reform</td>
<td>31</td>
</tr>
</tbody>
</table>
2.4 Research Agenda .............................................................................................................. 38
  2.4.1 What are the Determinants of Selective Withdrawal? .................................................. 38
  2.4.2 Methodology .............................................................................................................. 39
  2.4.3 Case Selection .......................................................................................................... 40
  2.4.4 Explanatory Variables .............................................................................................. 41
  2.4.5 Fieldwork and Data Sources .................................................................................... 44

2.5 Conclusion ...................................................................................................................... 47

3 THE NEOCONSERVATIVE LEGACY AND STATE SECTOR REFORM ........... 49

3.1 Introduction ...................................................................................................................... 49

3.2 The Political Economy of State Asset Management Reform, 1978-2011 ..................... 50
  3.2.1 The Command Economy System ............................................................................. 50
  3.2.2 Early Experiments in the Separation of Ownership and Management .................. 51
  3.2.3 Enter SASAC ........................................................................................................... 54
  3.2.4 The Huijin Model ..................................................................................................... 56
  3.2.5 Challenges and Tensions in the SASAC System ...................................................... 57

3.3 The Post-Tiananmen Development of State Sector Reform Priorities .............................. 61
  3.3.1 The Large Enterprise Strategy ............................................................................... 62
  3.3.2 Grab the Large, Let Go the Small ........................................................................... 67
  3.3.3 The ‘Going Forth’ Strategy ...................................................................................... 69
  3.3.4 Adjusting the Layout of the State Sector .................................................................. 71
  3.3.5 Summary: Accounting for the Relative Strength of State Sector Reforms .............. 80

3.4 Conclusion ...................................................................................................................... 80

4 A BIRD’S EYE VIEW OF THE STATE-OWNED ECONOMY (1991-).......... 82

4.1 Introduction ...................................................................................................................... 82

4.2 Impact of the Neoconservative Legacy .......................................................................... 82
  4.2.1 Grab the Large, Let Go the Small ............................................................................ 82
  4.2.2 Gauging the Effects of the Large Enterprise Strategy ............................................. 86
  4.2.3 The National Team Going Global ........................................................................... 89

4.3 SOE Retreat and Advance Across China’s Basic Industries ........................................... 91
### 4.3.1 Advance of the State, Retreat of the Private Sector (*Guojin Mintui*)

Page 95

### 4.4 Conclusion

Page 102

### 5 FROM SHORT-TERM WINNERS TO NATIONAL CHAMPIONS: CHINA’S TELECOMMUNICATIONS REFORM

Page 103

#### 5.1 Introduction

Page 103

#### 5.2 Industrial Policy

Page 104

- **5.2.1** Formation of “Big Push” Industrial Policy, 1978-1995
- **5.2.2** Metrics of the Big Push in Telecommunications Basic Services
- **5.2.3** The Impact of Short-Term Winnings on the Course of Telecommunications Reform
- **5.2.4** Grooming National Champions and Global Players (1994-)

#### 5.3 Regulatory Reform

Page 119

- **5.3.1** The Ups and Downs of Telecom Regulation (1978-1998)
- **5.3.2** The Persistence of Regulatory Bottlenecks (1998-)
- **5.3.3** WTO and the Labeling of Telecommunications as a Strategic Sector

#### 5.4 Ownership Reform

Page 133

#### 5.5 Conclusion

Page 140

### 6 THE TURBULENT PATH OF AIRLINES REFORM

Page 143

#### 6.1 Introduction

Page 143

#### 6.2 Industrial Policy

Page 144

- **6.2.1** The Cultural Revolution and the Decentralized Big Push
- **6.2.2** The Early Development of Airline Groups

#### 6.1 Regulatory Reform

Page 157

- **6.1.1** 1982-1992: Gradual Decentralization and Liberalization
- **6.1.3** External Liberalization of the Air Services Market
- **6.1.4** 2002-present: A New Era of Managed Competition

#### 6.2 Ownership Reform

Page 174
6.2.1 The New Terrain of Oligopoly: The Big Four Groups ........................................................................ 177
6.2.2 Advance of the State-Owned Airlines, Retreat of the Private Carriers ............................................. 184

6.3 Conclusion .............................................................................................................................................. 187

7 CONCLUSIONS: CHINA’S STATE CAPITALIST TURN .............................................................. 189

7.1 Introduction ........................................................................................................................................... 189

7.2 China’s emerging state capitalism...................................................................................................... 189

7.3 Role of government policy and actions ............................................................................................... 190

7.4 Selective Withdrawal .......................................................................................................................... 193

7.5 Future Research ................................................................................................................................. 195

7.6 Implications for the Study of Chinese Economic Reform ............................................................... 196

REFERENCES ............................................................................................................................................... 199

APPENDICES ............................................................................................................................................. 215
List of Tables

Table 2-1: Key Tenets of Dengism and Neoconservatism ..................................................... 25

Table 3-1: SASAC Categorization of Priority Industries circa 2004........................................ 74

Table 4-1: National Team Business Group Characteristics.................................................... 87

Table 5-1: Key Industrial Policies in Telecommunications, 1980s and 1990s.......................... 110

Table 6-1: Key Industrial Policies in Airlines, 1980s and 1990s............................................. 150

Table 6-2: Structure of Air China Group.................................................................................. 154
List of Figures

Figure 2-1: The J-Curve Model ................................................................. 13

Figure 2-2: The Partial Reform Equilibrium Model ................................................. 15

Figure 2-3: Administrative Reform in Selected Industries, 1978-2008 ......................... 33

Figure 3-1: The Formation of SOE Group and Listed Companies .......................... 53

Figure 3-2: State Asset Management Reform, 1978-2010 ...................................... 55

Figure 3-3: Central SOE Profit Remittances ....................................................... 59

Figure 3-4: The Development of State Sector Reform Priorities (1991-) ......................... 61

Figure 4-1: Number of Registered Central and Local SOEs, 1998-2007 ........................ 83

Figure 4-2: Central SOE Profit Growth .................................................................. 85

Figure 4-3: Tax Contributions by Industry as a Percentage of Tax Collected from SOEs .... 86

Figure 4-4: BRICs Outward Foreign Direct Investment, 2003-2009 ............................ 89

Figure 4-5: Proportion of Assets held by State-Owned, State-Controlled Enterprises, 1999 and 2008 ........................................................................................ 94

Figure 4-6: National Team 'Land Kings' ................................................................ 98

Figure 5-1: Post and Telecommunications Investment in Fixed Assets, 1981-1995 ........ 111

Figure 5-2: Increase in Fixed-Line Subscriptions, 1980-2005 ............................... 113

Figure 5-3: Increase in Telecommunications Usage, 1990 to 2007 .......................... 113

Figure 5-4: Telecommunications Business Revenue Growth and GDP Growth .......... 115

Figure 5-5: Telecommunications Services Providers Proportion of Industry Revenue, 2007 ... 135
Figure 5-6: Sales and Net Profit Margins of Selected Telcos (2008) ........................................ 137

Figure 5-7: Competition in Telecommunications Basic Services, 1994-2009 ......................... 139

Figure 6-1: Airline Passsenger Traffic, 1970-2008 ................................................................. 152

Figure 6-2: Fixed Asset Investment in Four Modes of Transport, 1991-1994 .......................... 162

Figure 6-3: 2002 Restructuring of the Airlines Market ........................................................... 167

Figure 6-4: Concentration Ratio of Big Three and Big Eight Airlines, 1987-2003 .............. 175

Figure 6-5: Market Share of the Big Four Airlines, 2008 ......................................................... 178

Figure 6-6: Corporate Structure of Hainan Airlines Group (2005-) ...................................... 184
List of Appendices

Appendix 1: Summary of Premier Li Peng’s Report to Central Work Conference, 1991 ........ 215


Appendix 3: Members of the Large Enterprise Trial Group (1991, 1997).......................... 219
## List of Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMECO</td>
<td>Aircraft Maintenance and Engineering Corporation</td>
</tr>
<tr>
<td>BoC</td>
<td>Bank of China</td>
</tr>
<tr>
<td>CAAC</td>
<td>Civil Aviation Administration of China</td>
</tr>
<tr>
<td>CCB</td>
<td>China Construction Bank</td>
</tr>
<tr>
<td>CCP</td>
<td>Chinese Communist Party</td>
</tr>
<tr>
<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
</tr>
<tr>
<td>CDMA</td>
<td>Code Division Multiple Access</td>
</tr>
<tr>
<td>CIC</td>
<td>China Investment Corporation</td>
</tr>
<tr>
<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
</tr>
<tr>
<td>CNAC(G)</td>
<td>China National Aviation Corporation (Group) Ltd.</td>
</tr>
<tr>
<td>CNAHC</td>
<td>China National Aviation Holding Company</td>
</tr>
<tr>
<td>CNKI</td>
<td>China Knowledge Resources Library</td>
</tr>
<tr>
<td>CNOOC</td>
<td>China National Offshore Oil Corporation</td>
</tr>
<tr>
<td>CRS</td>
<td>Computer reservations systems</td>
</tr>
<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
</tr>
<tr>
<td>CPE</td>
<td>Comparative Political Economy</td>
</tr>
<tr>
<td>DGT</td>
<td>Directorate General of Telecommunications</td>
</tr>
<tr>
<td>EVA</td>
<td>Economic Value-Added</td>
</tr>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FIEs</td>
<td>Foreign Invested Enterprises</td>
</tr>
<tr>
<td>GATS</td>
<td>General Agreement on Trade in Services</td>
</tr>
<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GSM</td>
<td>Global System for Mobile Communications</td>
</tr>
<tr>
<td>HI</td>
<td>Historical Institutionalism</td>
</tr>
<tr>
<td>HNA</td>
<td>Hainan Airlines</td>
</tr>
<tr>
<td>IPO</td>
<td>Initial Public Offering</td>
</tr>
<tr>
<td>JCM</td>
<td>J-Curve model</td>
</tr>
<tr>
<td>LCCs</td>
<td>Low-Cost Carriers</td>
</tr>
<tr>
<td>MBOs</td>
<td>Management Buy-Outs</td>
</tr>
<tr>
<td>MEI</td>
<td>Ministry of Electronics Industry</td>
</tr>
<tr>
<td>MII</td>
<td>Ministry of Information Industry</td>
</tr>
<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
</tr>
<tr>
<td>MofCOM</td>
<td>Ministry of Commerce</td>
</tr>
<tr>
<td>MPT</td>
<td>Ministry of Post &amp; Telecommunications</td>
</tr>
<tr>
<td>MNEs</td>
<td>Multinational Enterprises</td>
</tr>
<tr>
<td>NBS</td>
<td>National Bureau of Statistics</td>
</tr>
<tr>
<td>NOCs</td>
<td>National Oil Companies</td>
</tr>
<tr>
<td>NPC</td>
<td>National People’s Congress</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
</tr>
<tr>
<td>NPL</td>
<td>Non-Performing Loans</td>
</tr>
<tr>
<td>ODI</td>
<td>Overseas Direct Investment</td>
</tr>
<tr>
<td>OFDI</td>
<td>Outward Foreign Direct Investment</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------</td>
</tr>
<tr>
<td>PLA</td>
<td>People’s Liberation Army</td>
</tr>
<tr>
<td>PBC</td>
<td>Political Business Cycle</td>
</tr>
<tr>
<td>PRE</td>
<td>Partial Reform Equilibrium</td>
</tr>
<tr>
<td>RMB</td>
<td>Renminbi</td>
</tr>
<tr>
<td>SAMB</td>
<td>State Asset Management Bureau</td>
</tr>
<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
</tr>
<tr>
<td>SARFT</td>
<td>State Administration of Radio, Film and Television</td>
</tr>
<tr>
<td>SASAC</td>
<td>State Owned Assets Supervision and Administration Commission</td>
</tr>
<tr>
<td>SCDRC</td>
<td>State Council Development Research Center</td>
</tr>
<tr>
<td>SCM</td>
<td>Subsidies and Countervailing Measures</td>
</tr>
<tr>
<td>SCIO</td>
<td>State Council Informatization Office</td>
</tr>
<tr>
<td>SCRE</td>
<td>State Commission for Restructuring of the Economy</td>
</tr>
<tr>
<td>SEC</td>
<td>State Economic Commission</td>
</tr>
<tr>
<td>SIA</td>
<td>Singapore International Airlines</td>
</tr>
<tr>
<td>SIEC</td>
<td>State Import and Export Committee</td>
</tr>
<tr>
<td>SPC</td>
<td>State Planning Commission</td>
</tr>
<tr>
<td>SOEs</td>
<td>State-Owned Enterprises</td>
</tr>
<tr>
<td>TVEs</td>
<td>Township and Village Enterprises</td>
</tr>
<tr>
<td>VAS</td>
<td>Value-Added Services</td>
</tr>
</tbody>
</table>
1 Introduction

Certain that command economies are doomed to fail but fearful that truly free markets will spin beyond their control, authoritarians have invented something new: state capitalism. In this system, governments use various kinds of state-owned companies to manage the exploitation of resources that they consider the state’s crown jewels and to create and maintain large numbers of jobs. They use select privately owned companies to dominate certain economic sectors. They also used so-called sovereign wealth funds to invest their extra cash in ways that maximize the state’s profits...[I]n all three cases, the ultimate motive is not economic (maximizing growth) but political (maximizing the state’s power and the leadership’s chances of survival). This is a form of state capitalism but one in which the state acts as the dominant economic player and uses markets primarily for political gain.

-Ian Bremmer, *The End of the Free Market*, pp. 4-5

1.1 Research Questions

In early 2008, two years after Bank of China’s (BoC) US $11 billion initial public offering (IPO), I sat down to chat with a former employee to get his take on the bank’s changes. He said that when he had worked there eight years before, he had been driven away by the listlessness of the place—in that time, the central government had just concluded a US $200 billion bailout of China’s four largest state-owned commercial banks in what many regarded as a band-aid fix for China’s debt-ridden financial sector. Seeing no future for himself in one of China’s moribund state-owned enterprises (SOEs), this ambitious Cambridge finance grad opted to build his career in a multinational consulting company. In light of his own underwhelming experience at the bank, he said the BoC’s apparent reversal of fortunes had taken him completely by surprise: in the intervening time, the bank had posted years of strong profit growth, driven non-performing loans down to acceptable levels (1.1% in 2011) and achieved a healthy capital adequacy ratio (12% in 2011). While the jury is still out on the lasting significance of China’s
banking reforms, the banks’ makeovers have been astonishing whether or not they prove to be skin-deep.\(^1\) In the space of a few short years, China’s state-owned banks have decisively shed their image as outmoded relics of the command economy and been reinvented as sound and increasingly world-class financial institutions. At the height of the late 1990s non-performing loans (NPL) crisis, no one would have guessed that the 2011 ranking of global financial institutions’ brand value would find four of China’s state-owned commercial banks in the world top ten, Bank of China among them.\(^2\)

I encountered versions of this story again and again during my time spent in China researching this project. The image of China’s economic transition I had formed from the scholarly literature led me to believe that an aggressive program of state sector retrenchment combined with ever-more fierce competition in the domestic market after WTO entry had left China’s SOEs in ruins; upon beginning fieldwork, I quickly discovered that news of the state sector’s death had been greatly exaggerated. While it is true that thousands of SOEs met an end in the “Grab the Large, Let Go the Small” reform (zhua da fang xiao 抓大放小) of the late 1990s and early 2000s, in many ways the smaller state-owned economy that has emerged from retrenchment now leaves a bigger footprint in China’s political economy than its hefty former self.

Within China, evidence of this apparent reversal of fortunes in the state sector is everywhere. For one, the Bank of China employee’s experience represents something of a zeitgeist among China’s elite job-seekers: a survey of employment preferences conducted annually since 2002 shows that SOEs have now displaced foreign companies as the top choice of China’s graduating university students (ChinaHR.com, 2010). State-owned telecommunications giant China Mobile has held the number one position in job-seekers’ wish lists since 2008. And

\(^1\)While the banks’ balance sheets have improved markedly in recent years, there is still considerable debate about the degree of substantive change in China’s financial sector. Anderson’s (2007: 164) assessment that “the ‘bad old days’ of massive resource misallocation and flagrant disregard for economic realities are well and truly over” stands as one of the more optimistic perspectives on this issue. Shih (February 26 2011; February 8 2010) paints a less rosy picture and suggests that behind the banks’ low NPL ratios another bad loan crisis is looming, a result of the banks’ policy lending to local governments and central SOE subsidiaries.

\(^2\) They are: Industrial and Commercial Bank of China (#1), China Construction Bank (#4), Bank of China (#6) and Agricultural Bank of China (#10) (Goff, May 18, 2011).
whereas SOEs were once a perennial drain on the state’s finances, the prized core of the post-reform state sector—the national team of SOEs under the State Owned Assets Supervision and Administration Commission (SASAC)—is now awash in cash. In 2007, aggregate profits of nonfinancial SOEs amounted to 7% of China’s GDP up from 0.3% in 1998 (World Bank, 2009: 4). In 2010, China’s central-level, nonfinancial SOEs net profits topped US $130 billion, a 40% increase over the previous year. The phoenix-like rise of China’s SOEs is also increasingly reflected in the corridors of power. SOE bosses in sectors of the economy that remain solidly state-owned—the so-called “lifeline industries” （mingmai hangye 命脉行业）—bring considerable influence to bear on industry regulation and the tenets of broader economic policy with their ministerial-level rankings in the Communist Party hierarchy and, increasingly, in their role as representatives on the Party’s Central Committee. Indeed, central SOE CEOs quite literally have a direct line to the Party elite: each has a red phone sitting on his desk that connects the top leadership through an internal network (McGregor, 2010).

At the same time, the national team’s increasingly bold “going forth” （zou chu qu 走出去） into global markets has brought China’s state capitalism to the world’s attention. Anyone who has spent time in Beijing cannot fail to notice Sinopec’s imposing headquarters opposite the Ministry of Foreign Affairs on Chaoyangmen Dajie, a potent reminder of the state-owned oil giant’s record of multi-billion dollar investments around the world. Besides the behemoth resource enterprises, China’s service sector SOEs are also increasingly active in global mergers and acquisitions markets. Tellingly, 65 of China’s national team SOEs account for almost half of China’s outward foreign direct investment (OFDI). And in recent years, global capital markets have been kept busy with a wave of big-ticket “red chip” SOE IPOs that peaked with the world’s biggest-ever listing: Industrial and Commercial Bank of China’s 2006 offering for US $19 billion. Yet these IPOs made the national team enterprises public companies in name only; foreign and non-state investors were sold minority stakes that did not entail substantive transfer of corporate control away from the state (Walter and Howie, 2010). The national teams’ overseas listings have helped them quickly advance up the ranks of the Forbes Global 500, a closely-watched list in Beijing which is seen as a measure of central SOEs “Going Big and Going Strong” （zuo da zuo qiang 做大做强）. In 2005, only 15 mainland enterprises made the Forbes
list. By 2010, the number of Chinese companies on the list had nearly tripled to a total of 43; of these, 30 companies are SASAC SOEs.

At its broadest, this study aims to unearth the roots of China’s state capitalist turn. The work of Bremmer (2010), cited at the beginning of this chapter, and other popular commentators have identified some of the statist characteristics of China’s economy but tend to neglect the fact that the growing wealth and clout of China’s large SOEs actually represents a puzzling break with the past. Until quite recently the conventional wisdom held that Chinese economic reform aimed towards a gradual, minimally disruptive transition to a free market economy by slowly ushering the state-owned economy into retirement while simultaneously encouraging non-state sector development. And for many years the state sector’s lethargic performance leading finally to a massive retrenchment supported the view that SOEs were increasingly being relegated to the margins of the Chinese economy; however, this conventional wisdom sits much less comfortably with the state sector’s precipitous rise over the last decade and begs the question: what accounts for China’s state capitalist turn? Building on Huang’s (2008) seminal Capitalism with Chinese Characteristics this study positions the state sector’s reversal of fortunes against the changing political economy of reform since 1978. Of particular relevance to this study is Huang’s identification of a decisive policy shift in the early 1990s that prioritized urban SOEs and penalized private enterprises in rural areas.

Looking more narrowly, the thesis investigates the industry foundations of China’s emerging state capitalist system. While the state-owned portion of the Chinese economy has not withered away, it has concentrated in some industries and largely retreated from others. What is driving this process of what Pei (2006) calls the “selective withdrawal” of state ownership from the economy? This question goes to the heart of a current debate over the political dynamics of post-communist economic transition in China and elsewhere. The theory of partial reform would

---

3 Chapter Two provides an extended analysis of the various dimensions of emerging state capitalism in China. Broadly, state capitalism is defined here as an economy in which “the state exerts extensive control” (Huang, 2011: 4). Bremmer (2010) characterizes politically-connected large SOEs, loyal non-state companies and the state’s sovereign wealth funds as the basic units of China’s state capitalism. This study focuses primarily on the role of state-owned and state-controlled companies in the political economy.
suggest that explaining why some industries remain dominated by SOEs ought to look first to the material interests of “short-term winners”, in this case powerbrokers in the state sector. An alternative view attributes a greater degree of autonomy to policymakers and argues that selective withdrawal is a far more complex process than the partial reform perspective allows. This study brings historical institutionalist lenses to the question and argues that while the partial reform model offers valuable insights, a statist policymaking agenda which rose to prominence in the wake of Tiananmen has also left an imprint on the process of selective withdrawal as it has on other elements of the state sector reform agenda.

In sum, this study analyzes China’s state capitalist turn through the following three research questions: 1.) What are the most salient changes in China’s state-owned economy in the last two decades? 2.) How have central government policies and actions shaped these changes? 3.) Why does state ownership remain dominant in some industries and not in others?

1.2 Contributions

This study’s primary empirical contribution to the study of China’s state sector reforms is analysis of the relatively unexplored question of what is driving the selective withdrawal of ownership from the Chinese economy. The investigation begins with an examination of the government’s explicit plan for redrawing the boundaries of the state sector unveiled at the Fifteenth Party Congress in 1997, “Adjusting the Layout of the State-Owned Economy” (guoyou jingji buju tiaozheng fangzhen 国有经济布局调整方针). To the best of my knowledge this important though weakly developed policy has not previously been studied in the English language Chinese political economy literature. The study also sketches salient changes in state ownership across Chinese industry. While the big picture of selective withdrawal lends some insight into the factors driving the advance and retreat of state ownership in recent years, comparative analysis of the reform pathways of two industries in which state ownership remains dominant, telecommunications and airlines, deepens the analysis by taking a longer and lower-hovering view. Drawing from previously unused primary sources, the case studies reveal the salience of Cultural Revolution legacies in shaping early reform strategies after 1978. These early policy choices in the reform era were, in turn, crucial in forming the de facto and de jure
rules and practices that shaped the respective degrees of state, non-state and foreign ownership in the two industries.

The dissertation also adds to the theory of state sector reform by demonstrating the importance of seeing Chinese “politics in time” (Pierson, 2004). The analysis employs historical institutionalist concepts to help explain the state capitalist turn. The core premise is that the brief “order and rectification period” (zhili zhengdun 治理整顿) which followed the Tiananmen uprising constituted a critical juncture in the unfolding of China’s state sector reforms. The fleeting ascendance of Chen Yun’s faction presented the neoconservative elite with an opportunity to redirect the reform course set by Deng Xiaoping and his supporters which had aimed toward the gradual but steady dismantling of the state-owned economy. While Deng Xiaoping’s famous Southern Tour in 1992 formally brought the neoconservative period to a close, an important SOE-directed industrial policy initiative that had taken shape under the leadership of neoconservative Premier Li Peng—the “large enterprise strategy” (da qiye jituan zhanlue 大企业集团战略)—survived the policy turn and formed the nucleus of a three-pronged industrial policy regime that grew in importance over time. This neoconservative legacy helps to explain the growing prominence of the national team in the past decade and also sheds light on the halting process of withdrawing state ownership from the economy.

1.3 Thesis Structure and Summary of Findings

Chapter Two positions this study of China’s state capitalist turn in both the post-communist transitions and Chinese political economy literatures. The chapter begins with review of the Przeworski-Hellman debate on the political dynamics of economic reform which has recently become influential in the field of China political economy. The argument is made that while Hellman’s elegant partial reform equilibrium model is a powerful tool for extracting broad lessons about the political economy of transition, the model’s uncomfortable fit with the record of particular critical transition cases, principally post-Yeltsin Russia, reflects the analytical costs of its parsimony and rational choice ontology. The chapter then outlines the historical institutionalist ontology that informs this dissertation which sees political agency as shaped both by actors’ material interests and their essential beliefs about the world, in this case about the essential nature of markets, or their “market visions” (Steinfeld, 2006). Focus then shifts to
outlining the causes and consequences of the post-Tiananmen critical juncture before turning to a
discussion of the significance of sweeping regulatory reforms in shaping the politics of state
sector reform, often in unintended ways. The chapter concludes with an outline of the analytical
framework and a description of the methodology, case selection and data collection process.

Chapter Three analyzes the evolution of state sector reforms since the early 1990s. The
first section focuses on change over time in China’s state asset management system which, in
recent years, has become the site of intense struggle between the powerful and wealthy managers
of national team SOEs and central government agencies. The chapter then traces the emergence
and development of four key state sector reform policies that took shape over the 1990s.
Complimentary economic and political logics help to explain the robust development of a three-
pronged industrial policy regime which aimed to cultivate market-dominant SOEs in key
industries. Neoconservative economic principles derived from Chandlerian economics and the
experience of the East Asian developmental states provided the ideological backing for a new
slate of SOE-directed industrial policy. Party elites’ enthusiastic embrace of industrial policies is
in turn explainable in terms of elites’ particularist interests in strengthening their patronage
networks and broadening their power bases. The burgeoning strength of this industrial policy
regime effectively crowded out a rival policy which portended a diminishing role for SOEs
known as “Adjusting the Layout of the State-Owned Economy”（guoyou jingji buju tiaozheng
fangzhen 国有经济布局调整方针）. The chapter concludes with a discussion of some of the
prominent tensions within the broad mandate of the central bureaucracy tasked with guidance
and oversight of China’s national team. Since its establishment in 2003, SASAC has struggled to
balance its dual responsibilities for maximizing the value of state assets and guiding the selective
withdrawal of SOEs from the economy.

Chapter Four traces the impact of the neoconservative policy legacy on the changing
nature of the state-owned economy. The chapter begins with an examination of the outcomes of
three key policies associated with this SOE industrial policy regime: “Grabbing the Large”, the
“Large Enterprise Strategy” and “Going Forth.” The accumulated evidence suggests that these
policies have collectively left a deep imprint on the Chinese political economy. By comparison,
“Adjusting the Layout of the State-Owned Economy”, has exerted much less force on state
sector reform, partly because the tenets of this policy exist in some tension with the aims of the SOE industrial policy regime. The data show some evidence of state sector rationalization with the proportion of state ownership staying the same or increasing in some priority sectors and declining in others. And yet SOEs remain distributed widely across industry. Partly this is due to the complexities of commanding the retreat of state ownership in industries with a high employment burden such as agriculture and textiles. Quite a different logic is evident in a number of profitable industries in which national team SOEs seem to be advancing further and, in some cases, hastening the retreat of private enterprises (guojin mintui 国进民退). The chapter concludes with a brief analysis of the role of central SOEs in the booming business of real estate development where partial reform is very much in evidence.

Chapter Five explains why state ownership remains dominant in telecommunications basic services. The key finding is that the complimentary political and economic logics discussed in previous chapters also shed light on the reform pathway of this sector. Hellman’s vision of “short term winners” straining to protect rents in partially reformed markets is a valuable heuristic for illuminating the politics of telecommunications reform, especially in the critical period of the 1990s when many key decisions about the participation of non-state and foreign investors in this industry were made. In keeping with the partial reform model’s predictions about the pace of initial reforms as defining the longer-term prospects for reform, the decision to preserve the incumbent’s monopoly into the 1990s, while successful by the measure of fast-paced network expansion, unwittingly placed obstacles in the way of deeper reforms once the networks had been built. In the last decade, the legacy of the neoconservatives’ emphasis on building up a robust state sector has come to the fore as three state-owned players in telecommunications basic services have been honed in successive rounds of administrative industry restructuring. Under SASAC’s guidance, China Mobile and, to lesser extent, China Telecom and China Unicom have emerged as the stars of the national team, a development which has reinforced the status of telecommunications basic services as an inviolable segment of the state-owned economy. While the government’s interest in monitoring and censoring information flows is undoubtedly an important factor in shaping the degree of overall state control in telecommunications, the political sensitivity of this field is just one of several drivers
in the incremental process of defining telecommunications as a domain of absolute state ownership.

Chapter Six analyzes the case of airlines which has followed a more circuitous, and more puzzling, route into the ranks of China’s strategic sectors. In contrast to telecommunications, the leadership’s early approach to development of the airlines industry—premised on disassembling government monopoly and rapid investment liberalization—laid the groundwork for a competitive airlines market with minimal state intervention. The core puzzle in airlines reform is why this trajectory of gradual state retreat was suddenly reversed in 1997 with a major retrenchment that culminated in an administrative restructuring of the industry that pushed the market share of the Big Three state-owned carriers back above 80%. The evidence suggests that complimentary political and economic logics were the most decisive factors in the airlines industry volte-face. Even after the dramatic reforms of the first decade, in the mid-1990s the regulator retained strong ties to industry so that when competitive pressures cut into the state-owned airlines’ revenue intake, the government intervened to defend its players in industry. At the same time, the retrenchment also drew normative legitimacy from the slate of neoconservative industrial policies that gathered force over the 1990s. Inclusion of the Big Three airlines in the ranks of the national team served to make promotion of large, profitable and internationally competitive state-owned airlines a bedrock norm of airlines market regulation.

Chapter Seven summarizes the answers to the study’s three key research questions provided in the empirical chapters. The dramatic reversal of fortunes in the state sector over the past decade stands out as one of the most salient changes in the Chinese economy over the past two decades. Regarding the role of central government policies and actions in shaping this change, the study highlights the significance of the neoconservative legacy in driving the state capitalist turn. As for the determinants of selective withdrawal, while the limits of the research design preclude a definitive answer, the case studies suggest that partial reform dynamics and the neoconservative legacy have each importantly shaped the shifting boundaries of the state-owned economy.
2 Selective Withdrawal: An Analytical Framework

2.1 Introduction

This chapter places the study’s core research question—why does state ownership remain dominant in some Chinese industries and not in others?—in the context of a current debate between China scholars over the political dynamics of economic reform. Scholars influenced by the theory of partial reform have argued that an Olsonian logic best explains the changing pattern of ownership across the industrial landscape. That is, the state has tended to grab industries characterized by high profitability and high ownership concentration and let go of low-rent sectors with many producers. They point to the burgeoning wealth and political clout of China’s largest SOEs in the so-called “monopoly sectors” (longduan hangye 垄断行业) as evidence that policymaking is increasingly captive to the particularist interests of corporate and political leaders with close ties to these behemoth state-owned enterprises. An alternative viewpoint, one more consistent with Przeworski’s J-Curve theory of economic reform, attributes a far greater measure of autonomy to Chinese policymakers. In this perspective, selective withdrawal has not been determined uniquely by the demands of short-term winners in the state sector; rather it is best understood as a complex process in which exigency and contingency have been of central importance in shaping policy outcomes. Scholars in this camp tend also to be more sanguine about political leaders’ commitment and ability to discipline SOEs in key sectors.

This thesis casts the debate in new light by showing that the broader state capitalist turn has deeply imprinted the process of post-1978 state sector reforms including the selective withdrawal of state ownership. This chapter describes the normative, political and institutional bases of China’s incipient state capitalism. Building on Huang’s (2008) work and drawing from the historical institutionalist literature, the framework for analysis outlined here presents the post-Tiananmen “order and rectification” (zhili zhengdun 治理整顿) period (1989-1992) as a critical juncture in the process of state sector reform. A centerpiece of the neoconservative market vision that pervaded officialdom in the post-Tiananmen period was the aim of restoring beleaguered SOEs, particularly large SOEs in industry, as pillars of the national economy. Although Deng Xiaoping’s countermoves against the conservative leadership formally brought
an end to the post-Tiananmen interregnum in late 1992, the neoconservative emphasis on preserving and enhancing the role of large SOEs in the Chinese economy survived the Southern Tour and remains a core tenet of economic policy.

Two mutually reinforcing factors helped to lock in this SOE industrial policy regime. First, in the post-Deng era of elite politics, ideology largely receded as the currency of factionalism and in its stead patronage emerged as the primary means through which political elites amassed and maintained power. In this setting, doling out *quid pro quo* favours to politically salient large SOEs was highly consistent with elites’ particularist interests in advancing up the Party ranks. Second, a series of sweeping regulatory reforms in the late 1990s had the unintended consequence of raising the political status of large SOEs in key industries; as wealthy, high-ranking members of the Party, SOE heads exercise an increasing measure of control over industry regulation and broader economic policy. The normative underpinnings and bureaucratic form of China’s state capitalist system were forged in this critical period.

This chapter positions the argument in the field of Chinese political economy and outlines the research strategy and methodology employed in this study. The first section provides a brief overview of the comparative political economy literature on the political dynamics of economic reform and then examines how these issues have been reprises in the study of Chinese political economy. In both the generalist and China fields, Hellman’s (1998) partial reform model has emerged as an influential frame for analysis of the political dilemmas of post-communist economic transition. While the parsimony and innate plausibility of the partial reform model lends it a strong appeal, silences in the theory and challenges from prominent transition cases call into question the model’s sufficiency as a heuristic for analyzing Chinese reform policymaking. The second section outlines a historical institutionalist approach to the study of state sector reform which incorporates elements of the partial reform framework and builds in a claim about the causal significance of the shifting temporal underpinnings of Chinese reform. The chapter then contextualizes the research question which engages debate over the nature of reform policymaking and concludes with a discussion of case selection, methodology and data sources.
2.2 The Politics of Postcommunist Transitions

2.2.1 Przeworski vs. Hellman

This analysis focuses on the work of two scholars in the comparative political economy (CPE) transitions literature who have been particularly influential in the China field. Przeworski and other proponents of the “J-curve” theory of dual transition (economic and political) emphasize the potential for reforms to be derailed or even preempted by raucous political opposition from the prospective losers of economic reform. Since inflation, rising unemployment and goods scarcity are some of the more common short-term problems associated with the introduction of market reforms, the J-curve theory posits that the basic challenge facing reformist leaders is managing to, in effect, shield themselves from the demands of reform losers in order to maintain momentum through the deep valley of initial reform. An alternative perspective elaborated by Hellman suggests that the primary political challenge faced by reformers is in fact minimizing the policy influence of the beneficiaries of early-stage economic reforms status: the so-called “short-term winners” who derive considerable rents from arbitraging between the price differentials in the planned and market segments of the economy.

Przeworski’s (1991) influential J-Curve model (hereafter the JCM) of the political dynamics of dual transitions hinges on the salience of threats from reform losers, especially those groups that inordinately bear the short-term pain of adjustment. In his approach, managing the pain of “transitional effects” is the trickiest dilemma in any dual political and economic transition scenario because “a transient deterioration of material conditions may be sufficient to undermine either democracy or the reform process” (Przeworski, 1991: 137). In Przeworski’s rendering, choice of reform strategy (either radical or gradual) is primarily determined by the strategic interaction between three key groups with distinct preferences: ordinary people who “want to eat”; technocrat reformers who “want to succeed”; and politicians who “want to enjoy support” (Przeworski, 1991: 163-4). The JCM (Figure 2.1) posits that politicians and reformers will tend to push for adoption of a “bitter pill” or big bang reform strategy in the hopes that after an initial drastic decrease in consumption resulting from stabilization measures, the gains of growth will be widely felt by the end of the election cycle at time T. First and foremost, this strategy satisfies both the technocrats’ interest in seeing through reform and the politicians’ interest in re-election. Przeworski suggests that voters may also prefer the bitter pill to
gradualism provided they have adequate confidence in the outcome of reforms and sufficient ability to withstand the transitional effects (Przeworski, 1991: 164).

**Figure 2-1: The J-Curve Model**

![Image of the J-Curve Model]

Source: Przeworski (1991): 137

Hellman’s (1998) rejoinder to Przeworski as well as Haggard and Kaufman (1992) turns the logic of the JCM on its head. In his partial reform equilibrium model (the PRE model), short-term “winners” rather than short-term losers are seen to be the most potent political force in the transition from command to market economy. Hellman argues that the JCM exaggerates the magnitude of transitional effects and finds that countries which have adopted a “Big Bang” approach to reform have not, in fact, suffered the largest contractions in growth over the short term as the JCM implies (Hellman, 1998: 209-210). He argues that post-communist reform agendas are in reality shaped less by reformers’ fears about the political fallout of transitional effects than they are by the policy demands of short-term winners who tend to support initial reforms but oppose later-stage reforms which threaten their privileged positions in partially reformed markets. Hellman contends that obstacles to reform do not come primarily from the
downtrodden and disadvantaged but instead “from enterprise insiders who have become new owners only to strip their firms’ assets; from commercial bankers who have opposed macroeconomic stabilization to preserve their enormously profitable arbitrage opportunities in distorted financial markets; from local officials who have prevented market entry into their regions to protect their share of local monopoly rents; and from so-called mafiosi who have undermined the creation of a stable legal foundation for the market economy” (Hellman, 1998: 204).

Against the conventional wisdom about the benefits of authoritarian rule in seeing through economic reform, the PRE model suggests that democracies characterized by a large number of veto players offer the best prospects for successful transition to a market economy. In a twist on Olson’s (1982) pathbreaking discussion of “distributional coalitions”, Hellman argues that short-term winners interested in maximizing the particularistic benefits derived under the conditions of partial reform tend to make very effective lobbyists (Hellman, 1998: 222). He suggests that the likelihood of policymakers falling captive to these groups is determined in large measure by the openness of the political process to reform losers. Accordingly, more democratic political systems with institutionalized representation of many segments of society will \textit{ceteris paribus} be less prone to the problem of partial reform traps than authoritarian systems in which power and authority are more highly concentrated. Slantchev’s (2005) statistical analysis of panel data from 25 former communist countries lends support to Hellman’s conjecture in finding that democracies can in fact sustain socially costly economic reforms, contrary to the predictions of the JCM. And in an extension of Hellman’s model, Gehlbach and Malesky (2010) demonstrate formally that special interests tend to have less influence over policy outcomes as the number of veto players increase.

In comparison to discussion about the benefits of democracy vis-à-vis autocracy stimulated by Hellman’s seminal article, his claims about the significance of the scope and pace of initial reform sequences, a key focus of this dissertation, remains relatively unexplored in the CPE literature. Hellman’s emphasis on the importance of minimizing the duration of partial reforms is derived from the claim that the contours of reform are largely determined by the shape of the winners’ consumption curve which is the mirror image of the losers’ curve (Figure 2.2).
The theory suggests that if reforms are implemented tentatively, allowing short-term winners to amass substantial rents (as in $W_p$ above), policymakers will find it hard to advance reforms after time $t_1$ at which point further liberalization, privatization or price deregulation measures are greatly at odds with the interests of short-term winners. Accordingly, Hellman argues that “while the political challenge of the J-curve was to maintain reforms through the valley of the transition, the challenge of partial reform is to sustain the momentum of reform past the ‘peak of transition,’ that is, the point at which further reforms threaten the rents accruing to winners from the distortions created by earlier reforms” (Hellman, 1998: 222). More comprehensive reform sequences, by contrast, generate a smaller gap between the winners’ ($W_c$) and losers’ curves ($L_c$) before $t_1$ so that winners may voluntarily cede their (minimal) private benefits in the initial stages of reform in exchange for a share of the efficiency gains which they expect deeper reforms to yield (Hellman, 1998: 220).
2.2.2 The China Transition Debate

In recent years, the PRE model has become influential in the study of Chinese reform policymaking. A leading example is Pei’s (2006) widely-read account of China’s “trapped transition” which argues that there are deep, inlaid deficiencies in the combination of gradualist economic transition and one-party rule in China. His analysis highlights the endemic problems of widespread corruption, growing inequality and the pronounced decline of state capacity, all of which he attributes to the root problem of unbridled official rent-seeking and venality (Pei, 2006: 12-16). Shih (2006) has also applied the partial reform model to the study of financial reform in the late 1990s and his analysis of the determinants of financial policy under Premier Zhu Rongji challenges the widely-held accepted view of Zhu as a defiant technocrat reformer (e.g. Yang, 2006, Naughton, 2007; Heilmann, 2005). Shih argues that various actions of the central government in the financial sector since the late 1990s—especially the recentralization of banking authority, the absorption of massive amount of state-owned banks’ bad debt, the maintenance of high barriers to entry for private banks and the failure to liberalize interest rates—were shaped strongly by the personal interests of “politcized technocrats” in the policymaking elite. He contends that these policy choices served elites’ interests by either padding their patronage resources or making them appear as indispensable problem-solvers (Shih, 2007: 1245). Zhang and Liu’s (2010) study of local governance also employs the PRE model in arguing that local political elites not effectively checked by village elections will tend to devise means of selectively implementing reform policies in order to protect both their intake of economic rents and their rent-seeking behavior.

While not explicitly invoking the PRE model, some commentary in the Chinese press on the growing influence of special interest groups echoes Hellman’s theory. For instance, a widely-read op-ed in Caijing magazine written by a key economic adviser in the early years of reform, Wu Jingliang, sounded a stern warning about the growing clout of short-term winners:

In the beginning of reform, much of the initial resistance came from ideology but now it comes mainly from vested interests. Whereas early reforms were characterized by Pareto improvement so that state-owned monopolies and government departments have been enjoying the fruits of reform for a long time, further reforms will harm their interests. Pushing the reform of the state-owned monopolies and that of the political system means that the government will have
to reform itself. Consequently, reform has entered a more difficult battle and progress has slowed significantly (Wu, September 28 2009).

The topic of monopoly industry interest groups has also become a regular topic in official news sources. In October 2006, state-run Xinhua news agency ran a sharply-worded editorial entitled “Special Interest Groups are the Enemy of Social Harmony” which called on the government to break administrative monopolies (dapo longduan 打破垄断) in the interests of making public policy more aligned with the interests of ordinary citizens (Xinhua, October 5, 2006). In October 2009, the former editor of the Communist Party’s Renmin Ribao, Zhou Ruijin, published an article calling for the top leaders to “cut their ties to special interest groups” (Zhou, October 20, 2009). A striking feature of the Chinese commentary on special interest groups is that use of the term typically refers to clusters of power brokers with links to the so-called monopoly sectors.

Yet not all scholars of Chinese political economy see China’s transition in terms of partial reform. Naughton and Yang’s work, in particular, highlights the Party leaders’ autonomy, resilience and flexibility in guiding China’s transition. One of the themes consistently emphasized in Naughton’s work is the Chinese leadership’s solid will and political acumen in keeping reform on track in the face of formidable obstacles. Indeed, Naughton’s depiction of the arc of reform since the early 1990s is almost diametrically opposed to Pei’s account and comports much more with Przeworski’s image of reform as driven forward by insulated technocrats. In a partial rebuttal of Lau, Qian and Roland’s (2000) argument that Chinese transition was Pareto optimal, Naughton argues that “reform without losers” describes only the dynamics of policymaking in the Deng era when fragmentation among Party elites precluded the adoption of difficult reforms to the fiscal system as well as the state-owned, foreign and financial sectors (Naughton, 2008). After 1993, he suggests, the realignment of power at the top emboldened reformers in taking on these entrenched interest groups, especially the military, in a burst of “remarkably decisive and effective reform policymaking” (Naughton, 2008: 116). The contributions to Naughton and Yang’s co-edited volume, Holding China Together: Diversity and National Integration in the Post-Deng Era (2004), also underscore these themes of resilience and adaptation in reform policymaking since the 1990s. The papers together highlight the various ways in which the leadership employs an intricate system of positive incentives and checks and balances to discipline cadres and prevent interest groups from capturing the policymaking agenda.
2.2.3 A Critique of the Partial Reform Equilibrium Model

The empirical and theoretical backing for the PRE model that has emerged in both the CPE and China fields over the last decade—and waning scholarly interest in the JCM—has established partial reform as perhaps the pre-eminent theory of postcommunist reform. Yet, while the parsimony and innate plausibility of the PRE model makes it a powerful tool for analysts aiming to extract broad lessons from postcommunist transitions, the model stands up less well against the record of particular transition cases. As discussed, the PRE model has drawn support from statistical analysis which suggests that transition effects are not as damaging to democracies as Przeworski had thought. And formal modeling supports Hellman’s contention that special interests will exercise progressively less influence over policy outcomes as the number of veto players increases. Looking closely at reform politics in the critical case of Russia over the last decade, however, we see a striking departure from the expectations of the PRE model. The Russian anomaly calls into question the accuracy of Hellman’s image of transition politics and points up three shortcomings of this parsimonious model of economic reform.

First, the Russian case suggests that the PRE depiction of short-term winners in autocratic regimes as nearly omnipotent powers is worth consideration. Hellman’s characterization of “short-term winners” as the pivotal power-brokers in transition scenarios was largely patterned on the politics of economic reform in post-Soviet Russia under Yeltsin and this correspondence arguably contributed greatly to the prima facie appeal of Hellman’s article among transition scholars in the late 1990s. And yet, while the Russian oligarchs may have exercised veto over some domains of economic policy in the years of Yeltsin’s leadership, they have been largely restrained under Putin’s rule in the last decade. The 2003 arrest of Russia’s wealthiest man, Yukos head Mikhail Khodorovsky, an industrialist who gained control of the sprawling oil empire in the infamous “loans for shares” privatization scheme, was widely interpreted as Putin’s “declaration of war” against the oligarchs (Goldman, 2004: 33). Khodorovsky’s imprisonment for fraud and tax evasion and the subsequent nationalization of Yukos assets was undoubtedly linked to the oligarch’s mounting political aspirations which defied a July 2000 closed-door pledge the oligarchs were said to have made to Putin to stay out of politics (Goldman, 2004). Putin’s bold moves against Khodorovsky and the oligarchs—quintessential short-term winners—
is starkly at odds with the predictions of the PRE model. The surprising turn of events in Russia over the last decade suggests that the power and influence of short-term winners may in fact ebb and flow with the vagaries of leadership shifts.

Second, the neglect of institutions and process in the PRE model leaves the actual practice of politics in transitions scenarios under-theorized. In particular, there is little account of how short-term winners actually use their influence to secure their policy preferences, a process which Hellman characterizes vaguely as the exercise of “implicit veto power.” As Ganev (2001: 4) has argued, the PRE model “fails to specify the exact nature of the activities whereby winners vitiate attempts at further reforms: do they rely on regular political procedures, or other types of strategic interventions? What is it that makes their ‘veto’ effective?” To Ganev’s questions we might add another: how do organizational reforms, a matter of course in transition economies, affect short-term winners’ opportunities for influencing policy? Regarding the matter of institutional change, Malesky’s (2009) application of the PRE model to Vietnamese reform suggests that organizational reforms profoundly affect short-term winners’ opportunities for policy capture. He finds that gerrymandering in the Central Committee helped Vietnam’s authoritarian regime ‘escape’ an incipient partial reform equilibrium by reducing the influence of state sector interest groups on the policy agenda.

Third, the implicit definition of reform in the PRE model carries weighty normative assumptions about what constitutes appropriate policy choices. In Hellman’s account, “reform” is synonymous with the elements of the so-called Washington Consensus. The measures of reform employed in Hellman’s article are based on the World Bank’s nine components of what is “generally considered to constitute a comprehensive reform program”: privatization (large- and small-scale), enterprise restructuring, price liberalization, foreign trade liberalization, competition policy, banking reform, securities market reform and legal reform (Hellman, 1998: 223-4). Defining reform narrowly in terms of conformity with a single, highly contested, vision of the proper balance of states and markets conceals many alternative conceptions. Indeed, since 1978, self-described reformers in China have drawn eclectically from neoliberal policy prescriptions, the experience of neighbouring East Asian countries as well as pragmatic knowledge gained from local experimentation (Heilmann, 2008).
In this vein, Steinfeld’s (2006) critique of the partial reform approach in the China field argues that what some have seen as “paralysis” in economic reform is not primarily the result of particularist interests as PRE theorists would claim but instead reflects Chinese officials’ idiosyncratic but widely-held “market vision.” On the basis of hundreds of interviews with well-placed decisionmakers, Steinfeld concludes that officials tend to see the process of creative destruction among small, local firms as largely beneficial and appropriate, but place much less faith in the market selection mechanism for industries populated by large enterprises: “When such firms run into trouble, the conclusion is generally that something unrelated to the market has occurred, something that requires not the dissolution of the firm but rather a policy treatment” (Steinfeld, 2006: 482). In similar terms, Pearson (2005) argues that calibrating a state of “managed competition” (youxu jingzheng 有序竞争) among large, mostly state-owned enterprises is a bedrock norm of the regulatory institutions overseeing the commanding heights of the domestic economy. These works point to the salience of a factor omitted from the PRE model: policymakers’ preferences are shaped not only by their particularist interests but also by their beliefs about the nature of markets and appropriate forms of intervention therein.

2.2.4 A Historical Institutionalist View

To some degree, the preceding critique of partial reform is more appropriately directed at the rational choice ontology which informs the PRE model. This section outlines the salient aspects of a historical institutionalist ontology which informs this dissertation. This view of politics allows that actors’ material interests and policy preferences, elements foregrounded in the partial reform model, are indeed central features of political life. Yet HI ontology perceives a complex world that incorporates but is not limited to purposive political action. In the interests of brevity, the discussion here focuses on the salient differences between HI and rational choice ontology in terms of three key issues: the origin of institutions, institutional change and the nature of political agency.

The HI perspective on the origins of institutions differs sharply from the rationalist view embedded in the partial reform model. Hellman’s theory is grounded in a tradition of micro-foundational rational choice which treats the rules of the game structuring social, political and
economic interactions as endogenous, i.e. as generated by the players themselves, typically the most influential among them. Such rules are called institutions when “(nearly) everyone engages with one another according to particular patterns and procedures (nearly all the time)” (Shepsle, 2005: 26). Accordingly, in the PRE model, partial reform equilibriums are depicted as products of the preferences of a powerful minority of short-term winners who derive selective benefits under these institutions. In a point closely related to Ganev’s critique of the PRE model discussed previously, Pierson (2005: 45) has argued that a pitfall of this approach is the functionalist temptation to “impute a comfortable ‘fit’ between policy outcomes and structures of political interests” without actually demonstrating the link between cause and effect. Historical institutionalists tend to see the costs of the rationalists’ parsimonious theory of institutions as outweighing the benefits and aim at lower-hovering explanations of political phenomena. Against this rational-functional view of institutions, historical institutionalists seek institutional origins in the territory beyond the preferences of powerful actors: “rather than conceiving of institutions as ‘holding together’ a particular pattern of politics, historical institutionalists are more likely to reverse the causal arrows and argue that institutions emerge from and are sustained by features of the broader social and political context” (Thelen, 1999: 384).

The two schools’ divergent perspectives on the salience of history in the process of institutional change are also germane to this study. The PRE model belongs to a rationalist tradition that sits outside of history in regarding institutional change as a matter of mechanical switching between equilibrium orders (Thelen, 1999: 381). In this view, while particular institutional orders arise and decline with the changing cast of relevant players, the covering laws of politics producing these ephemera are seen as ontologically prior to the particularities of time and space. In this way, the scope of Hellman’s theory includes the set of all possible post-communist transitions in its ambit. Historical institutionalists challenge this claim and emphasize the importance of seeing “politics in time” (Pierson, 2004). The focus on sequencing and the slow accretion of new ideas and practices in Polanyi’s (1944) study of the construction of the self-regulating market exemplifies this approach. Besides studying slow-moving processes, historical institutionalists also draw attention to the path-dependent effects of swift breaks in

---

4 Of course, some rational institutionalists (e.g. North, 1990) take history much more seriously.
order, or critical junctures defined as “moments when substantial institutional change takes place thereby creating a ‘branching point’ from which historical development moves onto a new path” (Hall and Taylor, 1996: 242).\(^5\) While historical institutionalists acknowledge that purposive political action is often crucial in channeling outcomes in moments of institutional genesis, they also look to a world outside of actors’ preferences in explaining policy change. Blyth (2001), for example, emphasizes the salience of ideas—over and above their instrumental use by political actors—in moments of crisis. Pierson’s (2000) discussion of increasing returns has added substance to the concept of path-dependence by shedding light on how and why embryonic political changes that emerge from critical junctures can become locked-in over a relatively period of time.

Finally, the rationalist view of the bases of political action also differs from the historical institutionalist perspective. Rational choice accounts tend to characterize politics as a game comprised of actors’ strategic efforts to attain their preferences. In theory, these preferences could be derived from norms or other-regarding interests (Snidal, 2002: 75); however, in the field of comparative political economy, rational choice scholars typically read actors’ preferences off their putative material interests. Accordingly, the PRE model builds up from a claim about the policy preferences of short-term winners, i.e. for freezing partial reforms which maximize their selective benefits. While a majority of historical institutionalists would accept that politics is, in large measure, characterized by such instrumental behavior, they also tend to attach importance to norms and other non-rational bases of action. Indeed, March and Olson’s (1998) ontological middle ground of the “the logic of consequences” and the “logic of appropriateness” is home to a majority of historical institutionalists.\(^6\)

The view of political agency adopted in this thesis sees actors’ policy preferences as informed both by their material interests—here especially their interests in political advancement—as well as their beliefs about the essential nature of markets, their “market visions” to borrow Steinfeld’s felicitous phrase. As the following section argues, the post-

\(^5\) A recent contribution emphasizes that some critical junctures actually wither on the vine instead of moving history onto a new path (Capoccia and Kelemen, 2007).

\(^6\) Notably, Pierson (2004) takes a holistic view of agency and structure which sees individuals’ preferences and beliefs about causal relations as themselves generated by the forces of historical change.
Tiananmen order and rectification period constituted a critical juncture in the process of Chinese economic reform which served to lock-in a neoconservative market vision regarding the appropriate role of SOEs in the economy. In parallel to this neoconservative normative shift, change in the contours of elite politics coupled with an incremental process of regulatory reform has also left a deep imprint on state sector reform and the process of selective withdrawal. Chapter Three extends this line of argument by showing that the crystallization of neoconservative state sector policies over the 1990s was helped along by the logic of consequences, especially by elites’ interests in padding their patronage networks in the interests of political advancement.

### 2.3 A Critical Juncture in China’s Economic Transition: Tiananmen and Everything After

#### 2.3.1 The Neoconservatives’ Economic Legacy

While the Tiananmen uprising in spring 1989 is viewed by many if not most China scholars as a defining moment in Chinese politics after Mao’s death, the economic legacy of the conservative period of rule following Premier Zhao Ziyang’s ouster is less widely appreciated. Regarding the long-term political consequences of the Beijing Spring, Shirk (2007: 38-78) has argued that the Tiananmen uprising impressed upon the political elite the importance of three key lessons: prevent large-scale protests; avoid public leadership splits, and; maintain the military’s loyalty to the Chinese Communist Party (CCP). Yet, while the Tiananmen uprising is widely seen as a pivotal moment in establishing the rules of the game structuring both state-society relations and elite politics in the reform era, political economists have tended to see the economic significance of Tiananmen and the years of “order and rectification”（zhili zhengdun 治理整顿）as transitory, as no more than a brief pause in the process of reform and opening that was promptly revived with Deng’s Southern Tour in 1992. Naughton’s (1995: 273) assessment is

---

7 While the retrenchment drive gathered force in the conservative climate after Tiananmen, the beginning of the order and rectification period actually dates to September 1988, to the Third Plenum of the Thirteenth Central Committee. Amid spiraling inflation and concerns about official corruption, the leadership pledged “bring order to the economic environment, rectify the economic order and comprehensively deepen reform.”
typical of this view: “In the economic arena, Tiananmen did not mark a sustained shift to more conservative policies. Instead, it merely touched off one more cycle of retrenchment followed by renewed growth and reform.” Building from Huang’s (2008) work on the legacy of the post-Tiananmen period for private sector development this study finds that the neoconservative interregnum was in fact crucial in defining both the normative content and the methods of key state sector reforms over the last two decades. Of particular significance was a SOE-directed industrial policy regime which took shape under the conservative leadership of Premier Li Peng.

After the purge of Deng’s protégé, Premier Zhao Ziyang, in the wake of the Tiananmen uprising, Chen Yun’s ascendant faction moved swiftly to staunch Deng’s reformist policy line and enshrine a neoconservative economic orthodoxy premised on reasserting the state’s control of the market. Chen, Deng’s chief rival in the first decade of reform, espoused an economic vision that prioritized planning, central control and stability (see Table 2.1). While the hallmark of this post-Tiananmen period of retrenchment was a macroeconomic austerity program which aimed to dampen the high inflation of the late 1980s, the conservative leadership also devoted significant resources to strengthening beleaguered SOEs and revived central planning mechanisms to this end. Deng’s opponents had long been unhappy with reforms that encouraged investment to flow towards upstart township and village enterprises (TVEs) bringing increased competition to bear on large- and medium-sized SOEs (Fewsmith, 2008: 40-1). In an effort to fortify the state-owned “pillars” of the economy, the conservative leadership used policy levers to redirect investment towards SOEs with the result that the state sector’s share of fixed asset investment grew from 61% to 66% between 1988 and 1990 (Naughton, 1995: 277). In late 1989, amid a deep credit crunch, Premier Li Peng introduced a “double guarantee system” for 50 large SOEs which was subsequently extended to cover 234 of the country’s largest enterprises. The system guaranteed SOEs preferential access to scarce credit, energy, transportation and raw materials in exchange for a promise to deliver a set amount of goods, tax revenue and profits to the state (Fewsmith, 2008: 41). In this period, neoconservative policies also reversed some of the gains in enterprise autonomy that had been made over the course of the 1980s by bolstering the role of Party Committees in SOE decisionmaking under the slogan: “The management is the

---

8 In November 1989, the Fifth Plenary Session of the Thirteenth Central Committee formally endorsed Chen Yun’s economic thought and critiqued Zhao’s economic policies (Fewsmith, 2008: 38-39).
center and the Party committee is the core of enterprise management” (quoted in Naughton, 1995: 279).

**Table 2-1: Key Tenets of Dengism and Neoconservatism**

<table>
<thead>
<tr>
<th>Dengism</th>
<th>Neoconservatism</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Decentralization to localities and production unit （放权让利）</td>
<td>• SOEs as pillars: concern that SOEs’ weakness would compromise long-term economic growth, state strength and sovereignty</td>
</tr>
<tr>
<td>• Ownership Diversification: encouragement for growth of TVEs</td>
<td>• Large Enterprise Strategy: efforts to replicate Korea and Japan’s successes with picking winners</td>
</tr>
<tr>
<td>• Market competition: as economy “grew out of the plan”, SOEs exposed to competition with TVEs on the margin</td>
<td>• Economic nationalism: technonationalist industrial policy to promote autonomous innovation capacity; emphasis on creating state-controlled MNCs</td>
</tr>
<tr>
<td>• Opening: establishment of SEZs; foreign technology imports</td>
<td>Sources: Bachman (1986); Fewsmith (1995); Misra (2003); Shambaugh (2001)</td>
</tr>
</tbody>
</table>

Deng’s “Southern Tour” in January 1992 was the capstone of the pre-eminent leader’s effort to bring the order and rectification period to a close and reinvigorate the pathway of reform and opening. Deng’s speeches in Shenzhen, Zhuhai, Wuchang and Shanghai pointedly charged the “leftist” leadership with having betrayed the goals of reform and opening set out at the Third Plenum in 1978 (Fewsmith, 2008: 63). Tapping into local governments’ thirst for credit and their hopes of reviving the decentralist measures of the 1980s, Deng called on local officials to vigorously pursue high growth in their localities (Shih, 2008: 147). While the leftist leaders Li Peng, Yao Yilin and Deng Liqun initially mounted resistance against Deng’s efforts to wrest control of the economic agenda, Deng’s tactic of “playing to the provinces” ultimately successfully turned the tables on the neoconservatives (cf. Shirk, 1993). The Fourteenth Party Congress in October 1992 represented a dramatic victory for Deng. The Party Congress Report declared establishment of a “socialist market economy” the ultimate goal of reform and Deng’s faction secured a number of key politburo appointments (Fewsmith, 2008: 72). The effects of this policy turn were far-reaching and set off a new wave of reform which saw, in quick succession, creation of the Shenzhen stock market, establishment of approximately 8000 new
“developmental zones” and a foreign and domestic investment surge that drove double-digit growth after 1992 (Fewsmith, 1995: 643).

Although the Southern Tour proved to be a successful elite politics maneuver in the pitched battle between Chen Yun and Deng Xiaoping’s factions, the order and rectification period nevertheless left a deep imprint on the course of China’s post-Tiananmen reforms. Intellectual histories of the post-Tiananmen period suggest that neoconservative and neoauthoritarian thought, which pervaded officialdom after June 1989, did not fade from view with the fall of Chen’s faction and actually gained support among disparate groups of intellectuals who had for various reasons grown disenchanted with the Dengist vision of reform and opening (Fewsmith, 2008, 1995; Misra, 2003). An eclectic mix of socialist principles and developmental state-inspired industrial policies which took shape in the early 1990s was particularly influential in shaping the course of state sector reforms in the post-Tiananmen period. Misra’s (2003) work highlights the policy impact of widely-read leftist critiques of ownership reforms which had left the state sector with a dwindling share of output, a sign to some of an impending class crisis. These neoconservative critiques had comprised the theoretical backing of the “double guarantee system” and the central government’s various other preferential policies for large SOEs in the post-Tiananmen retrenchment. While Premier Li Peng’s neoconservative leadership elevated the notion that government should use the tools of industrial policy to make large SOEs strong pillars of the economy, as the following chapter will show in detail, this policy norm survived the Southern Tour and remains an important component of economic policy down to the present day. Similarly, prominent critics of Dengist decentralization drew inspiration from the East Asian developmental states in arguing that the state should combine centralized industrial policy with managed market forces to adjust China’s industrial structure (Fewsmith, 2008: 93-4). This market vision closely resembles the central government’s current approach to management of the SOE-dominated “lifeline industries” (mingmai hangye 命脉行业).

9 As Fewsmith (1995: 643) describes the post-Southern Tour: “however remarkable this new wave of reform and growth was, it did not put an end to neoconservative thinking. Indeed, to a great extent, it revived it by aggravating old problems and exposing new ones in the economy and polity. Corruption reached new heights as insiders made fortunes on real estate deals. Stock schemes similarly enriched the well connected while draining assets from state-owned firms.”
In the order and rectification period following the Tiananmen uprising, Chinese policymakers began experimenting with means of replicating the developmental states’ success with large enterprise groups. The following chapter details how Premier Li Peng championed experiments with developmental-state style industrial policies aimed at creating a “national team” of globally-competitive, state-controlled firms in strategic sectors (Nolan, 2001; Sutherland, 2003). In 1991, the State Council first selected a batch of state-owned large enterprise groups to form the national team and in 1997 the list was expanded to 120 enterprises across a range of strategic sectors (see Appendix 2). These enterprises were the beneficiaries of *inter alia* protectionist regulations which limited competition with domestic and foreign players; soft loan financing from state banks, and; government-coordinated and investment bank-executed corporate restructuring efforts and overseas IPOs. This privileged group of SOEs forms the nucleus of a group of highly profitable and influential centrally-owned enterprises overseen by the powerful SASAC bureaucracy.

Huang’s work highlights the significance of what he calls a SOE-directed “industrial policy blueprint” for private sector development in the reform period. In *Selling China: Foreign Direct Investment During the Reform Era* (2003), he argues that the prominence of Foreign Direct Investment (FDI) in China’s growth story was a function neither of technology transfer imperatives nor the desire to acquire management techniques from foreign corporations as economists have typically assumed. Rather, Huang suggests that Chinese entrepreneurs were drawn to establishing FIEs primarily because foreign businesses were one of the few sources of capital available in a financial system that channeled the majority of investment funds to the state sector. His more recent work builds on this argument and advances the controversial claim that, contrary to conventional wisdom, China has not been steadily shedding the command economy and transitioning to a non-state sector-led economy (Huang, 2008; Haggard and Huang, 2008). Looking at the development of the rural private sector after 1978, Huang argues that the apotheosis of private sector reform was actually in the 1980s, when government at all levels encouraged private entrepreneurs in rural areas to establish new businesses. In the period of neoconservative rule following Tiananmen, he argues, the pendulum swung decisively in the other direction as policymakers directed investment and credit away from the rural sector and toward SOEs in urban centers.
Toward the end of the 1990s, the neoconservative aim of restoring large SOEs as pillars of the domestic economy began to intermingle with the incipient strategy of a new generation of policymakers for dealing with China’s deepening integration with the world economy. As China’s GATT/WTO re-entry negotiations entered the final stages, central policymakers increasingly looked to industrial policy as a solution to the problem of “how to make a frail domestic industry capable to bear the shock of trade liberalization” (Marukawa, 2001: 32). Elites in the Jiang Zemin and Zhu Rongji administration laid particular emphasis on the role of the SOE national team in anchoring China’s core economic interests in the process of opening up. Typical of this view, Wu Bangguo, former Secretary of the Central Work Committee of Large Enterprises, declared in a 1998 speech that China’s “position in the international economic order will be to a large extent determined by the position of our nation’s large enterprises and groups” (quoted in Nolan, 2001: 17). As the following chapter describes in detail, the mid- and late-1990s saw the emergence of the “going forth” (zou chu qu 走出去) strategy which encouraged China’s large enterprises to invest overseas in the interests of securing access to natural resources and gaining international business experience. Finally, the 2003 establishment of a powerful new bureaucracy to oversee and guide China’s largest state-owned enterprises, the State Assets Supervision and Administration Commission (SASAC), added momentum to this policy when creation of 30-35 state-owned world class corporations was made one of its founding goals.

### 2.3.2 The Shifting Tides of Elite Politics

This section lends insight into elites’ embrace of the neoconservative SOE-directed industrial policy even after the Southern Tour revived the Dengist line of reform and opening. The argument advanced here is that in the post-Deng era leadership aspirants were more strongly incentivized to use policy tools at their disposal to solidify support from the most politically influential segments of Chinese society, not least among them the state sector. The key change comprising the political logic of state capitalism is that in the less ideologically polarized third and fourth generations of leadership, patron-clientelist ties have emerged as the primary means of holding together factional groupings.

Whereas factional ties in the Maoist period and the early years of reform were forged largely on the basis of elites’ professed allegiance to various policy lines, ideology has now
largely receded from the terrain of elite politics (Lam, 2006). The vicious, publicly-aired ideological attacks that defined the Cultural Revolution came to an end with the arrest of the Gang of Four but policy differences still divided the two most powerful factions of the 1980s. After Hua Guofeng’s ill-fated reign as Chairman of the CCP (1976-1981), supporters of fast-paced economic reform lined up behind Deng Xiaoping while moderates and conservatives tended to support Chen Yun. Since the retreat of the revolutionary elders from day-to-day politics in the late 1980s and early 1990s, the new generation of leaders has not, for the most part, staked their rule on particular policy platforms. Indeed, the long period of Jiang Zemin’s tenure as “core” leader (lingdao hexin 领导核心) from 1993 to 2003 was notable for the absence of a programmatic policy vision articulated from on high (Shambaugh, 2001) and seemed to signal that “programatism and technocracy” had fully displaced the “idealism and personality cult” which defined the first generation of CCP rule (Guo, 2006: 170). Unlike Mao and Deng who worked to burnish their policy doctrines throughout their rule, as core leader, Jiang preferred to play “triangular politics”, sometimes tilting towards reformer Zhu Rongji while backing conservative Li Peng at other times (Dittmer, 2003). In the current era, policy differences are said to divide the populist coalition (tuanpai 团派) associated with Hu Jintao and Wen Jiabao from the elitist coalition or the “princelings” (taizi dang 太子党) linked to Jiang Zemin, Zeng Qinghong as well as Hu’s heir apparent, Xi Jinping. Yet leaders’ biographic traits—especially the bureaucratic paths to power—and not their policy leanings are seen as the most salient criteria of coalitional membership (Li, 2008; Shih, 2008).

In the new game of elite politics, the relative importance of distributing patronage as a strategy of advancement seems to be on the rise. While the precise nature of the political elite’s exchange relations remains quite opaque, scholars of elite politics tend to see quid pro quo ties as an increasingly prominent feature of CCP politics in the new era of “technocratic rule” (Wu, 10

---

10 Jiang’s formal contribution to CCP doctrine is the “Three Represents” (san ge daibiao 三个代表) ideology which holds that the Party should represent China’s advanced production capacity, advanced culture and the interests of the “broad majority” of citizens. Official endorsement of the “Three Represents” on the occasion of Jiang’s retirement, at the Sixteenth Party Congress in 2003, was politically significant because it signaled that the CCP was formally abandoning its claim to be a Leninist vanguard of the proletariat. While adoption of “Three Represents” ushered in important changes such as the legitimation of private entrepreneurship, most analysts view Jiang’s effort as driven less by vision than by some Party leaders’ utilitarian interests in forging alliances with the beneficiaries of reform (e.g. Lewis and Xue, 2004).
Fewsmith (2001: 89) argues that the retreat of revolutionary legitimacy combined with faltering Party discipline has contributed to a “marked increase in the importance of personal power and personal ties.” Dittmer and Wu’s studies (1995, 2006) of the political business cycle (PBC) in the reform era point to a similar conclusion. The authors’ earlier work found that boom and bust cycles were related to factional competition between pro-growth and pro-stability groups in the early reform period. Their follow-up study suggests that while faction-driven PBCs survived into the Jiang period it was driven by quite different concerns: “There was still elite factionalism, but not on ideological grounds (as under Mao), nor on macro-policy grounds (as under Deng). Now factionalism was fueled by elites struggling for resources, prestige and power” (Liu and Dittmer, 2006: 9). Similarly, Shih’s (2008, 2006) work on the financial sector finds that crucial policy choices have been shaped strongly by top leaders’ interests in maintaining a hold on economic resources needed to maintain the allegiance of their networks of loyal officials.

Taking stock of evolution in the nature of factional competition is relevant to the present task because the nature of these changes suggest that policymakers have become progressively more beholden to politically influential segments of society over time. In the heightened struggle for resources, prestige and power, the top leaders now have a strong incentive to strengthen relations with clients who have a say in shaping their political future. In the Chinese political system, senior cadres with vice-ministerial rank or above comprise the most attractive set of potential clients for leadership hopefuls and traditionally provincial leaders and the ministerial elite have been the two most important blocs for elite patrons in the Standing Committee of the Politburo (Shih, 2008: 51). High-ranking officials in the ministries and regulatory bodies under the State Council are another important group for elite patrons because they control policy levers in key segments of the economy and, as Central Committee members, participate in the selection of Politburo members (Shih, 2008: 52). As discussed in the following section, the growing numbers of SOE bosses in the ranks of the Central Committee makes them an important client group in their own right. The addition of SOEs to the ranks of politically influential clients would suggest that elite patrons sensitive to their political standing would be less inclined to move against these increasingly important political players.
2.3.3 The Growing Clout of SOEs in the Crucible of Regulatory Reform

This section moves the argument from the domain of norms and elite politics to the arena of incremental institutional reform. If the post-Tiananmen neoconservative turn served to lock in the idea that large SOEs ought to be pillars of the Chinese economy, a series of sweeping regulatory reforms in the 1990s has significantly re-cast the politics of state sector reform, not least by raising the political status of large SOEs. The cumulative effect of these regulatory reforms is a much-debated issue in the field of Chinese political economy. On the one side, Yang (2004: 9) boldly declared that China’s regulatory reforms amount to no less than the “reconfiguration of the socialist state” in which the command economy bureaucracy was replaced with modern institutions integral to a well-functioning market economy. On the other side, a number of scholars contend that, under the cover of this neoliberal transformation, the Communist Party remains deeply embedded in all aspects of economic life (cf. Ferchen, 2008: 25-61). While the regulatory state literature has come to encompass a wide array of issues ranging from the government’s efforts to reign in corruption, to the changing role of the military in the economy, the focus here falls on the changing role of SOEs in policymaking and regulatory politics.

Much of the debate about China’s regulatory reforms has focused on contrasting interpretations of a sweeping reform of the central economic bureaucracy that began in earnest in March 1998 (Yang, 2004; Pearson, 2005, 2007). Shortly before reformer Zhu Rongji took over Li Peng’s post as premier, the National People’s Congress approved a State Council plan to reduce the total number of central government ministries from 40 to 29 and impose major cuts on government personnel which had expanded rapidly over the course of the 1980s and 1990s. While the expansive goals of this multifaceted reform, which took shape under Zhu’s lead, extended beyond the economic realm, the most controversial and boldest reform by far was the restructuring and administrative downgrading of the industrial line ministries. These ministries had overseen production in the Maoist era and, in the late 1990s, they still assumed ownership responsibilities for most of the largest SOEs which had been carved out of the ministries in the previous decade. Under the banner of “government enterprise separation” (zhengqi fenkai 政企分开), the reform aimed to drive a wedge between the central bureaucracy and the SOEs. Many economic ministries were unceremoniously stripped of their SOE ownership rights, downgraded
to bureau status and placed under the authority of the State Economic and Trade Commission which had been a Zhu stronghold in the 1990s when he served as Vice-Premier (Brødsgaard, 2002: 372). Zhu was supposed to have believed that striking out at the central bureaucracy was necessary to both leveling the economic playing field that still tipped towards state-backed players in key markets and also initiating the difficult process of SOE restructuring (gaizhi 改制) which would entail the professionalization of management and large-scale layoffs (Lan, 1999: 31).

While the central government had been continuously experimenting with reorganization of the administrative structure under the State Council since 1978, Figure 2.3 illustrates how dramatic the changes have been since 1998. In the last decade, authority over economic governance has flowed away from ministries and toward a mish-mash of central-level administrative bodies including amorphous “service organizations” (shiye danwei 事业单位), bureau-level bodies, ad hoc agencies under the control of the National Development and Reform Commission (NDRC) and even to central SOEs themselves (as in the case of aircraft manufacturing). While there is no debate about the significance of these changes, there is considerable disagreement as to whether these reforms have improved the quality of market regulation.
<table>
<thead>
<tr>
<th>Year</th>
<th>Aircraft Manufacturing</th>
<th>Banking</th>
<th>Chemicals</th>
<th>Petroleum</th>
<th>Coal</th>
<th>Power</th>
<th>Telecom</th>
<th>Electronics</th>
<th>Machinery</th>
<th>Airlines</th>
<th>Pharmaceuticals</th>
</tr>
</thead>
</table>

Sources: compiled by author
Yang (2004) has made the most upbeat claims about the implications of this sequence of administrative reforms. In his account of the critical period of the late 1990s, Premier Zhu Rongji’s reforms are characterized as having decisively turned the tide of reform by courageously taking on the increasingly corrupt and powerful beneficiaries of partial reform whom leaders in the Deng era had been happy to appease (e.g. Yang, 2004: 19-20). In Yang’s view, these reforms significantly strengthened the center’s economic governance capacity by centralizing rule-making authority in key industries. Centralization struck a blow at unchecked local protectionism and corruption, while simultaneously eliminating the fiefdoms that had built up around the powerful industrial line ministries (Yang, 2004: 38). He focuses especially on the significance of the rise of a new breed of regulatory institutions in the financial sector: the China Securities Regulatory Commission (CSRC), the China Banking Regulatory Commission (CBRC) and the China Insurance Regulatory Commission (CIRC). As ministerial-level (zhengbuji 正部级) special service organizations under the direct authority of the State Council, a new species as Figure 2.3 shows, Yang sees the establishment of these institutions as having significantly furthered the cause of impartial and professional regulation in the financial sector and beyond. Indeed, he views these organizations as the incipient foundations of an autonomous regulatory state: “With strong administrative muscle that is less beholden to local authorities, central state power can potentially be used to offer fair administration such as uniform registration for companies, protection for consumers, and production safety” (Yang, 2004: 108).

The 1998 reforms were vigorously opposed by powerful ministries. Lan (1999: 38) describes “former bureaucrats whose interests were sacrificed in the reform” as making “rampant complaints” and “looking forward to the expiration of [Zhu’s] term.” Burns outlines the tough choices leaders faced in meeting downsizing targets: “According to one official, many experienced division-level bureaucrats were sacked in his ministry, which undermined the ability of the ministry to function. New officials had to be trained to take over their duties, a process that took time and resulted in substantial delays and near paralysis in the summer of 2000. In another case, officials were asked to vote on which of their colleagues should be required to leave to achieve the targets. This resulted in the least competent (or popular?) colleagues leaving the organization” (Burns, 2003: 787).

One of the perceived advantages of the shiye danwei organizational form is that since they are not bound by the terms of the Civil Servants Law, they have more freedom in hiring and firing personnel which is thought to make them more an attractive draw for professionals from the private sector (Yang, 2004: 95; 09BJ0429). In addition, shiye danwei do not face the restrictive caps on personnel that ministries do. Appointments of the directors of these organizations also do not need the approval of the National People’s Congress (NPC) as is required of ministerial appointments (Pearson, 2005: 311).
In a series of articles examining these new regulatory institutions, Pearson presents an alternative interpretation. In a *World Politics* article, Pearson (2005) sized up regulatory practices in the so-called “economic lifeline” industries (*mingmai hangye* 命脉行业) including securities, banking, insurance, telecommunications, aviation and electric power and concluded that while the Zhu-era regulatory reforms had significantly altered the landscape of economic governance, they did not finally amount to a radical break with the past: “[T]he relationship between regulators, the rest of the state, and (though, to a lesser degree) the regulated firms remains bound in a Gordian knot” (Pearson, 2005: 27-8). Of particular relevance to this study is Pearson’s finding that the new breed of service organizations have struggled to establish a firm footing in the central government hierarchy. For instance, the securities regulator has had difficulty defending its turf against encroachments by the central bank since the CSRC’s inception in 1992 (Pearson, 2005: 311-2).

Pearson’s work (2007) also casts doubt on the true extent of “government-enterprise separation”, a key aspect of the administrative reform drive emphasized in Yang’s work. She finds that the central government’s effort to mold national champions in the lifeline industries has significantly colored the practice of regulation of markets in these industries. Her work also emphasizes the role that powerful central bureaucracies, including SASAC and the NDRC, play in these priority industries. As she writes: “Broadly speaking, the large state-owned firms in China’s lifeline industries are seen as too important to allow the party-state to stay at arm’s-length or to leave them in the charge of the newly formed regulators, much less to privatize” (Pearson, 2007: 724). Many of the themes explored in Pearson work are echoed in this dissertation.

The findings of other close observers of China’s regulatory system also call into question the claim that we are witness to the re-embedding of markets and rationalization of the structure of government. Yeo (2009) concludes that regulation in the telecommunications industry is heavily skewed towards the interests of producers (ie. the state-owned telecommunications service providers) due to an overarching emphasis on “maintaining and increasing the value of state assets” (baozhi zengzhi 保值增值). Downs’ research on the governance of China’s energy sector tells a story that is even more in tension with the regulatory state thesis. As Figure 2.3 shows, regulation of the coal, petroleum and power industries has been in almost constant
flux since the Ministry of Energy was dissolved in the early 1990s. Downs (2008: 42) characterizes the energy bureaucracy as in a condition of “policy paralysis” due largely to ceaseless turf battles between the various interested players. An example of this dysfunction is a fuel tax passed by the National People’s Congress in 1999 which has yet to be implemented because the various bureaucracies involved cannot agree on who should take responsibility for the 27,000 toll collectors who would be unemployed upon enactment of the tax (Downs, 2008). How can it be that regulation remains so fragmentary in such a vital sector of the economy? Downs argues that the interests of various powerful players, principally the energy SOEs and NDRC, are staunchly aligned against the unification of energy policy. Her analysis poses a deep challenge to Yang’s assertion that powerful interests in industry are being steadily brought to heel under rejuvenated central state power.

A number of scholars have drawn attention to the growing influence of large SOEs vis-à-vis government agencies and policymakers. Naughton (2008a) examines the complex interplay between SASAC and the large SOEs in its charge and finds that when SASAC pushes hard against the interests of these enterprises, as it has in the effort to harvest their dividends (to be discussed in Chapter Three), it “makes progress only slowly and tentatively, as it grinds against the formidable power of large, wealthy, and politically connected organizations” (Naughton, 2008a: 8). Drawing from Brødsgaard’s recent work on the political implications of business group formation, Walter and Howie (2010) discuss how the inclusion of the Chairman/CEOs of central SOEs on the Party’s central nomenklatura list acts as a considerable constraint on the authority of regulatory bodies in practice. In the wake of the 1998 reforms, as many high-ranking officials from the former ministries were grudgingly taking up leadership positions in SOEs, Premier Zhu Rongji made a significant concession by allowing many of them to retain their ministerial-level Party rank. Since several of the reconstituted service organization cum regulatory bodies had only a bureau-level rank at the time, the net result was a bizarre situation wherein many industry regulators did not have sufficient rank to directly engage the Chairmen and CEOs of the companies under their watch (Walter and Howie, 2010). Currently, of the approximately 120 SASAC SOEs, fully 54 of the bosses of these corporations enjoy full ministerial rank (Walter and Howie, 2010). While many of the new regulatory bodies have now been upgraded to full ministerial status in order to mitigate this rank problem, interviewees in Beijing described the high rank of SOE heads as a factor that continues to frustrate the impartial
enforcement of regulations. Scholar Wang Junhao (2008: 57) summarized the difficult predicament of regulatory bodies this way: "The cat wants to catch the mouse, but the mouse is bigger than the cat." Besides their high rank which confers considerable power vis-à-vis industry rule-makers, SOE CEOs also increasingly exercise power over the direction and substance of policymaking as members of the CCP elite; the Seventeenth Central Committee of the CCP includes an unprecedented seventeen SOE heads.\(^{13}\)

There is also evidence to suggest that the central SOEs power and influence has been effectively parlayed into regulatory capture in industries where SOEs are the commanding presence. Downs argues that the National Oil Companies (NOCs) are becoming progressively “more autonomous and less influenced by the party-state” (Downs, 2008a: 125). As an example of the power the NOCs wield vis-à-vis the fractious energy bureaucracy, she cites their influence in the NDRC’s decision to partially liberalize the domestic prices of gasoline and diesel which have traditionally been kept artificially low to stave off consumer unrest. In 2005, as the spiraling price of international crude oil vastly outpaced modest domestic price increases, thereby putting considerable downward pressure on NOCs’ profit margins, the companies began to use their considerable market power to pressure the central government to raise domestic prices. The NOCs most effective tactic was selling a portion of their diesel and gasoline products into international markets leading to widespread shortages at home. Outrage over the shortages combined with sustained lobbying by NOC bosses—three of whom are alternate members of the Central Committee—resulted in the NDRC’s capitulation in March 2006 when it raised domestic prices on petroleum products by 3-5% and by a further 10-11% in May of that year (Downs, 2008a: 130).\(^{14}\)

\(^{13}\) It is striking that another politically powerful industry, aircraft manufacturing, also shows the hollowing out of regulatory authority over the period of reform (see Figure 2.3). Like the oil & gas industry, aircraft manufacturing SOEs are well-represented on the Central Committee.

\(^{14}\) They are: Sinopec’s Su Shulin, China National Petroleum Group Company’s Jiang Jemin and Petrochina (Daqing Oilfield) Company’s Wang Yupu. The oil industry has long been a powerful presence in Chinese politics. In the 70s and 80s an elite “petroleum faction”, led by Vice Premier Yu Qiuli, formed a powerful bloc in the selectorate (cf. Downs, 2008a: 121). Though the processes of corporatization and regulatory reform have significantly altered the nature of the industry’s power, oil industry figures continue to occupy high positions at all levels of government. In the Sixteenth Central Committee, for example, fully four members of the Politburo (of a total 25) hailed from the oil industry.
2.4 Research Agenda

2.4.1 What are the Determinants of Selective Withdrawal?

In the regulatory state literature as in the Chinese political economy literature more broadly, scholarly perspectives are increasingly divided between two schools of thought. The first image views policymakers as relatively autonomous and committed to deepening and extending economic reforms including in the politically sensitive state sector. The second image sees the Communist Party as increasingly captive to the demands of short term winners who have profited from partial reforms in the state sector and elsewhere. This study focuses on one salient point of debate between the partial reform school and the autonomy school, namely: what factors are behind change in the industrial layout of the state-owned economy since the beginning of reform? In Pei’s (2006) view, the “selective withdrawal” of state ownership from various segments of the economy has been driven primarily by patronage considerations. Using a partial reform logic, he argues that the leadership has aggressively pursued liberalization and deregulation in low-rent sectors in which profits are distributed widely among a large number of producers, e.g. in agriculture, light industry and the consumer retail industry. Pei contends that opening these markets to non-state and foreign ownership was minimally costly to policymakers in terms of lost political patronage and foregone rents. He argues that sectors in which large profits are distributed among a small number of large enterprises have been largely protected both to avoid confronting powerful interests and also to lay claim to industry profits (Pei, 2006: 31).

Naughton counters that selective withdrawal or what he calls the “disarticulation” of government ownership has been shaped by many more factors than simply rent-seeking and patronage concerns. He suggests that while Pei’s hypothesis finds support in the liberalization of agriculture, it is less useful in explaining the early market opening of such high-rent sectors as the external sector (Naughton, 2008: 99). In Naughton’s view, the pattern of state retreat was shaped much more by contingency and exigency than Pei’s account allows:

In practice, the Chinese regime did not have the luxury of choice in determining which sectors to liberalize. Instead, politicians had to trade off costs and benefits in several dimensions in order to decide on selective opening. Was the sector in crisis? Were rents large and concentrated? Could the sector be detached from the
central plan without threatening the government’s strategic priorities? Would the opening foster autonomous groups that could challenge Communist rule? (Naughton, 2008: 99).

While Naughton and Pei have debated the likely determinants of this process, to date there has been little investigation of what factors are driving ownership reform across the state-owned economy.

This dissertation begins to address this important and complex question. Chapters Three and Four provide a bird’s eye perspective on selective withdrawal by, first, analyzing the various policies and initiatives that touch on the advance and retreat of state ownership and, second, detailing the most salient changes in the dimensions of the state-owned economy over the past two decades. While these chapters give a sense of the big picture, the core of the dissertation is a focused comparison of the reform pathways of two key industries (airlines and telecommunications) which found their way into the ranks of China’s SOE-dominated lifeline industries by very different routes.

2.4.2 Methodology

Given the lack of research on the topic of selective withdrawal, the dissertation combines theory-testing and exploratory research objectives (George and Bennett, 2005: 75; Yin, 1994: 3-5). While the case studies of telecommunications and airlines reform were selected to probe Hellman’s (1998) hypothesis about the salience of early-stage policy choices in shaping reform trajectories, the analysis remained open to other explanatory factors uncovered in the research process. In order to minimize the limitations of the semi-inductive case study approach employed here, the method of “structured, focused comparison” was employed in order to generate findings of relevance beyond the particulars of the two cases themselves.15 In order to facilitate comparison between cases, both studies were structured by chronological analyses of three elements of key theoretical significance: the impact of industrial policy, the features of

15 In George and Bennett’s (2005: 67) rendering: “The method is ‘structured’ in the sense that the researcher writes general questions that reflect the research objective and these questions are asked of each case under study to guide and standardize data collection, thereby making systematic comparison and cumulation of the findings of the cases possible. The method is ‘focused’ in that it deals only with certain aspects of the historical cases examined” (George and Bennett, 2005: 67).
regulatory reform and the nature of ownership reforms. Analyzing each case from these three perspectives allowed for conclusions to be drawn about the range of factors which have shaped the *de facto* and *de jure* rules on the role of state ownership in airlines and telecommunications over the reform era.

The historical institutionalist ontology which informs this study lends itself to the qualitative method of process tracing. As Hall has argued, accepting the premise that the social world is characterized by path dependence and equifinality means looking to methodological approaches which take history seriously:

If important political outcomes depend not on a few socioeconomic conditions but on complex chains of strategic interaction, they cannot be explained except by reference to that chain. If contemporary outcomes reflect the outermost tips of a branching tree of historical developments, allusion to one or two causal variables of putative importance will not constitute an adequate explanation for them. Accordingly, parsimony is no longer seen as a key feature of explanation in political science, and views about what constitutes an acceptable mode of explanation have shifted toward the historical (Hall, 2003: 387).

The method of process tracing “which attempts to trace the links between possible causes and observed outcomes” offers one such means of historical explanation (emphasis added, George and Bennett, 2005: 6). The historical explanations generated from process tracing differ from atheoretical historical description since the effort is to uncover the causal chain and causal mechanisms that connect independent variable(s) and the outcome of interest (George and Bennett, 2005: 206). The method entails rigorous examination of secondary sources, archival material, interviews and other data sources to ascertain the unfolding of politics in time (George and Bennett, 2005: 6).

### 2.4.3 Case Selection

The cases were selected in the interests of probing Hellman’s hypothesis about the significance of initial reform trajectories in shaping the contour of reform politics. The search was for one industry among China’s key sectors in which a tentative approach to reform was adopted after 1978 and another which had adopted a slate of comparatively comprehensive reforms from the outset. In order to maximize the comparability of the cases, the focus fell on sectors with some natural monopoly properties. To establish the universe of such cases, the work
of China’s foremost economist on the regulation of natural monopolies, Wang Junhao, was consulted. Wang (2008: 39-100) lists the following industries as having natural monopoly features: telecommunications, power, rail transport, airline transport, postal service, water and gas. After a preliminary review of the reform process in each of these industries, telecommunications and airlines were selected as the most appropriate cases for further study because of their high variance on initial reform trajectories. Largely due to the legacy of Cultural Revolution politics, decisionmakers in the airlines industry adopted a bold slate of reforms premised on decentralization and early government-enterprise separation. Telecommunications policy, by contrast, has remained more centralized and a measure of government-enterprise separation was achieved only after forceful interventions by the State Council in the 1990s.

2.4.4 Explanatory Variables

Listed below are six factors which the post-communist transitions and Chinese political economy literatures suggest ought to be important factors in shaping the selective withdrawal of state ownership. They are: initial reform trajectory, profitability, distribution of profits, political sensitivity, economic salience and policy signaling. These factors were used to structure the case study analyses and facilitate comparison between the two sectors.

2.4.4.1 Initial Reform Trajectory

As discussed, the primary case study selection criterion is derived from the partial reform model’s hypotheses about the longer-term consequences of early policy choices in transition economies. In Hellman’s rendering, early-stage partial reforms strongly predispose policymakers to adopt a more protectionist policy stance later on when short-term winners are well-placed to capture the policymaking agenda in order to prevent the diminution of their rent streams. He suggests that more comprehensive approaches taken early on are more easily deepened at a later stage because the accumulated rents accruing to short-term winners are much less than they would be under a partial reform scenario. Hellman’s cross-national regression analysis uses the European Bank for Reconstruction and Development’s (EBRD) indicators of nine different elements of the reform process to assess the degree of partial reforms in different countries. The nine measures are: privatization, enterprise restructuring, price liberalization, foreign trade liberalization, competition policy, banking reform, securities market reform and legal reform.
Since this dissertation uses a within-country, cross-industrial research design, several of these EBRD indicators drop out because they are constant across cases. This leaves the industry-specific indicators: 1.) price liberalization; 2.) enterprise restructuring (especially hardening of the budget constraints); 3.) privatization/ownership reform, and; 4.) international liberalization. According to the logic of partial reform, all else equal, an industry in which policymakers introduced more radical reforms in the early years of reform should now be a more open market than one in which a more cautious approach was taken at the outset.

2.4.4.2 Profitability

An explanatory variable offered by Pei’s (2006) analysis is the importance of industry profitability (“rents” in his account) in shaping reform pathways. The hypotheses are straightforward: we would expect relatively profitable industries to be characterized by the non-retreat of state ownership and less profitable industries to show a declining proportion of state ownership over time.

2.4.4.3 Distribution of Profits

Pei’s (2006) assertion that the distribution of rents affects the selective withdrawal process yields the following hypotheses: industries in which profits are distributed among a small number of market players will be characterized by a higher degree of state ownership, and; industries in which profits are distributed widely are more likely to exhibit the retreat of state ownership. In this study, the comparative market share of different firms and concentration ratios are used to assess the distribution of profits.

2.4.4.4 Political Sensitivity

There are two senses in which selective withdrawal may have been shaped by concerns about the sensitivity of particular industries. First, Chinese policymakers, like most government decision-makers worldwide, have been cautious about fully liberalizing sectors seen as crucial to national security. In China’s official policy statements explicating the logic of selective withdrawal, discussed in Chapter Three, the sensitivity of industries in this sense has been held up as the primary criterion in the reshaping of the state sector. As will be discussed in the next chapter, the government has pledged to maintain “absolute control” (juedui kongzhili 绝对控制...
in those industries most deeply related to national security (sheji dao guojia anquan 涉及到国家安全). Indeed, most countries impose foreign investment ceilings on the electricity, telecommunications, transportation and finance sectors suggesting that China’s limits on foreign participation in these sectors are more or less consistent with international practice. And yet applying such restrictions to the participation of non-state domestic investors in sensitive industries is not as typical. This leads us to the second sense in which an industry might be construed as politically sensitive in the Chinese context: the domestic liberalization and deregulation of certain industries may be seen by policymakers as contrary to the interests of the Communist Party as distinct from the interests of the Chinese state writ large. Kroeber (2006), for instance, has argued that the Party’s interest in stymieing the development of alternative bases of power in the political economy has been extremely important in the process of selective withdrawal. Contrary to the image of China as steadily rolling back the state-owned economy, Kroeber suggests that throughout the process of “dismantling” the command economy, the policymaking elite has always believed that “the party-state must remain in direct control of large chunks of the economy through ownership of dominant enterprises in strategic sectors” (Kroeber, 2006: 6).

2.4.4.5 Economic Salience

As Hsueh’s (2011) analysis of the role of FDI in different sectors of the Chinese economy argues, the perceived contribution of particular industries to China’s growth model may also have been a factor in shaping selective withdrawal. As discussed above, majority state ownership is common to all of China’s designated “lifeline” industries. As scholars of the developmental state would point out, in this regard China’s policy choices have not been all that unlike other late-developing East Asian countries where policymakers sought to maintain state control of key sectors, especially finance, in the early stages of rapid development (cf. Woo, 1999: 11-13). In addition to retaining tight control of the financial system, many developing and developed countries maintain state-owned monopolies in such public utilities as electricity, water, natural gas, sewage treatment and telephone service in view of the natural monopoly properties of these economic activities. Indeed, given the importance of modern infrastructure to building a market economy, policymakers may well judge that allowing the private sector to assume sole responsibility for development of these segments of the economy is simply too
risky. Thus, we would expect the government to exhibit a preference for maintaining a high degree of state ownership in key infrastructure industries with natural monopoly features; in sectors without a strong justification for continued state ownership, by contrast, we would expect a policy preference for withdrawal of state ownership.

2.4.4.6 Policy Signaling

This final variable differs in kind from the others because it draws attention to changes over time in the government’s priorities with respect to state sector reform. The suggestion here is that the central government’s increasing emphasis on creating a stable of globally competitive, state-controlled enterprises in the wake of the post-Tiananmen period of neoconservative rule has also imprinted the process of selective withdrawal. A number of scholars have analyzed the significance of the central government’s efforts to foster a “national team” of large business groups in key sectors that first took shape in the late 1980s and were prominent features of both the Fifteenth and Sixteenth Party Congress policy platforms (e.g. Nolan, 2001; Sutherland, 2003). To date, little attention has been paid to what impact these externally-oriented policies trumpeting the importance of SOEs “going big and going strong” （zuo da zuo qiang 做大做强） as well as their “going forth” （zou chu qu 走出去） may have had on the domestic reform pathways of key sectors. Yet, as we will see in the next chapter, encouraging SOEs to build up super-profits at home in order to finance their expansion abroad via the means of limiting competition in the domestic market has been a key, though mostly unstated, element of China’s strategy for facing up to the challenge of deepening integration with the world economy. The hypothesis about the link between macro-policy signals and industry-level policy is this: as central government macro-policy signals increasingly prioritized building up SOEs in key industries over the 1990s, economic policy in these industries also increasingly slanted toward the interests of large SOEs.

2.4.5 Fieldwork and Data Sources

Data gathering and fieldwork were conducted in a period of almost four years spent in China between January 2006 and July 2010. After a program of advanced academic language training at the Inter-University Program for Chinese Language Study at Tsinghua University in Beijing, the author was a Visiting Fellow at the Institute of World Economics and Politics at the
Chinese Academy of Social Sciences (IWEP-CASS) in Beijing between January 2008 and July 2009. With the support of IWEP-CASS faculty members, the majority of fieldwork for the dissertation was conducted in this period. In September 2009, the author returned to Renmin University as a Canada-China Scholars’ Exchange Program fellow. Between September 2009 and July 2010, the author held final interviews and conducted archival work at China’s National Library.

The most valuable data source used in this dissertation is a set of fifty interviews conducted by the author in China. Interviews were held with a wide range of knowledgeable informants including: officials in government ministries and regulatory bodies, government advisors, SOE managers, managers of non-state Chinese companies, academics, foreign businesspeople, scholars and journalists. These meetings were held between January 2008 and July 2010 and the most intensive period of interviewing was between March and July 2009. The majority of these interviews took place in Beijing though the author also took short research trips to Tianjin, Shanghai, Hangzhou (Zhejiang), Xi’an (Shaanxi) and Panjin (Liaoning). The interviews were solicited by means of the snowball method and cold-contacting. The interviews lasted for an average of one hour. These semi-structured interviews focused on informants’ perceptions of the factors that have shaped policy outcomes in the telecommunications and airlines industries as well as the state sector more broadly over the course of reform. Most of these interviews were conducted one-on-one though a small number were conducted with colleagues who shared research interests with the author. In the text, interviews are referenced by the date and city in which they took place and take the form “Year/City/Month/Day”, e.g. “09BJ1205” denotes that the interview took place on December 5th, 2009 in Beijing.

In addition to interviews, primary and secondary materials were also key sources of evidence for this dissertation. A range of documents and economic data were invaluable to analyzing the main features of ownership reform in the state sector (presented in the following chapters). Data from a wide range of annual Chinese industry yearbooks contributed greatly to the findings of this study. The statistics contained in these books published by the National Bureau of Statistics (NBS) and industrial ministries helped in identifying changes in ownership patterns in various industries over time and the summaries of policy innovations and notable events shed light on how government policy has evolved in key areas. Of course, there are
serious concerns about the reliability of official data and data triangulation is used to minimize the impact of data inaccuracy on the thesis findings (Holz, 2003). As a visiting fellow at Renmin University, the author had access to a number of excellent electronic Chinese statistical databases including: CEInet Statistics Database (zhongjingwang tongji shujuku 中经网统计数据库) which provides users with access to downloadable spreadsheets of monthly and annual Chinese government and OECD data; China Infobank (zhongguo zixunwang 中国资讯行) which covers national, provincial and city-level economic data from 1986 to present as well as data on Chinese listed companies and financial media reports, and; Wangfang Database (zhongwen shujuku 中文数据库) which provides access to a range of economic data.

Besides economic and policy data sources, the research was considerably strengthened by consulting the Chinese secondary literature as well as media coverage of state sector and industry reform. Several Beijing libraries provide access to influential government and party periodicals such as Decisionmaking (juece cankao 决策参考), Reform (gaige 改革) and Truth Seeking (qiushi 求实) which were useful in shedding light on high-level debates about the appropriate direction and pace of reform. In addition, consulting the voluminous academic literature in Chinese on reform in telecommunications and airlines was helpful in understanding the context of policymaking in these industries. Access to China Knowledge Resources Library (CNKI) (zhongguo zhishi ziyuan zongku 中国知识资源总库) made the process of collating these materials quick and straightforward. Finally, an internal government report was extremely helpful in providing insight into the “adjusting the layout of the state sector” policy line discussed in the subsequent chapter.

The use of archival material helped to flesh out the currents of policymaking at key junctures. In particular, the research benefited from consulting leaders’ personal memoirs. The most influential minister in the Ministry of Post and Telecommunications during the reform period, Wu Jichuan, has written an illuminating book called The Great Leap: Thirty Years of Reform in China’s Telecommunications Sector (dakuayue zhongguo dianxin sanshi chunqiu 大跨越—中国电信业三十春秋) that sheds new light on the factors which have shaped the initial reform strategy in this industry. Similarly, a remarkably plainspoken account of the beginnings of airlines reform written by the first minister of the Civil Aviation Administration of China in
the reform period, Shen Tu, provided key insight into the strong political currents at the outset of reform. A key figure in the airlines industry over the past decade, Li Jiaxiang’s (2008) *My Way: The Eight Strategies of China Towards Success* was also a very useful source. Additionally, former Premier Li Peng’s (2007) three volume diary of economic events *Markets and Control (shichang yu tiaokong 市场与调控)* shed light on the shifting priorities of state sector reform over the late 1980s and 1990s. Likewise, a recent book *Zhu Rongji Answers Journalists’ Questions (zhu rongji da jizhe wen 朱镕基答记者问)* (2009) which includes the full text of all interviews the former Premier held with members of the foreign and Chinese media between 1993 and 2002 was helpful in reconstructing the pressures bearing down on the Premier during the final phases of WTO negotiations in 1998.

### 2.5 Conclusion

This chapter has outlined a research agenda for addressing a key point of debate among scholars of Chinese political economy: namely, what is driving the selective withdrawal of state ownership from the Chinese economy? The core proposition outlined here and substantiated in the following empirical chapters is that the short-lived period of neoconservative rule in the wake of the 1989 Tiananmen uprising constituted a critical juncture in the unfolding of China’s state sector reform agenda and left a deep imprint on the process of selective withdrawal. The neoconservatives’ market vision of an economy dominated by a national team of large SOEs formed the ideological basis of an SOE-directed industrial policy regime that gained momentum over the decade of the 1990s and has become only increasingly prominent since SASAC’s establishment in 2003.

Subsequent chapters explore the ways in which efforts to nurture the national team have been driven forward by the force of mutually reinforcing economic and political logics. Chapter Three discusses the intellectual antecedents of the neoconservative market vision which drew inspiration from the developmental states and the tradition of Chandlerian economics in envisioning large enterprises as key drivers of growth and sources of innovation in late-developing economies (cf. Doremus et al., 1999). In addition to this economic logic, the SOE-directed industrial policy regime was also helped along by the political logic of patronage. Distributing policy benefits to the most powerful players in industry was advantageous for elites
interested in soldering their support from the most politically salient segment of the state-owned economy. Sluggish development of the government’s policy for guiding selective withdrawal also reflects the salience of this political logic which made commanding the retreat of SOEs from lucrative sectors politically unwise. The case study chapters show how these logics have shaped policy outcomes in the telecommunications and airlines sectors.
3 The Neoconservative Legacy and State Sector Reform

3.1 Introduction

This chapter analyzes the evolution of state sector reforms since the crucial post-Tiananmen “order and rectification” period. The central argument developed in this chapter is that neoconservative policy norms have left a deep imprint on the development of state sector reform priorities down to the present day. The neoconservative market vision of large, market-dominant SOEs in “lifeline” and “pillar” industries fueled the emergence of an industrial policy regime that gathered force over the 1990s and into the first decade of the new century. Dating from Li Peng’s tenure as Premier (1987-1998), centrally-coordinated industrial policy aimed at raising the domestic and international competitiveness of the country’s largest SOEs became a focal point of the state sector reform agenda (Nolan, 2001; Sutherland, 2003). While this period also saw the emergence of policies that portended a diminishing role for SOEs in the reforming economy, this chapter shows that rival policies tended to be developed less enthusiastically, and implemented less faithfully, than SOE-focused industrial policy initiatives. Indeed, the evidence suggests that one such key policy line, “Adjusting the Layout of the State-Owned Economy” (guoyou jingji buju tiaozheng fangzhen 国有经济布局调整方针) has been effectively crowded out by the state’s SOE industrial policy drive.

The chapter examines changes in both the institutional setting and policy content of state sector reforms. The first section analyses the evolution of China’s state asset management system which, in recent years, has become the site of intense struggle between the powerful and wealthy managers of national team SOEs and central government agencies. The chapter then traces the emergence and development of four key state sector reform policies that took shape over the 1990s. Complimentary economic and political logics help to explain the robust development of certain of these initiatives and the languishing of others. While neoconservative economic principles provided the normative backing for a new slate of SOE-directed industrial policy, Party elites’ enthusiastic embrace of industrial policies, even after Deng’s Southern Tour formally ended the neoconservative interregnum, is explainable in terms of their particularist
interests in bolstering patronage networks and broadening their power bases. The chapter concludes with a discussion of some of the prominent tensions within the mandate of SASAC, the central bureaucracy tasked with guidance and oversight of China’s national team. Since its establishment in 2003, SASAC has struggled to balance its dual responsibilities for maximizing the value of state assets and guiding the selective withdrawal of SOEs from the economy.

3.2 The Political Economy of State Asset Management Reform, 1978-2011

Among the greatest challenges faced by Chinese policymakers in the era of reform and opening has been transforming the industrial relics of the command economy into profit-oriented, efficient enterprises. While the manifest failures of various schemes designed to enhance enterprise autonomy undertaken in the 1980s and early 1990s paved the way for the large-scale privatization, or “letting go”, of unprofitable local SOEs under Premier Zhu Rongji, the state’s largest SOEs were spared and became the focus of renewed enterprise reform efforts which focused heavily on listing SOEs on overseas capital markets, principally Hong Kong (Walter and Howie, 2006). These large enterprise reforms have been a highwire balancing act: while the leadership has gone to great lengths to embed a profit-maximizing ethos within the members of the national team, they also endeavour to keep these enterprises tethered to the state, primarily through the mechanism of SOE Party Committees and the nomenklatura system (McNally, 2002).

3.2.1 The Command Economy System

Under the planned economy, the ownership and management rights of state assets were dispersed widely in a labyrinth of state agencies. In this complex system which combined political, social and economic goals, an SOE’s primary task was to fulfill the targets set by government and Party officials in a non-market environment. Decisions regarding enterprises’ production and investment activities were generally made by the economic and planning commissions housed in different levels of government. The appointment and dismissal of enterprise chief executives was the province of the Communist Party’s Organization Department and the government personnel bureau. The Ministry of Finance directly managed all aspects of enterprise finance and enterprise profits were deposited in government coffers and losses covered
by the state. Workers were assigned to enterprises by the offices of the Ministry of Labour. For its part, the SOE was responsible for meeting planned production targets in addition to providing cradle to grave “iron rice bowl” social services and providing political thought work through the all-important work unit (danwei 单位) (Wu, 2005: 140-141). In the reform era, carving out semi-autonomous SOEs from this warren of command economy institutions and assigning property rights compatible with the aims of a socialist market economy have proven immensely challenging (Steinfeld, 1998).

3.2.2 Early Experiments in the Separation of Ownership and Management

Local governments launched the first experiments in disentangling the ownership and management of state assets. In so doing, governments hoped to boost SOE efficiency and mitigate the myriad problems associated with the soft budget constraint on enterprises. Shenzhen was the first jurisdiction to formally separate the government’s ownership and management functions when the government established the Shenzhen Investment Management Company to supervise the city’s state assets in 1987. A 1988 act of the National People’s Congress (NPC) extended the experiment nationwide and brought the State Asset Management Bureau (SAMB) into existence (Zhang, 2006: 663). The Third Plenary session of the Fourteenth Central Committee (1993) laid the groundwork for a geographically differentiated system of oversight by clarifying the rights of different actors in the state sector. The session gave birth to a system of “unified state ownership with oversight exercised by different levels of government and independent enterprise operations” (Zhang, 2006: 663). In short order, a patchwork of state asset management authorities sprang up at the central, provincial, city, and township levels. Alongside these fledgling organizations, line ministries continued to exercise ownership rights over many industrial SOEs until 1998, when Premier Zhu Rongji’s bold administrative reform decisively severed the ministries’ ownership ties with industrial enterprises.

While these early reforms made strides in assigning rights and responsibilities to government agencies and SOEs in the nebulous state sector, the SAMB system was quickly

---

16 This discussion of state asset management reform draws from Zhang’s (2006) excellent account in 《Zhongguo Guoyou Qiye Gaige Bian Nianshi 中国国有企业改革编年史》.
mired in bureaucracy. While these newly-established state asset management bodies nominally assumed the state’s ownership interests in SOEs, since they were subordinate to powerful ministries in the structure of government, typically the Ministry of Finance, the exercise of this role was highly circumscribed in practice. The circuitous process of divesting state assets illustrates the point. Applications for ownership transfer of an SOE were vetted first by the supervising government department and only then turned over to SAMB for consideration (Zhang, 2006: 664). The manifest failings of this system led some policymakers to call for establishment of a new, wholly independent system to replace SAMB while others advocated turning ownership rights over to an existing government ministry. In 1998, conservative voices won out when the National People’s Congress abolished the SAMB and handed responsibilities for SOE oversight to the Ministry of Finance. This makeshift system quickly ran aground as SOE applications for restructuring routinely filtered upwards to the offices of the State Council, even occasionally winding up on the premier’s desk (Zhang, 2006: 664).

Premier Zhu Rongji’s 1997 “Getting SOEs out of Trouble in Three Years” Campaign effectively transferred responsibility for SOE reform to the State Economic and Trade Commission (SETC) in the period between SAMB’s demise and SASAC’s establishment in 2003. Taking a page from his earlier experience in tackling the SOE “triangular debt” problem in the early 1990s (discussed below), Premier Zhu’s strategy for pushing SOEs out of the red relied on the complicity of the state’s financial institutions, in particular the newly-established asset management companies (AMCs) and the state-owned commercial banks (Shih, 2008: 175-176). The SETC provided “recommendations” to the AMCs as to which SOEs were deserving of debt-for-equity swaps. Such administrative guidance was also used to encourage banks to increase disbursals of both technical innovation loans to SETC-vetted enterprises as well as close-ended loans to unprofitable SOEs (Shih, 2008: 175-176). On the face of it, Zhu’s campaign was a great success since the state sector’s share of industrial production jumped from 28% to 33% and SOE profitability surged between 1998 and 2000 (Lin, 2003: 75). Yet Lin (2003: 75) estimates that the total cost of the central government’s various means of boosting SOE profitability in this period was eight times greater than total state sector profits.

In parallel to these reforms, the process of restructuring the state’s largest SOEs and repackaging them for overseas stock market listings created a new cast of characters in the
management of the state’s most prized “national team” assets. With passage of the Company Law in 1994, SOEs were required to reorganize as corporations, either as limited liability companies (the choice of many smaller enterprises) or as joint-stock corporations, the path of most of China’s large SOEs. In the case of a number of favored SOEs in key sectors, officials killed two birds with one stone by organizing the Company Law-mandated restructuring around the goal of tapping overseas capital markets.\(^{17}\) The world’s leading investment banks were central figures in the wave of SOE restructurings cum “Red Chip” listings in Hong Kong in the 1990s (Walter and Howie, 2006: 85-109). Chart 3.1 shows how a traditional SOE’s productive assets would be carved off into a listed company and the non-productive assets plus pension obligations hived off in a group company (Walter and Howie, 2006: 100). The group companies were made the listed companies’ majority shareholders—many are in control of 80% or more of listed company stock—and collected a share of the listed companies’ profits commensurate with their ownership interests. Amazingly, prior to 2007, most of these group companies did not remit any profits to the state, a dubious legacy of the end of the SOE contract managerial responsibility system.\(^{18}\) Thus, these de facto and largely unaccountable owners of the state’s most valuable assets became, in one stroke, the most powerful players in the state sector. As discussed below, the central government is now fighting an uphill battle to establish leverage over these group companies and lay claim to a portion of their swelling profits.

**Figure 3-1: The Formation of SOE Group and Listed Companies**

<table>
<thead>
<tr>
<th>Pre-Restructuring SOE</th>
<th>Post-Restructuring SOE</th>
</tr>
</thead>
</table>

\(^{17}\) Former SCRE Minister Chen Jinhua records that one of the six points comprising the “guiding thoughts” about SOE restructuring in the early 1990s was “actively promoting China’s large enterprises listing in overseas stock markets” (Chen, 2005: 237).

\(^{18}\) The contract managerial responsibility system (chengbao jingying zerenzhi 承包经营责任制), introduced in 1983, was designed to promote SOE profit orientation. Under the system, enterprises negotiated long-term contracts directly with government bodies to apportion rights and responsibilities related to enterprise control and the division of profits. When the first round of contracts came up for renewal in the early 90s, many loss-making SOE managers had lost faith in a system that obliged them to make profits, while simultaneously commanding them to bear the burden of the government’s stability mandate. SOE managers opted overwhelmingly not to renew these contracts and the system fell into disuse.
3.2.3 Enter SASAC

The partial vacuum in authority left by SAMB’s demise served to strengthen the hand of reformers pushing for a robust and independent state asset management system. In the early 2000s, a modicum of consensus had formed around the need for a system free from ministerial interference; debate now focused on defining the particular role and powers of this new body. One group pushed for this new body to follow the model of state asset management adopted previously in Shenzhen, Shanghai and Inner Mongolia (Zhang, 2006: 665). In these locales, state asset management organizations possessed all the powers of public company shareholders: appointing upper management, collecting dividends and participating in major corporate decisions. An opposing group argued that the new body should be invested with only supervisory authority. Opinion was also split on the critical issue of who should bear primary responsibility for “maintaining and increasing the value of state assets” (baozhi zengzhi 保值增值), the new agency or the SOEs themselves. One view was that the government should use annual reviews of SOE economic performance to apply pressure on senior management. The opposing view was that baozhi zengzhi should remain the responsibility of the enterprises themselves in order to ensure a measure of autonomy from government. Another bone of contention concerned the assignment of ownership rights to different levels of government. One group pushed for the allocation of supervisory authority and ownership rights to different levels of government. Proponents argued that only making local governments solely responsible for SOEs would prevent their becoming chronically dependent on the central government for bailouts. Critics
countered that downloading property rights for weak SOEs could significantly dampen local development (Zhang, 2006: 665).

In the end, policymakers adopted a comparatively sweeping reform proposal. Immediately prior to the Sixteenth Party Congress in October 2002, the State Council Development Research Center with backing from the World Bank submitted a report advocating adoption of a geographically differentiated ownership system (fenji suoyou 分级所有). This model was subsequently adopted at the Sixteenth Party Congress which set out the broad framework of the new system: “the central and local governments separately fulfill the responsibilities of investor on behalf of the state and separately enjoy ownership interests.” In March 2003, the State Council passed a motion which established SASAC to “perform investor’s responsibilities, supervise and manage the state-owned assets of the enterprises under the supervision of the central government (excluding financial enterprises), and enhance the management of state-owned assets.” As a special commission under the direct authority of the State Council, SASAC was endowed with a unique administrative rank placing it nominally out of reach of the ministerial-rank organizations of the central government. The initial work in setting up the new expansive system focused on building the central-level bureaucracy which was given authority over an original 196 central SOEs. After central SASAC began operations in June 2003, the provincial- and municipal-level organizations began to appear in 2004 and 2005. Consistent with the principle of fenji suoyou, the local state asset commissions are quite autonomous from the center. They are enfolded in local government structures and are subject only to the “guidance and supervision” of central SASAC which is primarily exercised through annual meetings where the center relays policy priorities for the coming year.

Figure 3-2: State Asset Management Reform, 1978-2010
3.2.4 The Huijin Model

While SASAC assumed responsibility for many of the largest SOEs overseen by the central government, there are significant portions of the state-owned economy that remain beyond its range. Financial SOEs, principally the Big Four commercial banks along with a handful of state-owned securities companies, fall under a separate state asset oversight system that is seen by some as a superior system to SASAC. The Central Huijin Investment Company, often referred to as “financial SASAC” (jirong guozhiwei 金融国资委) in the press, was created in December 2003 to oversee the reform and stock-market listing of China’s state-owned commercial banks. Huijin was later absorbed by China’s sovereign wealth fund, China Investment Corporation (CIC). In preparing the banks’ initial public offerings (IPOs), Huijin injected US $45 billion of foreign exchange reserves into Bank of China (BOC) and China Construction Bank (CCB) and received equity stakes in return, making Huijin the banks’ major

Sources: Broadman (1999); Wu (2005: 139-141); Author
shareholder. Following the listing of these banks on the Shanghai and Hong Kong stock exchanges, Huijin has achieved impressive returns on these investments. A second key difference separating the two asset management bodies is that Huijin, which resembles Singapore’s esteemed Temasek Holding Company, has significant board representation within the banks. Thus, in contrast to SASAC, which contends with the powerful group companies for influence over the nominally state-owned listed companies, Huijin can credibly claim to be owner of the state’s financial assets. Indeed, some observers have argued that SOEs are held to account more effectively within the Huijin system (21 shiji jingji baodao, December 17 2008).

Beyond finance, the SASAC system also does not extend over the politically powerful rail SOEs and the state-owned tobacco industry.

3.2.5 Challenges and Tensions in the SASAC System

In comparison to Huijin, SASAC possesses few levers of influence over the SOEs in its bailiwick. At present, the commission’s key means of exerting influence over central SOEs are: appointment of upper management (in practice this responsibility is shared and, most often, led by the CCP Central Committee’s Organization Department); annual reviews of SOE economic performance, and; dispatching of supervisory panels to SOEs. As discussed below, annual reviews of SOE management have proven to be a useful tool for guiding SOE investment decisions but SASAC is severely hamstrung by the fact that while it has been tasked with fulfilling the role shareholder on behalf of the state, it does not actually hold shares which are controlled by group companies that sit at the apex of state-owned business groups. A number of local SASAC bodies, including Shanghai and Chongqing, have addressed this problem by establishing asset management companies and absorbing shares from the holding companies but central SASAC’s efforts to follow their lead have been plagued by dogged resistance from the holding companies and the central government’s own reservations about broadening central SASAC’s powers in such fashion (10BJ0702). Indeed, Walter and Howie (2011: 173-4) characterize the leadership of the national team as veto players in domains of economic policy that touch on their particular interests: “With access to huge cash flows, broad patronage systems and, in many cases, significant international networks, the senior executives of the National Champions can expect to succeed in lobbying the government for beneficial policies or even to set the policy agenda from the start.”
SASAC is currently striving to gain additional leverage over the SOEs in its charge. In June 2010, SASAC finally received approval from the State Council to set up its own asset company, Guoxin Asset Management Company, colloquially referred to as “CIC No. 2” (zhong tou er hao 中投二号). At the time of writing, Guoxin had only just set up shop and its precise role remained undefined, yet early indications are that this new company will not have property rights over the stars of the national team such as Sinopec and China Mobile. Instead, Guoxin will assume responsibility for a small group of central SOE stragglers destined for merger or bankruptcy in furtherance of SASAC’s aim of reducing the total number of enterprises in its ranks from the current 122 to 100 (Kang, December 22, 2010). SASAC has also worked to expand its influence in the boardroom through its role as overseer of the central SOEs’ establishment of corporate boards which satisfy the terms of the Company Law. As a government department, SASAC cannot dispatch its own officials to serve on the boards of these SOEs (as Huijin does), but the commission has established indirect control by arrogating responsibility for nomination of the external directors who typically account for five of nine total board members (shanghai guozi, July 16 2007). While central SASAC has made some considerable headway in establishing control in the arcane structure of ownership in China’s state sector, its authority over SOE groups is continually tested by the fact that, within the Party hierarchy, CEOs of the largest SOEs have the same ministerial-level administrative rank as SASAC’s most senior leaders.

In recent years, SASAC has been criticized for failing to constrain the rapid expansion of sprawling SOE business empires, a phenomenon fed by the group companies’ ballooning retained earnings. As mentioned above, most SOEs did not remit any after-tax profits to government between 1994 and 2007. This was a non-issue for several years after the demise of the profit contract system since the vast majority of SOEs were unprofitable in the 1990s; however, circumstances changed radically after restructured SOEs in key sectors including telecom, power, natural resources and energy began making windfall profits around the turn of the century. In the interests of wresting some of these profits for the state and gaining a measure of leverage over the increasingly powerful group companies, SASAC made an early push for establishment of a Capital Management Budget that would skim a portion of SOE profits. After arduous bargaining between SASAC, the Ministry of Finance and the Finance and Economics
Committee of the National People’s Congress, dividends were finally harvested from most central SOEs for the first time in 2007. Going into these talks, policymakers had hoped to extract 20% of SOE profits but the SOE holding companies successfully lobbied to set the rates much lower. In the end, eighteen enterprises, mostly from the natural resources sector, were required to remit 10% of their profits while the remaining ninety-nine enterprises paid just 5% and enterprises in military industries were granted three year exemptions (Naughton, 2008). The vast sums of cash in the unaccountable middle layer of the state sector are seen as having contributed to the routine overheating of the economy—the state sector’s rate of increase in fixed asset investment has hovered around 30% in the booms years between 2000 and 2008—and, perhaps more ominously, to the crowding out of the private sector in some industries, an issue explored later in the chapter.

Figure 3-3: Central SOE Profit Remittances


The SASAC system is generally seen as an improvement on China’s previous experiments with state asset management, but the expansive aims and growing ambitions of this body have also given rise to concerns about the potential for SASAC to become an obstacle standing in the way of deeper state sector reforms. Two examples of conflicting imperatives within SASAC’s broad mandate serve to illustrate the relevance of these concerns. In the first

19 At the time of writing, the issue of SOE dividends was again on the national agenda. The Ministry of Finance was leading a push to raise central SOEs’ remittance rates closer to the average rate of 20% remitted by local SOEs (jingji guancha bao, June 18 2010). SASAC Director, Li Rongrong, was said to be not firmly in support of raising existing rates, preferring that SOEs use retained earnings to build up their R&D capacity which generally remains quite weak in comparison to leading MNCs (10BJ0702).
place, responsibility for “maintaining and increasing the value of state assets” was finally placed in SASAC’s hands and now comprises one of its core responsibilities. If SASAC’s role had been strictly limited to acting as shareholder on behalf of the state, there would be little tension between this mandate and the central government’s interests in further liberalization of the state sector; promoting competition in “monopoly industries” (longduan hangye 垄断行业), and; strengthening market institutions such as the commercialized allocation of credit. Yet, as the case study chapters show, SASAC has also assumed certain de facto market regulatory powers in China’s fluid policymaking environment (e.g. Yeo, 2009; Mattlin, 2009). Critics argue that the intermingling of these roles gives SASAC both the incentive and the means to protect SOEs market share in profitable industries.20

The aim of maximizing the value of state assets also sits uneasily with SASAC’s responsibilities as the government agency with responsibility for guiding the selective withdrawal of state ownership from the Chinese economy. As discussed below, since 2003, SASAC has assumed primary responsibility for development and implementation of the “adjusting the layout of the state sector” policy which aims to gradually usher SOEs out of industries with a weak rationale for state ownership. In recent years, the commission has taken some tentative steps toward defining the industries in which the state ought to advance as well as those from which it should retreat, yet hard rules are not forthcoming. From SASAC’s perspective, the conundrum is that there are plenty of profits to be made in the so-called “competitive industries” where experts see little economic justification for maintaining a large proportion of state ownership. Indeed, at the time of writing, senior SASAC officials seemed to be backing away from earlier commitments to compelling SOEs to retreat from non-strategic industries (10BJ0702). The October 2009 comments of a senior SASAC official strongly hinted that the commission’s view of the terms of SOE retreat are changing: “Whether private enterprise or state-owned enterprise, the market is the real litmus test. Whoever can win the competition, no matter what kind of enterprise it is, should survive” (Kang, October 19, 2009).

20 For instance, prominent telecom expert, Kan Kaili (September 27, 2008), has argued that SASAC’s baozhi zengzhi mandate combined with its regulatory functions place it in a deep conflict of interest with Chinese consumers since its primary interests are in maximization of SOE revenue and not in the promotion of competition. In a speech at a forum on “The Price System and Monopoly Sector Reform” held at Beijing University in September 2008, Kan boldly called for SASAC’s immediate dissolution.
The dramatic reversal of fortunes in China’s state sector over the past decade has radically altered the contours of reform and given rise to new challenges. In the early days of reform, policymakers struggled to push SOEs out from the state’s embrace by assigning property rights and separating out enterprises’ management and ownership functions. Yet the leadership pushed only so far and early efforts to enshrine enterprise autonomy invariably ran aground on problems associated with Kornai’s soft budget constraint. A radical and paradoxical shift has taken place since then. Now the main problem faced by SASAC and other arms of the central government is that the members of the national team are only weakly tethered to the state. Indeed, as the preceding discussion has showed, the central government has quite limited leverage over SASAC SOEs. An understanding the new politics of state sector reform is, in turn, crucial to making sense of the uneven development of state sector reform priorities.

3.3 The Post-Tiananmen Development of State Sector Reform Priorities

This section analyzes the emergence and development of four key policies that have, to varying degrees, shaped the course of state sector reform since the critical period of the early nineties. The discussion emphasizes the high degree of intermingling between these policies and shows that China’s largest state-owned enterprises were beneficiaries of state sector reforms in this period. Although these reforms have dramatically reduced the overall size of the state-owned economy, developmental state-style policies which prioritized the development of globally-competitive state-controlled corporations have caused a major realignment of forces in China’s political economy. The combined legacy of these industrial policies has, in turn, frustrated efforts to rationalize the distribution of the state sector across industries under the banner of “adjusting the layout of the state sector”.

Figure 3-4: The Development of State Sector Reform Priorities (1991-)

3.3.1 The Large Enterprise Strategy

In the second decade of economic reform, a group of policy-oriented academics, government officials and industry leaders began to advocate using industrial policy to create a stable of large industrial groups on the model of Japan’s kereitsu and Korea’s chaebol. In the mid-1980s, with guidance from an influential policy economist, Ma Hong, the State Council Development Research Center (SCDRC) first began publishing research emphasizing the value of large industrial groups as engines of growth and sources of innovation (Sutherland, 2003: 44). In this early period, the first experiments in administrative construction of enterprise groups took shape in the auto sector as enterprise managers in the three largest automaker SOEs exchanged ideas with local and national policymakers about which institutional arrangements would best benefit their future development (Sutherland, 2003). In December 1987, the State Commission for Restructuring of the Economy (SCRE) and the State Economic Commission (SEC) jointly published the first major policy document on the subject, “Opinions on the Formation and
Development of Enterprise Groups.” The “Opinions” document decreed that enterprise groups would be “based on public ownership” and stated that they should become leaders in the “production of name brand quality products” (Zhang, 2006: 191). This first policy also defined the basic form of the enterprise groups which had at their center a “backbone enterprise” (gugan qiye 骨干企业) which would have at its core a scientific research unit with dense economic linkages extending out to other research and economic units (Zhang, 2006: 191).

The development of this incipient policy line was given a significant boost by Premier Li Peng’s ascent in the leadership ranks and the prevailing mood of neoconservatism in the post-Tiananmen “order and rectification” period. Although it is impossible to know just how state sector reforms might have proceeded had the reformist line not been interrupted following the events of June 4th 1989, the evidence suggests that calls to strengthen the state sector—emanating from both segments of the intelligentsia wary of rapid reform and the leadership itself—had a decisive impact on the approach taken to the urgent problem of SOE reform in this period. In late 1991, the Hong Kong newspaper Wen Wei Po quoted an unnamed “top level” State Council official as saying that the central government was extremely concerned that the state sector’s share of industrial production had fallen to 59% (Lam, 1995: 54-5). The official was reported to have said that since large and medium-sized SOEs anchored the public ownership system “this phenomenon is not only an economic but a major political problem” (Lam, 1995: 55). The flipside of mounting official concern about the state sector’s dwindling share of industrial production was growing worry about the political implications of wealth accruing to the non-state sector. Lam (1995: 96) reports that in this period “Premier Li Peng and other party elders issued internal documents warning that many dissidents had gone into business in the coastal economic zones—and that they were biding their time for a second democracy movement.”

---

21 Chen Jinhua’s (2005) memoir sheds light on how the ownership question became enfolded in debate about the appropriate role of market and plan in a “socialist market economy with Chinese characteristics” in the run up to the Fourteenth Party Congress in 1992. As the newly-minted minister of SCRE, Chen took a leading role in these debates. On the issue of public ownership and market mechanisms Chen’s conclusion was that while “market economy has a certain relationship to ownership, it is not absolute. Different forms of ownership can use the market as a means of developing and expanding their intended systems of ownership” (Chen, 2005: 251). The memoir also relates an anecdote about a Margaret Thatcher visit to China in 1991 during which she argued with Jiang Zemin and Zhu Rongji about the particular requirements of a market economy. To Chen, Thatcher’s insistence that privatization was a precondition of a market economy seemed too narrowly based on her own experience as British prime minister and lacked “worldly and historical vision” (Chen, 2005: 247).
Officials’ concerns about the perilous political consequences of the declining share of the state sector and burgeoning private enterprise prescribed a cautious approach to fixing the state sector, a perennial problem which had reached crisis proportions in the early 1990s. In 1991, approximately 37% of SOEs were in the red and total losses topped 87 million RMB (Lam, 1995: 71). Adding in state sector subsidies of 56 billion RMB, some commentators joked that shuttering the state sector altogether would yield savings of 13 billion a year since SOEs were expected to contribute no more than 127 billion in profit and tax payments (Lam, 1995: 71).

While these numbers were alarming, by far the more worrisome development was “triangular debt” in the state sector which totaled 300 billion RMB or 16% of GDP in 1991 (Lin, 2003: 55; Shih, 2008: 145). In another political context, the leadership might have seriously entertained the possibility of “Big Bang” privatization at this juncture but, as it was, the instincts of Li and the neoconservatives prevailed.

The leadership’s SOE reform agenda, summarized in a presentation by Premier Li Peng to the Central Work Conference in September 1991 (see Appendix 1) aimed primarily at the short-term goal of propping up the ailing state sector. The leadership pledged to: extend the “double guarantee” for SOEs (under which they were accorded priority access to bank loans and materials); subsidize their technological upgrading; adjust interest rates, and; reduce the tax rate to 33%. Tasked with solving triangular debt, new Vice Premier Zhu Rongji’s “politically and economically savvy” solution was to lean on the banks to disburse loans of almost 80 billion RMB to the most heavily indebted enterprises who were, in turn, ordered to repay their debts to other SOEs, a method which succeeded in erasing 380 million RMB in debt (Shih, 2008: 146). Shih (2008: 146) points out that while Zhu’s solution earned him accolades within the Party, the costs of this approach were ultimately borne by the financial sector since the banks were further exposed to the weakest performers in the state sector.

Premier Li Peng astutely paved the way for adoption of the large enterprise strategy by tacking it on to the 1991 SOE reform agenda. As Director of SCRE between 1988 and 1990, Li had overseen the development of large enterprise policy after publication of the 1987 “Opinions” document and he moved to substantially broaden the scope of the group company experiments when his power was at its peak during the conservative period preceding Deng’s Southern Tour. Li’s diary records a high-level January 1991 meeting in which the assembled agreed that “in
order to increase the competitiveness of SOEs”, SCRE, the State Planning Commission (SPC) and the Production Committee would jointly select one-hundred SOEs enterprises to serve as pilot enterprise groups (Li, 2007: 796-7). The meeting participants agreed that pilot enterprises should be granted broad foreign trade rights and have ready access to preferential loans (Li, 2007: 796-7). In the above-mentioned report given to the Central Work Conference in September 1991, item number ten on the SOE reform agenda reads: “Further improve work on the large enterprise group pilot project. Now we have established 55 compact enterprise groups. After we gain experience the pilot group can be further expanded.” (Appendix 2). In 1997 the ranks of the incipient “national team” expanded to 120 with the addition of 63 enterprise groups. After the 1997 additions, a number of industries were represented by several pilot enterprises including electronics (ten), steel (eight), autos (six) and chemicals (seven). In picking multiple winners in key industries, policymakers had apparently been influenced by the views of the leaders of the influential Association for the Promotion of Business Groups who had travelled to Japan and South Korea to study how to promote oligopolistic competition between business groups (Sutherland, 2003: 49).

In the 1990s, pilot enterprises were the beneficiaries of various forms of industrial policy. Nolan (2001: 18) notes that most important of these were the diverse policy measures that served to minimize and channel the participation of foreign firms in priority industries. Pilot enterprises benefited from the protections afforded by higher-than-average tariff structures as well as an array of non-tariff barriers including rules that limited foreign competitors’ access to domestic supply chains; technology transfer requirements, and; regulations obliging foreign firms to establish joint ventures with Chinese partner companies. Pilot enterprises also enjoyed a greater degree of enterprise autonomy than most SOEs in this period. In contrast to non-targeted SOEs,

---

22 While the pilot enterprises were granted especially broad rights over business decisions, in the early 1990s the expansion of state-owned enterprise autonomy was a major policy priority. After Deng’s Southern Tour helped to bring the conservative period to a close, in 1992, a series of linked reforms were introduced which aimed to push SOEs to adapt to an increasingly competitive domestic marketplace. In 1992-1993, the liberalization of prices accelerated rapidly and by year-end 1992, state-set pricing applied to just 89 of an original 737 industrial goods and transport prices covered under the plan (cited in Yusuf et al, 2006: 70). It was also in this period that accounting reforms were introduced to replace the existing Soviet-style system. In 1992, a State Council document affirmed managers’ decision-making authority in such key areas as employment, the setting of output prices and the distribution of salaries and bonuses. After the promulgation of what was colloquially known as the “bill of rights” for SOEs, notable advances were made in the flexibilization of the labor market in 1992 and 1993 (Naughton, 1996: 295-298).
where business decisions were still strongly shaped by the priorities of various government bodies, pilot enterprises were granted broad autonomy over investment decisions, export and imports. They were also permitted to retain their profits before many other enterprises (Nolan, 2001: 19). Finally, members of the national team were provided with major financial supports from the state. Pilot enterprises were guaranteed capital funding through state plans which was disbursed primarily though soft loans provided by China Development Bank and the state-owned commercial banks, with whom most pilot enterprises had formal agreements designating one of them as its “lead bank” (zhū bān yìngháng 主办银行) (Yu, 1998: 4). Among the commercial banks, China Construction Bank (CCB) was most strongly associated with the large enterprise policy line. Nolan (2001: 19) reports that CCB had 500 branches based in large enterprises which provided management with financial consultation and ready financing options.

By the time Zhu Rongji replaced Li Peng as Premier in 1998, the large enterprise policy, in its formal guise, had already begun to fade from view. Yet the tenets of this policy continue to exert a strong influence on state sector reform down to the present day. While the 1997 additions to the national team mark the last significant development in this policy line, it did not disappear from national policymaking; instead, the aims of the policy were absorbed into the “grab the large, let go the small” and “going forth” policies discussed below. Indeed, as China’s WTO negotiations entered the final stages in the late 90s, elite pronouncements placed steadily greater emphasis on the pivotal role of large enterprises in China’s internationalizing economy. In a 1998 speech, for example, Wu Bangguo, then Secretary of the Central Work Committee of Large Enterprises, declared that China’s “position in the international economic order will be to a large extent determined by the position of our nation’s large enterprises and groups” (quoted in Nolan, 2003: 17).

Traces of the large enterprise policy line have also become evident in SASAC policy. At the time of establishment in 2003, SASAC was tasked with creating between thirty and fifty globally competitive enterprises by the year 2010 and SASAC’s first Director, Li Rongrong, consistently emphasized the importance of SOEs “going big and going strong” (zuo da zuo qiang 做大做强) in order to compete with global companies. In the introduction to his co-edited volume, *Mergers and Acquisitions: The Only Way for Enterprise Development* (2004), Li argued that promoting consolidation in key sectors of the economy in the interests of creating first-class
large enterprises would be crucial to Chinese companies finding a place in the global marketplace characterized by oligopolistic competition between global firms.

3.3.2 Grab the Large, Let Go the Small

In the early 90s, as Premier Li Peng was heading development of large enterprise policy, the outlines of the controversial “grab the large, let go the small” (zhua da fang xiao 抓大放小) policy were taking shape under the guiding hand of then-Vice Premier Zhu Rongji. Zhu first tabled his ideas for the rationalization of state ownership at the Third Plenum of the Fourteenth Central Committee in November 1993; his proposal was subsequently accepted by the leadership at the Fifth Plenum of the Fourteenth Central Committee in 1995 (Lin, 2008: 61). “Letting go” meant, in effect, giving the green light to provincial and local governments eager to sell off burdensome loss-making SOEs that were a perennial drain on local fiscal resources. In the latter half of 1995, township governments began the vigorous privatization of small and medium-sized SOEs by various means including bankruptcy, merger, direct sale and leasing (Wu, 2005: 196). The consequences of letting go were quick and far-reaching. In 1998 alone, approximately 20 million jobs were cut from the state sector and a further 30 million had been lost by mid-2003 (Yusuf et al, 2006: 79). Between 1997 and 2002, the state sector’s share of urban employment declined from 53% to 29% and non-state sector employment surged from 33% to 67% (Wu, 2005: 199).

The strongest popular associations with this controversial policy are with the massive social dislocation and corruption stemming from “letting go.” Only a small portion of laid-off SOE employees benefited from enterprise-based unemployment insurance schemes. And in the process of this hasty divestment, insider privatization emerged as a serious problem. Ding (2000: 1) estimates that, in the early 90s, theft of state assets (guoyou zichan liushi 国有资产流失) ranged between $US 6 and 12 billion each year. While the most dramatic downsizing of the state sector took place during Zhu’s tenure as Premier (1998-2003), the loss of state assets remains a major subject of social commentary and has become especially heated since the Ministry of
Finance authorized management buy-outs (MBOs) of SOEs for a brief period in 2002.\(^\text{23}\) In a widely-read report, Chinese University of Hong Kong finance professor, Larry Lang alleged that top managers in some of China’s most famous companies including Greencool, TCL and Haier had engaged in state asset-stripping via shady MBO methods and the illicit expansion of share holdings.

Two key considerations underpinned the “grabbing the large” side of the policy which stands for protecting the state’s most valuable assets in large SOEs. First, China’s industrial concentration ratios in many key industries lagged far behind most other countries. Under the planned economy, factories had been the endpoints of an administrative hierarchy that extended over the entire country, meaning that local operations tended to be excessively small in scale. Yusuf et al. (2006: 92) found that in 1988 the top 18 to 100 firms accounted for more than 60% of output in only 13% of China’s industrial sectors. Down to the present day, key capital-intensive industries such as steel are still only very loosely organized. In 2007, China’s top ten steel firms produced just 37% of total output (Zhu, January 22 2009). This problematic industrial organization has hindered economies of scale and has also contributed to environmental degradation because managers of small-scale factories tend to select cheap, polluting technologies. Second, “grabbing the large” dovetailed with the aims of the large enterprise strategy championed by Premier Li. In the Fourth Plenary Session of the Eighth National People’s Congress held in March 1996, the government specified the terms of “grabbing the large” in a document stating that the state would thereafter focus on transforming the 1000 largest state-owned enterprises into the “core of a modern enterprise system” (Xia, 1999: 4). And as the text of the Fourth Plenary Session of the Fifteenth Central Committee’s *Decision on Some Problems in SOE Reform and Development* makes clear, a primary goal of “grabbing the large” is cementing the pivotal role of large SOEs in domestic and international markets. The Decision includes the aim of making large enterprises into “pillars of the national economy and the main strength in China’s participation in international competition.” Because of its momentous social

\(^{23}\) In 2008, a novel was published on this subject to popular acclaim. Ji Xun’s *SASAC Director《Guozwei Zhuren; 国资委主任》* tells the story of two brothers who make a fortune by stripping assets from their town’s state-owned textile factory. The elder brother uses his position as head of the textile SOE to funnel cash into a private enterprise set-up by the younger brother. The private enterprise then quickly imperializes all the town’s industries. The hero of the novel, the township-level SASAC director, is tasked with recovering the state’s assets.
and economic impact, “grab the large, let go the small” is probably the most derided reform undertaken since 1978 and helps to explain why Premier Zhu was a one-term premier. Indeed, the Hu-Wen administration’s emphasis on building a harmonious society (hexie shehui 和谐社会) is in part a reflection of the leadership’s effort to distance itself from this widely unpopular policy.

3.3.3 The ‘Going Forth’ Strategy

The “going forth” policy is closely associated with former core leader Jiang Zemin though it has only become a prominent feature of government policy since the Sixteenth Party Congress in 2002. Over the course of his time as Party Secretary-General, Jiang’s speeches placed increasing emphasis on the twin concepts of “bringing in” (yin jin lai 引进来) and “going forth” （走出去 zou chu qu）which are now the pillars of China’s strategy for facing deepening economic integration. Whereas “bringing in”—absorbing cutting-edge technology and management practices from foreign enterprises—has been a prominent feature of China’s transition strategy from the outset, the policy provenance of “going forth” is linked with Jiang’s time as Party leader and head of state (1993-2002).

From the first, the “going forth” strategy was linked with policymakers’ interest in satisfying China’s growing demand for natural resources. An extended trip to Africa in 1996, left Jiang deeply impressed with the continent’s abundant natural resources and the many opportunities for China (Chen, 2009: 63). From this point forward his speeches made frequent reference to the importance of enterprises “going forth” into global markets. In a January 2000 Politburo meeting, in an atmosphere of widespread uncertainty and anxiety about China’s imminent WTO entry, Jiang explicated the links between yin jin lai, zou chu qu and China’s fate in the globalizing economy:

In the last 20 years, we have focused on “bringing in”. We have taken in foreign capital, technology, human capital and management experience and this was completely necessary. If we had not first “brought in”, it would be difficult to improve our products, technology and management ability; had we wanted to go forth, we would not have been able. The situation now is much different than twenty years ago. Our economic level has increased greatly so that we should, and possess the means, to go forth. It is only if we bravely go forth that we will be able to remedy our resource shortages and insufficient domestic market. Only if
we go forth will we be able to introduce our technology, equipment and goods into foreign markets; this, in turn, will allow us to bring in new technologies and develop new products at home. Only this way will be able to gradually shape our own multinational companies and better participate in international competition. Only in this way will be able to promote the economic development of developing countries; combat hegemonism and power politics, and; protect world peace (quoted in Chen, 2009: 64).

While Jiang nurtured the going forth strategy, it was only in the Hu-Wen era that it came to be official policy. The Sixteenth Party Congress report describes going forth as a “major new action in the new phase of China’s opening” and the phrase is also prominent in the report of the Seventeenth Party Congress.

Over the past decade, the central government has developed an impressive range of policies to support large enterprises’ “going forth” into overseas markets. Most importantly, the central government has steadily relaxed control over enterprises’ overseas investment decisions. At the beginning of China’s reform and opening process, only state-owned trading corporations and technological cooperation enterprises had foreign investment rights and the State Council reviewed each and every overseas direct investment (ODI) application (Zhang, 2005: 6). Over the 1980s and 1990s, the these restrictions were gradually loosened and a 2004 State Council document formalized the shift in the government’s role from approval to supervision of overseas investment (Zhang, 2005: 7). Since the Sixteenth Party Congress, various levels of government have unveiled policies to promote overseas investment including: soft loans for financing on key projects; simplified approval procedures; looser capital controls, and; information and guidance on investment destinations in the Ministry of Commerce’s Guidelines for Investment in Overseas Countries’ Industries (Zhang, 2005: 7-9). Results of an annual survey of Chinese companies’ overseas investment intentions underscores the significance of the state’s “going forth” policy in shaping ODI decision-making in Chinese enterprises. The 2009 survey covering 1104 Chinese companies reveals that capitalizing on “going forth” policy-related incentives was a main driver of investment for nearly 40% of respondents, making it the most-cited reason companies had for investing overseas (Asia Pacific Foundation of Canada, 2009: 10).

A key argument advanced in this study is that the increasing emphasis placed on positioning Chinese enterprises—principally large SOEs—in global markets has left a deep imprint on the practice of domestic regulation. As aspirants in the Communist Party hierarchy,
industry regulators are highly sensitive to policy signals that emanate from on high and have a strong incentive to nudge rulemaking and enforcement in ways that comport with the center’s stated priorities. One intriguing excerpt from the official Annual Report on the Development of China’s Large Groups lends support to the notion that industry regulators are tacitly and often overtly encouraged to consider the impact of rules on the revenue intake of the national team SOEs:

In order to create large-scale operations in a short period of time, the state must aggregate its resources and make large-scale investments in priority industries. At the same time, the state should limit the entry of foreign enterprises for a period of time, in order to provide domestic enterprises with a protective buffer zone behind which they can develop. The state should also limit market-entry in the domestic market so as to prevent excessive competition; this will allow enterprises to make profits. In the process of expanding into the international market, Chinese enterprises will be able to use these super-profits earned in the domestic market to subsidize losses abroad. In this way, Chinese enterprises will be able to establish a base in international markets (ZGDQYJTNDFZBG, 2007: 73).

As the subsequent case studies of telecommunications and airlines policy will show, preventing “excessive competition” is a bedrock norm in both the telecommunications and airlines industries even after repeated efforts to enforce a rigid separation between government bodies and enterprises in these sectors. And “super-profitability” certainly describes circumstances in most of the so-called monopoly sectors in recent years. The case studies will draw out the links between the industrial policy regime that has grown up around the national team of SOEs and the practice of market regulation in key industries in recent years.

3.3.4 Adjusting the Layout of the State Sector

Another important policy line dating from the nineties has received much less attention in the English-language literature. For this reason and also since this policy line contains the principles that are putatively guiding the state’s selective withdrawal, the next pages trace its development at much closer range. “Adjusting the layout of the state sector” (guoyou jingji buju tiaozheng 国有经济布局调整) is the effort to define which industries ought to retain a high proportion of state ownership and those which should be left primarily for development by non-state and foreign enterprises.
In contrast with the policies discussed above, the view that the state sector should advance in some areas and retreat from others （you jin you tui, you suo wei you suo bu wei 有进有退, 有所为有所不为）is not associated with policy entrepreneurialism by a senior leader but emerged incrementally from three kinds of concerns. First and most importantly, the state was badly underperforming in the provision of core public services including education and law enforcement (Wu, 2005: 190). Second, the sectoral adjustment policy was consistent with growing recognition and support for the non-state sector expressed in national policymaking. Beginning in the early 1980s, the contribution of township and village enterprises (TVEs), collective enterprises and FIEs to China’s GDP increased rapidly but legitimation for the non-state sector lagged behind practice. The central government first sent a strong message of encouragement when the constitution was amended in 1988 to include an article acknowledging the importance of the private sector. After the post-Tiananmen conservative interregnum, the center’s policies again provided encouraging signals to the private sector. Yet despite these positive signals, the playing field remained far from level in most sectors. Non-state enterprises were at a particular disadvantage in gaining access to financing because state-owned banks habitually distribute loans to SOEs much more readily than they do to private enterprises (Tsai, 2002; Haggard and Huang, 2008). Given these impediments to private sector development, establishing rules to compel SOEs to retreat from non-core industries was seen as a much-needed boost. Finally, against the backdrop of large and growing state sector losses, SOE “retreat” would also serve the goal of reducing the heavy fiscal burden imposed by the predominantly loss-making state sector.

The broad principles of “adjusting the layout of the state sector” took shape between 1997 and 2000 amidst rancorous debates about the ultimate aims of the state sector’s reconstitution. The first significant development dates to the 15th Party Congress Report (1997) which included the goal of “strategic readjustment of the state sector” defined in the following terms:

In lifeline industries and key areas, the state sector must maintain a commanding position. In other areas, asset reorganization and structural adjustment are acceptable means of improving the core strength as well as the overall quality of state assets. As long as the state sector remains the core, as long as the state controls economic lifelines, as long as the state sector’s controlling force as well
as competitiveness improve; if these conditions are met and the proportion of the state economy is reduced somewhat, it will not influence China’s basic socialist nature (Report of the Fifteenth Party Congress).

This first pronouncement amounted to an imprimatur from officialdom on the idea of redrawing the boundaries of the state sector. It was followed, in 1999, by an influential State Council Development Research Center report which argued forcefully the economic benefits of state sector “advance” and “retreat” (Zhang, 2006: 512-516). The authors argued that the reason SOE reforms were only minimally successful was because they had focused exclusively on enterprise-level problems and neglected macro-considerations. The report called for clear rules pinpointing the sectors in which SOEs ought to remain the main players and those from which they should retreat. It also suggested that one of the goals of SOE reform ought to be the establishment of an equal foundation for the state and non-state sector to develop side by side. “Adjusting the layout of the state sector” was then included in the 1999 Decision on Some Problems in SOE Reform and Development which set out the government’s state sector reform priorities. In 2000, a professor at the Central Party School, Wang Jue, added further legitimacy to the still highly controversial notion that SOEs ought to retreat from certain sectors when he published an article arguing the merits of “the state’s retreat and the private sector’s advance” (guotui minjin 国退民进); this catch-phrase subsequently became a rallying point in the debate about state sector retrenchment.

A 2000 report produced by the National Bureau of Statistics (NBS) Research Group brought into the open simmering disagreements in officialdom about how the policy ought to develop. The report, which had taken shape under Qiu Xiaohua, then Vice-Director of the NBS, called for a radical retreat of the state sector:

The essence of the problem is that state capital is too widely dispersed and there is currently no way to achieve the optimal allocation of state-owned assets. In areas of the economy which should be guaranteed by the state economy, there is a shortage of funds and a lack of vitality. State capital should not blindly enter competitive areas of the economy. Due to the backwardness and imperfection of management structures and operating mechanisms in SOEs, they will lack competitiveness and reduce the efficiency of state-owned capital leading to serious wastage of state-owned assets (National Bureau of Statistics, November 6, 2000: 3).
In a critical evaluation of the existing layout of the economy, the report argued that SOEs should be a monopoly presence in just 18 industries and retreat completely from 146 competitive industries. The report prompted several angry rejoinders from a former director of the NBS, Li Chengrui (2001, 2001a) which were published in an orthodox party journal, *The Pursuit of Truth* 《Zhenli de Zhuiqiu 真理的追求》. Li countered, first, that Qiu’s statistical analysis was faulty and claimed Qiu’s research group had unfairly selected data which would support their claim that state assets were being wasted in competitive sectors. Li also charged that Qiu’s proposal for restructuring the layout of the state sector “defied the constitution and the Party line” (Li, 2001a: 19). Li’s rebuttals took aim at the report’s claim that the “the ultimate goal of this reform should be to adjust the focus of the state-owned economy to meeting social and public needs while competitive industries should be turned over to a competitive market economy.” Li argued that this “turn-over theory”, if adopted, would mark a “grave step” towards privatization of the entire economy (Li, 2001a: 23). While this exchange was probably partly fuelled by personal differences between Qiu and Li, it also reflected fiery internal policy debates at the time (10BJ0629).

The Sixteenth Party Congress (2002) heralded a new phase in the development of this policy as it assigned responsibility for implementation of state sector advance and retreat to SASAC. Though scholarly analysis of SASAC has tended to focus on the bureaucracy’s efforts to strengthen and reduce the number of SOEs in its charge via merger and restructuring, the commission has assumed a no less important role as lead author of the “adjusting the layout of the state sector” policy line. While the high-level policy pronouncements prior to 2003 had established the rectitude of SOE advance and retreat, there were as yet no authoritative guidelines on precisely which industries counted as “lifeline”, which were “competitive” et cetera. SASAC’s inaugural yearbook (2004) provides some insight into how officials’ thinking on this question developed between the key years 2003 and 2006 (Table 3.1).

<table>
<thead>
<tr>
<th>Type 1: National Security-Related and Lifeline Industries</th>
<th>Type 2: Indirectly National Security-Related and Lifeline Industries</th>
<th>Type 3: Other Industries</th>
</tr>
</thead>
</table>

Table 3-1: SASAC Categorization of Priority Industries circa 2004
### National Security-Related Industries:
- e.g. arms manufacturing, important material reserves, arms trade

### Monopoly Industries (both administrative and natural)
- e.g. telecom, power supply

### Public Goods and Service Providers
- e.g. power generation, civil aviation

### Important Natural Resource Industries
- e.g. oil, petrochemicals, natural gas, coal, gold, salt

### Pillar Industries:
- e.g. metallurgy, technical equipment, auto, construction, real estate, construction supplies, chemicals

### High Tech Industries:
- e.g. IT, biotech, scientific research

### e.g. internal and external trade, investment, design, consulting, transportation, agriculture

Source: ZGGYZCJDGLNJ, 2004: 42.

In 2004, SASAC began to phase-in implementation of the state sector readjustment policy for central SOEs. SASAC officials cleverly anchored implementation of this policy to the commission’s primary source of leverage over SOE management: annual performance reviews. SOE managers attach great importance to these reviews which assign grades on a five-point scale (A to E) for two reasons: first, evaluations are directly linked to their salary levels, and; second, these assessments bear heavily on the future career prospects of these manager-officials. Beginning in 2004, SASAC tied implementation of this policy to its primary stick mechanism by obliging all SOEs to declare their main business operations (zhuye 主业), a number which may not exceed a total of three business areas, and requiring that they only conduct business within these designated areas. By its own measures, SASAC’s efforts have been successful in correcting the problem of state asset sprawl but outside observers tend to be more skeptical about the efficacy of this tool.²⁴

---

²⁴ According to the 2008 yearbook, SASAC SOEs investment in core business areas accounted for 97.2% of total investment by 2007 (ZGGYZCJDGLNJ, 2008: 26).
According to interviewees, the basic problem is that, before 2010, the main criterion in SASAC performance reviews was not compliance with zhuye rules but rather profitability and return on equity (10BJ0702). Thus, under this system, when conflicts arose between adhering to zhuye guidelines and maximizing revenue intake, managers were strongly incented to choose the latter option. To correct this and other problems related to the original system of evaluation, in late 2009, SASAC announced that it would replace the existing system with an Economic Value-Added (EVA) method that measures net returns above the cost of capital. This change is intended primarily to apply pressure to those SOE managers who have posted impressive returns on the backs of cheap policy loans from state-owned financial institutions and direct state subsidies. The new EVA system also adds teeth to zhuye rules. In January 2010, SASAC Vice Chairman, Huang Shuhe, announced at the Central SOEs Leading Cadres’ Management Evaluation Work Meeting that under the new system, gains made in areas outside enterprises’ designated zhuye would be counted at only half their value (di yi caijing ribao, January 8 2010). The political context for SASAC’s newfound commitment to enforcing zhuye rules was widespread anger about the growing presence of central SOEs in the real estate market, an issue that we return to in the final section of this chapter.

And yet, while SASAC has devised means of setting limits on central SOEs’ self-defined business areas, establishing unambiguous rules specifying which industries the state-owned economy should advance towards and those from which it should retreat has been a slower and more contentious process. The most important policy in this regard was issued in December 2006. Notice Regarding Promoting State Asset Adjustment and SOE Reorganization, hereafter referred to as Policy No. 97 was widely interpreted as having clearly demarcated the industries from which SOEs should retreat and those in which they should advance. Indeed, in the official Xinhua media report of the press conference, Policy No. 97 is made to sound crystal clear on the matter of which industries count as lifeline industries: “Li Rongrong said that the state sector should maintain absolute control in national security and lifeline industries including in the seven big industries: defense industry, the power grid, petroleum and petrochemicals, telecommunications, coal, civil aviation and shipping.” In fact, the actual text of Policy No. 97 says only vaguely that the “state’s controlling force” should increase in “important industries and key areas” and, up to now, SASAC has never definitively stated industries are included in this category. Interviewees suggested that the marked discrepancy between the Xinhua version of
events and the actual text of Policy No. 97 reflects a difference of opinion between SASAC and the State Council (10BJ0629; 10BJ0702). The press release version listing seven lifeline industries reportedly reflects the contents of a SASAC report which had been submitted to the State Council and which was supposed to have accompanied Policy No. 97 that was unexpectedly held up at the higher level. Since this curious affair, the most notable development in the development of this policy was SASAC’s 2009 announcement that it would prohibit group companies from selling subsidiaries in certain sensitive industries (jingjiguanchabao, January 22 2009). Apparently a “not for sale” (fei maipin 非卖品) name list of companies had been drawn up as of early 2010 but SASAC reportedly did not plan to make it public (10BJ0702). Taken together, these documents provide some guidance on which industries should retain a high proportion of state ownership, but the rules are notably silent on the appropriate role of SOEs in non-priority sectors.

The contents of a SASAC report (2007) not widely circulated provides the clearest indication of the government’s vision of the future layout of the state-owned economy (see Appendix 2). The report is most unambiguous in discussion of the lifeline industries in which majority state ownership should be either maintained or increased. In all, ten industries are included in the highest priority “important national security and lifeline industries and key areas” category—three more than appear in Policy No. 97.25 Repeated use of “et cetera” (deng 等) in these typologies indicates that the name lists are not exhaustive. Interestingly, the report suggests that “absolute” state control should be maintained in only a small portion of these highest priority industries, specifically “defense industries, oil and other strategic resource industries as well as the power grid and telecommunications infrastructure” suggesting that SASAC perceives a hierarchy within the category of lifeline industries. SASAC’s emphasis on SOEs “going big and going strong” is also in evidence here as the report calls for taking steps to increase market concentration in these industries: “The state should encourage consolidation and reorganization and cultivate large corporate groups to solve the problem of insufficient capital.”

25 This category includes enterprises in four areas: 1) industries directly linked to national security (e.g. defense industries, grain reserves, cotton reserves etc.); 2) natural monopoly enterprises (e.g. telecommunications, power grid etc.); 3) enterprises that supply important public goods (e.g. airlines, electricity supply etc.), and; 4) important resource enterprises (e.g. petroleum, petrochemicals and coal).
In sharp contrast to SASAC’s vision of SOE advance, the role of “retreat” in the state-owned economy is hardly apparent. In the second-most important category of “pillar industries and high-tech industries”, which extends over a number of disparate sectors, the document hints at more grabbing than letting go.\textsuperscript{26} The report states unequivocally: “The state should maintain fairly strong control of a number of backbone and vanguard enterprises.” As for less competitive enterprises in this category, the call is not for retreat but rather for Darwinian adaptation: “[they] should intensify their reform and restructuring efforts and be exposed to the law of survival of the fittest in the marketplace.” While the report does note that in many industries “the distribution of state capital is too heavy and has resulted in the wastage of state assets”, throughout, the prescribed cure for such ills is not market exit but rather exposure to competition. In the reform schema presented in Appendix 2, the only mention of government-mandated retreat is found in the low priority “other industries” category. In this group, enterprises “characterized by a small scale, low economic efficiency and limited potential for development should exit in an orderly way” via the means of merger with large enterprises, transfer of ownership to asset management companies or localization. Yet even in this lowly category, SASAC finds a rationale for supporting large SOEs: “The state should maintain control of large enterprises with well-known brands in trade flows, shipping and other areas.”

3.3.4.1 The High Stakes of Sector Labels

Underpinning this delicate discussion of the advance and retreat of state ownership are starkly opposed visions of the endpoint of capitalism with Chinese characteristics. In many ways, SASAC’s vision is an inheritance of the post-Tiananmen upsurge of neoconservative norms emphasizing SOE revitalization and preservation of state ownership. SASAC policies and pronouncements look to a system not unlike Singapore’s lean state capitalism, in which state ownership of large segments of the economy and economic planning co-exist with an open business environment. Indeed, as discussed above, the Temasek model of market-conforming state ownership has become a key template of China’s state asset management reform and served

\textsuperscript{26} This area include includes these industries: metallurgy, machinery manufacturing, construction and real estate, chemical building materials, electronics manufacturing, biomedicine, scientific research institutes, and civil engineering etc.
as a blueprint for the Huijin system in the financial sector (Caifu, October 2007). In sharp contrast to the sense of crisis in the period of massive retrenchment in the late 1990s, in SASAC’s hands, the SOE reform discourse has acquired a decidedly muscular tone. Whereas previous SOE reforms aimed at staunching the flow of state resources to unviable enterprises, state sector reforms under SASAC have the goal of positioning SOEs at the center of China’s dynamic, globalizing economy. The key phrase in SASAC messaging is the goal of “increasing the state-owned economy’s level of control, driving force capacity and influence” (yao zengqiang guoyou jingji de kongzhili, daidongli, yingxiangli 要增强国有经济的控制力，带动力，影响力). The critical Policy No. 91 (2006) discussed previously, couches the process of selective withdrawal in the terms of strengthening state capitalism: “Restructuring the state’s capital and reorganizing state-owned enterprises will further improve the control of state-owned economy, its driving force capacity and influence.”

But not all observers share in SASAC’s ambitious state capitalist vision. A number of prominent policy economists have urged policymakers to take China down the path trod by most Western countries in limiting state ownership to a small segment of the economy. They tend to see a rationale for majority state ownership only in areas of the economy characterized by market failure such as natural monopolies and advocate SOE retreat from industries with competitive markets. In this vein, Pan Wei’er, Vice-Director of the Central Economic and Technology Commission, has argued that “the key areas for state investment are in those areas in which non-state investment is unable or unwilling to enter” (zhongguo jingji zhoukan: February 2, 2010). Similarly, in a pointed criticism of the sluggish development of the adjusting the layout of the state-owned economy reform, Wu Jinglian argued that the central government’s failure to effect SOE retreat from a broad range of competitive industries has significantly “tightened the room for private enterprises to develop” because state-owned enterprises still tend to receive non-market regulatory and financial advantages which their non-state competitors do not (21 shiji jingji baodao: January 1, 2011). Wu characterizes the very fate of Chinese economic reform as hinging on the matter of SOE retreat from competitive industries: “If this task is not accomplished there will be no way to either establish a market economy based on common prosperity and the rule of law or achieve China’s sustained and stable development.”
3.3.5 Summary: Accounting for the Relative Strength of State Sector Reforms

A conclusion to be drawn from the preceding comparative analysis of the development of these four key policies is the crucial role of elite sponsorship in determining the fate of policy lines in state sector reform. Policy entrepreneurship by a high-ranking leader was a key factor in the smooth emergence and development of the large enterprise, grab the large let go the small and the going forth policies. In stark contrast, adjusting the layout of the state sector conspicuously lacks an elite sponsor and the development of this policy line has accordingly been much slower and more hesitant. Why does the last policy lack this kind of high-level support? Here an interest-based explanation is intuitive. In short, while the first three policy lines promised clear patronage benefits to each of the sponsors, the last did not. For Premier Li, the large enterprise strategy would have been appealing not just because it was consistent with neoconservative policy norms but also because it was a means of strengthening his network of supporters in industries by dangling the carrot of preferential treatment for pilot enterprises. And while the “let go the small” portion of Premier Zhu’s policy line was extremely unpopular with the newly unemployed and other downtrodden segments of society, “grab the large” soldered Zhu’s support from the most politically salient portion of the state-owned economy. The same political logic accounts for Jiang Zemin and his successors’ support of the going forth strategy. Faithful implementation of adjusting the layout of the state sector, by contrast, would entail significant patronage losses for elites. Although development of the “advance” portions of the policy line promises some patronage benefits for elites, implementing the “retreat” side would be highly politically costly. Indeed, an understanding of elite incentives sheds light on why it is that rules specifying the criteria for maintaining and advancing state ownership have developed furthest while rules specifying the retreat remain at the level of fuzzy principles.

3.4 Conclusion

This chapter has shown how and why the priorities of state sector reform shifted markedly beginning in the early nineties and highlights the importance of mutually reinforcing economic and political logics. The preceding discussion of the intermingling of four key policy lines details how the promotion of large SOEs emerged, in incremental fashion, as a major focus of central government policy. Reigning conservatism in the post-Tiananmen, pre-Southern Tour period proved to be fertile ground for the adoption of an industrial policy regime premised on providing
large-scale policy supports to state-owned “winners” in priority sectors. Crucially, the adoption of these policies was also highly compatible with elites’ interests in strengthening their patronage networks in industry. Indeed, this political logic helps to explain the relative strength of certain policy lines in state sector reform and the weakness of others.

China’s GATT/WTO negotiations, which began in earnest in 1992, also pushed China’s leaders to think about means of “mitigating the expected shock” of deep economic integration (Murakawa, 2001: 32). As the work of Nolan and his colleagues has shown, in this process, several of China’s leading economic policymakers were deeply influenced by the experience of the East Asian developmental states with large-scale industrial policy, especially that of South Korea and Japan. Nolan’s (2001) work also suggests that the increasing emphasis China’s policymakers place on consolidation in the state sector reflects a widely held view in government that these measures will help Chinese enterprises adapt to the realities of the “global business revolution” characterized by a sharp increase in market concentration in many sectors over the last two decades. In sum, this policy shift has been shaped by a combination of policymakers’ essential beliefs about what kinds of policy prescription would benefit China’s globalizing economy as well as their parochial interests in amassing political power.
4 A Bird’s Eye View of the State-Owned Economy (1991-)

4.1 Introduction

This chapter provides a bird’s eye view on the rise of China’s national team in the context of the fast-changing state-owned economy. The neoconservative policy legacy is evident in a robust industrial policy regime that aims to mould China’s largest SOEs into a fleet of competitive, state-controlled firms to stand as pillars in the domestic economy and serve as vanguards in China’s going forth into global markets. The chapter begins with an examination of the impact of three key policies associated with this SOE industrial policy regime: “Grabbing the Large”, the “Large Enterprise Strategy” and “Going Forth.” The evidence shows that these policies have collectively left a deep imprint on the Chinese political economy. By comparison, the fourth reform discussed in the previous chapter, “Adjusting the Layout of the State-Owned Economy” has had a less dramatic effect on the state sector, partly because the tenets of this policy exist in some tension with the aims of the SOE industrial policy regime. The data show some evidence of state sector rationalization with the proportion of state ownership staying the same or increasing in some priority sectors and declining in others. Yet SOEs remain distributed widely across industry partly due to the complexities of realizing retreat of state ownership in industries with a high employment burden such as agriculture and textiles. Yet, quite a different pattern is evident in a number of profitable industries as national team SOEs seem to be advancing further and, in some cases, hastening the retreat of private enterprises. In these industries, the logic of partial reform is very much in evidence.

4.2 Impact of the Neoconservative Legacy

4.2.1 Grab the Large, Let Go the Small

Adoption of “Grab the Large, Let Go the Small” at the Fifteenth Party Congress in September 1997 led to a radical overhaul of the state sector. The central government’s imprimatur on the exit of loss-making, local SOEs led to the substantial and rapid slimming of the state sector. In 2007, the approximate number of registered state-owned and state-controlled
enterprises nationwide (112,000) was just 48% of what it was in 1998 (238,000). The most dramatic period of privatization took place between 1995 and 2000, when the number of registered industrial SOEs was cut approximately in half. Consistent with the aims of letting go the small and grabbing the large, this slimming of the state sector has taken place at the sub-national level while the number of central-level enterprises has remained roughly constant over the period (Figure 4.1). The approximately 22,000 central enterprises in existence in 2008 was only slightly below the 1998 figure of 23,000. In the same period, the number of local SOEs plummeted from 215,000 to 90,000.

The wave of bankruptcies, auctions and mergers and acquisition set off by adoption of the “Grab the Large, Let Go the Small” was an important catalyst for growth of the non-state sector. By 2004, the urban non-state sector employed roughly 55 million workers compared to 30 million in SOEs (Naughton, 2007: 106).

The National Bureau of Statistics defines a state-owned enterprise (guoyou qiye 国有企业) as one that is wholly owned by government. A state-controlled enterprise (guoyou konggu qiye 国有控股企业), by contrast, refers to a shareholding company in which the state accounts for a high proportion of equity and in which the government maintains material control of the enterprise.
The dislocating effects of this dramatic state sector downsizing varied in intensity by region. Across the country, newly-unemployed workers were shunted into Reemployment Centers which ordinarily provided laid-off workers with small stipends in addition to retraining and job search assistance services for up to three years. Since local governments funded these programs, the quality and range of services tended to be quite good in wealthier regions such as Shanghai and quite limited in poorer regions, as in the province of Heilongjiang in China’s rust-belt northeastern region (Naughton, 2007: 187-88). The 83% surge in employment in private enterprises (siying qiye 私营企业) has absorbed some of the newly unemployed but this too is a strongly regional story since the private sector is most developed in the prosperous central and south coast (zixun database). 28

While a huge number of jobs were cut from the state sector in this process, in keeping with the aims of grabbing the large, central SOE employment has actually grown since 1997. The official figures report that between 1993 and 2003, a total of 28.2 million SOE employees were laid off (xiagang 下岗) and this figure is probably conservative (Naughton, 2007: 186). Combined with the numbers of registered unemployed—a separate category from xiagang workers—a total 50 million jobs may have been shed from the state sector between 1993 and 2003 (Naughton, 2007: 186). While workers in small, local SOEs were laid off en masse, total employment in central-level SOEs actually increased by 36% between 2001 and 2007, from 8.2 million to 10.1 million (ZGCZNJ, 2008: 437). Central SOEs growing clout is also reflected in the shifting aspirations of China’s job-seekers. Whereas attaining work in foreign-invested enterprises was once the top choice of university graduates entering the job market, longitudinal data from an annual survey suggest that, since 2008, SOE employment has topped job-seekers’ wish lists (ChinaHR.com, 2010).

“Grab the large, Let go the Small” also served to magnify the differences between local and central SOEs in terms of enterprise size and profitability. Although there has been enormous asset growth among both central and local SOEs in recent years, the average size of enterprises at the central level far exceeds the scale of local SOEs. In 2007, central-level enterprises were,

28 A siying qiye is defined as a for-profit company that employs more than eight people. Private enterprises with less than eight employees are referred to as getihu (个体户).
on average, ten times larger than provincial SOEs in terms of asset size (ZGDQYJT, 2007: 227). Figure 4.2 reflects a surge in central SOE profits since 2001 which now account for roughly 2/3 of total SOE profits (OECD, 2009: 6).

**Figure 4-2: Central SOE Profit Growth**

The trimmed-down state sector left over from retrenchment has experienced a striking reversal of fortunes. In 1998 just 31% of SOEs were profitable, as compared to 57% of SOEs in 2007 (ZHCZNJ, 2008: 429). Yet these figures largely reflect strong profitability among central SOEs. Many provinces with a large state sector continue to struggle even after the massive restructuring efforts. While the profitability of local SOEs in Shanghai and Guangdong has risen sharply in recent years, SOEs in have-not regions such as Guangxi and Heilongjiang continue to languish (ZHCZNJ, 2008: 432).

As discussed in the previous chapter, the state’s claim on SOEs profits is still minimal, yet central SOEs in key industries are increasingly important as contributors of tax revenue to central government coffers. Figure 3.5 shows that industries dominated by central SOE monopolies or oligopolies account for the majority of tax revenue from the state sector. In 2007, tax contributions from a small number of SOEs in the petroleum and petrochemicals, tobacco, power and post and telecommunications industries together accounted for nearly half of all tax collected from SOEs (Figure 4.3).
The surge in tax revenue supplied by central SOEs has, in turn, been a key factor in expansion of the government’s tax base in recent years which grew an average of 24% annually between 2003 and 2007 (ZGXXCYNJ, 2008: 509). Whereas SOEs were once the greatest fiscal drain on the state, they are now increasingly vital suppliers of fiscal resources to the central government.  

4.2.2 Gauging the Effects of the Large Enterprise Strategy

Not only were large SOEs spared the fate of local enterprises in “Grab the Large, Let Go the Small”, government agencies seeking to replicate the East Asian developmental states’ success with business groups have sought to envelop the state’s most prized large SOEs in the protective embrace of business groups. In so doing, policymakers aimed to create a group of state-controlled companies large enough to compete in global markets and also prevent wasteful duplication in the domestic market (Smyth, 2000: 727). Institutional reforms are particularly salient among the national team enterprises—the 100 odd members of the “trial group” (guojia shidian qiye jituan 国家试点企业集团) handpicked as part of the neoconservatives’ Large Enterprise Strategy in the early and mid-1990s. These state-controlled business groups have

---

29 Shih (February 26, 2011) notes that behind the appearance of financial health, central SOEs and their subsidiaries are in fact highly leveraged and owe an estimated 10 trillion RMB to Chinese banks.
since grown into vast empires linking together dozens of companies connected to each other through interlocking business relationships, cross-shareholdings and often linked to a main bank responsible for guiding the firms’ investment decisions and long-term planning (Smyth, 2000: 722).

The trial group enterprises form the prized core of China’s nearly 3,000 large enterprises catalogued in the Large Corporations of China 《Zhongguo Da Qiye Jituan Nianjian 中国大企业集团》 yearbook series. The 101 trial group enterprises included in the 2007 yearbook collectively generated US $119 billion in profits, accounting for nearly half of all profits earned by China’s designated 2,926 large enterprises in 2007 (ZGDQYJT, 2007: 24, 290). Data collected by Guest and Sutherland (2010) shown in Table 4.1 show that, among China’s large enterprises, the most extensive and autonomous business groupings have sprung up around the trial group.

Table 4-1: National Team Business Group Characteristics

<table>
<thead>
<tr>
<th></th>
<th>Trial Group (%)</th>
<th>Large Enterprises (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full investment autonomy</td>
<td>95</td>
<td>91</td>
</tr>
<tr>
<td>International financing rights</td>
<td>46</td>
<td>25</td>
</tr>
<tr>
<td>Export credit guarantees</td>
<td>84</td>
<td>72</td>
</tr>
<tr>
<td>Independent export and import rights</td>
<td>96</td>
<td>69</td>
</tr>
<tr>
<td>Combined group tax payment</td>
<td>61</td>
<td>26</td>
</tr>
<tr>
<td>Rights to contract international projects</td>
<td>82</td>
<td>53</td>
</tr>
<tr>
<td>Rights to approve foreign business affairs</td>
<td>74</td>
<td>9</td>
</tr>
<tr>
<td>Technology and research centres</td>
<td>84</td>
<td>55</td>
</tr>
<tr>
<td>Finance companies</td>
<td>40</td>
<td>11</td>
</tr>
</tbody>
</table>

Source: Guest and Sutherland (2010: 621)

The trial group enterprises are also vastly larger than the majority of large enterprises outside the ranks of the national team. As of 2007, the 101 trial groups collectively employed 9.5 million employees, accounting for nearly 30% of the total 32.4 million people working in China’s large enterprises (ZGDQYJT, 2007: 29-30; 300-1). Similarly, the national team’s assets made up nearly one-third of total large enterprise total assets (ZGDQYJT, 2007). Looking beyond China,

---

30 Government-orchestrated mergers have steadily reduced the group’s ranks from the original 120 in the interests of aiding the national team’s “going big, going strong”. The pace of administratively-led consolidation has quickened since SASAC assumed primary responsibility for the majority of the trial group enterprises in 2003.
the Global 500 ranking of the world’s largest MNEs illustrates how China’s largest enterprises are closing in on the world’s largest companies. In 2005, 15 mainland enterprises were listed in the Global 500, all of which were either wholly state-owned or state-controlled public companies and all of which hailed from protected industries including oil and gas exploration, power, banking, telecommunications and steel. By 2009, 35 Chinese SOEs made the list including state-owned giants in rail, shipping and metallurgy (Table 4.2).

While the growing influence and reach of the national team business groups in the Chinese political economy and beyond is now widely acknowledged, a more controversial subject is the putative contribution of large enterprises to China’s overall economic growth. The conventional view, what Nolan and Wang (1999) refer to as the World Bank’s “transition orthodoxy”, emphasizes the contribution of small-scale, non-state enterprises—especially Township and Village Enterprises (TVEs)—to China’s economic miracle and characterize large SOEs as perennial laggards destined for privatization. Typical of this view, Broadman, a lead economist for the World Bank, writes: “It is increasingly recognized—both within and outside China—that the SOE sector is the Achilles heel of China’s otherwise remarkable economic performance” (Broadman, 2001: 849). Against this perspective on China’s large SOEs, a group of economists linked with the Cambridge Judge Business School’s China Big Business Programme argue that China’s large SOEs are in fact “not stagnant fossils waiting to die” but, thanks to institutional innovations associated with the large enterprise strategy, increasingly vital and competitive firms (Nolan and Wang, 1999: 169). In this vein, a recent analysis comparing the performance of 69 subsidiaries of national team groups against a control group of 983 listed Chinese firms with no such pedigree suggests that the national champions do in fact outperform their unaffiliated counterparts in key categories including profitability and share returns (Guest and Sutherland, 2010). While engaging this debate is beyond the scope of this study, the point worth emphasizing is that the national team’s growing clout has prompted fresh debate about the merits of the neoconservative’s large enterprise strategy.
4.2.3 The National Team Going Global

The national team enterprises are also protagonists in the story of incredible growth in China’s OFDI over the past decade. While China’s outward investment was negligible until 2003, Figure 4.4 depicts the dramatic surge in OFDI from China along with the BRIC countries, a phenomenon fed by high domestic growth rates, booming commodity prices and less restrictive FDI regimes in host countries (UNCTAD, 2010: 7).

Figure 4-4: BRICs Outward Foreign Direct Investment, 2003-2009

![Graph showing BRICs OFDI from 2003 to 2009]


While Chinese OFDI still amounts to a small fraction of OFDI from other large economies, the gap is rapidly narrowing. In 2002, China’s OFDI flows amounted to just 2% of the US total; by 2009 that figure had surged to 19% (UNCTADstat database). Chinese overseas investment will only continue to grow in scale as the task of economic rebalancing looms larger and Chinese enterprises pursue industrial upgrading through gaining leading-edge technologies through mergers and acquisitions (M&A) (Rosen and Hanemann, 2009; Hong and Sun, 2006).
In the seven years since the “going forth” strategy was declared a “major action in the new phase of China’s opening”, at the Sixteenth Party Congress in 2002, members of the national team have enthusiastically heeded the call, establishing plant operations overseas, investing in natural resource development abroad and acquiring equity stakes in the world’s largest corporations. Although the Sixteenth Party Congress Report pledged support for the going forth of “enterprises of all ownership types”, a striking feature of the record of Chinese enterprises going forth to date, is the dominant role played by the state-controlled members of the national team, six of whom are profiled in Table 4.2. In 2007, 65 of China’s large enterprises accounted for overseas investments of US $10.6 billion, roughly half of China’s total OFDI in that year (ZGDQJT, 2007: 5).\(^{31}\) In recent years, the national team has become increasingly active in global M&A activity. China’s thirst for natural resources is reflected in a wave of huge deals in the energy sector led by Sinopec and China National Offshore Oil Corporation (CNOOC). Besides energy, China’s 251 overseas M&A deals in 2010 totaling US $43 billion were in hi-tech companies, machinery, equipment manufacturing and the auto sector (PwC, 2010: 17).

The three policies described above have collectively moved China closer to the neconserervative vision of large, market-dominant SOE business groups driving domestic growth and leading expansion into overseas markets. In industries with a long history of national team membership such as airlines, discussed in greater detail in Chapter Six, these business groups have grown into vast empires extending across a wide range of industries. While the dramatic reversal of fortunes in China’s state sector is deservedly a source of pride for SASAC officials and the SOE managerial class, the following section explores the ways in which the very success of industrial policies aimed at promoting the national team’s development have stymied the progress of another key reform outlined in the last chapter: “Adjusting the Layout of the State-Owned Economy.” As the tentacles of the national team extend ever deeper into the Chinese economy and as the political clout of SOE managers continues to grow, SASAC’s job of exercising control over the confines of the state-owned economy becomes increasingly difficult. A more profound source of resistance to imposing limits on SOE investment sprawl is SASAC’s

\(^{31}\) Data accuracy for Chinese OFDI figures is a significant concern. Rosen and Hanemann (2009: 3-4) provide a detailed comparison of the varying figures provided by the Ministry of Commerce and the State Administration of Foreign Exchange.
own role as national team coach. The tensions between SASAC’s duals mandate to discipline and promote central SOEs is explored in a brief case study of the national team’s role in real estate.

4.3 SOE Retreat and Advance Across China’s Basic Industries

In a widely-read op ed in Caijing magazine written on the 60th anniversary of the founding of the PRC, Wu Jinglian (September 28, 2009) wrote: “if reform in the early stages benefitted everyone, now, deepening reform cannot but harm the interests of some, including the government itself.” The evolution of state sector reform is very much a case in point. Industrial policies which lent a helping hand to China’s largest SOEs were not at all costly from the vantage of political elites’ all-important interests in amassing and maintaining power; in fact, these initiatives would have enhanced their support within the most politically salient segment of the state sector. As noted in the previous chapter, the policies described above were closely linked with three top leaders: Li Peng (the large enterprise strategy), Zhu Rongji (grabbing the large, letting go the small) and Jiang Zemin (going forth). By contrast, reforming the industrial layout of the state-owned economy is a reform that runs counter to the interests of powerful players in the state sector. While the “advance” components of the policy are costless in elites’ political calculations, engineering SOEs “retreat” from lucrative industries beyond the designated lifeline industries is a much more difficult proposition, especially in view of the growing clout of the SOE managerial class in matters of economic policy. It is unsurprising, then, that this policy lacks a conspicuous champion in the politburo and has languished since its unveiling at the Fifteenth Party Congress in 1997.

The remainder of the chapter explores the complexities of change in the industrial layout of the state-owned economy. Official data show that there has been some rationalization of the state sector in the last decade with SOEs concentrating in upstream sectors such as petroleum and coal processing, public utilities and industries linked to national defense. Yet the matter of SOE retreat is a more complicated story. While liberalization of administrative barriers to entry

---

32 The case study of telecommunications reform presented in Chapter Five suggests that during China’s WTO negotiations industry insiders made a concerted effort to define telecommunications as a strategic sector in the interests of maintaining barriers to entry.
have eroded SOEs once-commanding market share in many non-lifeline industries. SOEs remain a significant presence in many so-called competitive industries. And in the wake of the 2008 global financial crisis, large SOEs on the national team actually extended their reach in some lucrative industries, a trend known as “advance of the state, retreat of the private sector” (guojin mintui 国进民退).

Research shows that SOEs remain distributed widely across the Chinese economy but tend to perform weakly in non-lifeline industries. State-owned enterprises wield commanding market share in a number of capital-intensive heavy industries including machinery, smelting and equipment manufacturing. Rail, water and air transport are also characterized by a high proportion of state ownership. Yet the state sector also extends far into a number of so-called competitive industries. A study employing 2002 data found that SOEs in the “natural monopoly” and “public service and other sectors” categories accounted for just 22% of the total number of nationwide SOEs and the remaining 78% of SOEs operated in “competitive industries” (Li et al., 2005: 129). The profit contributions of SOEs in these different industries show a quite different pattern. The relatively smaller number of SOEs in natural monopoly industries account for two-thirds of total profits in the state sector. While SOEs in competitive industries contributed just one-third of profits, they commanded 55% of total assets in the state sector. The authors explain this “irrational layout of the state-owned economy” in terms of the practical difficulties of retreat: competitive industries account for 62% of state sector employment in comparison and 38% natural monopoly industries and public service sectors (Li et al., 2005: 133).

33 The nature of natural monopolies and the appropriate forms of regulation in such markets is debated among Chinese economists as it is elsewhere. In the literature cited here, the authors tend to characterize “natural monopolies” (ziran longduanxing hangye 自然垄断性行业) as industries in which technology or other factors mean that one firm can satisfy demand for a given good or service at a price lower than two firms competing with each other could. Commonly cited examples include some telecommunications services, power provision and certain modes of transport (e.g. rail). The term “competitive industries” (jingzhengxing chanye 竞争性行业) refers to industries which are typically populated by a large number of buyers and sellers in which no one seller or buyer is sufficiently large to exercise control of the market price. While agriculture is one a small number of markets that actually approach the conditions of perfect competition, the term is typically used as a residual category to include all non-natural monopoly industries.
More recent employment and enterprise registration figures suggest that SOEs are, in fact, retreating from some competitive industries but also advancing in others. In agriculture, still one of the main sources of employment in the state sector, SOE employment fell 16% between 2001 and 2007 (ZGCZNJ, 2008: 446). A number of other industries show more dramatic reductions including textiles (-74%), construction (-25%), electronics (-22%), chemicals (-50%), building materials (-61%), food processing (-66%) and food & beverages (-62%). Yet state sector employment figures are strongly on the rise in some non-lifeline sectors including real estate (+50%) and information technology (+103%). The enterprise registration figures are broadly consistent with these employment trends. Between 2001 and 2007, the number of registered SOEs fell sharply in agriculture (-38%), textiles (-57%), chemicals (-39%), building materials (-48%), electronics (-28%) and food processing (-65%) (ZGCZNJ, 2008: 445). The number of registered SOEs increased over the period in real estate as well as IT. These figures suggest that while SOEs are retreating from many industries, they are also expanding in a number of key growth industries. A 2007 SASAC report acknowledged that in spite of government efforts to focus central SOE business on designated core areas discussed in the previous chapter, national team subsidiaries remained “too broadly” dispersed across Chinese industry and were found in fully 86 of China’s 95 official industries (SASAC, 2007: 166).

Although SOEs continue to be a significant presence in non-lifeline industries, their market shares have been significantly reduced in many industries as barriers to entry protecting statutory monopolies have fallen dramatically, especially since China’s WTO entry in 2001. Liberalization has encouraged non-state and foreign-invested firms to enter previously protected markets en masse. Figure 4.5 compares the market share held by state-owned or state-controlled enterprises across a number of key industries in 1999 and 2008.

34 The real estate market only really came into existence in the late nineties when the privatization of housing began in earnest meaning that employment and enterprise registration figures were on the rise among all ownership types in this industry.
The chart shows that a number of industries have undergone dramatic change in recent years. In the textile industry—in which SOE market shares have plummeted since 1999—non-state enterprises accounted for half of of industry assets and two-thirds of profits in 2007 (ZGTJNJ, 2008). In communication equipment manufacturing, computers and other electronics industries, FIEs held 79% of assets and generated 86% of industry profits. FIEs now have commanding market shares in a number of other industries including machinery manufacturing, raw chemicals materials and products and transportation equipment manufacturing.

The data presented here reflect substantial churning in the state sector over the past decade. One conclusion to be drawn is that SOEs wield commanding market share in fewer and fewer industries. In keeping with the broad principles of the “Adjusting the Layout of the State Sector” policy, SOEs remain the key players in certain segments of the resource, transport and public service sectors. Ownership change in other areas of the economy is, however, a more complex story. Registration and employment figures show that SOEs have begun the delicate task of retreating from a number of industries including agriculture, textiles and electronics. As
noted, employment is one of the factors inhibiting SOE retreat from non-lifeline industries with large numbers of workers on the payroll. Yet, the state’s interest in mitigating the social costs of state sector rationalization does not account for the pattern in other non-lifeline industries. Not only are SOEs not retreating from some other competitive industries, SOE operations are in fact scaling up in some growth industries such as real estate and information technology. The next section examines the phenomenon of the state’s advance in more detail.

4.3.1 Advance of the State, Retreat of the Private Sector (*Guojin Mintui*)

The expanding presence of central SOEs in some industries since the 2008 financial crisis has given rise to a new phrase: “the state sector’s advance and the private sector’s retreat” (*guojin mintui* 国进民退). While SOEs have long enjoyed privileged access to financial resources vis-à-vis private enterprises, the government’s 2008 fiscal stimulus plan is seen by some observers as having substantially boosted the competitive advantages of SOEs and contributed to the retreat of private enterprises from some industries. Unveiled in November 2008, the $586 billion plan became wedded to the state’s aims for industrial restructuring expressed in the early 2009 “Ten Industries Revitalization Plan” which aimed to promote industrial consolidation (via M&A) as well as technological upgrading in the steel, auto, shipbuilding, textiles, light industry, non-ferrous metals, equipment manufacturing, IT and logistics industries. Since industrial SOEs tend to be much larger than private enterprises in these industries, industrial consolidation typically focused on state-owned enterprises and at the expense of private enterprises (EIU, 2009: 23). The most audacious example of consolidation-by-administrative-fiat took place in Shandong where Rizhao company, a thriving private steel enterprise, was heavily pressured by the Shandong government into accepting takeover by state-owned Shandong Steel in September 2009 (Naughton, 2009). In the wake of the financial crisis, *guojin mintui* was also seen to be taking place in a number of other key industries. Chapter Five

---

35 In 2007, SOEs in the following industries employed at least two million people: agriculture, machinery, metallurgy, electronics, power, construction and rail transport.

36 A poll by *The Economic Observer* newspaper conducted in Fall 2009 asked respondents to identify the industry, from a list of five, in which they thought *guojin mintui* was most apparent. The results were: 1) steel (55.56%); 2)
examines the phenomenon of *guojin mintui* in the airline industry while the next section looks at the changing role of central SOEs in real estate.

### 4.3.1.1 SOE Land Kings: *Guojin* in Real Estate

Among the most controversial subjects pertaining to the Chinese state sector is the growing prominence of SOEs in real estate, a fast-growing market characterized by huge profit margins, widespread clientelism and corruption and an ambiguous status in central government policy. In the days of the planned economy, there was essentially no market for land as work units (danwei 单位) assumed responsibility for the provision of housing in addition to food and medical care. In the early 1980s, cities around China began experimenting with real estate by making rental rates more flexible and, in some cases, organizing the direct sale of state-owned housing to resident. In 1988, the constitution was amended to allow for the transfer of land use rights, a momentous change that paved the way for the commercialization of land. By the late 1990s, the State Council had lifted a bevy of restrictions on the real estate market and a 1999 survey of residents in fourteen cities showed that more than 70% of residents had some form of private ownership of their residences (Davis, 2003: 189). In this freewheeling market, shadowy alliances linking real estate developers and municipal governments—for whom revenues from real estate transactions constitute an increasing share of the budget—are commonplace and have contributed to an acute shortage of affordable housing in many Chinese cities (Choo, forthcoming).

In fact, large industrial SOEs have been protagonists throughout the process of post-1978 urban land reform by virtue of their valuable land holdings in Chinese cities, an inheritance of the command era. Industrial SOEs along with Party units and agencies enmeshed in the vertical (tiao 条) government apparatus possess use rights over valuable tracts of land in urban centers. These “socialist land masters” were the beneficiaries of Maoist-era planning which dedicated large parcels of centrally-located urban land to industry in the interests of making production
rather than consumption the economic heart of Chinese cities (Hsing, 2006: 580). While Chinese law defines the State Council as the owner of land under control of socialist land masters, in practice, they behave as de facto owners in the real estate market. Industrial SOEs profit from their valuable land holdings in many ways including transferring land use rights to commercial developers and collecting the rent generated and, increasingly, entering the real estate development market directly by establishing their own companies (Hsing, 2006).

While these substantial land holdings have long made SOEs behind-the-scenes powerbrokers in real estate, in recent years their overt role as corporate players in real estate development has increased, prompting calls of guojin mintui from the media. Central SOEs under SASAC have become particularly prominent players in the market for corporate control of China’s large real estate enterprises. Recent transactions on the domestic stock exchange have rendered the distinctions between public and private in the largest real estate enterprises increasingly blurry. China’s largest housing development company at present, Vanke, is a prime example of the trend. Established by entrepreneur Wang Shi in 1984, Vanke began life as a private enterprise and after listing on the Shenzhen exchange in 1991, maintained a widely dispersed ownership structure throughout the 1990s. Following a succession of share increases by SASAC enterprise China Resources after 2003, however, this central SOE has now become Vanke’s largest shareholder with 15% of Vanke shares as of year-end 2008. In an interview with Nanfang Zhoumo, Feng Lun, a former official in the State Commission for Restructuring the Economy and prominent real estate watcher speculated that guojin would increasingly define real estate: “Real estate companies in the A-share market will increasingly be state-owned. Three years ago, in the A-share listed company top ten, 60% were private, a few were mixed ownership and one or two state-owned. Last year, it was already 60% state-owned, two or three mixed and just one private enterprise. I can say for sure that in this year’s top ten there won’t be a single private real estate company” (quoted in Wang, July 8, 2009).

The central government’s tepid and equivocal response to guojin in real estate underscores the practical and political difficulties of imposing limits on the national team’s activities, especially in highly profitable sectors of the Chinese economy. While real estate is not included among SASAC’s “lifeline” industries discussed in the last chapter it is frequently listed in the next highest rung of “pillar” industries in SASAC documents. In the process of defining
enterprises’ core business areas—SASAC’s primary means of implementing the “Adjusting the Layout of the State-Owned Economy” policy—real estate was designated the main business area of sixteen central SOEs. Real estate is also an important business for many central SOEs with designated core business areas in other industries. Since the financial crisis, some central SOEs have earned the label “land king” (diwang 地王) for their increasingly prominent role in high-profile land auctions. In the first half of 2009, companies linked to SASAC enterprises were the buyers in six of ten of the country’s most expensive real estate deals (Zhongguo Xinwen Wang, August 15 2009). In the context of mounting public controversy over the skyrocketing price of housing in major cities reflected in Figure 4.5 below, SASAC announced in March 2010 that 78 central SOEs without real estate as a designated main business area would be required to sell off their real estate assets. While the move met with praise in the press, media reports and an interviewee suggest that implementing the SOEs retreat from real estate will be extremely difficult in practice because the managers of SOE business groups can readily move real estate assets off their balance sheets without actually selling them (Li et al., April 12 2010; 10BJ0702).

**Figure 4-6: National Team 'Land Kings'**

![Cartoon of central SOEs and a family discussing real estate](http://dichan.sina.com.cn/bj/zt/78fqtc/index.shtml)

SASAC is not alone in its equivocal approach to real estate. In recent years, a number of central government agencies have flip-flopped on the question of what role SOEs ought to play in China’s real estate markets. In 2003, the State Council officially pronounced real estate a pillar industry. Affixing the word “pillar” to real estate is no trivial matter since many of China’s other designated pillar industries, a group which includes auto and steel, are characterized by a high proportion of state ownership. One analyst explained the significance of real estate’s pillar designation this way: “The distinction between pillar and non-pillar industries is akin to changing what was once a tree in the backyard into the beam of a house. Under the original conditions of free growth, the private economy had a certain amount of voice and pricing authority; now that the market is state-led, pricing and authority will of course incline towards state-owned assets” (NFZM, December 2009). Four years after the State Council branded real estate a pillar industry, the powerful National Development Reform and Commission (NDRC) signaled a possible change in course when it published a report recommending that central and local governments rescind the designation in order to cool the badly overheating property market (Zhonghua Gongshang Shibao, April 28 2007). The global financial crisis sparked yet another change in course. In early November 2008, amid growing fears of a housing market collapse in major cities—concerns were especially great about the stability of the Shenzhen market at the time—the State Council’s seven point plan to stabilize the economy characterized real estate as “an important pillar of the national economy” (zhongyao zhizhu chanye 重要支柱产业), a move that was a key factor driving the expansion of central SOEs in this industry following the crisis.

This brief discussion of SASAC SOEs evolving role in China’s booming real estate market underscores the practical and political difficulties of commanding the retreat or even halting the advance of the national team in lucrative, non-lifeline industries. Due in part to the legacy of the Large Enterprise Strategy, the national team SOEs are buttressed by sprawling corporate empires distributed widely across industry. Given the extensive reach of these business groups, SASAC faces a monumental task in simply trying to monitor the investment activities of the SOEs in its bailiwick. It is for this reason that knowledgeable observers expressed doubt about the implementation prospects for SASAC’s March 2010 rule commanding the retreat of 78 SOEs from the real estate market. Aside from the enforcement difficulties posed by pervasive
information asymmetries, SASAC’s incentives to faithfully implement the retreat sides of “Adjusting the Layout of the State-Owned Economy” are counterbalanced by its competing mandate to promote the national team’s development and increase the value of state assets. Indeed, the tension between these two SASAC mandates discussed in the last chapter help to explain the bureaucracy’s equivocation on the role of SOEs in real estate. Simply put, if SOEs are making money in the real estate sector, why should they retreat? As discussed in the last chapter, SASAC’s recent pronouncements on survival of the fittest as the appropriate final arbiter of SOEs place in competitive markets suggest that retreat by administrative fiat may disappear entirely from this policy.

### 4.3.1.2 Controversy over the State’s Advance

While the SOE national team’s overseas acquisitions have raised concerns about Chinese state capitalism abroad, it is perhaps less well appreciated that perceptions of the “state’s advance” in the domestic economy has become a hot topic of debate in Chinese press and society. Indeed, caustic commentary about SOE super profits in what are commonly referred to as the “monopoly industries” (longduan hangye 垄断行业) is a mainstay in the mainland’s financial press. In an echo of Pei’s “partial reform” perspective on state ownership discussed in Chapter Two, some observers have questioned SASAC’s true criteria in selecting the priority industries for majority state ownership. Economist Xu Xiaoping challenged each of the government’s stated justifications for continued state control in the seven big industries associated with SASAC’s Policy No. 97 (2006) discussed in the previous chapter:

Looking at the returns of the seven industries gross profit margins we see that except for power generation, petroleum processing and aviation, the others all had margins significantly higher than the rate of what is considered to be excessive profit-making in the real estate development industry which, in 2005, had a gross profit rate of 35.3%. The data shows that either the government has entered markets it should not be in, or the impulse to increase the value of state assets has replaced the original goal of overcoming market failure” (Xu, January 4, 2007).

Other commentators complain about the burden that price controls in the longduan hangye impose on consumers. Su Wenyang, a popular editorialist in Beijing Wanbao had a cynical response to the release of China Mobile’s 2008 annual report showing net profits 113 billion
RMB. Su (March 27, 2009) wrote: “At last, Chinese consumers can hold their heads up high and declare: China has the world’s most profitable enterprise.” He argued that if the government would not reform the telecom market via restructuring and liberalization, then it should unilaterally force Mobile to lower its service charges. Four days later, Su had all the longduan hangye in his sites. Commenting on the very high salaries of central SOE managers that had just been made public, he wrote that the trillion RMB worth of profits recorded by SOEs in the finance, oil & gas and telecom sectors were not a sign of their competitiveness, but evidence only that administrative pricing had propped up their profits (Su, April 1, 2009).

Besides this rising tide of critical commentary in the press, citizens are also increasingly active in using the courts as well as the complaints process in the China Consumers’ Association to lay challenge to what some perceive as SOE profiteering. As a sign of Chinese consumers’ growing rights consciousness as well as their frustration with high prices in mobile and fixed-line services, among the many legal actions taken against China Telecom (China Mobile’s predecessor), some have been for as little as two RMB (Hooper, 2005: 13). The long-awaited passage of the Anti-Monopoly Law in August 2008, has encouraged a slate of new legal actions against central SOEs. The first challenge to China Mobile under the new regime came in April 2009, when a Beijing court accepted a case brought by Tianjin lawyer Zhou Ze who argued that the telecommunications operator had violated both the Anti-Monopoly and the Consumer Protection laws by using its dominant market position to charge an unjustified monthly basic fee to consumers. Zhou was seeking damages of 1200 RMB from Mobile, equal to two years worth of the basic fee he had paid (Zhong, April 1, 2009). In October, Mobile agreed to remove the fee from Zhou’s mobile service and also awarded him a 1000 RMB “incentive fee” as compensation. Zhou’s success has since spurred other lawyers to bring similar cases against other central SOEs including against China Netcom in relation to its broadband internet service. Yet the applicability of the Anti-Monopoly Law in oligopolistic SOE markets remains a fuzzy and highly sensitive area of the law in practice. An activist lawyer who has tried and failed to bring similar suits against China National Petroleum Corporation and China Rail writes that though “the Anti-Monopoly Law does not specify that oil, telecommunications, railways and other monopoly industries fall outside the scope of this law, since the relevant supporting systems behind the Anti-Monopoly Law are still not perfect, the discretion of the courts and relevant government departments is too great” (Wang, November 2, 2009).
4.4 Conclusion

This chapter has explored the neoconservative legacy in the changing nature of the state-owned economy. It shows that the SOE industrial policy regime comprised of “Grabbing the Large”, the “Large Enterprise Strategy” and “Going Forth” has radically altered the Chinese political economy in the past fifteen years. The policy prioritization of central SOEs in the process of paring back the state sector combined with a surge in state sector profitability starting around 2001 have helped SASAC’s national team extend their influence in the domestic economy and has made them vanguards in China’s incipient going forth into overseas markets. The chapter also showed that the increasing clout of the state-owned national team has to some degree stymied efforts to further develop the “Adjusting the Layout of the State Sector” policy line. While there has been some progress on developing and implementing the “advance” portions of this policy line, the efforts to bring about SOEs “retreat” from industries with a weak justification for continued state ownership have proven more difficult. Discussion of the considerable and growing influence of central SOEs in real estate highlights the major political obstacles that stand in the way of efforts to retract state ownership from profitable industries. The following case study chapters will revisit these themes.
5 From Short-Term Winners to National Champions: China’s Telecommunications Reform

5.1 Introduction

The question at the heart of this case study is: why has the state “grabbed” the telecommunications sector for majority state ownership? The key finding is that the complimentary political and economic logics discussed in previous chapters also shed light on the reform pathway of this sector. Hellman’s (1998) model of “short term winners” straining to protect rents in partially reformed markets is a valuable heuristic for illuminating the politics of telecommunications reform, especially in the critical period of the 1990s when many key decisions about the participation of non-state and foreign investors in this industry were made. In keeping with the PRE model’s predictions about the pace of initial reforms as shaping the longer-term prospects for reform, the decision to preserve the incumbent’s monopoly into the 1990s, while successful by the measure of fast-paced network expansion, placed obstacles in the way of deeper reforms once the networks were in place. In the last decade, the legacy of the neoconservatives’ emphasis on building up a robust state sector has come to the fore as three state-owned players in telecommunications basic services have been honed in successive rounds of administrative industry restructuring. Under SASAC’s tutelage, China Mobile and, to lesser extent, China Telecom and China Unicom have become the celebrated stars of the national team, a development which has reinforced the status of telecommunications basic services as an inviolable segment of the state-owned economy. The evidence suggests that while the government’s interest in monitoring and censoring information flows is an important factor in shaping the degree of overall state control in telecommunications, the political sensitivity of this field is just one of several drivers in the incremental process of defining telecommunications as a domain of absolute state ownership.

37 This case study focuses on development of the telecommunications basic services market which in China’s somewhat idiosyncratic definition includes only fixed-line and mobile operations (Hsueh, 2011: 76). Neither the market for telecommunications value-added services (VAS) nor the manufacture of telecommunications equipment are considered here.
The argument is developed in tracing the pathway of telecommunication reform along three dimensions. The first section draws on previously unused sources to trace the emergence, evolution and impact of an industrial policy regime which took shape in the early 1980s. Savvy policy framing by leading figures in the telecommunications bureaucracy paved the way for a slate of bold industrial policies in the early 1980s which granted the incumbent considerable autonomy over the raising and disbursal of funds for network construction. Over time, the focus of telecom industrial policy has shifted from an initial focus on building networks and infrastructure to an emphasis on transforming the telecom SOEs into large enterprises capable of competing on the global stage. The second section examines the evolution of regulatory institutions in the telecommunications sector. It includes a discussion of the transformation of the Ministry of Post & Telecommunications (MPT) from its role as rule-maker and sole player in the telecom market to a more impartial regulatory authority starting in 1998. Despite these advances, the governance of telecom remains highly contested and ad hoc, partly because of fierce and abiding turf wars between interested parties. This section also includes an analysis of battles over foreign investment that flared during China’s WTO negotiations. The third and final section examines changes in the industrial organization of the telecommunications sector over the reform period. The analysis focuses on the political forces that gave shape to the dismantling of the MPT monopoly, the introduction of limited competition in the 1990s and the implications of having SASAC act as owner of all the big telecommunications service providers after 2003.

5.2 Industrial Policy

5.2.1 Formation of “Big Push” Industrial Policy, 1978-1995

The dynamics of partial reform are very much in evidence in the legacy of the central government’s ad hoc approach to building up China’s telecommunications sector cobbled together in the early reform period. Drawing from industry leaders’ recollections of this time, not previously used in the English language literature on China’s telecommunications reform, this section sheds light on the whys and wherefores of the “Big Push” strategy pieced together by the leadership in the late 1970s and early 1980s. At the outset of reform, China had earned the nickname the “country with no telephones” since, in 1980, China’s average fixed-line penetration rate was about one-tenth the world rate, one-seventh the average in Asia and one-third that of African nations (Wu et al, eds., 2008: 44). Thanks to the sustained efforts of several
leading figures in telecommunications, the policy elite was eventually persuaded that fast-paced telecommunications development would be necessary to securing China’s long-term economic growth. Yet, in the context of a meager central budget which tilted toward heavy industry, policymakers adopted a network development strategy paid for with investment funds raised by the incumbent monopolist, the MPT. The strategy proved tremendously successful and drove an unprecedented expansion of fixed-line, mobile and broadband telecom services. As time wore on, however, the MPT’s interest in protecting its privileged position in the burgeoning telecommunications market increasingly defined the politics of telecommunications reform.

China’s reform-era leaders inherited a telecommunications sector left in disarray by the ideological campaigns of the Maoist era when telecommunications was decried as a “tool of autocracy” (youdian shi zhuanzheng gongju 邮电是专政工具).\(^\text{38}\) After the Great Leap Forward, the Ministry of Post and Telecommunications bureaucracy was left severely weakened by a disastrous round of localization (xiafang 下放) of SOE control rights between 1958 and 1961 in which the provision of telecom services was made the responsibility of local governments. And later, during the Cultural Revolution, leftists launched attacks on officials in the telecom bureaucracy as well as on physical telecommunications infrastructure. In Chongqing, for example, the destruction of communication cables left the Sichuan provincial network crippled such that 91% of the wired communication infrastructure was unusable. In Fujian province, employees simply stopped reporting to work at the local Telecom Bureau in Ningde county and telecommunications ground to a halt for more than half a year (Wang, 2001: 18).

The telecom investment figures and bureaucracy were also left deeply frayed by the chaos. Between 1950 and 1978, investment in telecom accounted for just 0.86% of total investment and dipped as low 0.41% in 1962 (Wang, 2001: 23). For comparison, the International Telecommunications Union recommended at the time that Asian countries allocate at least 2.5% of total investment to telecom development and many countries met or exceeded this target. Not only was the physical infrastructure badly underdeveloped, the telecom

\[^{38}\] This paragraph draws from Wang’s (2001) superb economic history of telecom reform. Though there is now a large number of Chinese-language studies tracing telecom reforms post-1978, Wang’s is one of the few to look in detail at the Maoist era and this work points up some continuities in the Maoist and post-1978 eras, particularly the pronounced “fragmented authoritarianism” in this sector (Lieberthal and Oksenberg, 1988).
bureaucracy was left in tatters after a series of politically-driven bureaucratic reorganizations. In 1967, the MPT was placed under control of the People’s Liberation Army (PLA)—probably so as to protect infrastructure from further damage by the Red Guards—and then altogether abolished in 1970 before being finally restored in 1973 (Harwit, 2008: 33). In the waning years of the Cultural Revolution prior to Mao’s death, the MPT was said to have been all but excluded from decision-making on important telecom policies. Instead, decisions about technical issues such as tariff-setting and the allocation of resources were made by top-level generalist officials in government (Wang, 2001: 28).

After the start of the period of “reform and opening” in December 1978, telecom development quickly earned a place on the national agenda thanks to interventions from top leaders.39 Indeed, just a month after the historic Third Plenary Session of the Eleventh Central Committee of the CCP, Deng Xiaoping declared that “investment focus should fall on electricity, coal, petroleum, transportation and telecommunications” (Wang, 2001: 31). In the first year of reform, emphasis was placed on identifying the errors that had been made in the past and starting to devise policies that would spur fast-paced development (Wu et al., eds., 2008: 15-17). The Seventeenth National Post and Telecommunications Work Meeting, held in April 1979, was a crucial first step. This gathering, which ordinarily did not attract attention from the top leadership, was attended by three vice-premiers—Yu Qiuli, Wang Zhen and Gu Mu. At the meeting, MPT Minister and Party Secretary Wang Zigang presented a report of more than forty pages detailing the serious damage that been wrought during the “ten years of chaos” (1966-1976) and emphasizing the importance of making telecom development a high priority.

Shortly after conclusion of the work meeting, MPT presented a report based on Minister Wang’s analysis and recommendations to the State Council. This report subsequently became the basis for the State Council Document No. 165 issued in June 1979 (see Table 4.1). “No. 165” designated telecom as a leading-edge sector which would lead the development of other sectors

---

39 This section draws especially from former MPT and MII Minister Wu Jichuan’s (1997) personal account of telecom reform as well as a recent (2008) official history of telecom reform, Great Leap: Thirty Years of China Telecommunications published in commemoration of thirty years of “reform and opening.” (Wu was the director of the editorial team on this second book and much of the book’s content seems to reflect his input.) Together, these two accounts, especially the latter, provide rich insight into policymaking at the highest levels at various critical junctures.
Crucially, the policy also directed city-level officials to include the construction of urban telephone networks in cities’ construction plans. The policy also approved the collection of telephone installation fees to subsidize network construction. Following this decisive policy breakthrough, the Party’s propaganda apparatus went to work on dispelling telecom’s ideological dint left over from the Cultural Revolution. Accordingly, on October 17, 1979, People’s Daily ran an article titled “Strengthen the Building of Post and Telecommunications” which cited Marx’s discussion of the contribution of the telegram to the enormous productivity of capitalism in support of the argument that telecommunications is a productive sector. The People’s Daily editorial, in turn, led to a number of academic articles advocating the importance of telecommunications to a communist economy.

In 1980, the high priority of telecom development was further cemented following a high-level meeting held to set priorities in the upcoming planning period. Chaired by Premier Zhao Ziyang and attended by eight vice-premiers in addition to the Central Finance Leadership Small Group, the purpose of the June meeting was to hear reports from the railroad, transport and post and telecommunications ministers. The inclusion of MPT in the discussion was seen to be highly symbolic: “For MPT, having eight vice-premiers listen to their work report was without precedent” (Wu et al., eds., 2008: 19). Minister Wang’s report to the leadership detailed telecom’s woes and his comments were said to have been warmly received by the leaders, especially by vice-premiers Gu Mu and Bo Yibo, each of whom had been previously responsible for telecom policy. Wang also presented the results of an empirical research project examining the relationship between the expansion of industrial output and the rate of increase in the number of telephones. The report concluded that, in most countries with fast-growing economies, expansion in the number of telephones was 1.5 times greater than the rate of industrial expansion. He pointed out that, in China, the rate of increase in telephones had always lagged behind industrial output.

Bo Yibo was said to have been particularly impressed by Wang’s report and, along with Gu Mu, became a vocal advocate for telecommunications development in the three-day planning meeting and at high-level forums thereafter (Wu et al., eds.: 19-22). At the June planning meeting, Central Committee member Wan Li expressed skepticism and pointed out that
telephones at the central headquarters in Zhongnanhai worked quite well. In response, Bo Yibo joked that: “The work of the Zhongnanhai Telephone Bureau is indeed MPT’s greatest achievement but this very achievement is one of the main reasons that China’s telecommunication is now so backward. Since all of us use the central government’s telephone network (hongjizi 红机子) and all our calls go through as they should, we’re not very upset. If the hongziji worked like the phones used by everyone else, we’d also see the problem! MPT’s current hardships are precisely the result of having done a good job with hongziji” (Wu et al., eds., 2008: 20). Bo’s joke was said to have become widely known as he frequently used it in public speeches to underscore the importance of building a thriving telecom sector.

While this early policy entrepreneurship helped to forge a consensus around the urgency of telecom development, in the first three years it remained unclear just where such large-scale telecom investment would come from. Though policy “No. 165” had given MPT a revenue stream for investment, the installation fee sums fell well short of what was envisioned when policymakers spoke about making telecom into a vanguard sector. The key obstacle was that, in the first years of reform, investment decisions were still decided by the centralized planning bureaucracy which allocated funds to different industrial ministries on the basis of stated planning priorities. In vying for a larger slice of what was at the time a relatively small pie of budgetary funds, MPT found itself in a zero-sum competition with politically more powerful industrial ministries that had long eaten a much larger portion of central government funds. In a meeting in April 1980 with new MPT minister, Wang Minsheng, Bo Yibo conceded that: “regarding future investment, it probably won’t be less than today’s, but an increase would be very difficult to achieve. My guess is that the state will not be able to increase investment for two or three years” (Wu et al., eds., 2008: 24).

The critical breakthrough came at a large meeting in February 1982 held to discuss how to clear the telecom bottleneck. The meeting was chaired by Bo Yibo and attended by leaders from seventeen central government authorities with a stake in telecom development including heavyweights such as the State Planning Commission, the Ministry of Finance, the State Economic Commission, the State Import and Export Committee and the People’s Bank of China. The very act of bringing together all these influential government bodies to discuss telecommunication was in itself a matter of key significance: “The true meaning of this meeting
was not in its size or scale; rather it meant that telecommunications development had truly become a part of national economic planning. In the giant chess game of national economic development planning, the meeting established the coordination relationships (xietao guanxi; 协调关系) that would link together post and telecommunications and other interested parties and decided how policies affecting multiple parties would be decided” (Wu et al., eds., 2008: 24).

The meeting also laid the groundwork for the slate of industrial policies that would substantially increase MPT’s access to investment funds. Bo Yibo was said to have criticized officials from the finance ministry for “taking good care” of the transportation sector but neglecting telecom. He also appealed to the State Import and Export Committee (SIEC) to allow MPT to retain the foreign exchange which had been earned primarily from international calling. The SIEC representatives are said to have protested, claiming that there was no precedent for such a measure and complaining that granting the MPT special treatment would lead to endless demands for the same treatment from other ministries. Bo Yibo is said to have responded sharply with a Maoist phrase to “seek truth from facts” and to be nimble in addressing any such problems. These exchanges paved the way for passage of two of the “Three 90 Percents” policies (Table 5.1). In 1982, the State Council ruled that MPT could retain 90% of its profits for re-investment. And subsequently, the SIEC softened and permitted the telecom authorities to keep 90% of non-trade foreign currency revenue.
<table>
<thead>
<tr>
<th>Year</th>
<th>Policy</th>
<th>Content and Policy Evolution</th>
</tr>
</thead>
</table>
| 1979 | “No. 165” | Authorized the collection of initial installation fees to subsidize city telephone construction. Also permitted formerly within-government private networks to expand into the provision of services to households.  
- In 1985, the fee schedule was set at 2000 RMB installation fee for businesses and 1500 RMB for households.  
- In 1990, MPT and the State Price Bureau jointly issued a notice stipulating that fees should be set on a capital-cost recovery basis such that each new telephone number should recover the construction costs of one telephone (including telephone line construction, machinery and equipment investment costs etc.). Local authorities were given discretion over how to set the fees. In Beijing, installation fees reached as high as 5000 RMB. |
| 1981 | “Use phones to raise phones” (yi hua yanghua; 以话养话) | Authorized local authorities to use revenue earned at the local level to finance city telephone construction.  
- In 1981, MPT issued a regulation stipulating that provincial-level MPTs could use revenue from three earmarked funds for city telephone construction.  
- In 1982, the Ministry of Finance issued a notice to MPT stating that between 1982 and 1985, the MPT could retain the entirety of profits derived for reinvestment, ie. rather than turning it over to state coffers. |
| 1984 | “Three 90 percents” (san get dao yi jiu; 三个倒一九) | Authorized the MPT to retain revenue derived from three sources.  
- In 1982, the State Council announced that MPT need only turn over 10% of its profits to the central government; the remainder could be reinvested.  
- Later, the MPT was authorized to retain 90% of non-trade foreign currency revenue (the bulk of which accrued from international calling).  
- In 1986, the central government decreed that the MPT could be relieved of paying up to 90% of the principal and interest on central government loans.  
- In 1992, the State Council authorized the continuance of the “Three 90 percents” in order to spur investment in telecom to meet ballooning demand.  
- Finally cancelled in 1995 |
| 1986 | Postal Surcharge | Authorized the charging of special tariffs in order to promote construction of local postal and telecommunications facilities.  
- In 1986, the former State Economic and Trade Commission issued a policy authorizing the charging of postal and telecom tariffs. Thereafter, local authorities began collecting surcharges on long-distance telephone calling, telegraph and postal business. |
| 1986 | Import Tariff Reduction | Authorized the reduction and cancellation of tariffs charged on the import of telecom technologies.  
- In 1986, the State Council decreed that import tariffs applied to the purchase of foreign communications equipments could be cancelled entirely. |

Sources: Wang (2001: 34-36); Wu et al., ed (2008); Harwit (2008: 36).
The effect of these industrial policies on telecom sector investment was tremendous. Looking first at the changing composition of investment funds, Figure 5.1 shows how the MPT self-raised funds pot grew exponentially between 1981 and 1995 and especially so from the early 1990s. The data also show the decisive retreat of the state budget from telecom investment over the period. In 1981, the budget supplied 50% of fixed asset investment in post and telecommunications whereas in 1995 this figure had shrunk to 0.5%. Over the same period, the percentage of fixed asset investment provided from MPT funds grew steadily from 49.6% to 76.5%.

**Figure 5-1: Post and Telecommunications Investment in Fixed Assets, 1981-1995**

Within the MPT’s pot of self-raised investment funds, the contribution of installation fees increased steadily as the fee schedules were ticked upward twice, first in 1985 and then again in 1990 (see Table 5.1). Between 1986 and 1990, the installation fee revenue collected by MPT contributed 33% to total investment in the post and telecom sector over the period. And between

---

40 Because the MPT oversaw both the post and telecommunications sectors, their statistics typically combine the two. Nevertheless, the numbers approximate actual investment in telecommunications since fixed asset investment in post was minimal over this period.
1991 and 1995, installation fees accounted for 46% of total investment in the sector (Wang, 2001: 39). Given that China’s per capita GDP in 1990 was 1644 RMB, the cost of installing a telephone, which reached as high as 5000 RMB in Beijing, was priced well out of reach of ordinary citizens. Although this method of subsidizing network expansion has been standard practice around the world, the astronomic expense of telephone installation fees became a matter of widespread resentment in this period and has fed public dissatisfaction with the telecom “monopoly” down to the present day.

5.2.2 Metrics of the Big Push in Telecommunications Basic Services

This slate of industrial policies afforded MPT considerable flexibility in meeting booming household and business demand for telephones and stimulated an unprecedented expansion of telecom services which took off in the early 1990s. Figure 5.2 shows the increase in rural and urban telephone subscriptions and reflects the changing proportions of rural and urban subscriptions between 1980 and 2005. Over the 1980s, the number of urban fixed-line subscriptions in cities quadrupled and rural subscriptions nearly doubled. The data from the 1990s show that in the second decade of reform, fixed line services became much more accessible to businesses and residents in rural areas. In the nineties, the number of rural subscribers grew 35 times while urban telephone subscriptions increased by only 17 times between 1990 and 2000. To put these numbers in comparative perspective, in 2005, 57 out of 100 Chinese citizens had a telephone, a figure roughly equivalent to the situation in Japan and Australia of the early 1990s (Harwit, 2008: 38).
And the 1994 market entry of a rival to MPT in basic services, China Unicom, helped to promote the wildfire spread of mobile services. As Figure 5.3 shows, mobile phone subscriptions overtook fixed-line telephones as the primary means of communication in 2003. The chart also reflects the incredible growth in internet usage since 2000.

**Figure 5-3: Increase in Telecommunications Usage, 1990 to 2007**
In the first decade and a half of reform, the MPT’s “self-raised” investment funds fuelled this incredible expansion of telecommunications services by providing a revenue stream adequate to the financing of a huge expansion and technological upgrading of China’s telecommunications infrastructure. In 1985, the MPT announced its goal of increasing the number of telephone lines nationwide five-fold by the year 2000 (from 6 million to 30 million). By 1993, the goal had already been met and in 1996, 93 million lines had been built (Wu et al., eds., 2008: 36-7).

5.2.3 The Impact of Short-Term Winnings on the Course of Telecommunications Reform

In the early 1980s, China’s leading telecom policymakers were creative and politically skillful in creating a tenable “Big Push” strategy for telecom sector under extremely difficult circumstances. And yet, by making MPT the decisive short-term winner of Big Push industrial policy in telecommunications, stubborn obstacles were unwittingly placed in the way of deeper reforms. As later sections analyzing the pathways of regulatory and ownership reform in telecommunications will show, the explosion of both administrative and business revenues (see Chart 5.4) sharpened the MPT’s protectionist instincts. As the prime beneficiary in the early days of telecom reform, by the early 1990s, MPT’s leaders had shown themselves steadfast opponents of market liberalization which would diminish their revenue intake. As we will see, the incumbent used myriad ways of stifling the business of its competitor, Unicom.
In the early 1990s, MPT was the envy of many cash-strapped industrial ministries and the lure of boosting department revenues was reported by a leading figure in the MPT in the late 1980s as the major factor in rival ministries’ efforts to gain access to this growth industry (09BJ0323). Subsequent sections of this chapter will show that the strong incentives to hoard and protect profits in this protected market has emerged as a central theme in the development of the telecom sector since the early 1990s.

5.2.4 Grooming National Champions and Global Players (1994-)

As the “Big Push” phase of telecommunications development began to wind down in the mid-1990s, the state’s ambitions for this sector shifted away from methods of driving fixed asset investment and towards building up the competitiveness of the telcos in a manner consistent with the neoconservative emphasis on large, globally-competitive state-controlled enterprises in key sectors. Molding global competitors in a transition economy is a wide-ranging and complex process. Later sections of this chapter will cover some of the broader changes in the telecom sector that influenced the behavior of telecom enterprises including regulatory reforms and the introduction of limited competition as a component of experiments in ownership reform. The current section focuses in on two phases of enterprise reform that have had major implications.
for the development of this sector: first, the complicated process of corporatizing the incumbent telecom monopolist, the MPT, in the 1990s, and; second, the implications of the central government’s more recent efforts to foster a number of internationally-competitive telecommunications enterprises under the slogan of “going forth.”

From the early 1990s, the arduous process of enterprise reform emerged as a priority in the telecom sector. Among the most difficult problems faced in the transition from planned to market economy has been the matter of transforming SOEs—what were once just the endpoints of industrial ministries in the planning era bearing little resemblance to autonomous firms in capitalist systems—into bona fide companies with clearly-defined assets and liabilities as well as legal rights and responsibilities. In the telecommunications sector, achieving compliance with the 1994 Company Law was especially thorny because the telecom ministry was itself the sole service provider in China’s telecom market into the early 1990s meaning that the first task of government-enterprise separation (zhengqi fenkai 政企分开) was actually to carve out an SOE from the ministry. Accordingly, in 1994, MPT’s role as sole provider of public telecommunications basic services formally came to an end with establishment of the Directorate General of Telecommunications (DGT), a separate state-owned corporation, renamed China Telecom in 1995. From this point onward, the MPT was tasked solely with responsibility for telecom regulation but, as the later discussion on the establishment of Unicom will show, the MPT and its successors were slow to adapt to the role of impartial referee.

By the end of the decade, with the basic building blocks of a semi-competitive telecom market in place, the government’s prioritization of government-enterprise separation had given way to a new emphasis on molding internationally-competitive “national champions” in telecommunications and other key sectors. In the making of these national champions, overseas capital markets have played a pivotal role. A wave of overseas IPOs by large SOEs began with the listing of Brilliance China Automotive on the New York Stock Exchange in October 1992 and was followed by a series of “red chip” offerings of municipal assets repackaged as

---

41 The DGT existed as a unit of within the MPT from 1988 but was only formally removed from the Ministry in 1994.
corporations in the Hong Kong market (Walter and Howie, 2006: 96-106). The October 1997 listing of China Telecom in Hong Kong marked a new phase of SOEs tapping global capital markets because it was the first time nearly an entire industry had gone public. The IPO raised a record US $4 billion and demonstrated the considerable confidence foreign investors had in the future prospects of an incumbent monopolist in a booming growth market (Walter and Howie, 2006: 105). The China Telecom offering was the model for the subsequent listing of oil and gas giants PetroChina and Sinopec in 2000. In that same year, China Telecom’s rival, China Unicom, went public and raised US $5 billion by selling a mere 5% of the company’s shares. From the perspective of China’s top policymakers, these overseas IPOs were attractive because they considerably strengthened the financial position of SOEs at minimal cost in terms of loss of influence since only a small fraction of the companies’ total equity was offered for sale to foreign investors. As discussed in the previous chapter, by virtue of majority equity holdings often exceeding 75%, the mainland group companies at the helm of these national champions continue to exercise unrivalled control over decision-making in the listed companies.

In keeping with a growing policy emphasis on the “going forth” of Chinese companies and especially that of the government-controlled national champions, the state has mobilized in support of China’s telecom enterprises expansion into the global market. A variety of key government agencies have been accorded important roles in supporting the telcos’ overseas expansion. As investor on behalf of the state, SASAC has assumed primary responsibility for guiding the “going forth” of China’s national champions in this and other industries. In 2006, then-telecom regulator, MII, unveiled a pilot program devoted to the internationalization of the telecom enterprises’ operations. In the same year, an onerous rule requiring domestic enterprises to apply for a foreign exchange quota from the State Administration of Foreign Exchange (SAFE) prior to making overseas acquisitions was rescinded thereby giving SOEs much more latitude in making international investment decisions. SAFE, a division of the central bank

---

42 The decisions about which companies would go public were heavily political as the securities regulator, the China Securities Regulatory Commission had responsibility over vetting domestic companies’ IPO applications on the domestic as well as overseas market. The CSRC’s decisions were made in consultation with the top leadership in Beijing. The record of Chinese companies’ IPOs shows the strong preference given to state-owned companies.

43 At the time, China Unicom commanded a small fraction of the market in mobile services and fixed line services were entirely monopolized by Telecom.
responsible for managing China’s currency peg, has also relaxed foreign exchange rules mandating the return of foreign exchange earned abroad. The NDRC and the Import-Export Bank jointly administer a system that provides financial support for overseas investment. Finally, the Ministry of Commerce (MofCOM) has played a pivotal role as escort to SOEs going forth. MofCOM operates a “National Reporting System on Barriers to Investment and Operations” which uses bilateral mechanisms to try and lift barriers faced by Chinese enterprises in Africa and elsewhere.

While SOEs “going forth” is a term most often associated with China’s energy giants, the country’s largest telecom operators have begun expanding into overseas markets focusing on the South and Central Asian regions. To date, China Mobile has been most active in Pakistan. In 2005, China Mobile effort to purchase Pakistan Telecom’s mobile operations failed but the company later succeeded in purchasing 89% of Paktel’s shares, a small mobile operator in 2007. China Mobile subsequently purchased Paktel’s remaining shares and established China Mobile Pakistan (CMPak) as a 100% subsidiary of the Chinese parent company. In addition to Pakistan’s market of more than 165 million people and strong GDP growth prior to the onset of the global recession, Mobile was said to have been lured by the opportunities among the 66% of the Pakistani population living in rural areas where the company had hoped to replicate its successes in expanding coverage to the Chinese countryside (Lee, January 23, 2007). As yet, though, China Mobile’s Zong brand has struggled to take market share from Pakistan’s four established larger telcos, in part because the rural strategy successfully employed in China has proven a difficult transplant to Pakistan where rural land prices are higher, making provision of telecom bases and equipment more expensive (Zhao, August 1, 2011).

In recent years, techno-nationalist industrial policy has also become a key theme in the telecommunications sector (Naughton and Segal, 2003). The state has invested billions of dollars in development of a homegrown third-generation (“3G”) mobile standard to compete with foreign standards, the most competitive of which are owned by US company Qualcomm which collects considerable patent fee revenue from Chinese operators. With a mandate from the highest reaches of government, the China Academy of Telecommunications Technology in cooperation with state-owned Datang and German Siemens jointly developed a 3G wireless standard, TD-SCDMA in preparation for the offering of 3G services in China which finally took
place in 2008 (discussed in further detail below). While political elites as high-ranking as Hu Jintao are said to have backed TD-SCDMA, the telecom service providers themselves have been far less enthusiastic about using the standard. In 2006, as trials of TD-SCDMA were being rolled out in several cities, the CEOs of all the major telcos publicly expressed their doubts about TD-SCDMA’s quality and urged the government to “let the consumer choose” the best 3G standard rather than forcing one of them to operate a TD network (Ramstad, March 31, 2006). Trials held between 2006 and 2008 encountered some problems but policymakers hope that as the TD technology matures, China will be able to market this standard to developing countries since one of the purported advantages of TD is that it works well in densely populated areas.

5.3 Regulatory Reform

5.3.1 The Ups and Downs of Telecom Regulation (1978-1998)

Battles between powerbrokers in the state sector with stakes in China’s lucrative telecommunications basic services market have also left a deep imprint on the evolution of market regulation. As the incumbent monopolist gradually morphed into a nominally arm’s length market regulator, an interconnection regime that gave preference to China Telecom set limits on the market development of new entrants in the basic services market. And in the last decade, technological innovations which have steadily blurred the line between telecommunications and cable services fed rivalry between two powerful agencies and prevented the development of a coherent, powerful regulatory body. This rivalry between the cable and telecommunications authorities is the majore reason a draft version of the Telecommunications Law has languished in committee for more than twenty years. The legacy of intra-state competition in telecommunications is tension in the current system of regulation so considerable that the State Council is regularly called upon to quell disputes between rival bureaucracies.

The most important aspect of telecommunications regulation is administration of an interconnection regime to facilitate the smooth flow of communications between different telecom service providers on the backbone network.44 This is typically the most challenging

44 The other main features of China’s telecommunications regime are: rules governing market entry and investment, and; tariff policy for telecommunications basic services.
aspect of telecommunications regulation and has been especially thorny in China, in large part because of MPT’s rocky transition from monopolist service provider to referee. After Unicom’s establishment in 1993, an interconnection regime had to be built *de novo* in China in the 1990s because previously the majority of connections ran through the MPT system with the exception of communications bound in a number of private networks (zhuan-yong-wang 专用网), circumstances discussed in greater detail below. In addition to the technical difficulties involved in setting prices and collecting interconnection charges, establishing an impartial regulator to police the practice of interconnection proved difficult and the MPT and, to lesser extent its successor, MII, showed pronounced favoritism towards the former monopolist China Telecom. In fact, problems associated with the absence of an interconnection regime had surfaced prior to the market entry of Unicom.

One of the unexpected consequences of the state’s early “Big Push” industrial policies was the establishment of commercially-oriented local private networks that ran in parallel to MPT’s network and resulting in messy interconnection problems in certain places. A number of private networks had long been in operation under the auspices of the military, the central bank as well as the railways, oil and gas, power and forestry ministries among other government departments. In the circumstances of telecommunications underdevelopment in the Maoist era, the purpose of these networks had been to ensure the steady flow of intra-department information in vital sectors of the economy but as part of the state’s effort to achieve fast-paced development of telecommunications, the networks were permitted to expand into the provision of telecommunication services to households after 1978 (Wang, 2001: 53). In certain regions, especially the resource-rich northwestern provinces where the oil and gas and power ministries had well-established private networks, resource enterprises gradually became important players in the household telecom market and de facto rivals to the monopolist MPT (Wang, 2001: 53-55).

45 The following two paragraphs draw especially from Wang’s (2001) dissertation.

46 The landmark policy “No. 165” issued in June 1978 (described in Table 4.1) formally authorized the broadening of the scope of the private networks. The policy decreed that the private networks should be complementary to and not competitive with the MPT network and stated that the two systems should “rely on each other, complement each other and support each other” (cited in Wang, 2001: 53).
In 1990, MPT signaled its displeasure with the encroachment of the private networks in Policy No. 54 which asserted the MPT’s role as the authoritative body（zhuguan bumen 主管部门）in telecommunications policy and set limits on the role of the private networks proclaiming that “the main communications business should be provided by the MPT” (cited in Wang, 2001: 67). Yet the MPT’s declaration did little to slow the development of the private networks. In China’s largest oil-base, Daqing, the switching capacity of the Daqing City Petroleum Private Network actually exceeded that of the public network. And besides the petroleum network, sizable private networks were also operated by Daqing Agricultural Cultivation Administration, as well as the forestry, coal and railway bureaus. In the absence of an established interconnections regime to relay calls among the various networks, telecommunications in Daqing had become extremely chaotic by 1992 as the vast majority of calls between the networks within Daqing city failed to connect and the connection rate for long-distance calls in and out of the city was also extraordinarily low (Wang, 2001: 54).

The difficulties officials faced in resolving the problems in Daqing illustrate the trials of managing inter-department relationships in this lucrative sector, a problem which remains a feature of governance in this sector down to the present day. Partly because the various players in the Daqing telecommunications markets of this period were not all operating under the same vertical government system（xitong 系统）, negotiating a solution to the interconnection problems was a long and arduous process (Wang, 2001: 54-55). Two of the key protagonists in the Daqing market, the Oil Field Communications Company and Daqing City government, were under the authority of the Heilongjiang provincial government and Party commission. Two other key actors, the Daqing City MPT bureau and the Heilongjiang MPT answered to the central MPT and were embedded in a system of ministerial authority. At one point, the Oil Field Communications Company used its authority in the resource bureaucracies to shut off the MPT Bureau’s water and power supplies. Given these complex and rancorous authority relations at the local level, the problem proved insoluble and gradually filtered upward for resolution by higher-level authorities. At long last, in late 1995, the Heilongjiang Party Commission and national MPT leaders succeeded in negotiating a solution and, in early 1996, the entire Daqing network was finally completely interconnected.
Stoked by ill will stemming from MPT’s efforts to defend its monopoly from intrusion by the private networks, an acrimonious rivalry developed between MPT and several other government departments determined to “break its monopoly”, principally the Ministry of Electronics Industry (MEI). In 1992, the China Electronics Newspaper, a publication of MEI, ran a sharply-worded editorial entitled “Quickening Development of the Telecommunications Sector Shouldn’t be Postponed” which called for the separation of enterprise and government in telecommunications, the breaking of MPT’s monopoly and making good use of the existing private networks (Wang, 2001: 67). Shortly thereafter, the MEI, the Ministry of Electric Power and Railways Ministry jointly appealed to the State Council to allow them to set up a new telecommunications service provider, China Unicom （联通; liantong）. As the leadership was considering the “Three Department Report”, MPT officials used every public opportunity to deride the proposal claiming, variously, that: government monopoly was vital to the balanced development of the telecommunications sector; telecommunications was a natural monopoly and therefore belonged in the hands of a single operator, and; as the country’s “nerve system”, telecommunications should remain a monopoly since it was a matter of national security (Wang, 2001: 68). In the same period, MEI Minister, Hu Qili, worked strenuously to gain the backing of top leaders. Premier Li Peng was said to have been in favour of the proposal, apparently because of the role the energy sector would play in the new company, a traditional stronghold of Li’s family (Harwit, 2008: 48). Vice-premiers Zhu Rongji and Zou Jiuhua were also vocal supporters and, in late 1993, the State Council’s Policy No. 178 finally issued approval.

Unicom formally set up shop as a fully licensed telecommunications service provider in July 1994. It is noteworthy that while the State Council’s decision to set-up Unicom was widely interpreted as a victory for the principles of competition and breaking the telecom monopoly, the actual text of No. 178 strongly suggests that the top leaders saw the entry Unicom more modestly as an effective way to marshal the private networks under the control of the government departments.

47 The exact reasons why MEI led the charge against MPT in this period remain unclear. It may have been that MEI which, at the time, was the primary player in the telecommunications equipment manufacturing market was retaliating for MPT’s forays into that market in this period (Wu, 2008: 26).
48 For an SOE, Unicom had an unusually large number of shareholders. MEI, the Ministry of Electric Power and the Ministry of Railways each held 7.5% of the company’s shares, while 6% allotments were doled out to thirteen other Chinese companies hailing from the financial, chemicals and hi-tech sectors.
railway and power ministries in the context of abiding excess demand for telecommunications services (Wang, 2001: 71). In 1994, the State Council also gave approval to a new a new company, Jitong, to provide value-added services and the People’s Liberation Army also began offering mobile phone and paging services (Wu, 2008: 26).

Even with the MPT’s divestment of its service provision arm, DGT, ostensibly signaling its transition from market player to referee in 1994, the Ministry’s opposition to Unicom did not soften and MPT found myriad ways to frustrate the new entrant’s development. Besides the MPT’s interests in protecting China Telecom’s monopoly and maintaining the status quo, its efforts to block Unicom’s access to the market also reflected the bitter rivalry between it and Unicom’s main patron, MEI. In addition, ministers had personal interests in the market share of SOEs under their watch since their revenue intake was an important component of ministerial assessment (09BJ0707). Although Unicom had been granted a general license entitling it to sell all the same telecommunications services as had been offered by China Telecom, the MPT, to which Unicom had to apply before opening any new service in any specific location, effectively blocked it from operation of wireline services in all but a few cities and strongly curtailed the development of its mobile network in the early years.

From the outset, strong constraints were placed on Unicom’s ability to finance the construction of its network by two MPT policies (issued in 1993 and 1995) which aimed to cut off the company’s access to foreign investment. In Tianjin, Unicom, in cooperation with Sprint and Sumitomo, spent US $72 million building a fixed-line network which the local telecom bureau subsequently refused to connect to China Telecom’s network, citing technical problems. Unicom officials used an interesting tactic to resolve the problems in Tianjin. In May 1998, China Central Television (CCTV) ran a one-hour documentary detailing China Telecom and MPT’s joint efforts to hinder the development of Unicom’s network. Two months after the broadcast, Unicom’s network in Tianjin was up and running. Apparently, it was the influence of Unicom’s general manager and former vice mayor of Tianjin, Li Huifen, which enabled the airing of the CCTV documentary (Wu, 2008: 84).

49 In 1993, the waiting list for telephone installation was at its peak and had reached nearly 2 million nationwide (Wu, 2008: 25).

50 Though the DGT (China Telecom as of 1995) was formally taken out of MPT in 1994, as an SOE under the authority of the MPT, the new company retained close links to the regulator as personnel and investment decisions were still made by MPT (Harwit, 2008: 50).

51 Unicom officials used an interesting tactic to resolve the problems in Tianjin. In May 1998, China Central Television (CCTV) ran a one-hour documentary detailing China Telecom and MPT’s joint efforts to hinder the development of Unicom’s network. Two months after the broadcast, Unicom’s network in Tianjin was up and running. Apparently, it was the influence of Unicom’s general manager and former vice mayor of Tianjin, Li Huifen, which enabled the airing of the CCTV documentary (Wu, 2008: 84).
competitive installation fees, which were just one-fifth the rate charged by Telecom at the time, lured legions of new customers and the network expanded to half a million customers in only the first half-year of operation (Wu, 2008: 84). China Telecom’s monopoly over international calling was protected with a 1997 State Council document ruling that Unicom should not enter this market since these revenues fed the expansion of the public network and competition from Unicom would drive prices down and lead to contraction of revenues (Harwit, 2008: 59). In mobile services, Unicom decided early on to focus on developing its GSM (Global System for Mobile) products but was granted a license by MPT only in late 1995, after China Telecom had its own GSM operations in place (Wang, 2001: 69). The incumbent also used its market power to frustrate interconnection between the Unicom and China Telecom networks. Unicom was charged exorbitant rates for connection to China Telecom’s fixed-line and mobile systems and placed technical obstacles in the network to irritate Unicom’s customers and drive them back to Telecom.

As problems in the partially reformed telecommunications market mounted, the need for deeper reforms of MPT became increasingly obvious. Since there was no interconnections regime in place prior to the entry of Unicom, the new company’s negotiations with the former monopolist were not bound by any regulations prior to the MPT’s issuance of cursory technical guidelines on interconnection in 1995 (Wu, 2008: 82). Predictably, Unicom fared badly in heavily asymmetric negotiations with the incumbent and, when bargaining stalemates emerged, Unicom sought interventions from the State Council. One sign of the immense imbalance between Unicom and Telecom in these negotiations is in the names given to the interconnection offices in each enterprise. In Unicom, the office responsible for interconnection was called the “Interconnection Department” whereas in China Telecom it was named the “Supervision of Interconnection Department” (08BJ1201).
In 1997, three high-ranking commissions jointly issued a report reviewing the competition that had emerged between Unicom and China Telecom and considering the arguments for and against further liberalization of the telecom market. Although the report did not side clearly with either China Telecom or Unicom’s positions, it did call for a decisive severing of the link between MPT and Telecom and for the establishment of a system of impartial regulation (Harwit, 2008: 59). MPT minister, Wu Jichuan, was said to have steadfastly blocked the plan until a version guaranteeing MPT jobs was tabled (Wu, 2008: 30). The decisive moment came in 1998 as part of a radical administrative overhaul of the central government. The plan saw the merger of MPT and MEI under a new ministry, the MII. Unsurprisingly, the process of combining the former adversaries involved pitched political battles over leadership positions in the new ministry. Following rumours that an MEI vice-minister would lead the new MII, the MPT’s Wu Jichuan was finally given the post which may have been a signal that the top leadership intended to stay a conservative course in telecom policymaking (Wu, 2008: 31). Under Wu’s leadership, many of the highest-ranking MEI figures in the new MII were pushed out of their vice-ministerial posts within months (Harwit, 2008: 63).

The establishment of MII led to a notable leveling of the playing field, yet smaller telecom operators continued to face difficulties gaining fair access to the backbone network operated by China Telecom under the new system. After MII’s creation brought an abrupt end to the damaging rivalry between MPT and MEI, the new regulator’s stance toward Unicom softened considerably as MII assumed the role of Unicom’s patron, a change signaled most obviously by the appointment of a former senior MPT official, Yang Xianzhu, to the posts of Chairman and President in China Unicom in 1999 (Wu, 2008: 31). Very quickly thereafter many of the most onerous regulatory constraints on Unicom’s business operations were lifted. In 1999, for instance, the company was granted a license to provide mobile services nationwide and was later given permission to operate an international network. With this dramatic change in the regulatory environment, China Unicom’s customer base tripled between 1998 and 1999 (Wu, 2008: 86). Yet interconnection problems remained. Partly they were due to continued favoritism toward China Telecom and its successor China Mobile on the part of local telecom authorities and partly they were a result of the fact that local authorities often had neither the technical
training nor the manpower necessary to carry out effective oversight of interconnection between the operators (Wu, 2008: 91). In these circumstances, the market player in control of the largest network wields considerable influence over its competitors’ business operations and can use dirty tricks to drive their customers away. For instance, China Mobile was known to engineer brief interconnection blackouts against smaller competitors in order to damage their business in the early 2000s, yet the tactic was impossible to prove in the absence of close monitoring by local regulatory bodies. As recently as 2002, subscribers to Unicom mobile services in a region of Henan province where competition between mobile operators has been particularly fierce reported that their calls were connected only thirty percent of the time (Wu, 2008: 90).

5.3.2 The Persistence of Regulatory Bottlenecks (1998–)

In addition, although the creation of MII did serve to quell one bureaucratic skirmish, the dynamics of fragmented authoritarianism remain very present in telecommunications policymaking. The current bureaucratic battles have migrated from the terrain of interconnection to technical questions posed by the rapid convergence of broadcasting and telecommunications technologies. In China, as in many other countries, cable and telecommunications are the authority of separate ministries with cable falling under the State Administration of Radio, Film and Television (SARFT). The cable and telecommunications authorities began to quarrel in the late 90s as new innovations blurred the technical distinction between cable and telecommunications services. In that time, cable networks under the authority of SARFT began to encroach on the telecom operators’ turf by offering telephone and internet services in some locations. In a town in Hunan province in 1997, supporters of the telecommunications and broadcasting bureaucracies actually came to physical blows in a riot that took place after a local cable network began offering phone services without MPT’s approval (Wu, 2008: 36). More recently, the telecom operators’ efforts to develop IPTV services have been blocked by SARFT which aims to keep broadcasting the preserve of the state-owned cable networks (08BJ1201). The turf wars between SARFT and MII/MIIT is the main reason that a draft Telecom Law has

53 At the national level, China Telecom was hived off from MII in 1999, but local authorities only completed the separation two years later. To make matters more difficult, most of the regulatory staff at the local levels had formerly been employed by China Telecom (Wu, 2008: 91). Interviewees in Beijing reported that the thick guanxi networks connecting China Mobile to the new regulator also compromised MII’s impartiality at the national level.
been mired in negotiations for more than twenty years. In the absence of clear rules assigning
definite roles to the different players in the changed terrain of telecommunications policymaking,
many important policies are now decided above the level of the ministries.

These regulatory bottlenecks have once again encouraged higher-level authorities to step
into the breach. The intention had been for MII to become a fully autonomous and authoritative
regulator for the telecommunications sector after 1998 but, in late 1999, the troubles with
SARFT prompted the State Council to establish a “leading group for national information work”
chaired by Premier Zhu Rongji to guide policymaking in telecommunications, internet and
broadcasting and resolve disputes in these areas between MII and SARFT. The State Council
Informatization Office (SCIO) serves as the secretariat of the leading group and has assumed a
key role in telecommunications policymaking (Wu, 2008: 38). Though the SCIO’s staff of about
twenty people is dwarfed by the MII/MIIT’s personnel, prominent figures have called for the
establishment of a truly independent telecommunications regulator to form around the nucleus of
the SCIO. In the context of a weakly institutionalized policymaking environment, SCIO looks to
some experts like the nucleus of a potentially effective regulator since it is a top-level authority,
specialized, impartial and strong (09BJ0707).

In addition to SCIO, SASAC now plays an ever-more prominent role in
telecommunications policymaking. Yeo (2009) argues that the most important role played by
SASAC in the telecom industry is not actually as owner of the telecommunications enterprise but
as industry regulator. She finds that the SASAC’s mandate to increase the value of state assets,
discussed at length in the previous chapter, has led to conflicts with the telecom regulator over
rule changes that would threaten the telcos’ profitability. For instance, SASAC was said to have
intervened after the MII tabled a proposal to introduce a caller-pay system which might have
reduced fees paid by consumers by as much 30 percent (Yeo, 2009: 1020). And as will be
discussed in more detail in the next section, SASAC was the main architect of the 2008
reshuffling of the telecom industry, a reform with momentous implications for industrial
organization of this sector. Similarly, Hsueh (2011: 94) suggests that one of SASAC’s aims in
instituting a periodic game of musical chairs between the major telco executives is dampening
price wars between the major players in the interests of maximizing total revenue intake.
In 2008, telecom regulation took what a number of interviewees described as a significant step backwards with establishment of a new telecommunications authority to replace MII. As part of the government’s “big ministry administrative reforms” (dabuzhi gaige 大部制改革), which aims to ease the problems associated with fragmented authoritarianism by reducing the number of ministries under the authority of the State Council, MII was merged with elements of the industrial bureaucracy to form the Ministry of Industry and Information Technology (MIIT) in March 2008. Premier Wen Jiabao is said to have personally pushed for the merger in the hopes that combining policymaking authority for these sectors would be a boon to industrial upgrading by encouraging industry’s embrace of information technology. One former MPT official offered a different account suggesting that the weakness of MII in comparison to other industrial bureaucracies provides the true explanation for the somewhat puzzling inclusion of telecommunications in MIIT (09BJ0323). The new super-ministry has authority over policymaking in a broad tract of the economy and pulls together regulation of heavy industry and tobacco in addition to telecommunications. In a series of interviews conducted in Beijing in 2008 and 2009, observers consistently emphasized China’s need for an independent and powerful telecommunications regulator along the lines of the US Federal Communications Commission and described the 2008 reform as a step in the wrong direction. As an indication of where the new ministry’s priorities lie, the official chosen to lead MIIT, Li Yizhong, who came directly from a high post in SASAC has strong ties with the oil industry and no prior experience in telecommunications.

While regulatory reforms have radically changed the face of this sector, the strong profitability of this sector has made infighting among state sector powerbrokers a persistent theme. Currently, the remaining problems in telecommunications are primarily the result of

54 Since each round of administrative restructuring involves courting powerful ministries, industries without powerful patrons in the Central Committee or politburo are seen to have less ability to defend their turf and, thus, become attractive targets for ministerial merger. Another aspect of the 2008 administrative reforms lends prima facie support to this argument. In an effort to streamline transportation policymaking, a new Ministry of Transport was created with final authority over shipping, air and roads policy. Amazingly, the Ministry of Rail was left out of the new structure which attests to the substantial political clout of this ministry.

55 The appointment of a non-telecom minister may have been a signal of the top leadership’s displeasure with the MII’s final minister, Wang Xudong, who was known to be skeptical of both the TD-SCDMA program and the most recent round of industrial restructuring discussed in the next section (09BJ0323).
various state actors’ efforts to establish and maintain their turf in this lucrative sector. At the beginning of the 1990s, the main clashes were between the short-term winner in the early reform period, MPT, and its rivals in the industrial bureaucracy, principally MEI as well as the power and rail ministries. The monopolist’s obvious efforts to undercut Unicom highlighted the existence of a void in telecom regulation in the area of interconnection, which the higher reaches of government was consequently forced to fill on an *ad hoc* basis. The establishment of MII neatly eliminated these rivalries but the resulting bureaucracy was ill-equipped to resolve regulatory disputes with a new adversary in the cable bureaucracy, SARFT. Once again, the State Council was called upon to fill a regulatory gap and, since the establishment of SCIO in 1999, important telecom policy decisions have increasingly been made above the level of MII/MIIT. The marginalization of the telecom regulator was shown most dramatically with the establishment of MIIT, in 2008, which has further reduced the input of telecom experts in this sector. Finally, as the body with authority over all the telecom SOEs, SASAC has absorbed significant regulatory powers in this sector, a theme to which we return in the following section.

### 5.3.3 WTO and the Labeling of Telecommunications as a Strategic Sector

Beginning from the mid-90s, the combined effect of MPT protectionism, heavy external pressure to liberalize foreign investment and technological change served to push telecommunications towards the privileged category of national security-related sectors. While scholars tend now to take for granted that the Party’s interests in controlling information marks telecommunications as a highly sensitive field of economic activity, the evidence suggests that this special designation was relatively late in coming. Further, an examination of the material interests which shaped debates about the proper role of foreign and private investment in telecommunications in the critical period of the late nineties strongly suggests that the shared interests of different branches of government in protecting the high profitability of China Telecom and its state-owned competitors was a major behind the scenes factor in this policy shift.

For foreign companies hoping to gain access to the telecommunications basic services industry, the foggy policy environment of the early 1990s offered clandestine opportunities (Hsueh, 2011: 64-66). In 1993, in the pitched battles over Unicom, the State Council issued the industry’s first ruling on foreign investment, Policy No. 55, which stated flatly that “foreign
businesses are not allowed to run or participate in the telecommunications service business in China.” Mueller and Lovelock (2000: 736) suggest that the timing of this foreign investment ban was not in the least coincidental. They argue that the rule, which had been drawn up by MPT, was primarily intended to stifle Unicom’s development by depriving the new company of much-needed capital and cooperative opportunities with foreign telecom service providers. The rule was also consistent with the State Council’s interests in breaking MPT’s monopoly but retaining a strong hand in development of telecommunications. In sum, “coupling competition with a ban on FDI was the bargain that reconciled these concerns” (Mueller and Lovelock, 2000: 737). Yet after its establishment, Unicom flouted the FDI ban by exploiting a loophole in the regulation that allowed Unicom operating through satellite companies to set up joint ventures with foreign companies. These “China-China-foreign” (zhong zhong wai 中中外) arrangements allowed Unicom to set up lucrative joint ventures with a legion of foreign companies including Ameritech (USA), Bell Canada and Deutsche Telecom before the MPT sealed the loophole in a 1998 ruling that forced Unicom to terminate its forty-six CCF agreements (Wu, 2008: 70). Foreign telcos angered by the MPT’s unilateralism and the poor compensation they received from Unicom in the process of dissolving the CCF joint ventures, thereafter noisily lobbied their home governments to make majority foreign investment in telecommunications a condition of China’s WTO entry.

The ensuing battles over telecommunications in China’s WTO negotiations were strongly colored by the currents of domestic politics and especially by MII Minister Wu’s bold interventions. In the late 1990s, leaders in the former industrial line ministries were incensed by Zhu’s upending of government-business relations in the 1998 administrative reforms. In the wake of these reforms, Minister Wu emerged as one of the most outspoken opponents of Premier Zhu and he used his post as head of the restructured telecom regulator to frustrate Zhu’s efforts to conclude the most difficult part of WTO negotiations, the US agreement. In April 1999, after a failed round of talks, Zhu came under intense pressure domestically after the Clinton administration unilaterally publicized concessions that had supposedly been made by Chinese negotiators at the meetings, including an agreement in principle to allow 51% foreign equity
investment in telecommunications service enterprise (Fewsmith, 1999). Upon Zhu’s return to Beijing, Wu was rumoured to have tendered his resignation in protest, a defiant gesture which the leadership rejected (Johnson, May 3, 1999). In the months following Zhu’s disastrous visit to Washington, MII Minister Wu worked assiduously to undermine the premier’s public assurances that China’s telecommunications industry was gradually opening to foreign investment. Most notably, in September 1999, Wu declared in an interview with a foreign newspaper that telecommunications basic services and Internet business remained closed to foreign investors (Johnson, September 20, 1999). Premier Zhu’s weakened position combined with Wu’s calls for foreign investment to be restricted on national security grounds were seen to be key factors in shaping the final terms of the US agreement, reached in November 1999, which limited foreign equity investment in telecom basic services joint ventures to 49% (after 2004 for mobile and after 2006 for fixed line) and 50% in value-added services (09BJ0924). In practice, because all applications for telecommunications joint ventures in basic services are vetted by the regulator, the market remains effectively closed to prospective foreign and private service providers in the basic services market segment (08BJ1201). Wu’s relatively successful campaign to block external liberalization of telecommunications in this period, while perhaps fuelled by his personal disdain for Premier Zhu and the opportunities presented by the Premier’s vulnerability, was entirely consistent with MPT/MII’s protectionist stance.

56 Fewsmith reports that Zhu was under pressure from on all sides in this period and especially so after the Belgrade embassy bombings in May 1999. In internet forums, Zhu was attacked by netizens as a traitor (mai guozei 卖国贼) and likened to the hated collaborators with the Japanese during the war of resistance. At the same time, Fewsmith argues that Jiang and other elites saw fit to distance themselves from Zhu and left the premier to bear alone the heated attacks from conservatives such as Li Peng’s reported tongue-lashing of Zhu in a spring Politburo meeting in which he charged his rival with attempting to usurp Jiang’s position as core leader and pursuing reform too ambitiously.

57 In an April interview with PBS, Zhu declared: “Our current disagreement with the United States is that they are demanding that foreign companies be permitted to hold controlling shares in joint ventures. I’ve said to them, I’m not against foreigners have controlling shares but please be patient; right now I have no way to persuade ordinary people that this is the right way to go” (Zhu, April 4 1999).

58 Foreign companies have though used the capital markets to gain minor equity holdings in the telcos themselves. Vodafone holds 3% of Mobile’s shares and Korea’s SK owns 7% of Unicom. Access to the VAS market, while also tightly controlled is much more open to direct foreign participation. By the end of 2006, 29 foreign firms had applied to MII to set up joint ventures and a number of these, including Microsoft’s application to set up a Shanghai-based VAS JV, were successful (08BJ1107).
While Minister Wu astutely played the national security card as a rationale for restricting foreign investment, Premier Zhu’s own statements in this period (see note 23) combined with evidence of the Party’s belated realization of the political implications of telecommunications, suggests that elites did not consider telecommunications a highly sensitive sector during the WTO negotiations. Indeed, while the state-owned telcos do play a role in state censorship efforts, profitability is a key factor in explaining why the provision of telecommunications basic services remains firmly within the state-owned economy. Lynch’s (1999: 194) research on the evolution of Party “thought work” in the 1990s shows that despite the role of fax machines in helping organizers to relay messages during the Tiananmen protests “only in early 1996 did the Chinese authorities finally seem to grasp the significance of the Internet and to target telecommunications services” in a series of regulations limiting the provision of internet services and requiring VAS providers to register with MPT. Lynch’s work also points out that largely because telecommunications and propaganda fall under different policy xitong, telcos in the 1990s were far removed from the business of thought work: “individuals working in the telecommunications industry do not see it as their responsibility to manage the content of telecommunications networks, while individuals working in the party's propaganda apparatus do not see it as their responsibility to concern themselves with what passes through the nation's telecommunications networks”(Lynch, 1999: 190-1).

It is widely known that the Chinese state goes to great lengths to police its citizens’ private communications but the prominent role of private companies in this work suggests that state ownership is not a hard requirement of carrying out censorship. In the Chinese blogosphere, foreign-invested and Chinese non-state service providers such as Sina shoulder the responsibility for censoring sensitive material that appears on their sites knowing that failure to do so could result in costly penalties, even losing their licenses (Hsueh, 2011: 101). As for monitoring short messages (SMS) and voice communications, the telecommunications carriers under SASAC, who are instructed to maximize their profitability above all else, are not always willing partners in costly monitoring efforts mandated by the state. In early 2010, for example, a new rule issued by six major departments including the Ministry of Public Security required the telcos to monitor the content of SMS communications passed between users for pornographic material and, implicitly, for anti-government messages. The rule was extremely unpopular not only with many
citizens but also with the telco managers who saw the new burdens of SMS monitoring in terms of lost revenue (10BJ0612).

5.4 Ownership Reform

The final section analyzes the complimentary economic and political logics that have contributed to the continuing dominance of state ownership in telecommunications. The focus here is on the evolution of industrial organization in the market as well as changes in the ownership structure over the period. Broadly three phases are evident. In the early reform period, lured by average annual revenue growth of 44% between 1991 and 1995, several ministries in addition to the military found ways of circumventing the MPT’s barriers to entry and began to provide various kinds of telecommunications basic services. After separation between regulator and operator was completed in 1998, with the establishment of MII, the central government undertook further efforts to level the playing field by breaking up China Telecom in 1999 and then again in 2002. Finally, with the establishment of SASAC in 2003, the ownership responsibilities for the largest telecommunications enterprises came under the same roof. In recent years, SASAC has come to play an important role in the telecommunications market as this powerful bureaucracy guides not only enterprise policymaking but also participates in a widening field of telecommunications policies.

Besides the three ministries which jointly established China Unicom in 1994, a number of other state actors established a toehold in the telecommunications market in this early period. Beginning in the mid-1980s, the PLA, which fell outside of MPT’s jurisdiction, began to utilize its telecommunications infrastructure to offer paging services, typically run by regional military outfits (Wu, 2008: 44). The MPT and PLA later established a joint venture, Great Wall, which offered commercial wireless services in Beijing and Shanghai. In 1998, Premier Zhu Rongji boldly ordered the divestiture of all of the PLA’s businesses and Great Wall’s wireless business was eventually turned over to Unicom. Besides Great Wall, the State Council licensed another telecom enterprise, Jitong, in 1993, to offer value-added data services. Since the new company had the backing of more than twenty government bodies and a high-level mandate from the State Council to oversee the construction of China’s nascent internet network and, more importantly, since its service offerings did not put it in direct competition with China Telecom, the MPT did not try stifle the development of this enterprise as it had Unicom’s (Wu, 2008: 46).
Shortly after establishment of MII in 1998, a major restructuring of the telecom market began to take shape. The government began formally vetting proposals for a structural separation of China Telecom’s businesses in 1998. Although the incorporation of Unicom under the MII umbrella did much to improve the terms of competition between the two major enterprises, even in the mobile phone market, in which Unicom had become relatively competitive, Telecom still commanded 91% of the market share in 1999 (Harwit, 2008: 65). With considerable pressure from the media which regularly derided China Telecom’s poor customer service, high installation fees and reputation for wasteful expenditures on extravagant office buildings, top policymakers began to consider various options for dismantling the former monopolist in order to increase competition and bring down prices (Wu, 2008: 47). In April 1999, Minister Wu Jichuan announced that Telecom would be “vertically” separated such that its wireline businesses would go to the new China Telecom (which also kept internet services); its wireless services would go to a new company, China Mobile, and; its paging business to Unicom; while its satellite operations were hived off in a new enterprise, China Satellite (see Figure 4.1). In 2000, two more enterprises, China Railcom and China Netcom joined the restructured market. In setting up Railcom, the railways ministry hoped to capitalize on its vast private network, which was second in size only to China Telecom’s national network, by offering local and long-distance fixed-line services. From the outset, however, Railcom was plagued with problems and became heavily indebted before finally being absorbed by SASAC in 2003 (under the terms of the deal, the Ministry of Rail had to repay these debts). The Ministry of Rail was also a major financial backer of Netcom, along with SARFT, the Chinese Academy of Sciences and the Shanghai Information Technology Office (Harwit, 2008: 86). Netcom operated a data network which was subsequently merged with a subsidiary of China Telecom which was also called China Netcom.

After the two largest pieces of the original China Telecom—new China Telecom and China Mobile—quickly emerged from the first round of reforms as the dominant players, a

59 It is likely that MII favored the vertical option because it would be ensure a higher stock valuation and allow China Telecom to hold its place as one of the world’s largest telecom operators (Wu, 2008: 49).
second restructuring of the market once again aimed to achieve more balanced competition. After 1999, China Telecom still controlled more than 90% of the market share in local fixed-line services and China Mobile held 74% of the mobile market in 2002, a lopsidedness which led their competitors to lobby for a second break-up (Yeo, 2009: 1017). China Mobile remained untouched by the 2002 reforms but China Telecom underwent a “horizontal” separation along geographic lines. About 70% of the company’s fixed-line network kept the China Telecom name and was based in the southern region of China. The remainder of the company’s assets were combined with China Netcom and Jitong’s businesses to form a company based in the north called China Netcom (Figure 4.1). Interestingly, MII was said to have been largely excluded from the design of the second restructuring, reportedly because the Ministry had been the main architect of the first round which was not seen to have been successful in promoting competition; instead, the State Council and the State Planning Commission oversaw the design of the second reform (Wu, 2008: 58).

The reform partially succeeded in reducing the market dominance of China Telecom but after 2002 China Mobile benefited most from the booming mobile market (Figure 5.5).

**Figure 5-5: Telecommunications Services Providers Proportion of Industry Revenue, 2007**

![Pie chart showing market share of telecommunications providers](image)

The number of subscribers to China Mobile’s GSM network more than doubled between 2002 and 2007, growing from 114 million to 356 million. While China Unicom’s subscriptions nearly tripled in the same period, Unicom had a customer base that was still just 44% the size of Mobile’s in 2007 (Harwit, 2008: 65). In the years after the 2002 restructuring, China Telecom and Netcom each lobbied the State Council for mobile licenses and pressure mounted for yet another market reshuffle.60

After it assumed the responsibilities of owner on behalf of the state over all the major telecommunications enterprises in 2003, SASAC has played an ever-more prominent role in the telecommunications industry (see Figure 4.1). As discussed in previous chapters, SASAC now exercises considerable influence over the SOEs in its charge through high-level management appointments, the dispatch of supervisory panels to SOEs and, most importantly, through annual performance reviews, the results of which are published in annual industry-specific rankings and SASAC-wide enterprise rankings. Consistent with SASAC’s responsibility for “maintaining and increasing the value of state assets”（baozhi zengzhi 保值增值），the main criterion in the annual performance reviews is profitability and the salaries of SOE managers are tied to the outcome of these reviews. China Mobile’s extremely high profit margins (Figure 5.6) have consistently landed it top marks in both the industry and SASAC-wide ranking. For several years, China Mobile ranked first overall in the cross-industry rankings.

60 In spite of their restriction to the fixed-line service market in this period, China Telecom and Netcom devised a creative way of tapping the lower-end of the booming mobile market. In major cities, the companies offered a service called “Little Smart” (xiaolingtong 小灵通) which allowed fixed-line customers to use a mobile phone to roam within a confined area. Though the “Little Smart” connections were not as crisp as calls made on mobile or home phones, the service’s lower calling charges attracted large numbers of budget-conscious consumers.
As noted previously, SASAC has also intervened in important regulatory decisions. Besides its efforts to stifle a caller-pays reform which threatened to narrow the telcos’ revenue stream, Yeo (2009) finds that SASAC makes increasing use of its influence and high administrative rank in participating in the design of regulations which have implications for the telcos’ revenue generation. For instance, SASAC is said to have been a main protagonist in the government’s effort to suppress a 2004 price war between mobile operators in Guangzhou, calling the competition between Guangzhou Mobile and Guangzhou Unicom “vicious” (exing jingzheng 恶性竞争) (Yeo, 2009: 1030).

Finally, SASAC was also the primary architect of a 2008 restructuring of the telecom market. The most recent round of restructuring combines the aims of technonationalist

---

61 Reportedly, none of the twenty or so leading telecommunications experts in Beijing participated meaningfully in the 2008 restructuring which took shape mainly within SASAC’s walls (09BJ0323).
industrial policy with a desire to partially rebalance competition in the mobile services market. As discussed previously, the central government devoted major resources to development of a homegrown 3G wireless standard and delayed the issuance of rival 3G standards to the telecom operators in order to allow TD-SCDMA’s design team sufficient time to bring the product to maturity. Besides these techno-nationalist goals, restructuring was also shaped by Mobile’s rivals’ concerns about its dominance in the most lucrative mobile market. In addition, Unicom was eager to shed one of its two 2G networks (a nationwide GSM network and a regional CDMA network) which had been competing against each other since it had begun building CDMA networks in Tianjin, Shanghai and Guangzhou in 1998.

In 2008, the “3+1” restructuring plan was formally announced: China Mobile would absorb China Railcom and operate a TD-SCDMA network; China Telecom would take over Unicom’s CDMA network and run a 3G CDMA2000 network, and; China Unicom would absorb Netcom, keep its GSM network and be licensed for a WCDMA 3G network (see Figure 4.1). In deciding the terms of restructuring, SASAC’s telecommunications performance ranking was apparently a critical factor in the decision for Netcom to be taken over by Unicom because Netcom had consistently finished behind its competitors Unicom, Telecom and Mobile (08BJ1107). While China Mobile is seen to be at a disadvantage in the 3G market, since the company kept its most lucrative business line, the 2G GSM wireless network, it is likely that Mobile will retain its commanding market position in the immediate future. According to one interviewee, at no point in the process was a structural separation of China Mobile’s businesses given serious consideration because policymakers were committed to preserving the company’s market capitalization and growing international presence (09BJ0323).
Figure 5-7: Competition in Telecommunications Basic Services, 1994-2009

Prior to 1994

MPT
(regulator & monopoly operator)

1994

DGT/ China Telecom

Great Wall
(PLA and MPT)

China Unicom
(under State Council, MEI)

Jitong
(under MEI, later MII)

1999-2001

China Telecom
China Mobile
China Satellite
China Paging

China Unicom
(1998- under MII)

China Netcom
(under MoR, SARFT et al; merged with Jitong then new Netcom)

China Railcom
(under MoR)

split

split

merged (1999)

2002-2007

China Telecom
(fixed line + data services of China Telecom in southern China)
-GSM wireless network

China Netcom
(fixed line + data services of China Telecom in northern China)

China Unicom
-GSM & CDMA mobile networks

China Mobile
-GSM network

China Satellite
*taken over by China Aerospace Science & Technology Corporation in 2009

China Railcom

2008-

China Telecom
-2G: given Unicom’s CDMA wireless network
-3G: CDMA2000

China Mobile
-2G: kept its GSM network
-3G: TD-SCDMA

China Unicom
-2G: operates GSM wireless network
-3G: WCDMA

Source: adapted from Harwit (2008: 51)

overseen/operated by MPT

overseen/operated by MII

overseen by Ministry other than MII

overseen by SASAC (2003-)

overseen by MoR
In the fifteen years of telecommunications reforms, the nature of competition has changed rapidly. Looking at Figure 4.1, during the peak years of telecom revenue growth, the MPT’s monopoly came under increasing pressure from state rivals eager to gain access to the market. The PLA first made inroads in the telecom market by making use of its privileged position to offer commercial paging services out of local army units. After the MEI, the Ministry of Power and the Ministry of Rail’s proposal to establish China Unicom found a sympathetic audience in the State Council, the process of dismantling the telecom monopoly was set in motion. Following the establishment of MII and the break-up of China Telecom, competition between the telecom operators intensified even as the core divisions of the former monopolist remained the dominant players in the most profitable mobile and fixed-line businesses. The second break-up of China Telecom, in 2002, once again altered the terrain as the company underwent a horizontal separation.

In the 2000s, though, the reform with perhaps the greatest lasting significance has been establishment of SASAC. As the bureaucracy responsible for maintaining and increasing the value of state assets in the telecommunications sector, SASAC has a strong incentive to intervene in the market to protect the revenues of the telecommunications operators under its authority. As a high-ranking commission operating in an industry characterized by complex and fluid authority relations, SASAC also frequently has the opportunity to intervene in telecom decision-making process. As described above, the Commission has gradually become an owner-regulator in this sector as it has played an important role in key regulatory decisions and, more strikingly, was the primary author of the 2008 restructuring.

5.5 Conclusion

The partial reform model is helpful in explaining why telecommunications remains firmly within the bounds of the state-owned economy. The industry’s initial reform trajectory positioned the incumbent monopolist as a short-term winner in the heady period of early reform. In the context of meager budgetary funds, the central government granted MPT broad powers over revenue generation and retention and the MPT’s self-raised funds powered China’s unprecedented network expansion in the 1980s and 1990s. In the early nineties, when telecom revenue annual growth rates were in excess of 40%, the MPT’s revenue streams became the envy
of other wings of government in addition to the military. In these circumstances, the MPT behaved as Hellman would expect, by working to defend its turf from encroachment using all means at its disposal. The top leadership, probably incented by the lure of abundant patronage resources as much or more than an innate desire to discipline the defiant monopolist, succeeded in forcing open the telecommunications industry with the establishment of Unicom in 1993. In the current context, high profitability distributed among a small number of firms offers a compelling explanation for the continued protection of the basic services core of the telecommunications sector.

The neoconservative legacy is also evident in the process of telecommunications reform. Owing to the comparatively late breakup of the MPT’s monopoly, the telecommunications enterprises were not included in Premier Li’s initial large enterprise trial group but the government-orchestrated 1997 Hong Kong listing of China Telecom nevertheless marked it as a late entrant to the ranks of national team. In the SASAC era, China Mobile regularly tops the bureaucracy’s overall performance rankings. As SASAC’s regulatory and administrative role in the industry has grown, some observers see the bureaucracy’s market interventions as motivated by an interest in protecting the national champions’ healthy profit margins and maximizing revenue intake among the three carriers. Support from SASAC and other government agencies for the carriers’ expansion into global markets are another indication of the ways in which the state’s national champions strategy is shaping telecommunications.

While this case study highlights the importance of these complimentary political and economic logics in shaping the direction of telecommunications reform, the political sensitivity of telecommunications is also relevant to explaining why state ownership remains dominant in this sector. While the state’s interest in exercising censorship is commonly seen as the most important factor in explaining China’s conservative telecom policy, evidence presented in this case study suggests that the Party leadership’s interests in controlling the flow of information has not been the only or even the primary consideration in preserving the state-controlled enterprises’ unrivalled position in basic services. As the governments’ facility in bringing competitive pressures to bear on service providers in order to muzzle Internet dissent would suggest, state ownership is not in fact a strict requirement of China’s censorship regime. Further, the preceding analysis of Minister Wu’s efforts to influence the outcome of China’s WTO
commitments on telecommunications suggests that the national security card is sometimes played in support of more prosaic reasons for opposing market liberalization.
6 The Turbulent Path of Airlines Reform

6.1 Introduction

In comparison to telecommunications, the civil aviation sector has followed a more circuitous, and more puzzling, route into the ranks of China’s strategic sectors. Whereas MPT was strongly reinforced by the government’s telecommunications Big Push, the leadership’s de-centred approach to development of the airlines industry—premised on taking apart the government monopoly and rapid investment liberalization in order to fund airport construction and aircraft acquisitions—laid the groundwork for a competitive airlines market with minimal state intervention. The puzzle in airlines reform is why this trajectory of gradual state retreat was suddenly reversed in 1997 with a major retrenchment that culminated in an administrative restructuring of the industry that ultimately pushed the market share of the Big Three state-owned carriers back above 80%. The evidence suggests that complimentary political and economic logics were the most decisive factors in the airlines industry volte-face. The political logic of retrenchment is that, even after the dramatic reforms of the first decade, in the mid-1990s the regulator retained strong ties to industry so that when competitive pressures cut into the state-owned airlines’ revenue intake, the government intervened to defend its players in industry. At the same time, the retrenchment also drew normative legitimacy from the slate of neoconservative industrial policies that gathered force over the 1990s. Inclusion of the Big Three airlines in the incipient national team served to make promotion of large, profitable and internationally competitive state-owned airlines a bedrock norm of airlines market regulation.

The argument unfolds in three sections. The first section draws on new sources to explain why the leadership adopted a comparatively radical initial approach to airlines reform. At the close of the Cultural Revolution, civil aviation was even more battered than telecommunications as the Civil Aviation Administration of China (CAAC) had become a major theater of confrontation between the “Gang of Four” and Zhou Enlai and Deng Xiaoping’s supporters in the mid-1970s. Yet despite or, as is argued in this chapter, because of the institutional chaos inherited from the Mao years, reform proceeded swiftly in this sector under the leadership of a high-ranking acolyte of Zhou Enlai. The fact that CAAC did not collect substantial rents in the partially-reformed market created by these early reforms helps to explain why the bureaucracy did not act to stymie the market entry and development of new airlines as
the MPT had done so boldly in the telecom sector. The focus then shifts to examining the implications of an airlines-focused industrial policy regime in the early 1990s. The following section analyzes the evolution of regulatory institutions in civil aviation over the course of reform. In 1985, the CAAC voluntarily shed the roles of owner and operator although the airline regulator retained broad powers over market entry and pricing into the next decade. The inherited legacy of successive phases of liberalization/retrenchment cycle is a system that combines, somewhat awkwardly, the aspirations to act as impartial referee of the airlines market with the industrial policy goal of supporting the Big Three state-owned airlines. The final section links regulatory interventions and industrial policy initiatives to observed changes in the airlines market over the past thirty years.

6.2 Industrial Policy

6.2.1 The Cultural Revolution and the Decentralized Big Push

In keeping with the predictions of the PRE model, the comparatively radical approach to airlines reform set this industry on a very different reform pathway than telecommunications. Drawing from a recollection of the period written by the top civil aviation policymaker at the time, an as yet unused source in the English literature on the subject of Chinese civil aviation reform, the argument advanced here is that the imperatives of elite politics were crucial to the early embrace of liberalization in airlines. Owing to a strong political incentive to devolve power from the aviation bureaucracy, by the end of the first decade of reform, the dismantling of the CAAC’s monopoly was already well-advanced. The leaders decided quite early on to pursue a slate of bold liberalization measures including: government-enterprise separation; encouragement for local governments and government ministries to sponsor airlines to compete with the CAAC-linked carriers, and; gradual price deregulation. By the end of the 1980s, these policies had already left a deep imprint on the sector: there were twelve airlines in operation and nearly six times as many passengers and freight were transported by air in 1990 as had been in 1980. In airlines the benefits of early-stage, radical market reforms were distributed widely and created a solid base in support of deepening reform.
As with telecommunications, the bureaucratic organization and operation of air services were ravaged by the succession of political campaigns that defined the Mao years. Between 1950 and 1976, the CAAC fell under the authority of, variously, the Central Military Commission, the State Council and the Ministry of Transportation before winding up as a division of the Air Force after 1969. In the latter half of the 1960s, many cadres in the CAAC became targets for the Red Guard attacks and those linked to the “Two Airlines Uprising” (lianghang qiyi 两航起义) were treated especially harshly. From an economic perspective, the most costly mistakes were made in the years after the CAAC was formally absorbed into the Air Force. After becoming a military unit, the existing cost accounting system for air services was scrapped and replaced with a haphazard “eating from one big pot” system (da guo fan 大锅饭) captured by a popular phrase of the time: “fly a little or a lot, it’s all the same; sell many or a few airline tickets, it’s all the same; provide good service or bad, it’s all the same; consume however much, it’s all the same; lose money or make money, it’s all the same” (Liu, 2007: 483). Political campaigns also left their mark on the pattern of fixed-asset investment in the period as airports were constructed in the inland locations of Xichang, Lanzhou and Taiyuan as part of a massive and costly effort to erect a “Third Front” in the event of foreign invasion. As the combined result of these policies, losses in the civil aviation sector are estimated in the official history to have exceeded 130 million RMB between 1968 and 1974 and probably much exceeded that figure (Liu, 2007: 483). The safety of air travel was also severely compromised. Over the course of the Cultural Revolution, more than thirty serious safety incidents took place resulting in the loss of 30 aircraft and 32 lives (Liu, 2007: 482).

---

62 Yet throughout these administrative shuffles in the Maoist period, the principle of “the primacy of military leadership” (yi jundui lingdao wei zhu 以军队领导为) established the PLA as the final authority on important policies in the civil aviation sector (Chung, 2003: 67).

63 Lianghang qiyi is one of the most celebrated events in the Communist-era history of civil aviation. In November 1949, the general managers of two KMT-controlled airlines operating on the mainland, China National Aviation Corporation and the Central Air Transport Corporation, turned against Chiang Kai Shek’s forces and handed their seventy-one airplanes and assets in Hong Kong over to the Chinese Communist Party. It was heralded as a major strategic victory for the Communists since the airlines had been supplying KMT outposts in the Southwest provinces which were effectively cut off after the insurrection. Since Zhou Enlai (then Vice-Chairman of the Central Military Commission) played the lead role in organizing the Hong Kong Party underground’s efforts to persuade the two businessmen to switch sides, in the Cultural Revolution, denouncing participants as “capitalist roaders whose death would not be worthy of regret” (死不该悔的走资派; si bu gai hui de zouzipai) amounted to a thinly-veiled attack on Zhou himself. The official civil aviation history notes that, in all, 70 people with ties to lianghang qiyi were subjected to “cruel attacks” and “persecution” in this period (Liu, 2007: 481).
Though the tumult of the 1960s heaped chaos on the civil aviation sector, it was political skirmishes between elites in the 1970s that set the stage for policymakers’ decision to select a comparatively radical pathway in this sector. Following the death of Lin Biao in 1971 and the subsequent return of Zhou Enlai and later Deng Xiaoping to leading positions in the Party and government, the leadership made civil aviation development a priority and depicted the development of long-distance international routes, “flying forth” (fei chu qu 飞出去), as a crucial component of China’s modernization and gradual opening to the outside world. In a speech made in August 1973, Premier Zhou declared: “We must fly forth in order to open up the situation. More and more countries are establishing diplomatic relations and exchange is increasingly frequent in the modernizing world. The country cannot lock itself up; we must make flying forth a political responsibility” (Liu, 2007: 484). To advance the cause of flying forth in the civil aviation bureaucracy, in 1973, Zhou personally intervened to rehabilitate a former acolyte and an experienced international negotiator in civil aviation, Shen Tu. Shen, who had been imprisoned for five years at the height of the Cultural Revolution was quickly made Vice-Director of the CAAC after his release and with his and Premier Zhou’s combined influence, considerable progress was made on developing international routes in the early 1970s.\footnote{For instance, between 1970 and 1976 international passenger and freight traffic increased by six times (Liu, 2007: 485).} When the Gang of Four rose to power at the end of 1975, however, the “flying forth” program became an obvious target for the anti-Zhou/Deng clique and Shen Tu and his colleagues in the CAAC were publicly criticized for being “rash” and “over-ambitious” (Liu, 2007: 485).

Shen’s (1992) personal recollections of this period characterize the CAAC during the height of the Gang of Four’s influence as a hotbed of anti-Deng activity. He notes that one member of the Gang, Wang Hongwen, personally intervened in the campaign and directed his trusted associates to spearhead the anti-Deng movement in the aviation bureaucracy. Shen reports that Wang’s followers pushed the CAAC Party Committee to hold a two-month long meeting, between August and September 1976, to inspect the mood of the “Criticize Deng” campaign within the bureaucracy (Shen, 1992: 7). Shen’s recollections of the period give an indication of the deep scars which the Cultural Revolution left in the CAAC:
A large number of cadres were framed; of them, 672 people were placed on file review and deeply persecuted. The factionalism created by Lin Biao and the Gang of Four undermined the unity of civil aviation and harmed many cadres. In this period, 705 people were subjected to “checking”, a situation which was not conducive to the construction of civil aviation business…The impact and aftermath of Lin Biao and the Gang of Four cannot be underestimated (Shen, 1992: 7).

Though his account does not elaborate on the “aftermath” of these events, Shen’s recollections do describe the CAAC’s process of trying to assign responsibility and atone for the errors of the Cultural Revolution, conducted in 1977 and 1978, as rocky and itself fraught with errors (Shen, 1992: 12-13). Although the Gang of Four were arrested shortly after these “Criticize Deng” meetings, the CAAC’s status as a unit of the Air Force and the bureaucracy’s key personnel remained intact into the beginning of the reform era. As a newly-minted leader still cementing his standing as supreme leader, it is not hard to understand why Deng would have supported a shakeup of this bureaucracy which had been so closely linked to his adversaries’ efforts to undermine him.65

From the very earliest days of the reform period, Shen Tu, who had been made director of the CAAC, along with top-level government elites, cobbled together an agenda for civil aviation reform that was premised on asserting government control over civil aviation, decentralization of power and government-enterprise separation. Though the scant historical record makes it difficult to draw firm conclusions about the currents of high-level politics at the time (see note 63), it is clear that the Air Force was reluctant to relinquish control over the civil aviation bureaucracy to the State Council. In late February 1979, Deputy Premier Li Xiannian announced in a State Council meeting that CAAC would henceforth be removed from the Air Force system and placed under the oversight of the State Council. Shen (1992: 1) writes that because Air Force leaders held “a different view” of matters, the State Council was forced to issue a moratorium on implementation of the shift in command in early March 1979; in fact, it remains unclear when exactly the Air Force finally did forfeit its ambiguous role as “manager” (daiguan 代管) of

65 Drawing inferences from Shen’s (1992) personal account, a number of Chinese scholars of civil aviation (e.g. Zhang, 2000; Tai, 2004) have suggested that Cultural Revolution “politics” was an important factor in deciding the course of reform in civil aviation; however, their analyses tend to be rather vaguely worded, which may reflect both the sensitivity of the subject matter as well as the thinness of the historical record in this period.
Though the State Council’s 1979 declaration failed to decisively wrest control of civil aviation from the Air Force, it did strengthen Shen’s hand in carrying out important internal reforms which served to reduce the influence of military leaders and increase the bureaucracy’s economic decision-making capacity. The reform also significantly expanded the powers of the sub-national aviation bureaus.

The following year, plans for deeper decentralization and government-enterprise separation began to take shape. In early 1980, Deng summoned Shen to his office for a rare one-on-one meeting to discuss what approach the government should take to civil aviation reform. Shen (1992: 4) notes that, regarding the Air Force’s daiguan role, Deng was adamant that a “change in leadership relations” should take place quickly. Deng also declared that “civil aviation must corporatize; this has already been decided.” Shortly after their meeting, the People’s Daily ran an article entitled “Civil Aviation Will Go the Route of Corporatization”, a decisive signal from on high that the policy would go forward. Soon after, in August 1980, Shen hosted a CAAC meeting where he outlined plans to, first, loosen ties with the sub-national bureaucracy by making the six regional CAAC bureaus (note 65) independent economic units responsible for their own profits and losses and, second, establish airlines within two or three years’ time. While Shen’s ambitious time target for enterprises were ultimately not met, in January 1985, the State Council formally approved the CAAC’s plan to establish airline and airport enterprises which were to be “autonomous, self-financing, self-developing and self-

66 For example, in the official history, March 1980 is recorded as the date that the Air Force gave up its role as CAAC’s daiguan (Liu, 2007: 639). Most Western accounts put the date somewhat later. Dougan (2002: 153) claims that CAAC was only returned to State Council control in 1985. Chung (2003: 68) rightly points out that even after the CAAC came under the State Council system, the Air Force remained very influential in the sector: “Only one of its three principal functions-airline management-became totally civilian (but still state-controlled). Air-traffic regulation has remained largely in the hands of the military and airport control has become increasingly demilitarized over the years.” See also Dougan (2003: 155-157). One Chinese observer suggested that authority relations were the primary issue in civil aviation reform over the first decade: “Strictly speaking, the reforms between 1980 and 1987 were not focused on marketization. Reforms in this period sought to take control of civil aviation away from the military; reforms were just a change of leadership and management styles” (Wang, 2006: 109).

67 Crucially, the Planning and Finance Departments in addition to other business departments were restored while the Military Command and Logistics departments were abolished.

68 Under the Air Force, the CAAC was a four-level administrative system. Beneath the national bureau were six regional bureaus in Beijing, Guangzhou, Chengdu, Shenyang, and Xi’an which had primary responsibility for managing aircraft flights and operating airports; 23 provincial/municipal department bureaus and finally 78 civil aviation “stations” (hangkong zhan 航空站).
restrained” (Liu, 2007: 640-1). Thereafter, each of the six regional bureaus established its own airline, the largest of which, the “Big Three” airlines, were formed out of the CAAC bureaus in Beijing (Air China), Guangzhou (China Southern) and Shanghai (China Eastern). While the tremendous losses incurred by the civil aviation sector in the 1970s probably contributed to the appeal of corporatization at this time—since establishing enterprises outside the CAAC and creating competition would likely serve to reduce the fiscal burden imposed by this sector—this was not the reformers’ only motivation in selecting this strategy which effectively diverted power and revenues away from the central bureau towards the newly-formed enterprises. In the context of intense jockeying for power between the government and the Air Force, Deng’s swift move to break the CAAC’s monopoly on air services dealt a deep blow to the Air Force since it meant that the airlines and not the former monopoly would collect rents as the air services market opened.69

As compared to telecommunications, key industrial policies in civil aviation had a very different effect on interest group formation for a number of reasons. First, though the method of profit retention was also used to spur fixed-asset investment (see Table 6.1), the high degree of decentralization and early-stage corporatization in air services meant that rents accrued first to the largely financially independent regional bureaus of the CAAC and, from the mid-1980s, to the airlines and airport enterprises themselves. In essence, the short-term winners in this partially-reformed market were the regional bureaus and then newly-formed enterprises and not the former monopolist in Beijing. As will be discussed in the next section, this key difference helps to explain why the CAAC-as-regulator did not adopt a hostile stance towards the market entry of new firms as MPT did in the telecommunications sectors. Second, one of the most important policies adopted in the early reform era, airplane leasing, did not actually put cash in the hands of bureaucrats or managers, rather it allowed them to expand the scale of operation by giving lessees claims on the airlines’ future revenue streams.70

69 In practice, links between the airlines and the CAAC bureaus remained tight after this first experiment with corporatization in the late 1980s. In particular, the airlines still received funding directly from the government budget (Chung, 2003: 70).

70 Shen (1992: 10-12) describes leveraged leasing as one of the key policy innovations of this period. Though there was reportedly much resistance within the bureaucracy to “renting” planes, partly because some felt this would
Table 6-1: Key Industrial Policies in Airlines, 1980s and 1990s

<table>
<thead>
<tr>
<th>Year</th>
<th>Policy</th>
<th>Content and Policy Evolution</th>
</tr>
</thead>
</table>
| 1980 | Airplane Leasing  | With guarantees from Chinese state-owned financial institutions, typically the Bank of China, CAAC and later the airlines themselves arranged long-term leasing arrangements with foreign aircraft manufacturers via foreign lenders:  
  - Method first used to lease three Boeing 747’s in 1980  
  - Between 1980 and 1984, CAAC was granted extensive tax exemptions/reductions on these leasing arrangements  
  - As recently as 2002, approximately 80% of planes operated by Chinese airlines were leased |
| 1985 | “Two 90 percents” | Authorized civil aviation enterprises to retain 90% of revenues derived from two sources:  
  - *Profits:* to be used for expanding enterprise scale; plane purchase/leasing, and; airport and other infrastructure construction  
  - *Foreign Currency Earnings:* giving enterprises access to foreign currency reserves substantially increased enterprise autonomy with regard to investment decisions |
  - To promote the faster development of civil aviation, after civil aviation enterprises had paid 18% taxes to the central government and fulfilled obligations on their loans, they could retain the remaining profits. |

Sources: Liu (2009): 706-708; Dougan (2002); Shen (1992)

In addition, in recognition of the fact that retained revenues would not be adequate to power the physical development of a sector that was growing at an annual rate of 50% in the early 1980s, the CAAC welcomed infrastructure investment from local governments, other central ministries as well as foreign investors (officially after a 1994 regulation authorized foreign investment in the sector). Indeed, while the central government shouldered most of the burden of constructing cause China to lose face internationally, in the context of strict budget limitations there was in reality no way that the government could afford to purchase planes in large numbers.
airports nationwide, local governments in addition to the military (principally the Air Force and Navy) also sponsored a number of major airport construction projects (Dougan, 2002:164-8). In all, due to differences in sectoral and especially political factors, “Big Push” industrial policy did not have the effect of strengthening the protectionist impulses of the former monopolist as it did in telecommunications.

The combined effect of these policies dramatically altered the civil aviation sector. Between 1985 and 1992, dedicated funds for civil aviation construction derived from enterprises’ retained earnings totaled 11 billion RMB (Liu, 2009: 707). Concurrently, total fixed asset investment in the sector surged from 2.0 billion RMB in 1978 to more than 14.3 billion RMB in 1989 (ZGTJNJ, 1990: 552). As Figure 6.1 shows, retained earnings combined with the popularization of plane leasing arrangements allowed the airline enterprises to considerably expand their capacity over this time period. While the data show that the most astounding increases have taken place since the late 90s—this is partly an effect of the cancellation of government restrictions on ordinary citizens’ flights—passenger traffic had already surged by 456% between 1978 and 1989 (ZGTJNJ, 1990: 548). Between 1980 and 1995, the total number of planes in use increased fourfold, from 143 to 722 (ZGTJNJ, 2007: 634). In the early 1990s, nodes on the domestic and international network considerably expanded with the construction of nineteen new airports (including Shenzhen and Wuhan) and major upgrades of 29 other airports which brought the total number of Chinese airports capable of landing Boeing 747’s to 14 and those which could accommodate Boeing 737’s to 81 (ZGTJNJ, 1996: 266).
6.2.2 The Early Development of Airline Groups

Due to the comparatively early corporatization of the airline industry, the development of airline enterprises became a focus of industrial policy much earlier than in telecommunications. In the early years of the liberalizing airline market, the aims of industrial policy fell on creating business groups around the airlines in order to support their development and spur their expansion into international markets. In 1991, the CAAC-affiliated Big Three airlines were included in the trial group of 57 state-owned enterprises chosen to develop a large business group framework discussed in Chapter Three. The policy that brought the national team into existence, Policy No. 71, decreed that the groups “must have a strong core member that has the capability to act as an investment centre. The core can be a large-scale production or service enterprise or even a capital rich holding company” (cited in Sutherland, 2003: 156). The Air China enterprise group (discussed at length below) is typical of most large enterprise groups in having a holding company at the helm. In the terms of Policy No. 71, the core member is charged with exercising stock control over smaller and more peripheral enterprises. The policy also states that “the group’s core and other members must, by means of capital ties and joint management of production, form a complete and integrated management system” (Sutherland, 2003: 156).
Analysis of the corporate structure surrounding China’s flagship carrier, Air China, gives an indication of the extensive reach the Big Three’s business groups have developed in the Greater China airline industry (see Table 6.2). The core member, China National Aviation Holding Company (CNAHC), sits atop five wholly owned subsidiaries and acts as the controlling shareholder in two shareholding companies and one public company (the airline, Air China Company Limited). In keeping with Policy No. 71, a fund management center for the group, China National Aviation Finance Co., Ltd., was established in 1994. The company provides settlement services for companies within the group and offers a range of financial services including lending and underwriting for corporate bond issues. After Air China and the other major airlines were transferred out from under CAAC’s watch to SASAC oversight in 2003, an asset management company was set up to “clean” and “integrate” the group company’s assets in a manner consistent with SASAC directives. The group also includes an investment holding company, China National Aviation Corporation (Group) Ltd. (CNACG), set up in 1995. In addition to its equity holdings in three major airlines—Air China, China Eastern and Cathay Pacific—CNACG also has major holdings in many other segments of the mainland and Hong Kong civil aviation markets. CNACG holds 50% of China National Aviation Fuel’s shares and is a major shareholder in two domestic airports, several cargo terminals and seven catering companies. The Air China group also includes in its realm an advertising/media arm, a travel service company, a construction company and a highly successful delivery, cargo and logistics company, China Air Express.
Table 6-2: Structure of Air China Group

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Corporate Status</th>
<th>Main Business</th>
<th>Subsidiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>China National Aviation Holding Company (CNAHC)</td>
<td>A wholly owned subsidiary of CNAHC</td>
<td>Provides project construction for airports, airlines and cargo companies. Also provides real estate services</td>
<td>Shareholder in 19 companies including in aerospace equipment manufacturing/maintenance; catering and fuel</td>
</tr>
<tr>
<td>China Aviation Group Construction Dev’t Co., Ltd.</td>
<td>A wholly owned subsidiary of CNAHC</td>
<td>Provides project construction for airports, airlines and cargo companies. Also provides real estate services</td>
<td>Tasked with cleaning up and integrating the group company’s assets in concert with SASAC directives</td>
</tr>
<tr>
<td>China Aviation Group Asset Management Co., Ltd.</td>
<td>A wholly owned subsidiary of CNAHC</td>
<td>Provides passenger and cargo transportation; aircraft maintenance</td>
<td>Shareholder in 19 companies including in aerospace equipment manufacturing/maintenance; catering and fuel</td>
</tr>
<tr>
<td>Air China Ltd.</td>
<td>Listed in HK, London and Shanghai. CNAHC and CNACG together account for 52% of shares. Other shareholders include Cathay (18%) and Swire Pacific Ltd. HK (18%)</td>
<td>Provides passenger and cargo transportation; aircraft maintenance</td>
<td>29 mainland and HK/Macau companies including airlines; aircraft maintenance &amp; repair operations; airports</td>
</tr>
<tr>
<td>China National Aviation Corporation (Group) Ltd. (CNACG)</td>
<td>A wholly owned subsidiary of CNAHC</td>
<td>An investment holding company</td>
<td>Major shareholder in 29 mainland and HK/Macau companies including airlines; aircraft maintenance &amp; repair operations; airports</td>
</tr>
<tr>
<td>China National Aviation Finance Co., Ltd.</td>
<td>CNAHC is the controlling shareholder. Minor shareholders include domestic airlines and cargo companies</td>
<td>Serves as the group’s fund management center. Provides settlement services and financial services, including lending and bond underwriting</td>
<td>Indicates that CNAHC is the controlling shareholder. Minor shareholders include domestic airlines and cargo companies</td>
</tr>
<tr>
<td>China National Aviation Media &amp; Advertising Co., Ltd.</td>
<td>Provides media (e.g. in-flight entertainment) and advertising services</td>
<td>Indicates that CNAHC is the controlling shareholder. Minor shareholders include domestic airlines and cargo companies</td>
<td>Provides media (e.g. in-flight entertainment) and advertising services</td>
</tr>
<tr>
<td>China Air Express Co., Ltd.</td>
<td>Express delivery, cargo and logistics.</td>
<td>Indicates that CNAHC is the controlling shareholder. Minor shareholders include domestic airlines and cargo companies</td>
<td>Express delivery, cargo and logistics.</td>
</tr>
</tbody>
</table>

Sources: Company websites; MERGENT online database
Interestingly, two of the companies within the Air China group also have significant stakes in China’s booming property market. China Aviation Group Construction Development Company’s primary business is in civil aviation construction projects but the group also offers comprehensive real estate services. Similarly, China National Aviation Holding Travel Services Company has business interests in: hotel ownership and management; property development; travel services, and; operation of a central airline ticket reservation center. The company’s real estate assets are in the care of two of the travel company’s immediate subsidiaries: Air China Property & Hotel Management Company and Xidan Civil Aviation Operations Building. Many of these properties formerly belonged to the airline and were reportedly transferred off its balance sheet, along with 38 of the airline’s subsidiaries and its pension obligations to retired workers, as Air China made preparations for its IPO in 2004 (Feng, January 27, 2010). In response to an early 2010 SASAC directive instructing central SOEs to exit the hotel and non-essential property management business, the group company announced that it would sell the building which houses its headquarters in Beijing on the Shanghai United Assets and Equity Exchange for a list price of 2.3 billion RMB. The group’s ties to the real estate market lend insight into how many central SOEs have come to be “land kings” discussed in Chapter Three. We return to this issue below.

As in telecommunications, with guidance from central government agencies, Chinese airlines began to tap financing opportunities in domestic and international capital markets in the latter half of the 1990s. Stock market participation aided the expansion of airlines’ scale in the domestic and international markets and assisted their adaptation to market conditions as they absorbed management expertise from major stockholders. 71 Interestingly, it was a small, independent carrier and not one of the Big Three airlines which began this experimentation. Hainan Airlines (a carrier founded by the Hainan provincial government in which George Soros later became a major investor) was the first airline to sell both A- and B-shares on the Shanghai stock market in 1993. To date, though, only the Big Three airlines have marshaled enough political clout to win approval from the China Securities Regulatory Commission for overseas

71 For instance, Air China’s strategic partnership with Hong Kong’s Cathay Pacific is seen a major factor contributing to Air China’s competitive edge in the domestic market (O8BJ1111).
listing. In 1997, China Eastern and China Southern joined the first wave of red chip IPOs as each made simultaneous offerings on the Hong Kong and New York markets, raising US $250 million and US $600 million, respectively. After an administrative consolidation of the airline industry in 2001, a restructured Air China listed simultaneously on the Hong Kong and London exchanges in December 2004 and raised US $1 billion to finance the expansion of the airline’s fleet. China’s most successful private airline, Spring Airlines (discussed in more detail below), is also planning a share offering to finance its expansion in the domestic market.

Finally, as China’s air services market has steadily opened to international competition, China’s largest carriers have cultivated partnerships with leading foreign airlines and global alliances in order to advance their development in the domestic market and aid their “going forth” into international markets. In 1989, Air China and Lufthansa formed a repair and maintenance joint venture to service Air China’s aircraft. The Aircraft Maintenance and Engineering Corporation (AMECO) based in Air China’s hub in Beijing now extends service to a number of other airlines and has become China’s largest aeronautical engineering center. In 1990 China Southern joined with an American and Hong Kong company in setting up a maintenance JV, Guangzhou Aircraft Maintenance Company (Liu, 2007: 683). In 2007, Air China joined the world’s largest airline alliance, Star Alliance, which has been led by Lufthansa and United Airlines since its founding in 1997. Alliance membership has helped the airline expand its presence in international markets via codesharing with the Alliance’s 26 members. Air China has an alliance and cross-shareholding agreement with Hong Kong-based Cathay Pacific. In early 2010, the two airlines announced they would operate Shanghai-based Air China Cargo as a joint venture after Cathay purchased a 49% stake in the company (Mitchell, February 25, 2010). Air China Cargo competes with Jade Cargo International which was established by Lufthansa Cargo and Shenzhen Airlines in 2004 and is China’s first joint venture in the air services market. China Southern Airlines has a codesharing agreement with Japan Airlines and

72 In comparison to passenger services, the government has maintained a more open posture with regard to foreign investment in cargo. This is reflected in different foreign investment treatments for the two markets: in cargo services, maximum foreign ownership is set at 49% and is just 25% in passenger services and foreign owners have no management rights. The different treatment reflects the difficulties that China’s trade deficit creates for cargo carriers. In essence, Chinese cargo companies have a strong incentive to build strong international networks in order to mitigate the problem of planes returning to China empty. One foreign airline executive reported that even if the foreign investment rules were more lax in passenger services, JVs in the passenger market would be unlikely to
established an alliance with Taiwan’s China Airlines after flight restrictions between the mainland and Taiwan were eased in 2008. In 2007, China Southern joined the SkyTeam alliance which is headed by KLM and Delta Airlines. China Eastern has a long-standing codesharing agreement with American Airlines and was reported to be in negotiations with the three major global alliances—Star Alliance, SkyTeam and Oneworld—at the time of writing (Wall Street Journal, March 7 2010). Hainan Airlines has a lucrative codeshare agreement with Air Berlin in addition to Brussels Airlines as well as several other Asian carriers. At the time of writing it was rumored that Hainan intended to join the Vancouver-based Oneworld Alliance.

6.1 Regulatory Reform

Airlines regulation is marked by the legacy of successive waves of reform and retrenchment. In the earliest stages of regulatory reform, policymakers introduced bold reform measures that saw a quick dismantling of the former monopolist paired with the introduction of competition to the market via the lowering of administrative barriers to entry. In the second phase of reform that began in the early 90s, the airline regulator increased the scope of competition between the airlines by permitting a measure of price competition in the market. Yet, just a few years later, airlines regulation decisively reversed course. As the airlines’ profitability was collapsing under the combined pressure of domestic price wars, excess capacity and the airlines’ inflexible cost structures, the regulator boldly intervened and engineered a two-pronged retrenchment plan designed to prop up profitability in the beleaguered industry. The course of airlines regulation since retrenchment has been marked by the inheritance of both early-stage liberalization and the state’s industrial policy aspirations. In 2002, a major regulatory reform saw an overhaul of the CAAC designed to achieve a deeper and lasting government-enterprise separation. In the years since 2002, the role of the CAAC in structuring competition in spring up because market conditions in passenger services are much less propitious. Foreign carriers have a weak incentive to pair with Chinese airlines because, to date, they remain more competitive than Chinese carriers on the most lucrative international routes. (On China-US routes, for example, approximately 90% of the tickets are purchased in the United States for flights on US carriers.) In these circumstances, code sharing arrangements are still the most attractive option for foreign players because it helps them to sell tickets and carries no investment risk (08BJ1024).
the airlines market has decreased markedly, though, since late 2008 the regulator has once again intervened to subdue “excessive competition” in the market. Behind the appearance of state retreat from the market, the hand of the state continues to operate though CAAC as well as other powerful central government actors, principally SASAC and NDRC.

6.1.1 1982-1992: Gradual Decentralization and Liberalization

Largely for the political reasons outlined above, in the early years of reform, emphasis fell on the swift dismantling of the airline monopoly via decentralization measures and laying the foundation of government-enterprise separation (zhengqi fenkai 政企分开). As discussed, the local civil aviation bureaus were formally made responsible for their own budget in the early 1980s in an effort to both stem the tide of losses in the industry and devolve power from the central bureau in Beijing which had been a center of anti-Deng efforts in the mid-70s and remained under the effective control of the PLA in the early reform period. In 1985, the State Council approved the CAAC’s proposal for zhengqi fenkai contained in the “Report on the Reform of the Management Structure of the Civil Aviation Department” which mandated the CAAC’s retreat from involvement in the day-to-day operation of airline services. Following passage of the policy, six “national backbone airlines” were carved out of the six regional bureaus between 1987 and 1991. Though the 1985 regulation nominally established the airlines as independent enterprises, in practice the CAAC retained considerable influence over these airlines’ business since the regulator remained their owner and supervisor after the reform. Indeed, in comparison to airlines set up in later years, the airlines under the direct supervision of CAAC had considerably less flexibility in adapting to changing market conditions. In particular, CAAC-owned airlines tended to have much higher fixed costs than their smaller competitors.

73 The policy clarified the aims of decentralization and government-enterprise separation: “The principle of the reform is to dissociate the governmental and company functions and to simplify the administration by delegating authority to units at lower levels...Once the governmental and company functions have been separated, the CAAC, as the organ of the State Council in charge of civil aviation, will play an administrative role [only] and will no longer be directly involved in the operations[s]” (quoted in Dougan, 2002: 154).

74 The largest of the airlines, Air China International was established in Beijing in 1988. It was the main airline servicing international routes and also commanded a major share of traffic on domestic routes. China Eastern, based in Shanghai, was set up in 1987 and operated mainly in the domestic market. The last of the Big Three, China Southern was established in Guangzhou in 1991 and was also primarily a domestic carrier in this period. The smaller remaining three “backbone” airlines were China Southwest Airlines based in Chengdu (est. 1987), China Northwest Airlines in Xi’An (est. 1989) and China Northern Airlines based in Shenyang (est. 1991).
largely because they did not have autonomy over aircraft purchases and were obliged to buy fuel from the CAAC-owned China Aviation Oil Supply Corporation which sold its product at more than 130% above the international price (Dougan, 2002: 167).

At the same time that the former monopolist was divesting its business operations, in order to meet skyrocketing demand for air services, the central government opened the airline market to local governments and government departments. A 1984 State Council regulation calling for the establishment of new airlines set off a wave of small airline entry that began with the July 1984 set-up of Xiamen Airlines, a joint venture between the Shanghai Civil Aviation Authority, the Fujian Enterprise Investment Company and the Xiamen Special Economic Zone Development Corporation. In the early years following market opening, local governments tended to seek out joint ventures with the backbone airlines (Dougan, 2002: 159). In 1990, for example, the Zhejiang provincial government and China Eastern together established Zhejiang Airlines as a CAAC-affiliated enterprise. Gradually, provincial governments began to set up their own airlines independent of the CAAC and by the mid-90s fifteen of China’s thirty provinces had set up their own airlines, often without due regard for whether there was sufficient demand in their service areas. In addition to local governments, a number of flush government ministries also entered the market. In 1996, a cargo airline, China Postal Airlines, was set up as a joint venture between the Ministry of Post & Telecommunications and the Tianjin city government. Overall, the “egalitarian nature of Beijing’s approval process” gave rise to a dramatic increase in the number of competitors in the industry (Chung, 2003: 72). The number of airlines swelled from eleven in 1987 to twenty-four in 1992 and to a peak of more than forty in 1995 before falling back to twenty-nine in 1996 and just seventeen in 2001. Yet, despite the

---

75 In this period, the CAAC’s China Aviation Supplies Corporation was nominally in charge of aircraft procurement although aircraft purchases from the likes of Boeing, Airbus and, formerly, McDonell-Douglas were actually high-level political decisions which China’s leaders have tended to use as tools in diplomatic horse-trading and to gain advantage for the aircraft manufacturing industry. As a result, the Big Three have checkered fleets with many different types of aircraft meaning that their maintenance costs are much higher than most other airlines which typically operate only one company’s aircraft.

76 Provincial governments were especially keen on establishing airlines as it had become an important status symbol among prosperous provinces by the mid-1990s.

77 The flood of new entrants put considerable strain on the CAAC’s ability to monitor airlines’ safety. Between July 1992 and December 1993 nine plane crashes occurred prompting the CAAC to declare a moratorium on the
rush of market entrants, the CAAC’s airlines remained the dominant presence in the market throughout. In 1998, the ten airlines under the CAAC’s direct supervision together accounted for 83% of passenger volume and 87% of freight volume. The thirteen largest airlines in the “CAAC-affiliated” (e.g. Xiamen Airlines) and “independent” (e.g. Hainan and Shanghai Airlines) categories had just 17% of passenger volume and 13% of freight volume (Dougan, 2002: 161)


Although regulatory barriers to entry fell away rapidly in the mid-80s, the scope of competition in the airline industry remained quite narrow until pricing policies began to loosen in the early 90s. In the 1980s, airline ticket prices were fixed by the State Price Control Bureau with input from the CAAC and airlines were required to sell tickets at the published price (gongbu jia 公布价) set by the Price Bureau meaning that there was no price competition between carriers. In 1992, some flexibility was introduced into the system when the pricing rules were amended to allow airlines to offer tickets at ±10% of the published price. Initially, airlines were only permitted to offer discount tickets to students and teachers during holiday periods but the policy was quickly extended to groups of ten or more passengers (Zhang, 2007: 77). In 1994, the price system was further relaxed when the CAAC expanded the discount/markup price range to ±20% of the published price and freed the airlines from having to register with the regulator when offering discounts. After passage of the Civil Aviation Law (1995) decisively transferred price-setting authority from the Price Bureau to the CAAC, in late November 1997 the airline regulator moved to further deregulate prices with the “one kind of ticket, many kinds of discount” policy.

---

78 In the early years of the planned economy, air service prices were fixed according to a formula which factored in flight costs as well as the price of alternate modes of transport (e.g. rail and water) on particular routes. So, for example, in 1950, the price of flying a route serviced by rail was set between 0.20-0.24 RMB per kilometer whereas routes with no corresponding rail line charged 0.31 RMB per kilometer (Tai, 2004: 30). During the Cultural Revolution, when civil aviation came under the authority of the Air Force who had no use for cost accounting, the price of air services plummeted to just 15% of the 1950 level and prices remained at this artificially low level until 1984 (Tai, 2004). After 1984, the published prices began to be adjusted upwards to better reflect flights costs and accommodate exchange rate fluctuations.
（yi zhong piao duo zhong zhekou 一种票价多种折扣）. The policy unified the price of tickets for foreigners and Chinese alike and allowed airlines to charge varying ticket prices for the same seats on the basis of such factors as purchase timing, route and flight distance.\(^\text{79}\) The rule change amounted to the *de facto* deregulation of ticket prices and fierce price wars set in which saw carriers selling tickets for as little as 50% of the published price (Zhang, 2007: 78).

The deregulation of ticket pricing and the resulting price war was the major factor contributing to a collapse in industry revenue starting from 1997. In the years between 1980 and 1996, annual growth rates in the industry hovered around 20% but shrank to just 7.5% in 1997 and only 3% in 1998 (Dougan, 2002: 172-3). As airlines struggled to recover their costs while ticket prices plummeted, total losses in the industry were estimated to have topped 24 billion RMB in 1998 (Tai, 2004: 82). The effect of this intensified competition was compounded by the Asian Financial Crisis (1997-98) which resulted in a major contraction in demand for air travel. The crisis also brought to light the lingering problem of over-investment in civil aviation which had created excess capacity in the late 90s (Zhang, 2007: 82). Figure 5.2 reflects the surge in infrastructure investment across the transportation sector in the early 90s. Between 1991 and 1994, fixed asset investment in the airline industry tripled from 4.2 billion to 12.5 billion RMB. The number of airplanes in use more than tripled between 1990 and 1995, growing from 222 to 722 (ZGTJNJ, 2007: 634). In the early years, this investment push was outpaced by booming demand but signs that the market had become saturated were all around by the end of 90s. On the popular Beijing-Shenzhen route, for example, the nine airlines offering flights managed to fill just 30% of their seats (Chung, 2003: 76). Overall, the average domestic passenger load factor of Chinese airlines slid from a high of 78% in 1992 to less than 60% in 1999.

\(^{79}\) Between 1974 and 1997 foreigners (this included citizens of Hong Kong and Macao) were charged a higher price for airline tickets than Chinese citizens (including Taiwanese). Cancellation of the two ticket system coincided with the return of Hong Kong to mainland control.
The 1998 crisis also brought to the fore endemic problems in China’s developing airline industry. At the enterprise level, the most basic problem was the prevalence of the soft budget constraint. As the majority of airlines were wholly state-owned, and all carriers had some large percentage of state ownership, manager-officials were typically more concerned with maximizing market share than they were with profitability; indeed, during the height of the late 90s price wars, some flights operating at full capacity were still unable to make a profit (Dougan, 2002: 173). As well, both the “backbone” and start-up airlines had become highly indebted over the course of the 90s largely as the result of costly plane acquisitions and overly ambitious network expansion efforts. As noted, the airlines under the direct supervision of CAAC were especially heavily burdened by having to purchase fuel at an inflated price from the China Aviation Oil Supply Corporation. Other factors which contributed to the weak profitability of airlines in this period, despite the industry’s double-digit growth, included a CAAC rule requiring that airlines contribute 10% of their annual sales to the CAAC’s Civil Aviation Infrastructure Construction Fund and exorbitant fees charged by sales agents, a business which began to develop quickly after it first appeared in 1993. Although agents’ fees were officially not...
supposed to exceed 3% of the ticket price, agents were known to levy fees as high as 20% which severely cut into the airlines’ profits (Chung, 2003: 76). Between 1995 and 1997, for example, the Big Three airlines’ together spent a total of 4.25 billion RMB on sales fees (Tai, 2004: 83).

As the dimensions of the crisis came into focus in 1998, CAAC embarked on a dramatic course of re-regulation in an effort to help the major airlines return to profitability. Previous analyses of this period as well as interviewees concur that what drove the regulator’s dramatic intervention in the market at this point was the aim of propping up the revenues of the state-owned backbone airlines; in this period, CAAC was still formally responsible for “maintaining and increasing the value of state assets” in the CAAC-affiliated carriers (Zhang, 2007; Tai, 2004; 10BJ0511). Pressure on the regulator to intervene on behalf of the major airlines under its supervision was especially intense at this time since, in December 1997, Premier Zhu Rongji had unveiled his “Getting SOEs Out of Trouble in Three Years” campaign to the Central Economic Conference (Zhang, 2007: 85; Shih, 2008: 175).

The retrenchment effort built up gradually. In May 1998, the CAAC first tried to shore up industry revenues by prohibiting airlines from selling discount tickets that were less than 20% of the published price and barring sales agents from charging fees in excess of 4% of the ticket price. The regulations were, though, widely flouted and the price wars continued largely unabated until December 1998 when CAAC undertook a stringent inspection of airlines’ pricing practices and imposed heavy fines on violators. Though the CAAC’s hardened stance served to stifle price wars in the short term, in the low season that followed Spring Festival in 1999, the airlines once again began to engage in cutthroat competition prompting the regulator to seek out new means of supporting the airlines’ revenue (Xuan, 2003: 35-6). Some of the regulator’s wide-ranging efforts to reign in excess capacity in 1999 and 2000 included: reducing the total number of domestic flights by 5%; reasserting control over airlines’ plane purchases from abroad, and; urging airlines to offer jointly operated services (lianying 联营) on 108 of the most popular routes which accounted for 50% all passenger air travel (Chung, 2003: 77). Yet

---

80 Officially, the industry returned to profitability in 1999 but industry insiders reported that the profits were largely engineered by a reduction in airlines’ obligations to the CAAC’s Civil Aviation Infrastructure Construction Fund (from 10% to 5% of annual sales) and a 15% rise in the published price of tickets nominally because of a spike in the price of jet fuel (Chung, 2003: 77; Zhang, 2007: 86).
these measures largely failed to stymie the malignant competition （exing jingzheng 恶性竞争） between carriers and industry revenues slipped again in 2000 after a brief upturn in 1999 (note 19) causing the regulator to take its boldest action yet when, in mid-2000, it ordered the airlines to turn their revenues over to the CAAC directly. The difficulty CAAC faced in re-regulating airline ticket prices was due in part to vocal opposition on the part of consumers who had benefited from deregulation and also due to foot-dragging on the part of the airlines who were unwilling to cede the autonomy they had been granted under the “one kind of ticket, many kinds of discount” regime (Zhang and Round, 2009: 309).

6.1.3 External Liberalization of the Air Services Market

The gradual opening of China’s air services market to foreign carriers and foreign investors has had a significant impact on the development of this industry. Largely because of the identification of civil aviation with core sovereignty and national security issues, the liberalization of international aviation has taken place bilaterally rather than multilaterally. The Chicago Convention (1944) created the framework for a system of bilateral agreements based on the reciprocal exchange of eight categories of traffic or “hard” rights and this remains the basis of the present system. During the Uruguay Round, the drafting of the GATS Agreement presented an opportunity to multilateralize the liberalization of global aviation but member states opted to preserve the existing system of more than 3500 bilateral agreements. China has participated in the Chicago system since its inception but has taken a relatively conservative approach to market liberalization (Zhang and Chen, 2003: 36-37). In 1994, Chinese regulators first allowed foreign investors to establish joint ventures and purchase equity up to a maximum 25% of voting shares and 35% of total shares. In 2002, the cap on total foreign equity ownership was raised to 49% which is consistent with international standards. In terms of the liberalization of traffic rights, a recent development of note is the US-China “Open Skies” agreement (July 2007) that allows US airlines servicing China to increase their daily number of flights from ten to twenty-three. China is also in negotiations with the EU over an “Open Skies” agreement though the EU framework has reportedly frustrated these efforts. China is reluctant to negotiate with the EU as a single country since giving countries with relatively weak airlines and those with strong airlines (e.g. Lufthansa) the same high levels of access to the Chinese market would frustrate Chinese carriers’ efforts to develop European routes (08BJ1111).
Interestingly, while top policymakers have cited the challenges associated with China’s WTO entry as justification for policies promoting oligopolistic competition in airlines (discussed below), China’s civil aviation commitments upon entry were minimal compared to many other industries. China’s commitments on transport services nominally grants foreign companies in the computer reservations systems (CRS) business full access to the domestic market, subject to CAAC’s approval. In practice China’s own CRS, China TravelSky, continues to enjoy a monopoly nine years after WTO entry (08BJ0920). The agreement also codified China’s open approach to Chinese-controlled joint ventures in the repair and maintenance business. Interviewees suggested that the real significance of WTO entry for airlines had to do with China’s commitments under the Agreement on Subsidies and Countervailing Measures (SCM), in which the government pledged to substantially reduce subsidies granted to SOEs, as well as the liberalization of financial services which threatened to disrupt the cozy relationship between state-owned banks and SOEs (08BJ0920). Certainly SOEs in the post-WTO period now face harder budget constraints than in the past but, as will be discussed later in the chapter, the major state-owned airlines still receive direct and indirect subsidies from all levels of government and the state-owned commercial banks continue to lend inordinately to the state-owned economy.

6.1.4 2002-present: A New Era of Managed Competition

The new era of airlines regulation reflects the inheritance of both the reform and retrenchment periods in the development of the airlines market. The crisis that emerged after the deregulation of pricing in 1997 and the CAAC’s failure to resolve the problem through regulatory and administrative measures paved the way for a major overhaul of the airline industry. In contrast to the earlier reform period which was marked by a continuous, if gradual, arc towards deregulation and liberalization of the domestic market, airlines regulations since 2002 has been characterized by more incongruous trends. On the one hand, what Dougan (2002) described as the “de-statization” process in the airline industry seems to have intensified in recent years. After a major administrative reform of the CAAC, which aimed to decisively sever the relationship between the airlines and the regulator, the regulatory playing field has become increasingly level and has led to a new wave of market entry by upstart airlines after 2003 (to be discussed in the ownership section). On the other hand, the role of the state in structuring competition has in some ways become more pronounced in recent years. Strikingly, at the same
time that the CAAC reform came down, the airline industry underwent an administratively-guided consolidation which substantially bolstered the market position of the Big Three airlines and especially that of the flagship carrier, Air China. And as one of SASAC’s priority sectors, the Big Three airlines now have a powerful advocate which plays an increasingly prominent role in the industry. In effect, while regulatory reforms have nominally made the rules of the game “fairer” for small players, the central government’s efforts to make its own players larger and stronger (zuo da zuo qiang 做大做强) has actually made competition more asymmetrical in recent years.

As CAAC struggled to reign in competition, the regulator began to consider more radical forms of market intervention to support airline revenues. In July 2000, the CAAC made public its plan to consolidate the ten carriers under its direct supervision (zhishu qiye 直属企业) around the Big Three airline groups (Chung, 2003: 78). In April 2001, CAAC submitted a formal reform proposal which also included plans for an overhaul of the regulatory body (discussed below) to the State Council. The proposal to create six large business groups gained swift approval and the arduous process of “voluntary” restructuring began the following year. As a sign perhaps of the significant influence of Air China on its home turf, Beijing, the consolidation was most advantageous to Air China and least welcomed by Shanghai-based China Eastern. Air China, arguably the weakest of the major airlines at the time, acquired the well-run Southwest Airlines in addition to CAAC’s own holding company, China National Aviation Corporation which owned Zhejiang Airlines in addition to valuable equity in the Greater China market (43% of Hong Kong’s Dragonair and 49% of Air Macau). China Eastern, which was Asia’s most profitable airline at the time, was saddled with the poorly-run Northwest and Yunnan Airlines. Upon acquisition of Northwest, Eastern immediately lost 9 billion RMB as it was forced to pay off the airline’s debts (08BJ1212). China Southern also fared relatively badly as it was given the weak China Northern and Xinjiang Airlines. For China Eastern and China Southern, these “hard bones” became only harder to digest when the CAAC subsequently opened up the Xinjiang and Yunnan route to rival airlines, effectively ending the airlines’ regional monopolies and further

81 The three other big business groups to come out of the reorganization were: China Travel Sky, China National Aviation Fuel and China Aviation Equipment Import-Export Company.
squeezing their revenue streams (He, October 11, 2002; 08BJ1212). The reorganization was an unambiguous signal of the government’s intent to foster oligopolistic competition in airlines. As the chief of Air China during reorganization characterized the aims of this reform: “The guidelines for the reorganization of the China’s civil aviation industry in 2002 were to ‘seize the big groups and ignore the small ones,’ as well as to create a favorable environment to help the core aviation companies to gain the upper hand in global competition” (Li, 2008: 48). The final section of this chapter looks more closely at the dynamics of competition in the airlines market since 2002.

**Figure 6-3: 2002 Restructuring of the Airlines Market**

<table>
<thead>
<tr>
<th><strong>China Southwest</strong> (Chengdu)</th>
<th>180 routes (8 int’l, 172 domestic); 39 planes (2001) Total assets of RMB 13.24 billion (2000)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Air China</strong> (Beijing)</td>
<td>115 routes (44 international, 71 domestic); 68 planes Total assets of RMB 38.3 billion (2000)</td>
</tr>
<tr>
<td><strong>China National Aviation Company</strong> (CAAC Holding Company)</td>
<td>HK listing; shares in 58 enterprises; total assets of RMB 91.3 billion. (2000)</td>
</tr>
<tr>
<td><strong>China Northwest</strong> (Xi’an)</td>
<td>30 planes 3.5% of passenger market</td>
</tr>
<tr>
<td><strong>China Eastern</strong> (Shanghai)</td>
<td>200 routes; 93 planes Total assets of 30.0 billion RMB (2001)</td>
</tr>
<tr>
<td><strong>Yunnan</strong> (Kunming)</td>
<td>26 planes 4.6% of passenger traffic</td>
</tr>
<tr>
<td><strong>China Northern</strong> (Shenyang)</td>
<td>46 planes 5.3% of passenger traffic</td>
</tr>
<tr>
<td><strong>Southern</strong> (Guangzhou)</td>
<td>385 routes (65 int’l, 320 domestic); 122 planes Total assets of 30.7 billion RMB (2001)</td>
</tr>
<tr>
<td><strong>Xinjiang</strong> (Urumqi)</td>
<td>19 planes 2.1% of passenger traffic</td>
</tr>
</tbody>
</table>

*Note: data are for 2002 unless otherwise noted

Sources: Li (2008); CTJKMH (2003); company annual reports

In the 2002 Civil Aviation Structural Reform Program (“No. 6”) the plan for consolidation of the airline industry was paired with an overhaul of the CAAC organized around three main goals: achieving decisive government-enterprise separation; streamlining the
regulator’s administrative structure, and; narrowing the CAAC’s regulatory ambit. In much the same fashion as MPT formally shed its ties to the telecom enterprises after 2001, the 2002 airlines reform aimed to transform CAAC from a ministry-owner into a market regulator. After creation of the six new business groups, CAAC’s responsibility for asset management supervision of the six new business groups was transferred first to the Ministry of Finance and then on to SASAC in 2003. The regulator’s former personnel management duties (e.g. appointment of airline managers) became the joint responsibility of the Party’s Organization Department of the Central Committee in cooperation with SASAC. In the same stroke, CAAC transferred ownership rights for 129 airports under its direct control (zhishu jichang 直属机场) to local governments and kept only the Lhasa and Beijing Capital airports under its wing. The reform also significantly reduced the size of the CAAC bureaucracy as the three-level administrative structure (central, regional, provincial) was slimmed to two levels comprised of the central bureau and seven regional bureaus. Finally, in keeping with the aims of establishing firmer enterprise autonomy and a more thorough “marketization” (shichanghua 市场化) of the industry, the reform also reduced the CAAC’s capacity to shape competition in the airlines market. No. 6 provided a narrow definition of the main functions of the new CAAC as providing “safety administration, market regulation, air traffic management, macro-control and international cooperation” (CAAC website). Interviewees suggested that the restructured CAAC now devotes the vast majority of resources to safety monitoring.

Yet, while the 2002 reforms heralded major change in the relationship between regulator and regulated, nevertheless, the CAAC still retains more levers of market control than do most developed-country airline regulators. In contrast to many other regulatory bodies, for example, CAAC, through its Planning, Development and Finance Department, remains responsible for the overall “development” of the industry and it is expected that the regulator use the tools at its

82 Airport reform is a fascinating topic deserving of its own chapter. While airport localization after 2002 was not a major focus of this research, a number of interviewees commented on the difficulties local governments have faced in supporting these airports after the reform. In particular, while major air traffic hubs have tended to be highly profitable (e.g. Baiyuan in Guangzhou and Shanghai’s Hongqiao and Pudong airports) many smaller cities, such as Hangzhou, have struggled to support their airports and a large number have wound up selling their ownership rights to the large airport business groups. As of year-end 2008, for example, Beijing’s Capital Airport Group had acquired ownership rights over 32 mid- and small-sized airports (08BJ1024b).
disposal to guide the industry accordingly. And while a 2004 ticket pricing reform once again substantially relaxed the ticket pricing system, domestic prices are still nominally managed by the NDRC with input from CAAC. And while the restructured CAAC maintains a fairly open licensing regime, especially after passage of a 2004 regulation encouraging private investment in the civil aviation sector, the regulator retains control over key aspects of the airlines’ business and interviewees reported that the Big Three airlines still enjoy considerable advantage in the distribution of regulatory goods. For example, one insider reported that graft is a major problem in the CAAC’s process of air-route allocation and since the Big Three have the deepest pockets, the upstart airlines have been effectively frozen out of competition for the most lucrative routes such as Beijing-Shanghai (08BJ1024b). The CAAC also still administers the system of airport user fees (e.g. landing charges, terminal navigation charges) which constitute a high proportion of airlines’ fixed costs. As well, an executive in a Big Three airline reported that the largest carriers are able to use their bargaining power to negotiate for lower landing fees (09BJ0709). CAAC also presides over the allocation of airport slots and on at least one occasion the regulator has used this leverage to try and influence the airlines’ business. In the early 2000s, as the “Western Development Program” (xibu da kaifa 西部大开发) was being touted by Beijing, CAAC intimated to foreign carriers that if they would extend service to the western regions, they would be guaranteed slots in one of the first-tier coastal cities (08BJ1111).

More recently, the financial crisis prompted the CAAC to taken an interventionist stance somewhat reminiscent of the late nineties re-regulation efforts. Under the leadership of a new director, Li Jiaxiang, a figure much less in favor liberalization and deregulation than his predecessor, Yang Yuanyuan, the CAAC mounted a vigorous response to the crisis. In December 2008, as concerns about the impact of the crisis were at their peak, the CAAC unveiled “Ten Measures to Address the Financial Crisis” (Zhongguo Xinwen Wang, December 9, 2008). As in the earlier crisis, the CAAC measures aimed to bolster industry revenue through easing

83 In April 2004, the NDRC and CAAC jointly issued the Civil Aviation Domestic Transportation Price Reform which set a band around the basic published price. Carriers may sell tickets for as much as 25% above and 45% below the state-set price. International airfare regulations are administered by the International Air Transport Association and the International Civil Aviation Organization.

84 See Williams (2009: 45-59) for a discussion of the influence of the Western Development Program on civil aviation priorities in the Tenth Five Year planning period (2000-2005).
competitive pressures, reducing capacity in the industry and promoting consolidation. Indeed, one of the key measures in the plan was “regulation of market order” defined as strict enforcement of the discount ticket price floor in order to “prevent and avoid vicious competition.” Regulation of market order also entails the CAAC’s “encouraging” the airlines to cancel or return their aircraft purchases for 2009. The CAAC also pledged to “support the consolidation and reorganization” of the airline industry so that Chinese airlines could form a “fist” (*quan tou* 拳头) in the arena of international competition. The CAAC also announced that it had issued a moratorium on the issuance of business licenses to new airlines (CAAC website, December 5 2008). The moratorium remained in effect as of the time of writing in June 2010. The CAAC’s plan also outlined a range of fee waivers and tax exemptions for all airlines in addition to major capital injections for the Big Three airlines (discussed in the next section).

The CAAC’s efforts to suppress “excessive competition” during the crisis served to highlight the increasingly complex authority relations in the airline industry. While the CAAC’s actions show a clear intent to help the major airlines’ minimize their losses and decrease the intensity of competition in the industry, the legacy of regulatory reform has starkly reduced the number and efficacy of the tools at the regulator’s disposal. The regulator’s attempts to use price controls to stifle price wars were seen to be quite ineffective as airlines continued to offer deep discounts throughout the crisis without drawing penalties from the CAAC. Indeed, a prominent airline expert recommended to the CAAC that the mechanism be done away with entirely in order to preserve the regulator’s credibility (10BJ0511). Credibility has become a growing concern for airline regulators since the CAAC became a division of the Ministry of Transport in a reshuffling of the central government in March 2008. Previously, CAAC’s top leadership had enjoyed ministerial rank in the Communist Party hierarchy but their ranks were downgraded to vice-ministerial level after the administrative reform. As the CEOs of the Big Three typically also have vice-ministerial rank in the Party this has endangered the regulator’s ability to enforce unpopular regulations on the major carriers. A number of interviewees described the parity of Party rank between regulator and regulated as having significantly compromised the CAAC’s authority (10BJ0511; 10BJ0511).
Over the past decade, changes in the CAAC leadership reflect the growing prominence of the state’s national champions strategy. The director of CAAC between 2003 and 2008, a first grade pilot and former CEO of China Southern airlines, Yang Yuanyuan, took a decidedly liberal stance on the participation of both non-state and foreign investors and firmly guided policy towards increasing market competition. Under Yang, the restructured CAAC gradually began to loosen the administrative barriers to entry erected during the earlier period of retrenchment. After a year of windfall profits in 2004—when the airlines’ cumulative profits exceeded the combined earnings of the ten previous years—the CAAC issued a new regulation in 2005 urging domestic and foreign interests to invest in the booming industry (Zhang, April 15, 2009). Shortly thereafter, the government issued an additional policy, the Regulation on Domestic Investment in Civil Aviation, which, for the first time, encouraged private investment in the airline industry. As will be discussed in the subsequent section, these liberalizing measures had a quick and decisive impact on the industry as the market once again swelled with new entrants. In marked contrast to his successor, Yang was also opposed to measures that would have increased the market power of the big players. In Fall 2007, amid high-level discussion of an administratively-led merger among the Big Three, Yang declared that any such union between large players would not benefit development of the air services market and would harm the interests of consumers (xinjingbao: October 31, 2007).

Following Yang’s dismissal after a corruption investigation, Li Jiaxiang was appointed director of the CAAC in December 2008, a decisive signal from on high that airlines policy should promote the interests of the Big Three state-owned carriers. Li, a former general in the Air Force, had become a prominent figure in civil aviation following his appointment as CEO of Air China in late 2000. Following a series of embarrassing incidents at Air China in the late 90s, including the hijacking of a plane by an Air China pilot dissatisfied with the apartment that had been allocated to him by the company, a “senior leader” personally ordered the general political department of the PLA to nominate a military cadre to lead Air China and Li was soon dispatched to the airline (Li, 2008: 3). In a widely read book recounting his achievements at Air China and outlining his vision for the future of China’s airline industry, My Way: The Eight Strategies of Air China Towards Success, Li describes his soldierly efforts to professionalize management practices and reduce the airline’s costs through such measures as cutting non-essential subsidiaries—in the fish farming industry, for example—out of the Air China group. Li
presided over the sharp reduction in Air China’s debt ratios and a surge in profitability that paved the way for the airline’s dual IPO in the Hong Kong and London markets in 2004.

In the penultimate chapter of his book, published just prior to his appointment as CAAC head, Li set out a “strategy for the future” of civil aviation which is a thinly veiled criticism of the course of civil aviation policy taken under Yang’s leadership. Li first expressed a deep skepticism about the domestic and international liberalization of the market that had accelerated during Yang’s tenure. He characterized the liberalization of air traffic rights as a process driven primarily by the interests of powerful countries: “The liberalization of global aviation transportation, initiated by the United States and practiced by aviation powers, is in fact a plan to gradually take over the resources of the weaker players, under the guise of ‘liberalization’” (Li, 2008: 194). Li also called for a firmer approach to the role of foreign investment in the industry:

We should pay close attention to the impact of foreign airlines’ investments upon the Chinese aviation industry. Domestic airlines should refrain from taking any major strategic moves unless they truly meet their interests. Otherwise, the pattern of domestic airlines will become rigid, making it very hard to initiate any reorganization of the Chinese aviation industry due to the opposition of foreign airlines. The situation of ‘divisive rule by feudal lords’ will become all the more severe in the Chinese aviation industry (Li, 2008: 207).

Li’s account also implies that CAAC had acted too hastily in nurturing the ambitions of smaller airlines. He argued that the market in 2008 faced a risk of overcapacity and had become bogged down by “excessive market competition” (Li, 2008: 198). Regarding the flood of private airlines after 2005, Li suggested that “if too many private airlines emerge in a short period of time, this can easily result in a fierce struggle between such companies for such important resources as pilots, which will then destabilize the whole industry” (Li, 2008: 198).

In his book and in various high-profile forums on civil aviation policy in the last few years, Li has advocated increasing concentration in the market and has called for the establishment of a “super carrier” (chaoji chengyun ren 超级承运人) capable of succeeding in the global marketplace. Li urged Chinese policymakers to adapt to the realities of the globalization of air services which, he argued, had mainly served the interests of the world’s largest airlines in increasing their market share via organization of industrial alliances. In Li’s view, fierce price competition in the domestic market had actually hindered Chinese airlines’
ability to compete in the global marketplace. In order to ease pressure in the home market, Li called for a “market-based division of labour” among Chinese carriers such that “[s]ome airlines will develop into hub-network aviation companies, targeting the high-end market and mainly operating international routes. Some will evolve into budget aviation companies, targeting the public market and mainly operating domestic point-to-point routes. Still others will grow into cargo transport aviation companies” (Li, 2008: 202). In addition to divvying up the domestic market according to airlines’ purported comparative advantages, Li also called for consolidation among the largest carriers: “In order to win this battle of the century, we must build a flagship for the Chinese aviation industry that can compete with international giants as a super-carrier” (Li, 2008: 202). Though he does not overtly lobby for Air China assuming this role in My Way, he obliquely makes the case noting that Air China had already discussed cooperation options with “top management of some domestic airlines” (Li, 2008: 208). Li’s proposal ends with a spirited defense of increasing market concentration in the airline industry:

Another round of reorganization and integration among domestic airlines will most likely trigger off public concern about an ‘industrial monopoly.’ …Actually, there is no monopoly, just excessive competition in the current Chinese aviation market. This so-called ‘monopoly’ has much to do with perspectives and standpoints. The U.S. government, which advocates free competition and opposes monopoly, played a dominant role in promoting the merger of Boeing and McDonnell Douglas. [And] Boeing and Airbus dominate civil airplane manufacturing the world, and this has not been perceived as monopoly (Li, 2008: 209).

The CAAC’s statist response to the financial crisis as well as the quickened pace of consolidation under his leadership suggests that Director Li is guiding civil aviation policy in a more conservative direction.

Of course, the policy vision of any CAAC director, while of key importance, is finally just one factor in shaping civil aviation policy and a number of actors besides the industry regulator continue to play an important role in rule-making and oversight of the airline industry. Interviewees in Beijing made frequent reference to the considerable influence of NDRC with one interviewee characterizing CAAC as a “front” since NDRC has primary responsibility for all important investment decisions (e.g. plane purchases) as well as the most influence in decisions about how the industry’s primary administrative revenue, airport user fees, are spent (08BJ1024).
In addition, after the 2004 pricing reform described above, NDRC assumed primary responsibility for policing the price system including responsibility for investigating frequent charges of price collusion between the major carriers. NDRC also decides the price of the industry’s key input: aviation fuel (08BJ0709). And although SASAC does not play as prominent an owner-regulator role in airlines as it does in telecom, the commission now wields considerable influence in the airline industry. As we will see in the following section, SASAC has played a particularly prominent role in guiding consolidation of the industry after the global financial crisis.

6.2 Ownership Reform

This section examines the evolution of the airlines market structure following the dismantling of the CAAC monopoly in 1984. The data show close linkages between regulatory change and the prevailing form of industrial organization throughout the period. After the CAAC adopted an open stance to the entry of new airlines in the late eighties and early nineties, the ranks of the airlines market swelled substantially and, following price deregulation that began in 1992, competitive pressures began to whittle away at the commanding market position of the largest CAAC-linked airlines. After the re-regulation of prices and the subsequent consolidation of the CAAC carriers, the market concentration of the Big Three in addition to Hainan Airlines increased markedly and this oligopolistic market structure has become more entrenched since the reorganization of the CAAC in 2002. Although a number of smaller airlines have found niches in the airlines market, principally on operating low-cost flights on regional feeder routes, the privileges accorded to the largest airlines by government authorities make it difficult for smaller carriers to directly compete with the major players especially on the most profitable international routes.

In the first cycle of de- and re-regulation the largest carriers struggled to maintain their commanding market share before the government’s interventions. As discussed previously, competition intensified over the first half of the 1990s as the market was inundated with upstart airlines and the regulator phased in price competition. While the Big Three carriers retained at least 50% of the market share throughout this first period of liberalization and deregulation, the time-series data show that competition pressures substantially eroded the dominance of the major carriers in the early nineties. Figure 6.4 summarizes changes in the combined market share of the
Big Three and the Big Eight (the six CAAC carriers plus Xiamen and Yunnan airlines) between 1987 and 2003.

Figure 6-4: Concentration Ratio of Big Three and Big Eight Airlines, 1987-2003

![Concentration Ratio Graph]

Source: Data from Tai (2004): 68

Whereas the Big Three accounted for 69% of the air transportation market in 1987, competition from smaller carriers had already pushed their market share down slightly to 66% in 1992 when CAAC first permitted airlines to offer discount tickets. After 1992, price deregulation quickly eroded the Big Three’s dominance in the market as travelers were lured to cheap tickets offered by newcomer airlines. Between 1992 and 1996, the concentration ratio of the Big Three airlines dropped precipitously from 66% to 56%. Despite the airlines’ foot-dragging in the re-regulatory period after 1997, the CAAC measures did have some impact on the Big Three’s revenue share as their combined percentage of the market climbed again between 1997 and 2002. Yet the major change came with the 2002 consolidation of the CAAC carriers which drove the Big Three’s market share to 76% and the share of the top eight airlines to 92% in one fell swoop (Yang, 2005: 92).

Director Yang presided over the second wave of liberalization in the air services market. The CAAC regulation on private investment had a particularly dramatic impact as private airlines entered the market en masse after passage of the 2005 regulation. The entry of these low-cost carriers (LCCs) has opened up a new market segment in the industry and a few of these
carriers have been successful in their first few years. Following a flurry of licensing after passage of the Regulation on Domestic Investment in Civil Aviation, the total number of private airlines had risen to fourteen by the end of 2005. Of these private start-ups, Shanghai-based Spring Airlines has been far and away the most successful. Spring got its start after entrepreneur Wang Zhenghua assiduously studied the business model of America’s Southwest Airlines, which is based on strict cost controls and high passenger load factors, and decided that a similar airline could succeed in the Chinese market. In its first year in 2005, Spring operated only one aircraft but a passenger load factor of 95% helped the airline to turn a profit of nearly US $5 million in 2006 and $10 million in 2007 (Cantle, 2008). In 2008, Spring was the only Chinese airline to turn a profit. Data compiled by the CAAC show that Spring’s operating costs were 69% lower than the industry average (CAAC, 2008: 270) Though Spring does not have licenses to fly the most profitable routes such as Beijing-Shanghai, the airline’s network of coastal to inland routes (e.g. Shanghai-Yinchuan) are very popular with price-conscious consumers and the company is increasingly setting its sights on competing with the railways on these routes (SH090713). In 2009, the airline even tried to persuade CAAC to allow it to sell standing seats (zhan piao 站票) as the railways do. In contrast to the Big Three’s heterogeneous fleets, Spring’s thirteen aircraft (one of which the airline owns, twelve of which are leased) are all Airbus 320 models which allows the company to minimize maintenance costs. Unlike other private airlines which tend to rely on fickle sources of financing such as foreign investment, Spring has a much firmer base. The airline is a subsidiary of the Spring Travel Services business group, the most successful travel company in China, and customers of the travel company’s tours constitute about 40% of the airline’s customers (Cantle, 2008). The travel company has also played a major role in financing the airline’s fast-paced expansion in the domestic market though the airline is

---

85 At the time of writing, competition between rail and air was a hot topic among civil aviation experts. In recent years, major investments have been made in building a nation-wide high-speed rail network and the 12th Five-Year Plan provides for a major increase in the number of airports before 2020. Interviewees often suggested that on routes of less than 500 kilometers, airlines would face increasingly stiff competition from rail.

86 The author had a taste of Spring CEO Wang’s legendary commitment to cost-cutting when she conducted an interview in the Spring headquarters near Shanghai’s Hongqiao Airport in early summer 2009. The headquarters consist of a few offices located on the second floor of a dingey hotel. The interview took place in a small, dimly-lit room that had once been the employee drink station; it had apparently been closed after it was found to be losing money.
now considering a capital market listing to meet its goal of operating a 100 aircraft fleet by the year 2015 (Cantle, 2008).

Yet, despite Spring Airlines’ success, the existing regulatory framework acts as a significant constraint on the development of China’s LCCs. First, as mentioned, the private airlines are at a distinct disadvantage in the competition for lucrative route allocations and in the major cities there is, as yet, no network of auxiliary airports such as London’s Gatwick or Frankfurt’s Frankfurt-Hahn airport where LCCs could simulate these major routes for budget-conscious travelers without having to pay for expensive slots in the major airports. Second, the private airlines also have difficulty manning their aircraft since the state-controlled airlines heavily penalize pilots they have trained who wish to leave for work at rival airlines. Finally, continued price controls also prevent the LCCs from making the most of their comparative advantage. In November 2006, for example, Spring Airlines made headlines when it offered a special 1 RMB ticket on its Shanghai to Jinan route for a ten-day period and the tickets were completely sold out within three days. The experiment was short-lived, though, as the Jinan Price Bureau subsequently ruled that Spring Airlines had violated the airline ticket price floor and levied a 150,000 RMB fine (Wang, February 1, 2007). As President of Okay Airways, Liu Jieyin, explains, the tradeoffs for LCCs in this still highly regulated environment are often stark: "In China, if you want to be a low-cost carrier, where do you find your pilots? If you pay more to hire foreign ones, your costs will be higher than others. Oil prices cost the same for everyone. How do you compete?" (quoted in Wang, February 1, 2007).

6.2.1 The New Terrain of Oligopoly: The Big Four Groups

Since the 2002 consolidation, the three largest airlines have regained their commanding presence in the airline market and a restructured Hainan Airlines has also steadily expanded its influence in the domestic market so that industry insiders now commonly refer to the “Big Four” airlines rather than the Big Three. The business groups huddled around these airlines exercise immense and growing influence in all corners of the civil aviation market as major shareholders in smaller airlines, airports, aviation fuel companies and catering businesses. As Chart 5.4 shows, at least one member of the Big Four has a controlling stake in nearly all of the significant smaller airlines. Among the top fifteen airlines, only Spring Airlines (the twelfth largest airline as measured by passenger traffic) remains non-aligned. Additionally, cross-holdings among the
largest airlines also provide the major carriers with a measure of leverage over their rivals’ business decisions as will be discussed in more detail below. Interestingly, the airline industry is one of the few in which central SASAC and a provincial-level SASAC (Hainan) are both in control of major enterprises. As we will see in the discussion of Hainan group’s real estate holdings, this division of authority has created pronounced central-local tensions as the central government attempts to impose limits on the business scope of state-controlled enterprises. The next pages briefly describe how each of these business groups has developed and expanded their reach in the domestic market in recent years.

Figure 6-5: Market Share of the Big Four Airlines, 2008

6.2.1.1 Air China Group

As mentioned, the 2002 reorganization greatly boosted Air China’s competitiveness. In the 1990s, Air China had a latent advantage as the carrier with the largest number of international routes—these tend to have much higher profit margins than domestic routes—but the airline suffered from the constraints of a limited domestic network. At the same time, as air service liberalization agreements steadily opened the market to foreign carriers, Chinese
passengers increasingly opted for foreign carriers and Air China’s market share in international flights slipped to just 36% (Li, 2008: 30). Thus, Air China’s acquisition of China Southwest Airlines and CNAC was pennies from heaven for the struggling airline. The acquisition of China Southwest Airlines (based in Chengdu) greatly expanded Air China’s domestic network. As China’s fourth largest airline, with routes linking China’s coastal and inland regions, Air China’s acquisition of Southwest meant that the carrier suddenly had a “vast network” that “linked up with domestic trunk and branch routes in support of international routes with Beijing as the hub and Yangtze River delta, Pearl River delta, and Chengdu-Chongqing economic zones as its bases” (Li, 2008: 44). With assets of RMB 9.13 billion, the absorption of the CAAC’s former holding company, CNAC, considerably improved Air China’s financing ability (Li, 2008: 44). Additionally, as China’s first “red chip” aviation listing in Hong Kong, CNAC had valuable management expertise to share with Air China management as the airline attracted Cathay Pacific as a strategic investor and later launched its dual international IPO in 2004.

Following the restructuring of Air China group, formally completed in January 2003, the airline’s strong profitability, the liberalization of domestic routes and strong policy backing from the central government all helped to propel its expanding presence in the domestic market via major equity investments in regional airlines. Shortly after the 2002 reorganization was complete, Air China began negotiations with Shandong Airlines, China’s ninth largest carrier, which operates lucrative routes around the Bohai Sea as well as in the Pearl and Yangtze River delta areas. In February 2004, Air China became Shandong’s controlling shareholder with a share purchase of RMB 560 million (Li, 2008: 48). With firm regional bases in the West and Northeastern regions following the Southwest and Shandong acquisitions, Air China’s focus turned to establishing a foothold in the bustling Southern market, the traditional stronghold of China’s largest airline, China Southern Airlines. Air China has made strenuous efforts to gain control of Shenzhen Airlines (China’s fourth largest in the passenger market) in which it has held a 25% share since Shenzhen’s establishment in 1993. In May 2005, Air China planned to purchase 65% of the airline’s stock rights when they came up for auction on the Shenzhen Assets and Equity Exchange Center but the stock value was bid well beyond the airline’s projections and two private investment companies controlled by businessman Li Zeyuan jointly purchased the rights for RMB 2.7 billion. Finally, in late 2009, an opportunity presented itself when Li Zeyuan and another Shenzhen executive, Li Kun, were investigated by the police for undisclosed
economic crimes. Following Li’s arrest in December 2009, Air China took control of Shenzhen’s management and in March 2010 Air China made an RMB 682 million investment in the airline bringing its total equity holdings to 51%, a move for control which Li’s bankrupt company, Shenzhen Huirun Investment Company, was powerless to block.

6.2.1.2 China Southern Group

The 2002 reorganization was much less advantageous for China Southern airlines, the most successful company in the 1990s and still China’s largest carrier. While the acquisitions of Xinjiang and China Northern airlines padded the airline’s already enormous domestic network of 320 routes, the subsidiaries had considerable financial troubles which both delayed the completion of China Southern’s restructuring and compromised the new group’s overall financial position. The acquisitions were only finalized in December 2004 when China Southern group formally assumed the two airlines’ debts and liabilities totaling RMB 13.6 billion (China Southern Airlines Annual Report, 2004: 51). Over the course of reorganization, the airline’s total debts grew 116% from RMB 19 billion (2003) to RMB 41 billion (2005) and its total debt to total capital ratio shot up from 58% in 2003 to 75% in 2005 (Xinhua Far East China Ratings, 2005: 1-2).

While Southern’s financial woes following reorganization have constrained its ability to meet the challenge for supremacy launched by Air China under Li Jiaxiang and his successor, Kong Dong, the Guangzhou-based airline has also extended its reach in the domestic market in recent years, though not as assertively as Air China. In the midst of its own reorganization, China Southern acquired 39% of Sichuan Airlines in a restructuring of the Chengdu-based airline which also saw China Eastern purchase 10% of the airline’s shares. The airline has also strengthened its bases in other regions of China through ownership and operation of airline terminals in Beijing, Urumqi and Xi’an. In 2005, the airline announced its “dual hub” strategy (in Guangzhou and Beijing) and established a subsidiary, China Southern (Beijing) to consolidate its presence in the Beijing market, Air China’s home base.

6.2.1.3 China Eastern Group

Of the Big Three airlines, China Eastern was least well-served by the administrative restructuring of the market. While Eastern’s acquisition of Yunnan and Northwest airlines,
completed only in late 2005, increased the airline’s domestic routes by one third, and its international routes by one quarter, the restructuring was plagued by debt-related problems and skirmishes over leadership positions. While Yunnan Airlines had a strong record of profitability owing largely to its monopoly in the southwestern province, Xi’an-based Northwest Airlines was debt-ridden and poorly-managed. As one China Eastern executive put it, in the interests of leveling competition between the Big Three, planners of Eastern’s restructuring had acted like shrewd vegetable vendors in adding to the bundle “a good one for every bad one” (Caijing, June 2 2005). Largely a consequence of assuming Northwest’s debts and liabilities, China Southern’s total debts increased 54% from RMB 24 billion to RMB 37 billion between 2004 and 2005. The company’s debt to capital ratio ballooned from 77.4% (2004) to 88.7% (2006) before swelling to crisis proportions (105.65%) during the financial crisis of 2008 (Xinhua Far East China Ratings, 2006: 1; CAAC Annual Report, 2009: 177). Senior management at Yunnan airlines was said to be unhappy about its absorption into the larger company and executives struggled with Eastern managers for leadership positions in the new group company. Yunnan’s pilots were also reported to be displeased with the ownership change since it meant that they would have to work longer hours and fly further distances (Caijing, June 2 2005). In March 2008, 21 pilots from the former Yunnan Airlines, China Eastern (Yunnan), displayed their displeasure by staging a dramatic job action involving such antics as turning planes back mid-flight and arriving at a destination, taxiing down the runway and promptly flying back to the departure city (The Economist, April 19, 2008).

Due to its mounting problems, China Eastern has been less active than its primary competitors in establishing strategic partnerships with international companies and acquiring smaller airlines in the domestic market. In 2005, China Eastern began negotiations with Singapore International Airlines (SIA) about setting up a strategic partnership. By late summer 2007, the two sides had reached an agreement and China Eastern had all the necessary government approvals for a deal which would have seen SIA purchase a 15.7% stake and Singapore’s sovereign wealth fund, Temasek, a further 8.3%. In a strange turn of events, however, Air China partnered with Cathay to block the deal by increasing their own holdings in China Eastern and voting down the takeover deal in a January 2008 shareholder’s meeting. Interviewees suggested that CAAC, NDRC and SASAC had all supported the Eastern-SIA deal and were angered by Air China’s unilateral actions but the central government had been reluctant
to directly intervene since this would compromise the still fragile principle of government-enterprise separation (08BJ0920). Later, central and Shanghai SASAC each pushed hard for China Eastern’s merger with Shanghai Airlines, the seventh largest domestic carrier. The primary aim of the merger, finalized in July 2009, was to increase Eastern’s market share in its hub, Shanghai, to a level similar to the percentage held by Air China and China Southern in their respective home bases. While the merger was reportedly unpopular with the top management of Shanghai Airlines, sustained pressure from central and Shanghai SASAC made the deal, finalized in July 2009, essentially a foregone conclusion.

6.2.1.4 Hainan Group

To meet the challenge of survival in the post-2002 consolidated airlines market, Hainan Airlines has built a group structure to rival the Big Three airlines’ business empires. After the CAAC signaled that it would lead an administrative consolidation of the industry around its own carriers, in 1999, Hainan’s CEO Chen Feng resolved to make Hainan (hereafter HNA) the center of a consolidation drive among the independent airlines (Men and Sun, 2007: 41). In 2000, Chen announced HNA’s “3-7-9 Strategy” which meant the airline would strive to become a well-known domestic brand within three years, a well-known Asian brand within seven years and a well-known global brand within nine years. In 2000 and 2001, HNA acquired controlling stakes of Xi’an-based Chang’an Airlines, China Xinhua Airlines and Shanxi Airlines. The acquisitions instantly made HNA China’s fourth largest airline group and significantly expanded its domestic network (especially its regional feeder routes) and padded HNA’s fleet. Since then, HNA has become the major shareholder in two more airlines, Yunnan Lucky Air (a low-cost regional carrier) and Deer Jet/Capital Airlines, a Beijing-based charter airline focusing on business jet service. HNA’s dogged market expansion against all odds, and its strong profitability prior to the financial crisis, has become a celebrated story of a non-state enterprise thriving in a SOE-dominated industry. HNA’s rise has spawned dozens of books and academic studies and the venerable State Council Development Research Centre even established an “HNA Development Strategy Research Group” which published a book entitled *HNA Phenomenon*, examining every

87 In the late 1990s, the ten major independent airlines were (in decreasing order of market share): Shanghai Airlines, Hainan Airlines, Sichuan Airlines, China Xinhua Airlines, Shenzhen Airlines, Zhongyuan Airlines, Chang’an Airlines, Wuhan Airlines, China United Airlines and Shandong Airlines.
aspect of the airline’s development since its establishment in 1991 (State Council Development Research Centre, 2005).

Yet, while HNA would have satisfied most definitions of a non-state enterprise in the 1990s, the company has undergone a partial nationalization, really “provincialization”, in recent years. As Chart 6.6 shows, in HNA’s increasingly complex corporate structure, Hainan SASAC through its wholly-owned holding company (Hainan Development Holding Company) is now the majority shareholder (40.65%) in Grand China Air Holding Company, the airline’s parent company since 2004. Executives are said to have appealed to the Hainan provincial government for help in 2005 when the company was struggling to meet its debt obligations and Hainan province became Grand China Air’s largest shareholder after a RMB 1.5 billion investment in October 2005 (Zhengquan Ribao, November 20, 2007). The other major shareholders in the new group structure created in 2004 is a hedge fund controlled by American investor George Soros (18.64%) and Hainan Airlines Group (32.72%) which still controls most of HNA’s ownership interests in civil aviation as well as the group’s significant holdings in the travel, real estate and hotel industries. Grand China Air has been preparing for a Hong Kong IPO but plans have been delayed by the financial crisis as well as sponsors’ reported concerns about the HNA’s mounting debt problems (Yang and Wang, June 30, 2009).

88 In 1999, state shares (held by the Hainan provincial government) comprised just 2% of the company’s total stock composition. The other holdings in that year were: public shares (30%), domestic legal person shares (33%), employee shares (9%) and foreign shares (26%) (guowuyuan fazhan yanjiu zhongxin haihan fazhan zhanlīe ketizu, 2004: 182).
As the central government’s efforts to reform the real estate industry progress, it will be interesting to see what will become of HNA’s considerable real estate assets which are the largest of any of the airline groups. As discussed in Chapter Three, central SASAC has pledged to reduce central SOEs’ real estate investments but these regulations are not binding on HNA which is under the auspices of the formally autonomous Hainan province SASAC. HNA first came into contact with the real estate industry when a subsidiary, HNA Hotel Group, was established to acquire and manage assets in China’s luxury hotels and tourism industries in the late 90s. HNA retains major assets in these areas and has expanded into the areas of real estate and real estate development in recent years. For instance, HNA wholly owns Xi’an Real Estate which has a registered capital of 30 million RMB. In late 2009, the media branded HNA as a “land king” after three of the group’s subsidiaries banded together to purchase a luxury property in Shanghai for RMB 1.8 billion (Renminwang, November 3, 2009).

6.2.2 Advance of the State-Owned Airlines, Retreat of the Private Carriers

The global financial crisis of 2008 only intensified the trend of consolidation around the Big Four airline groups. The central government’s asymmetric interventions in the airlines
market after 2008 attracted intense media scrutiny of policies which many commentators blamed for the “advance of the state and retreat of the private sector” (guojin mintui 国进民退) in the wake of the financial crisis. In addition to the CAAC’s ten-point plan for dampening “malignant competition” in the airlines market discussed previously, the central government also organized massive bailouts and indirect subsidies for the Big Three airlines, preferential treatments which were generally not granted to smaller airlines. First, China Southern received an RMB 3 billion capital injection via its parent company in November 2008. Later, China Eastern received two successive bailouts, totaling RMB 7 billion. Eastern’s funds came by way of a private issue of shares to its parent company which raised the group company’s share of the airline’s shares from 60% to 75%. Besides these direct measures, the Big Three were also reported to be receiving other indirect forms of assistance from government authorities. A senior airport executive reported that during the crisis, the Big Three received 80,000 RMB for each airport “movement” (a landing or take-off) in certain locales which were paid for by provincial governments and handed through the airports. These subsidies which, prior to the financial crisis, had only been issued for every tenth movement were reportedly not extended to smaller carriers except those who were able to finagle codeshare arrangements with the Big Three (XI100525).

Interestingly, SASAC played a very assertive role in shaping the Big Three’s response to the crisis, actions which sharply contrast with its earlier more hands-off approach to industry affairs. SASAC’s first move came in late 2008 when it orchestrated a management shuffle among its carriers in an effort to revitalize China Eastern’s management. At the height of the crisis, in December 2008, Eastern’s CEO, Li Fenghua, was replaced by China Southern’s Chairman, Liu Shaoyong and the Deputy General Manager of Air China’s parent company, Ma Xulun, swapped positions with Eastern’s Deputy Party Secretary, Cao Jianxiong. And though SASAC was a central player in the design and implementation of the airline bailouts, SASAC has also applied an increasing amount of pressure on industry leaders to make profitability their top priority. SASAC’s “2008 Report on Central SOEs’ Operations” comparing the performance of enterprises in nine key industries notes that among them “only airlines has not maintained the value of state assets.” A newspaper article commenting on the report suggested that the signals from SASAC were increasingly clear: as shareholder on behalf of the state SASAC “doesn’t only pull out money, it also asks for accountability” (zhongguo jingying bao, October 19, 2009). And
yet other aspects of SASAC’s response to the crisis give the impression of a less stern, more protective parent. In August 2009, SASAC instructed six of its SOEs which had bought fuel-hedging derivative products from international investment banks to write letters to the banks as notification of termination of these contracts ahead of the date of expiry (Zhang and Wu, November 9, 2009). Unfavorable fuel hedging contracts had contributed vast sums to China Eastern and Air China’s losses in the financial crisis and it was widely suspected that both of these companies were among these six enterprises.

With the exception of Spring Airlines, which claimed to be the only Chinese airline to turn a profit in 2008, smaller carriers were ravaged by the crisis and a number were taken over by larger carriers in sometimes murky circumstances. In early 2009, Sichuan Airlines moved to takeover United Eagle by increasing its shareholdings in the cash-strapped regional carrier which had been its competitor in Chengdu. Media scrutiny of the “advance of the state, retreat of the private sector” in the airlines industry focused on the controversial collapse of a small carrier based in Wuhan, East Star Airlines. Prior to the crisis, Air China’s parent company, CNAHC, expressed interest in purchasing the airline which would have helped it establish a stronger footing in central China, a weak point in its domestic network but CNAHC was said to have been rebuffed by East Star’s chairman Lan Shili. In March 2010, the Hubei provincial government reportedly signed an agreement with Air China to make Wuhan a regional hub (Caijing, April 15, 2009).

Given the backdrop of Air China’s interest in acquiring the airline and its cozy relationship with the local government, there was widespread speculation that political forces had been in play when CAAC, with support from the Wuhan municipal government, abruptly suspended East Star’s operations in March citing safety concerns. Suspicions that strong-arm tactics had been used to force East Star’s bankruptcy which paved the way for Air China’s acquisition of its assets at auction in November 2009 were fuelled by a report by the Financial Times’ Beijing correspondent, Jamil Anderlini, claiming that Lan Shili went missing on March 13 2009. East Star employees alleged he had been taken in to custody after steadfastly rejecting Air China’s takeover bid. The employees also reported that Wuhan officials had interfered in the negotiations and subsequently monitored the company’s communications and controlled the movements of its executives (Financial Times, March 18, 2009). One interviewee, an Air China
executive close to the episode, offered a different version of events. He claimed that East Star had actually been in protracted negotiations with Air China. In a weakening bargaining position (East Star had fallen months behind on its aircraft leasing obligations), Lan balked at Air China’s hard negotiating tactics and abruptly withdrew from negotiations because he felt he had lost face (09BJ0709). At the time of writing, the case had only become more bizarre. In 2010, Lan Shili was convicted of tax evasion and sentenced to four years in prison. From prison, in September 2011, Lan Shili publicly accused Wuhan’s deputy major, Yuan Shanla, of a number of crimes including embezzling public money and money laundering via local gangs.

6.3 Conclusion

How do we understand the shifting tides of airlines policy in the reform period? The story of the first fifteen years of airlines reform fits very well with Hellman’s view of the political dynamics of economic reform, yet events after 1998 strike a discordant note. As discussed in Chapter Two, Hellman’s model suggests that the interests of incumbents will be a less salient factor in policymaking when comprehensive reforms are adopted from the outset. Indeed, Shen Tu and Deng Xiaoping almost seem to have taken a page from Hellman in the design of their reform strategy which combined striking out at the most powerful interest group in the Mao years, the Air Force, while simultaneously anchoring the reform pathway to the interests of local government and flush ministries by encouraging them to enter the airlines and airport businesses. The strategy was largely effective in carrying civil aviation reforms through the liberalization and deregulatory phases of the 1980s and 1990s. So why did this policy trajectory ground to a halt in the late nineties?

Two explanatory variables, the distribution of profits and the neoconservative policy legacy are most helpful in accounting for explaining the airlines volte-face. While CAAC was not made a short-term winner in this reform process in quite the same way as MPT was in telecom, an analysis of retrenchment shows that the CAAC was not an entirely impartial observer either. When liberalization measures promoting competition have cut into the commanding presence of the largest state-owned carriers, the regulator has not hesitated to intervene and manage the market. The data presented in Chart 6.4, tracing the market share of the CAAC-linked airlines over the 1990s, illustrates this most clearly. The late 1990s retrenchment was fed the by the regulator’s responsibility for the profitability of these powerful
but struggling airlines. While the CAAC has now been completely shorn of its direct ties to the Big Three, as Li Jiaxiang’s biography attests, CAAC’s leadership retain close guanxi ties to these airlines. The neoconservative policy legacy also contributed to this policy shift. The industrial policy regime that built up around the Big Three starting from the early 1990s combined with policy signals emphasizing the importance of “grabbing the large”—especially Zhu Rongji’s high-profile pledge to the NPC in 1998 that all large SOEs would be profitable within three years time—served to legitimize the CAAC’s retrenchment efforts. In recent years, the importance of cultivating large carriers to compete in open skies competition has become an even more prominent feature of airlines policy.
7 Conclusions: China’s State Capitalist Turn

7.1 Introduction

This chapter returns to the three questions that have shaped this study: 1.) What are the most salient changes in China’s state-owned economy in the last two decades? 2.) How have central government policies and actions shaped these changes? 3.) Why does state ownership remain dominant in some industries and not in others? The first section summarizes the answers to these questions provided in the preceding chapters. The discussion then turns to possibilities for future research in this area before concluding with a discussion of what this study adds to a current debate in the field of Chinese political economy over the nature and direction of China’s economic reform.

7.2 China’s emerging state capitalism

In the past twenty years, China’s state sector has experienced a dramatic reversal of fortunes. Whereas China’s debt-ridden SOEs were once albatrosses around the necks of China’s leaders, the surging profitability of large enterprise groups in the so-called “monopoly sectors” have since made them the lynchpins of China’s emerging state capitalist system. While a retrenchment dating from the 1990s dramatically reduced the absolute size of the state sector, the growing wealth and increasing overseas presence of the SOEs that survived these reforms are the culmination of the neoconservative vision of a robust state sector in control of the commanding heights of the economy. And although a handful of SOE-dominated industries now form the core of China’s state-owned economy, the subsidiaries of these large and increasingly powerful SOEs are dispersed widely across industry and constitute a potent obstacle to efforts to adjust the layout of the state-owned economy.

In parallel to a bold state sector retrenchment program which reduced the SOE share of industrial output from 70% in 1990 to 46% in 2002, the state’s large enterprise groups have
evolved into vast business empires linking together dozens of subsidiaries in diverse sectors of the economy. China’s approximately 3000 designated large enterprises now control nearly 30,000 direct subsidiaries and employ more than 30 million people. Among the prized trial group enterprises—the national team—subsidiary growth has been especially rapid with some enterprises forming pyramidal business groups. The 100-odd enterprises that comprise the national team collectively employ nearly ten million workers and contribute almost half of all profits generated by China’s 3000 large enterprises. These national team enterprises are also leading China’s ‘going forth’ and, in 2007, 65 of them contributed nearly half of China’s US $10.6 billion in overseas foreign direct investment.

The lengthening reach of the national team across Chinese industry exists in some tension with the government’s pledges to confine the state-owned economy to a lifeline and pillar industries. While SASAC’s annual performance reviews nominally place pressure on central SOEs to focus on their designated core business areas, by the bureaucracy’s own admission, subsidiaries of SASAC SOEs can still be found in 90.5% of China’s basic industries (SASAC, 2007: 166). To be sure, the market entry of non-state and foreign-invested enterprises in many sectors of the economy over the decade since China’s WTO entry has substantially reduced the market share of SOEs in some industries. The diminishing role of SOEs in industries such as textiles and agriculture contrasts with the small number of lifeline industries characterized by majority state ownership; however, falling SOE market share is not evidence of the decisive retreat of state ownership from non-priority segments of the economy because SOE subsidiaries remain active in many so-called competitive industries and have been advancing into a number of lucrative non-lifeline industries.

7.3 Role of government policy and actions

This study has argued that these momentous changes in the state sector over the last two decades are, in large measure, a legacy of the brief period of neoconservative rule (1989-1992). The core premise is that the neoconservative era constituted a critical juncture in the unfolding of China’s state sector reforms. The fleeting ascendance of Chen Yun’s faction in the wake of the Tiananmen uprising presented the neoconservatives with an opportunity to redirect the reform course set by Deng Xiaoping and his supporters which had aimed toward the gradual but steady dismantling of the state-owned economy. Drawing eclectically from socialist principles,
Chandlerian economics and the example of East Asia’s developmental states, the neoconservative market vision placed large SOEs at the very center of China’s late-developing economy. In the short-lived post-Tiananmen “order and rectification” period, the leadership of Premier Li Peng laid the normative and institutional foundations for a robust SOE-directed industrial policy regime that survived the Southern Tour and gathered force through the 1990s and into the last decade. This neoconservative legacy is key to understanding the precipitous rise of the national team and also helps to explain the halting process of withdrawing state ownership from the economy.

Three key policies trace their roots to the neoconservative era and comprise the core of the SOE-directed industrial policy regime. The centerpiece of the large enterprise strategy, which took shape under the auspices of Premier Li Peng’s office, was the establishment of a 55-member trial group of large SOEs in 1991, which grew to a total 120 enterprises in 1997. In addition to generous tariff protection, ready access to soft loans and a high degree of autonomy over business decisions free from government or Party interference, the trial group enterprises were also encouraged to develop into kereitsu-like business groups with diverse holdings across industry; the national team’s vast business empires are largely an inheritance of this initiative. The aim of the “grabbing the large” policy—to transform the 1000 largest state-owned enterprises into pillars of the Chinese economy—looked to a broader segment of the state sector but shared with the large enterprise strategy a basis in neoconservative ideology. And while state sector retrenchment in the late 1990s is most often associated with the dislocating effects of “letting go of the small”, “grabbing the large” was no less important as it served to set the framework of China’s state capitalism. Finally, in the last decade, the onus on large enterprises “going forth” has opened new markets for China’s national team abroad.

Besides revamping the key units of China’s state capitalism—large SOEs—the neoconservative legacy has also left a deep imprint on the selective withdrawal of state ownership from the economy. In sharp contrast to the robust SOE industrial policy regime, the central government’s explicit policy for rationalizing the industrial layout of the state-owned economy—“Adjusting the Layout of the State-Owned Economy”—has languished since its adoption in 1997. This weak policy development is largely attributable to tension between this initiative, which aimed to concentrate state ownership in a small number of industries, and the
neoconservative vision of large SOEs with subsidiaries dispersed widely across industry. In the years since SASAC’s establishment, this tension has become especially apparent as the bureaucracy has struggled to balance its dual responsibilities for enhancing the profitability and competitiveness of the national team, on the one hand, and implementing the selective withdrawal of state ownership, on the other. The central bureaucracy’s reticence about unambiguously naming the industries in which state ownership should advance and those from which it should retreat is a manifestation of this tension. Indeed, recent SASAC actions suggest that the retreat portions of the policy may finally be dropped altogether from “Adjusting the Layout of the State-Owned Economy” leaving SOEs and non-state and foreign-invested enterprises to compete, however asymmetrically, for survival in non-priority industries. The crowding out of “Adjusting the Layout of the State-Owned Economy” policy by the state’s SOE industrial policy drive helps to explain why the state sector still extends widely over industry nearly fifteen years after adoption of the state’s plan for selective withdrawal.

The neoconservative market vision gradually took root with the aid of complimentary economic and political logics. In contrast to Deng’s economic vision which emphasized the importance of allowing market forces to drive development, the neoconservative leadership placed much more faith in the visible hand and on government picking winners in industry. The neoconservatives’ belief in the benefits of preserving a major role for government in guiding the development of late-developing economies formed the normative underpinnings of the SOE-directed industrial policy regime. At the same time, the economic logic of SOE-directed industrial policy was also consistent with elites’ particularist interests in bolstering their quid pro quo support from the most politically salient segments of the state sector: large industrial SOEs. This political logic of state capitalism was highly compelling in the post-Deng era of elite competition when ideology largely receded as the currency of factionalism and was replaced by the zero-sum struggle for resources and power between rival groups (Dittmer and Wu, 2006). As the wealth and political clout of the SOE managerial class has increased over time, the value of these patronage ties to the state sector has grown commensurately, giving political elites a strong incentive to guide policy in a direction favourable to the national team’s interests.
7.4 Selective Withdrawal

This study’s two comparative case studies of industrial reform pathways probed the question: what factors have driving selective withdrawal given the weak guidance provided by central government policy in this area? The cases together show the importance of industry-level government interventions in the incremental formation of *de facto* and *de jure* rules and practices that determined the respective degrees of state, non-state and foreign ownership in telecommunications and airlines. The case studies also lend support to the partial reform model’s hypothesis about the significance of initial policy choices for shaping later-stage policy choices. Pei’s (2006) vision of the process of selective withdrawal as driven by a rent-seeking logic also finds a measure of support in the analysis, especially in the telecommunications case. The significance of the neoconservative legacy also helps to explain the persistence of majority state ownership in these two industries and sheds particular light on the reasons behind an abrupt reverse-course in airlines policy in the late 1990s.

In both telecommunications and airlines, the approach to industry development adopted at the outset of the reform period shaped emergent norms on the appropriate level of state ownership. Each industry emerged from the Cultural Revolution with heavy scars and at a substantial disadvantage in the competition for meager central budgetary funds. In these difficult circumstances, industry officials had to devise innovative means of pooling investment funds to power infrastructure construction and market development. In telecommunications, dogged policy entrepreneurialism by an Ministry of Post and Telecommunications minister and a top State Council official led the central government to grant the incumbent monopolist broad authority to raise funds for network construction. While this approach was extremely successful in driving the fast-paced expansion of telecommunications services, it had the unintended consequence of positioning the MPT as a formidable opponent to market liberalization measures that threatened its exclusive claim to short-term winnings. In the airlines industry, by contrast, anti-Deng clamouring in the civil aviation bureaucracy in the waning years of the Cultural Revolution sealed the fate of the CAAC monopoly’s early demise as Deng personally intervened to craft quick government-enterprise separation and the decentralization of power to the regional bureaus. An open posture to market entry and relaxed investment rules were behind the rapid development of China’s air services market in the 1980s. Consistent with the PRE model’s
predictions about the legacy of radical initial reforms, the absence of a powerful short-term winner in airlines paved the way for the comparatively early adoption of measures that promoted competition from non-state and foreign-invested airlines.

While the monopolist-centered approach to industry development adopted in telecommunications helps to explain why MPT staunchly defended its turf from rivals, the strong profitability of this industry also sheds light on why telecommunications basic services remains exclusively state-owned well after the end of MPT’s monopoly. The political sensitivity of this sector is often taken to be the primary reason for sharp limits on non-state and foreign investment in basic services, but evidence suggests that profitability has also been of key importance in shaping the current SOE-dominated oligopolistic market structure. In the early 1990s, soaring telecommunications revenue growth rates made MPT the envy of several central government ministries who eventually succeeded in lobbying the State Council to break the incumbent’s monopoly and open the market to players from within the state sector. While successive waves of regulatory reform and restructuring of the telecommunications service providers have given rise to feverish competition between the three state-owned carriers, the market remains effectively closed to would-be entrants from outside the state despite China’s WTO telecommunications agreement nominally permitting 49% foreign ownership in basic services joint ventures. In the years since SASAC assumed the role of owner-on-behalf of the state in China Mobile, China Telecom and China Unicom, its strong mandate to “maintain and increase the value of state assets” has become an implicit regulatory norm making the prospect of market opening to non-state players extremely unlikely. In sum, an accident of history—the MPT-centered approach to industry development—reinforced by strong industry profitability throughout the reform era largely explains the non-retreat of state ownership from telecommunications.

While SASAC’s mandate to support the national team is an increasingly prominent feature of telecommunications policy, the neoconservative policy legacy is even more in evidence in the reform pathway of airlines. Although the first decade and a half of liberalizing airlines reform conforms to the PRE model, the dramatic reverse-course in the late 1990s is more puzzling. The CAAC’s retrenchment drive which succeeded in restoring the commanding market share of the Big Three state-owned airlines lost to smaller carriers in the deregulatory period was
driven by complimentary political and economic logics. The political logic for the regulatory volte-face is found in the incomplete separation of government and enterprise in the late 1990s; in this period the CAAC still retained responsibility for ensuring the value of state assets in airlines which gave it a strong incentive to intervene in the market to prop up the revenues of the state-owned backbone airlines. The economic logic was provided by the SOE industrial policy drive which trumpeted the importance of the development of large SOEs in key industries. As early members of the national team—all of the Big Three were included in the first trial group of the large enterprise strategy—the performance of the state-owned airlines acquired importance under the SOE industrial policy regime. In this context, Premier Zhu Rongji’s 1998 high profile pledge to the National People’s Congress that all large SOEs would be profitable within three years added urgency and legitimacy to the CAAC’s efforts to restructure the airlines market to the benefit of the Big Three. While the dual legacies of liberalization and retrenchment now each tug at airlines policy, in recent years the neoconservative legacy has found a champion in CAAC director Li Jiaxiang who has advocated for further consolidation among the state-owned carriers and a highly circumscribed role for non-state and foreign carriers.

The case studies lend insight into what factors are driving changes in the state-owned economy, yet the limitations of the quasi-inductive research design preclude a definitive answer to the question of what accounts for selective withdrawal of state ownership from the economy. The logic of partial reform and the neoconservative policy legacy shed light on the non-retreat of state ownership from telecommunications and airlines, yet conventionally strategic considerations are probably more salient in industries nearer the defense-linked core of the “lifeline” industries such as munitions manufacturing. Indeed, the findings of this study are likely to be most relevant to priority sectors more peripherally linked to defense such as general manufacturing, transportation, energy, chemicals and real estate. The findings of this study could be extended by comparison with one or more industries in which state ownership has decisively retreated.

7.5 Future Research

A promising area of future research in this area is analysis of the considerable sub-national variation in patterns of selective withdrawal. While this study has focused on developments in the portion of the state sector under the central government, there is much to
learn from the study of how “Adjusting the Layout of the State-Owned Economy” has developed at the local level. Under China’s present system of state asset management, provincial- and city-level SASAC bureaus develop and implement state asset management policies largely independently of the center. Contrasts between major cities’ approaches to redrawing the boundaries of the state sector are especially striking and invite in-depth comparative analysis. The different approaches taken by two cities that have been key innovators in state asset management reform, Shanghai and Shenzhen, are particularly intriguing. While these two cities have similar systems of state asset management, comparable levels of economic development and a shared legacy of state sector profitability, they have adopted very different approaches to implementation of “Adjusting the Layout of the State-Owned Economy.” Over the last decade, state ownership in Shenzhen has concentrated in a handful of areas—principally power, transportation and social services. In Shanghai, by contrast, the sub-national region in control of the greatest amount of state-owned assets—US $95 billion in 2009—SOEs are still dispersed widely across industry. While 90% of state assets are now concentrated in twenty of Shanghai’s industries, SOEs can still be found in 79 of the city’s industries (Zang, March 4, 2011).

The two cities’ divergent approaches to the state ownership of real estate, a booming market in both locales, make an interesting contrast. As a designated “pillar industry” in Shanghai, both the number of SOEs and the scale of assets in real estate have expanded rapidly in recent years. In Shenzhen, we find a marked retreat of state ownership from real estate. The findings of my dissertation would suggest that Shenzhen authorities are probably less politically beholden to state sector interests than their counterparts in Shanghai and Beijing, thus giving them more maneuverability in rigorously implementing “Adjusting the Layout of the State-Owned Economy.” Further research into the local dynamics of selective withdrawal would considerably add to our understanding of the logic of Chinese state capitalism.

7.6 Implications for the Study of Chinese Economic Reform

This thesis has highlighted the complex, contingent and contested nature of China’s emerging form of state capitalism. In contrast to the image of China’s state-owned economy as carefully designed and directed by a few men in the highest reaches of the Communist Party, state capitalism is instead a complex phenomenon that has been driven forward by disparate factors including leadership change, administrative reforms as well as rent-seeking behavior at
the industry level. Among the various contributors to state capitalism, a historical contingency—the neoconservative “order and rectification” period that followed the Tiananmen uprising—was particularly important as it planted the normative seeds and institutional shoots of a now-robust SOE industrial policy regime. Finally, the study has also drawn attention to the contested nature of state capitalism. Within China, the news media records mounting public skepticism about perceived corruption and profiteering in the “monopoly sectors” as well as outrage over SOE “land kings” in real estate development. As well, prominent intellectuals such as Wu Jichuan have argued that the fate of China’s emerging market system hinges on faithful implementation of “Adjusting the Layout of the State-Owned Economy.”

Finally, this study has argued that while the partial reform model is a useful heuristic for shedding light on aspects of the Chinese reform process, attention is also due to the shifting normative foundations of state sector reforms since 1978. While rent-seeking and the particularist interests of short-term winners help to explain the state’s unyielding grip on key sectors of the economy, this is not only a story about the emergence of partial reform traps. The historical institutionalist framework employed in this study has drawn attention to the ways in which the orientation of reform has shifted over time and shows that while the resources devoted to building up large SOEs in industry may have been a betrayal of the Dengist line dominant in the 1980s, the rise of the national team is consistent with the statist market vision implanted by the neoconservative leadership after 1989. That said, the neoconservative legacy has also generated unintended consequences. Ballooning profits in the murky middle layer of the state sector have made the SOE managerial class important powerbrokers as purveyors of patronage resources and, increasingly, as political figures in their own right on the Central Committee. Just as Russia’s leaders have struggled to check the oligarchs’ influence, China’s top leaders will struggle to chart an economic policy that balances the interests of the national team against those of other segments of Chinese society.
References


Chen, Jinhua (2005) 《国事忆迷》（*Remembering State Affairs*)


Choo, Jennifer (forthcoming) ‘Going Global and Yet Remaining Local: An Analysis of China’s Real Estate Sector’ Ph.D. Dissertation in progress in the Department of Sociology, University of California (Berkeley).


----------------------------------


*Jingji Guancha Bao* (October 26, 2010) 《‘国进民退’退步还是进步？》(*Advance of the State, Retreat of the Private Sector: A Step Back or Forward?*).

Johnson, Ian (September 20, 1999) ‘China’s Wu Looks to Derail WTO Talks—Fiery Minister’s Edict Hampers Negotiators’ Delicate Efforts’ *Asian Wall Street Journal*.


Kan, Kaili (September 27, 2008) 《市场经济中的政府作用：国资委为什么必须推销》(*The Function of Government in a Market Economy: Why SASAC Must be Abolished*) Presentation to the ‘Price System and Monopoly Sector Reform’ Forum, Beijing University.


--------------------(2001a) 《否定国有经济的主导作用必然导致私有化》(A Rejection of the Argument that a Dominant Role for the State-Owned Economy Will Inevitably Lead to Privatization) *Zhenli de Zhuiqiu* 《真理的追求》 No. 6: 19-24.


‘Corporatizing China: Reinventing State Control for the Market’ Ph.D. Dissertation submitted to University of California, Berkeley, Department of Political Science.


-----------------------

-----------------------

-----------------------

-----------------------

-----------------------


Shen, Tu (1992)《中国民航在改革开放中前进》(China’s Civil Aviation Progress in Reform and Opening) in Chen, Lanying, ed. 《中国民航的改革开放》(China Civil Aviation’s Reform and Opening), Beijing: China Civil Aviation Publishers.


208


Wang, Jun (February 1, 2007) ‘Flying for One Yuan’ Beijing Review.


Wu, Jichuan et al., eds. (2008)《大跨越：中国电信业三十春秋》 (The Great Leap: Thirty Years of Reform in China’s Telecommunications Sector, Beijing, People’s Publisher).


Xia, Shiying (1999)《访者名经济学家张钧教授》(An Interview with Economist, Professor Zhang Jun) Juece Shikong 《决策时空》: 4-6.

Xinhua (October 5, 2006)《“特殊利益集团”是社会和谐的大敌》(Special Interest Groups are the Enemy of Social Harmony), available at: http://news.xinhuanet.com/comments/2006-10/05/content_5169936.htm (accessed May 24, 2011).


Xuan, Yu’en (2003)《中国民航运输市场发展与创新》(Development and Innovation in China’s Civil Aviation Transport Market), Beijing: China Civil Aviation Publisher.


Zang, Qing (March 4, 2011)《上海国资进退》(Advance and Retreat of Shanghai’s State Assets) Shanghai Baodao 《上海报道》, Available at: http://www.21cbh.com/HTML/2011-3-7/zOMDAwMDIyNDMzOA.html (accessed May 26, 2011).


Zhong, Yijun (April 1, 2009) *《中国移动首遭反垄断诉讼律师索赔月租费 1200 元》 (Antitrust Litigator Successfully Sues China Mobile for 1,200 Yuan Monthly Fees; A First )* *Meiri Jingji Xinwen 《每日经济新闻》*.


**Government Sources**

*Cong Tongji Kan Minhang《从统计看民行》(CTJKMH) (Seeing Civil Aviation From Statistics),* various years, Beijing: China Civil Aviation Publishers.


*Zhongguo Caizheng Nianjian《中国财政年鉴》(ZGCJNJ) (China Finance Yearbook),* various years, Beijing: China Finance and Economics Publisher.
Zhongguo Daqiye Jituan 《中国大企业集团》（ZGDQJT）（Large Enterprises of China），各种年，北京：国家统计局。

Zhongguo Daqiye Jituan Niandu Fazhan Baogao 《中国大企业集团年度发展报告》（ZGDQYJTNDFZBG）（Annual Report on the Development of China’s Large Groups），各种年，北京：经济管理出版社。

Zhongguo Guoyou Zichan Jiandu Guanli Nianjian 《中国国有资产年监督管理年鉴》（ZGGYZCGLNJ）（Yearbook of State-Owned Assets Supervision and Administration Commission），各种年，北京：SASAC。

Zhongguo Tongji Nianjian 《中国统计年鉴》（ZGTJNJ）（China Statistical Yearbook），各种年，北京：国家统计局。

Zhongguo Xinxi Chanye Nianjian 《中国信息产业年鉴》（ZGXXCYNJ）（China Information Industry Yearbook），各种年，北京：电子工业出版社。
Appendices

Appendix 1: Summary of Premier Li Peng’s Report to Central Work Conference, September 23 1991

“On the Current Economic Situation and Further Improving State-Owned Large and Medium State-Owned Enterprises”

In our economic work, the task of enhancing the economic vitality of state-owned enterprises and improving their efficiency now occupies a prominent position. At present, among China’s large and medium-sized state-owned enterprises, in general about a third are good, a third are in the middle and a third are poor. Both external and internal causes have meant that some SOEs have weak vitality, low efficiency and lack development potential. To address the internal causes, enterprises must strengthen management and rely on technological advances to develop their potential and improve efficiency. To create favorable external conditions, government at all levels should adhere to the separation of duties between government and enterprises, avoid unnecessary administrative interventions and improve services for enterprises.

Next year, we must continue to implement the measures put forth by the State Council in May of this year [1991].

1.) To increase investment in technical transformation of enterprises. Planned investment for technology upgrading will not be less than 110 billion RMB. From now we will strive to use about US $1.5 billion annually in foreign exchange for technological upgrading.

2.) Gradually reduce mandatory plans for large and medium SOEs.

3.) Raise enterprise depreciation appropriately. From now we will increase depreciation by 3 billion RMB for a five year total increase of $15 billion.

4.) Increase new product development fund. Continue to extract 1% of sales revenue for new product development expenses.

5.) Continue to supplement enterprises’ liquid capital.

6.) Make modest adjustments in interest rates.

7.) Grant foreign trade autonomy to some enterprises

8.) Continue to implement ‘double guarantee’ for large and medium pillar SOEs to guarantee their supply of capital and state allocated materials.

9.) Clean up the ‘triangular debt’ problem. Resolve to do this within two or three years.

10.) Further improve work on the large enterprise group pilot project. Now we have established 55 compact enterprise groups. After we gain experience the pilot group can be further expanded.

11.) Firmly control the ‘three disorders’. Disorderly application of levies, charges and fines are a major disturbance to enterprises’ production and management; this problem
must be cured. Charges, fines and fundraising must abide by laws and regulations. Approval authority should be concentrated on the central and provincial levels of government.

12.) Resolve to reduce industrial SOEs income tax rate to 33%. Combined with the expansion of tax distribution and after-tax loan repayment pilot projects, enterprise implementation to be complete in three years.

Enterprises should deepen reform and transform their operations. Specifically, there are eight tasks: 1.) continue to perfect the contract management responsibility system; 2.) continue to implement the Enterprise Law and strengthen internal leadership systems; 3.) actively promote reform of the labor wage system; 4.) push large and medium SOEs to market; 5.) further accelerate technological progress; 6.) strictly manage factories and strengthen internal management; 7.) depend on the working class; 8.) strengthen the leadership of medium and large SOEs.


<table>
<thead>
<tr>
<th>Category</th>
<th>Important National Security and Lifeline Industries &amp; Key Areas</th>
<th>Pillar Industries and High-Tech Industries</th>
<th>Other Industries or Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Definition</strong></td>
<td>This category includes enterprises in four areas: 1) directly linked to national security (e.g. defense industries, grain reserves, cotton reserves etc.); 2) natural monopoly enterprises (e.g. telecommunications, power grid etc.); 3) enterprises that supply important public goods (e.g. airlines, electricity supply etc.), and; 4) important resource enterprises (e.g. petroleum, petrochemicals and coal)</td>
<td>This area includes industries: metallurgy, machinery manufacturing, construction and real estate, chemical building materials, electronics manufacturing, biomedicine, scientific research institutes, and civil engineering etc.</td>
<td>This area includes trade flows, transportation, consulting, investment, agriculture and other non-classified enterprises (e.g. light industry, tourism etc.). After years of development, a group of influential well-known enterprises has formed in these areas.</td>
</tr>
<tr>
<td><strong>Main Features</strong> (Strengths and Weaknesses)</td>
<td>In the more than twenty years of reform that have passed, these kinds of enterprises mainly face the following kinds of problems: incomplete reform, and; undiversified property rights structures. Some enterprises are characterized by insufficient capital; less-than-ideal economic productivity, and; a heavy historical burden.</td>
<td>The backbone enterprises in these industries embody China’s comprehensive national power. These are China’s leading industries in international competition and are pushing China’s industrialization. In their many years of development, these industries have already created a group of backbone enterprises that drive the national economy and serve as industrial vanguards. But compared to their international counterparts, the scale of these backbone enterprises is still too small and their innovation capacity too weak. The structures of some enterprises are too widely dispersed, their production concentrations too low and many have serious problems with redundant construction. Electronics, building</td>
<td>However these enterprises are in industries characterized by low barriers to entry and scattered layout. Most of these enterprises are small scale and many were formed in the process of government departments’ decoupling or were otherwise artificially kneaded into form. The main businesses in these companies are not prominent, they have poor assets and the restructuring and transition process in these enterprises has been onerous.</td>
</tr>
</tbody>
</table>
materials, chemicals, equipment manufacturing and other industries obviously lack vanguard enterprises. In some enterprises, reform has been sluggish as is evident by their high numbers of surplus employees, low productivity and weak operating efficiency.

**Policy Recommendations (selected)**

| Source: SASAC (2007): 175-177. | The state should maintain *absolute control* in: defense industries; oil and other strategic resource industries as well as the power grid; telecommunications infrastructure. The state should also maintain absolute control of some of the important subsidiaries of these companies. As for downstream petrochemicals products, telecommunications value-added services, in these industries reform should be stepped up, they should be reorganized and their operations should be opened to foreign and private capital. The state should encourage consolidation and reorganization and cultivate large corporate groups to solve the problem of insufficient capital.

The state should maintain fairly strong control of a number of backbone and vanguard enterprises. The role of state capital should gradually shift from “absolute” to “relative” control and foreign and private capital should be encouraged to enter in the interests of realizing diversification of investors. “Necessary” state control should be maintained over: scientific research enterprises that create general-use technology and whose research results make important contributions as well as design-oriented enterprises. These enterprises should participate fully in the national innovation system. Other enterprises should intensify reform, restructuring efforts and be exposed to the law of survival of the fittest in the marketplace. Some of these enterprises will have to retreat from the ranks of central SOEs.

Since these enterprises are in industries characterized by a high degree of market competition, in principle they should be subjected to the law of the survival of the fittest in market competition and they should also encourage the entry of foreign and private capital. The state should maintain control of large enterprises with well-known brands in trade flows, shipping and other areas.

Regarding the large number of SMEs, in the main, they should be invigorated by being let go. Some should enter large enterprises, others should be managed by asset management companies and others should be localized. Enterprises characterized by a small scale, low economic efficiency and limited potential for development should exit in an orderly way.
Appendix 3: Members of the Large Enterprise Trial Group (1991, 1997)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Automobile manufacturing</strong></td>
<td>First Automobile Works Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo diyi qiche jituan</em></td>
</tr>
<tr>
<td></td>
<td>Dongfeng Group (Aeoleus)</td>
</tr>
<tr>
<td></td>
<td><em>Dongfeng qiche gongsi</em></td>
</tr>
<tr>
<td></td>
<td>Heavy Vehicle Group (HVG)</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo zhongxing qiche jituan gongsi</em></td>
</tr>
<tr>
<td></td>
<td>Shanghai Auto Industrial Corporation</td>
</tr>
<tr>
<td></td>
<td><em>Shanghai qiche jituan</em></td>
</tr>
<tr>
<td></td>
<td>Tianjin Auto Industrial Corporation</td>
</tr>
<tr>
<td></td>
<td><em>Tianjin qiche gongye jituan</em></td>
</tr>
<tr>
<td></td>
<td>China Auto Industrial Corporation (CAIC)</td>
</tr>
<tr>
<td></td>
<td><em>Zhongqi jituan</em></td>
</tr>
<tr>
<td></td>
<td>Jialing Motorbikes</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo jialing gongye (jituan) gufen youxian gongsi</em></td>
</tr>
<tr>
<td><strong>Special Purpose Equipment</strong></td>
<td>First Tractor and Construction Machinery Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo diyi tuolaji gongcheng jixie gongsi</em></td>
</tr>
<tr>
<td></td>
<td>First Heavy Machinery Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo diyi zhongxing jixie jituan gongsi</em></td>
</tr>
<tr>
<td></td>
<td>First Heavy Machinery Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo dier zhongxing jixie jituan gongsi</em></td>
</tr>
<tr>
<td></td>
<td>China Textile Machinery Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo fangzhi jixie jituan</em></td>
</tr>
<tr>
<td><strong>Ordinary machinery</strong></td>
<td>Xuzhou Construction Machinery Group</td>
</tr>
<tr>
<td></td>
<td><em>Xuzhou gongcheng jixie jituan</em></td>
</tr>
<tr>
<td></td>
<td>Luoyang Bearing Group</td>
</tr>
<tr>
<td></td>
<td><em>Luoyang jituan</em></td>
</tr>
<tr>
<td><strong>Fabricated metal goods</strong></td>
<td>Monkey King</td>
</tr>
<tr>
<td></td>
<td><em>Houwang jituan</em></td>
</tr>
<tr>
<td><strong>Electronics</strong></td>
<td>China Zhenhua Electronics Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo zhenhua dianzi jituan gongsi</em></td>
</tr>
<tr>
<td></td>
<td>Great Wall Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo changcheng jisuanji jituan</em></td>
</tr>
<tr>
<td></td>
<td>Changjiang Computer Group</td>
</tr>
<tr>
<td></td>
<td><em>Changjiang jisuanji (jituan) lianhe gongsi</em></td>
</tr>
<tr>
<td></td>
<td>Legend</td>
</tr>
<tr>
<td></td>
<td>Lianxiang jituan</td>
</tr>
<tr>
<td></td>
<td>Caihong Group</td>
</tr>
<tr>
<td></td>
<td><em>Chaihong jituan</em></td>
</tr>
<tr>
<td></td>
<td>Founder Group</td>
</tr>
<tr>
<td></td>
<td><em>Beida fangzheng jituan</em></td>
</tr>
<tr>
<td>Company Name</td>
<td>Chinese Name</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>-------------------------------------------</td>
</tr>
<tr>
<td>Panda Group</td>
<td><em>Xiongmao dianzi jituan</em></td>
</tr>
<tr>
<td>Changhong Group</td>
<td><em>Changhong jituan</em></td>
</tr>
<tr>
<td>China Hualu Group</td>
<td><em>Zhongguo hualu jituan</em></td>
</tr>
<tr>
<td>Shanghai General Electronics Group (SGEG)</td>
<td><em>Shanghai guangdian jituan</em></td>
</tr>
<tr>
<td><strong>Power generation</strong></td>
<td></td>
</tr>
<tr>
<td>Huaneng Group</td>
<td><em>Zhongguo huaneng jituan gongsi</em></td>
</tr>
<tr>
<td>North China Power Group</td>
<td><em>Zhongguo huabei dianli jituan gongs</em></td>
</tr>
<tr>
<td>China Eastern Power Group</td>
<td><em>Zhongguo dongbei dianli jituan gongs</em></td>
</tr>
<tr>
<td>Central China Electric Power Group</td>
<td><em>Zhongguo huazhong dianli jituan gongs</em></td>
</tr>
<tr>
<td>China North Western Electric</td>
<td><em>Zhongguo xibei dianli jituan gongs</em></td>
</tr>
<tr>
<td>Guangdong Nuclear Electric Group</td>
<td><em>Zhongguo Guangdong hedian jituan gongs</em></td>
</tr>
<tr>
<td><strong>Power generation equipment</strong></td>
<td></td>
</tr>
<tr>
<td>Harbin Power Equipment Company</td>
<td><em>Zhongguo Haerbin dianzhan shebei jituan gongsi</em></td>
</tr>
<tr>
<td>Dongfang Electric Power Group</td>
<td><em>Zhongguo dongfang dianqi jituan gongs</em></td>
</tr>
<tr>
<td>Shanghai Electric Power Group</td>
<td><em>Shanghai dianqi (jituan) zong gongsi</em></td>
</tr>
<tr>
<td>Xian Power Generation Machinery Group</td>
<td><em>Xian dianli jixie zhizao gongsi</em></td>
</tr>
<tr>
<td>Northeast Electric Transmission and Transformation Equipment Group</td>
<td><em>Dongbei zhuangbian dianqi shebei jituan gongsi</em></td>
</tr>
<tr>
<td><strong>Aviation and aerospace</strong></td>
<td></td>
</tr>
<tr>
<td>Xian Aircraft Group</td>
<td><em>Zhongguo Xian feiji gongye jituan gongsi</em></td>
</tr>
<tr>
<td>Nanjing Aero Motive Machinery Group</td>
<td><em>Zhongguo Nanjing hangtian gongye jituan gongsi</em></td>
</tr>
<tr>
<td>Shanghai Aero Industry Group</td>
<td><em>Zhongguo Shanghai hangkong gongye jituan gongsi</em></td>
</tr>
<tr>
<td>Guizhou Aero Industry Group</td>
<td><em>Zhongguo Guizhou hangkong gongye jituan gongsi</em></td>
</tr>
<tr>
<td>Nanjing Air Industry Group</td>
<td><em>Zhongguo jiangnan hangtian gongye jituan gongsi</em></td>
</tr>
<tr>
<td>Sanjiang Air Industry Group</td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>Company Name</td>
</tr>
<tr>
<td>------------</td>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>Textiles</td>
<td>Zhongguo sanjiang hangtian gongye jituan gongsi</td>
</tr>
<tr>
<td></td>
<td>Xinjiang Textiles Group</td>
</tr>
<tr>
<td></td>
<td>Xinjiang fanzhi gongye jituan</td>
</tr>
<tr>
<td></td>
<td>Inner Mongolia Cashmere Group</td>
</tr>
<tr>
<td></td>
<td>Neimenggu errduosi yangrong jituan</td>
</tr>
<tr>
<td></td>
<td>China Shenma Group</td>
</tr>
<tr>
<td></td>
<td>Zhongguo shenma jituan</td>
</tr>
<tr>
<td>Iron and Steel</td>
<td>Panzhihua Steel Group</td>
</tr>
<tr>
<td></td>
<td>Pangang jitian</td>
</tr>
<tr>
<td></td>
<td>Wuhuan Steel Group</td>
</tr>
<tr>
<td></td>
<td>Wugang jitian</td>
</tr>
<tr>
<td></td>
<td>Anshan Steel Group</td>
</tr>
<tr>
<td></td>
<td>Angang jitian</td>
</tr>
<tr>
<td></td>
<td>Baoshan Steel Group</td>
</tr>
<tr>
<td></td>
<td>Baogang jitian</td>
</tr>
<tr>
<td></td>
<td>Capital Iron and Steel Group</td>
</tr>
<tr>
<td></td>
<td>Shougang jitian</td>
</tr>
<tr>
<td></td>
<td>Benxi Group</td>
</tr>
<tr>
<td></td>
<td>Bengang jitian</td>
</tr>
<tr>
<td></td>
<td>Chongqing Steel Group</td>
</tr>
<tr>
<td></td>
<td>Chonggang jitian</td>
</tr>
<tr>
<td></td>
<td>Taiyuan Steel Group</td>
</tr>
<tr>
<td></td>
<td>Taigang jitian</td>
</tr>
<tr>
<td>Chemicals</td>
<td>Donglian Petrochemical Group</td>
</tr>
<tr>
<td></td>
<td>Donglian jitian</td>
</tr>
<tr>
<td></td>
<td>Yizheng Group</td>
</tr>
<tr>
<td></td>
<td>Zhongguo yizheng huaxian gongye lianhe gongsi</td>
</tr>
<tr>
<td></td>
<td>Tianjin Bohai</td>
</tr>
<tr>
<td></td>
<td>Zhongguo Tianjin bohai huagong jitian gongsi</td>
</tr>
<tr>
<td></td>
<td>Nanjing Chemical Group</td>
</tr>
<tr>
<td></td>
<td>Zhongguo Nanjing huaxue ogngye (jituan) gongsi</td>
</tr>
<tr>
<td></td>
<td>China Jilin Chemical Industry</td>
</tr>
<tr>
<td></td>
<td>Zhongguo jilin huaxue ogngye gongsi</td>
</tr>
<tr>
<td></td>
<td>Shanghai Tianyuan Group</td>
</tr>
<tr>
<td></td>
<td>Shanghai tianyuan jitian</td>
</tr>
<tr>
<td></td>
<td>Zhejiang Juhua Group</td>
</tr>
<tr>
<td></td>
<td>Juhua jitian</td>
</tr>
<tr>
<td></td>
<td>Shandong Haiyanghua Group</td>
</tr>
<tr>
<td></td>
<td>Shandong haiyang huagong jitian</td>
</tr>
<tr>
<td>Mining</td>
<td>Datong Mine Group</td>
</tr>
<tr>
<td></td>
<td>Datong mekuang jitian</td>
</tr>
<tr>
<td></td>
<td>Yankuang Group</td>
</tr>
<tr>
<td><strong>Yanzhou kangye jituan</strong></td>
<td>Shenhua Group</td>
</tr>
<tr>
<td>-------------------------</td>
<td>---------------</td>
</tr>
<tr>
<td><strong>Zhongguo shenhua jituan</strong></td>
<td>China National Non-metallic Minerals Enterprise Group (CNMEG)</td>
</tr>
<tr>
<td><strong>Zhongguo feijin shukuang gongye zong gongsi</strong></td>
<td>Zhongguo feijin shukuang gongye zong gongsi</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Regional groups</strong></th>
<th>Shenzhen Special Economic Zone Development Group</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Shenzhen jinji tequ fazhan jituan</strong></td>
<td>China Xinjiang Construction Group</td>
</tr>
<tr>
<td><strong>Xinjiang jiantou jituan</strong></td>
<td>Changjiang United Economic Development Group</td>
</tr>
<tr>
<td><strong>Changjiang jingji lianhe fazhan jituan</strong></td>
<td>China Xinjiang Construction Group</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Transport</strong></th>
<th>China Ocean Shipping Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Zhongguo yuanyang yunshu</strong></td>
<td>China National Foreign Trade Transportation Group</td>
</tr>
<tr>
<td><strong>Zhongguo nanfang hangkong (jituan) gongsi</strong></td>
<td>China Eastern Airlines</td>
</tr>
<tr>
<td><strong>Zhongguo dongfang hangkong</strong></td>
<td>Air China</td>
</tr>
<tr>
<td><strong>Zhongguo guoji hangkong (jituan) gongsi</strong></td>
<td>Changjiang Shipping Group</td>
</tr>
<tr>
<td><strong>Zhongguo changjiang lunchan zong gongsi</strong></td>
<td>Guangzhou Rail Group</td>
</tr>
<tr>
<td><strong>Guangzhou tielu jituan</strong></td>
<td>Harbin Pharmaceutical Group</td>
</tr>
<tr>
<td><strong>Harbing yiyue jituan</strong></td>
<td>Nothern Pharmaceutical Group</td>
</tr>
<tr>
<td><strong>Zhongguo huabei zhiyue jituan gongsi</strong></td>
<td>China Northeastern Pharmaceutical Group</td>
</tr>
</tbody>
</table>
| **Zhongguo dongbei zhiyue jituan gongsi** | |}

<table>
<thead>
<tr>
<th><strong>Pharmaceuticals</strong></th>
<th>Sanjiu Group</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sanjiu qiye jituan</strong></td>
<td>Sanjiu Group</td>
</tr>
<tr>
<td><strong>Tongrentang Group</strong></td>
<td>Tongrentang Group</td>
</tr>
<tr>
<td><strong>Zhongguobeijing tongrentang jituan</strong></td>
<td>Harbin Pharmaceutical Group</td>
</tr>
<tr>
<td><strong>Harbing yiyue jituan</strong></td>
<td>Nothern Pharmaceutical Group</td>
</tr>
<tr>
<td><strong>Zhongguo huabei zhiyue jituan gongsi</strong></td>
<td>China Northeastern Pharmaceutical Group</td>
</tr>
</tbody>
</table>
| **Zhongguo dongbei zhiyue jituan gongsi** | |}

<table>
<thead>
<tr>
<th><strong>Construction</strong></th>
<th>Shanghai Construction Group</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Shanghai jiangong jituan</strong></td>
<td>Beijing Construction Group</td>
</tr>
<tr>
<td><strong>Beijing chengjian jituan</strong></td>
<td>China State Construction Engineering Corporation</td>
</tr>
<tr>
<td><strong>Zhong jian jituan</strong></td>
<td></td>
</tr>
<tr>
<td>Category</td>
<td>Company Name</td>
</tr>
<tr>
<td>--------------------------</td>
<td>--------------------------------------------------------------</td>
</tr>
<tr>
<td>Construction materials</td>
<td>Gezhouba Water Resources and Hydropower Engineering Corp</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo gezhouba shuili shuidaing gongcheng jituan</em></td>
</tr>
<tr>
<td></td>
<td>China National New Building Materials Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguoxinxing jianzhu cailiao (jituan) gongsi</em></td>
</tr>
<tr>
<td></td>
<td>Anhui Hailuo Group</td>
</tr>
<tr>
<td></td>
<td><em>Anhui hailuo jituan</em></td>
</tr>
<tr>
<td></td>
<td>China Yaohua Glass Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo yaohua boli jituan gongsi</em></td>
</tr>
<tr>
<td></td>
<td>Luoyang Floating</td>
</tr>
<tr>
<td></td>
<td><em>Luoyang fufa boli jituan gongsi</em></td>
</tr>
<tr>
<td>Trade Groups</td>
<td>Sinochem</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo huagong jinchukou zong gongsi</em></td>
</tr>
<tr>
<td></td>
<td>China National Technology Import and Export Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo ji jituan</em></td>
</tr>
<tr>
<td></td>
<td>China National Minerals and Metals Import and Export Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo wujin kuangchan jinchukou zong</em></td>
</tr>
<tr>
<td></td>
<td>China National Textiles Import and Export Corp</td>
</tr>
<tr>
<td></td>
<td><em>Zhongliang jituan</em></td>
</tr>
<tr>
<td></td>
<td>China National Import and Export Corp</td>
</tr>
<tr>
<td></td>
<td><em>Zhongyi jinchukou jituan</em></td>
</tr>
<tr>
<td></td>
<td>Dongfang International Group</td>
</tr>
<tr>
<td></td>
<td><em>Dongfang guoji jituan</em></td>
</tr>
<tr>
<td>Light Industry</td>
<td>Guangdong Ceramics Group</td>
</tr>
<tr>
<td></td>
<td><em>Guangdong fotao jituan</em></td>
</tr>
<tr>
<td></td>
<td>Tangshan Ceramics Groups</td>
</tr>
<tr>
<td></td>
<td><em>Tangshang fotao jituan</em></td>
</tr>
<tr>
<td></td>
<td>Guangxi Guitang Group</td>
</tr>
<tr>
<td></td>
<td><em>Guanxi guitang jituan</em></td>
</tr>
<tr>
<td>Others</td>
<td>China Lucky Film Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhongguo lekai zahopian jituan</em></td>
</tr>
<tr>
<td></td>
<td>Luoyang Chundu Group</td>
</tr>
<tr>
<td></td>
<td><em>Luoyang chundu jituan</em></td>
</tr>
<tr>
<td></td>
<td>Shanghai Hualian Group</td>
</tr>
<tr>
<td></td>
<td><em>Shanghai hualian jituan</em></td>
</tr>
<tr>
<td></td>
<td>Zhejiang Goods and Materials Group</td>
</tr>
<tr>
<td></td>
<td><em>Zhejiang wuchan jituan</em></td>
</tr>
<tr>
<td></td>
<td>China State Development and Investment Corporation (SDIC)</td>
</tr>
<tr>
<td></td>
<td><em>Guojia kaifa touzi gongsi</em></td>
</tr>
<tr>
<td>Category</td>
<td>Group Name</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-------------------------------------------</td>
</tr>
<tr>
<td><strong>TVEs</strong></td>
<td>Wanjie Group</td>
</tr>
<tr>
<td></td>
<td>Hongdou Group (Red Bean Group)</td>
</tr>
<tr>
<td><strong>Forestry</strong></td>
<td>Jilin Senlin Group</td>
</tr>
<tr>
<td></td>
<td>Heilongjiang Anling Forestry Group</td>
</tr>
<tr>
<td></td>
<td>Inner Mongolia Forest Industry Group</td>
</tr>
<tr>
<td><strong>Agricultural groups</strong></td>
<td>Zhongshui Group</td>
</tr>
<tr>
<td></td>
<td>China State Farms Agribusiness Group</td>
</tr>
<tr>
<td></td>
<td>Zhongmu Group</td>
</tr>
<tr>
<td></td>
<td>Shanghai Agricultural, Industrial, and Commercial Group</td>
</tr>
<tr>
<td></td>
<td>Jilin Province Development Group</td>
</tr>
</tbody>
</table>