The State as Owner – China's Experience

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Abstract

This essay explores China's experience with state ownership of business enterprise. After a short historical survey of the rise, fall, and re-emergence of the state-owned enterprise (SOE) as a form of business organization, the essay describes the creation, ownership structure, and role of SOEs under Chinese state capitalism. It further discusses the government's ongoing efforts to reform its SOEs. These efforts are illuminating because they highlight the serious tension inherent in the party-state's dual goals of maintaining SOEs as a tool for advancing non-financial social and industrial policy goals, and addressing the corporate governance challenges of these enterprises. The essay concludes by examining implications from the preceding analysis – for China's domestic economy, for policy makers outside China, and for the corporate form itself.

I. Introduction

Once nearly consigned to the junk heap of economic history, the state-owned enterprise (SOE) has staged a remarkable comeback in the first decades of the twenty-first century. Much, though by no means all, of the resurgence of the SOE is a result of China's remarkable rise since the launch of its economic reform program four decades ago. In an OECD (2017) study of seven non-member countries as of the end of 2015, China accounted for over 75% of the 628 listed companies with majority or minority state shareholdings and almost 85 percent of their combined market value of approximately $4 trillion. Notwithstanding the emergence of a vibrant private sector in China, SOEs remain an important component of the country's domestic economy and stock markets: listed companies with more than 20 percent state ownership account for 40 percent of total market capitalization and 56 percent of listed company revenues in China (Rosen et al., 2018).

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SOEs are a distinctive, if comparatively understudied, species of business organization because the state is a distinctive type of corporate "owner." While the state may run an SOE in the hopes of generating a profit, it typically also has non-financial motives for its ownership, for example, providing public goods or carrying out policy objectives such as reducing unemployment or creating national champions to compete globally. Following Milhaupt & Pargendler (2017; 2018), I will use the term "policy channeling" to describe a state's ownership of business enterprises to carry out non-financial objectives, as contrasted with the use of regulation or taxation to accomplish those objectives. Moreover, SOEs are distinctive because the state owns shares of an SOE ostensibly on behalf of its citizens. Therefore, state ownership introduces an additional layer of agency costs into SOE corporate governance – what might be termed the "agency costs of state capitalism" (ibid.). Chinese SOEs are a particularly interesting focus of inquiry because the Chinese party-state has distinctive features that indelibly shape its motivations as owner and the corporate governance of its SOEs.

This article explores China's experience with state ownership of business enterprise. Part II briefly surveys the rise, fall, and re-emergence of the SOE as a form of business organization. Part III describes the creation, ownership structure, and role of SOEs under Chinese state capitalism. It further discusses the government's ongoing efforts to reform its SOEs, an important policy objective of President Xi Jinping. These efforts are illuminating because they highlight the serious tension inherent in the party-state's dual goals of maintaining SOEs as a tool of social and industrial policy, and addressing the corporate governance challenges of these enterprises. Part IV explores several implications from the preceding analysis – for China's domestic economy, for policy makers outside China, and for the corporate form itself. Part V concludes.

II. (Re)Framing State Ownership

Attitudes toward the state-owned enterprise as a form of business organization have undergone a cyclical process of reframing over the past century and a half. Economic theory has traditionally explained the SOE as a response to natural monopolies or as a means of providing public goods such canals, railroads and mail service. In these settings and subject to various assumptions, government agents maximizing social welfare can be expected to make more optimal decisions than private, profit-maximizing managers (see Putnins, 2015; Atkinson & Stiglitz, 1980).

In fact, SOEs developed in the nineteenth century to provide public goods of the sort mentioned above. In a common arrangement, a government would partner with a private actor to build and operate a facility providing the public good. Often the government ended up owning the public good provider after failure of the private firm to which the concession had been granted (Musacchio & Lazzarini, 2014). Many nationalizations of business enterprises in the first half of the twentieth century are best understood as government bailouts of failing industries established to supply public goods (ibid).

Nationalizations of private industry reached their apex in the aftermath of World War II. A wave of nationalizations took place in Western Europe to rebuild economies devastated by the conflict. Nationalizations were prevalent in India following its independence in 1947 as the government pursued a socialist economic strategy. In many developing countries, import substitution policies relied upon SOEs to nurture industries where start-up costs exceeded the funding capacity of the private sector. State-owned banks were often used to provide the funding for these infant industries. SOEs were of course ubiquitous in the non-capitalist world as well, where state ownership of the means of production was a central facet of political ideology.

By the 1980s, however, the tide of sentiment had turned against the SOE as a mode of government intervention in the economy. Insulated from competition and subject to the whims of their governmental overseers, SOEs developed a reputation for inefficiency, waste, clientelism, and corruption, and became a serious burden on the public finances of many countries. The costs associated with government ownership came to be viewed as heavily outweighing the public benefits (Shleifer & Vishny, 1994). Agency theory provided an explanation for the real-world departure from the theoretical ideal: SOEs are ostensibly owned and operated in the public interest, but citizens are generally powerless to monitor and discipline the government agents and SOE managers actually running these firms. Lacking any true principals and in the absence of capital market discipline, the SOE came to be viewed as a black box of agency problems.

Margaret Thatcher famously embarked on an aggressive plan of privatization in the UK under the banner of increased efficiency and smaller government. By 1987, the Thatcher government had sold more than $20 billion of state assets, including British Airways and British Telecom (Goodman & Loveman, 1991). A wave of privatizations followed from New Zealand to the African continent, and from the Philippines to Brazil. By the end of the 1980s, the sale of SOEs worldwide reached $185 billion (ibid). When the Berlin Wall fell at the end of the decade, privatization campaigns swept over Russia and Eastern Europe. The death of the SOE appeared imminent.

Fast forward now to the twenty-first century. Not only has the SOE survived in the ecology of business organizations, it has proliferated and evolved into a major player in the global economy. As of the end of 2015, the central governments of 40 countries excluding China were full or majority owners of nearly 2,500 listed SOEs collectively valued at $2.4 trillion and employing over 9 million people (OECD, 2017). On its own, China's central government portfolio of SOEs is vastly larger than that of the other 40 counties combined (ibid).[1] SOEs are not only plentiful, they are increasingly prominent in the global economy. Over the period from 2005 to 2014, the share of SOEs in the Fortune

[1] China's central government has a portfolio of 51,000 SOEs valued at $29 trillion. Data on the number of SOEs in a given country, as well as cross-country numerical comparisons of SOEs, should be read with caution because there is no standard definition of SOE and the term is sometimes not defined in a publication. As developed below, the principal focus of this article is listed SOEs in which an organ of the Chinese state exercises effective control, either through majority or pyramidal ownership structures.

Global 500 increased from 9% to 23% (PwC, 2015).[2] As of 2018, there were 107 SOEs in the Fortune Global 500 (Bloomberg, 2018).[3]

As noted in the Introduction, much of the reemergence of the SOE is attributable to China's economic ascension over the past two decades. As of the end of 2017, over 30 percent of the companies listed on China's A Share market[4] (60% of market capitalization) trace their ultimate control to China's central or local governments (Rosen, et al., 2018). In 2005, less than one-third (29%) of the SOEs in the Fortune Global 500 were Chinese; by 2014 the proportion had risen to two-thirds (67%) (Kwiatkowski & Augustynowicz, 2015). But China's economic rise does not, by itself, completely explain the revival and transformation of the SOE as a form of business organization. In Norway, for example, SOEs account for almost 10% of non-agricultural employment. [5] And the reemergence of the SOE coincides with a rise in portfolio state ownership in the form of sovereign wealth funds (SWFs), which have also been in existence for decades but only came to global prominence in the mid-2000s (see Gilson & Milhaupt, 2008).

The revival and transformation of SOEs were fueled in part by developments in the capital market. "Corporatization" of SOEs emerged as a favored alternative to complete privatization as a means of addressing their governance deficiencies and improving their performance. Corporatization refers to the process of transforming an SOE from a unit of government into a joint stock corporation with a board of directors and shares issued to the government, in an attempt to separate the government's dual roles as investor and regulator. Crucially and in major contrast to most SOEs of prior eras, corporatization has permitted the shares of SOEs to be listed on stock exchanges, where some of the risk of the enterprise is transferred to public (non-state) investors and a measure of market discipline and transparency are provided by the capital market. As of 2015, listed SOEs[6] accounted for 45% of all SOEs by value and 25% by employment. Unlisted majority-owned SOEs comprise just 29% of the total enterprise value of all SOEs (PwC, 2015). Thus, while this form of partially privatized corporation is still widely known as an "SOE," most of the large, globally active firms in this category – particularly those in China – are more accurately thought of as *mixed ownership* enterprises.

Backlash against the more extreme forms of market capitalism witnessed in the global financial crisis, which renewed interest in policy channeling, further fueled the revival of state involvement in the corporation. As one commentator notes, "Since the 2008/2009 economic crisis, many governments have 'rediscovered' SOEs as useful instruments for

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[2] Virtually all SOEs take the corporate form. 92% of the SOEs by value (84% by employment) are incorporated according to their country's general corporation law (PwC, 2015).
[3] China has 78 SOEs in the Fortune Global 500, OECD countries 14, and non-OECD countries 15 (Bloomberg, 2018).
[4] The A share market refers to tradeable shares of Chinese companies quoted in Renminbi and listed on the country's stock exchanges in Shanghai and Shenzhen.
[5] To be sure, some state firms remain as legacies of the prior era of "SOE mission creep." India, for example, has 331 SOEs producing everything from fighter jets to sex toys (Stacey, 2018).
[6] Defined as enterprises whose shares are traded on a stock exchange and in which the state holds at least 50% of equity or otherwise exercises an equivalent degree of control.

dealing with specific policy objectives, creating a new generation of SOEs and partly reversing the privatization trend" (Putnins, 2015).

III. China's Experience

(i) Origins of SOE system

Nowhere has the just-described strategy of "corporatization without privatization" been pursued more vigorously than in China (Howson, 2017). After an unsuccessful experiment with the formation of contract-based business alliances among state-invested enterprises in the initial reform period, the Chinese central government took more control over the creation of state-owned business groups in the 1990s. The State Council formed 120 groups concentrated in critical industries, such as automobiles, machinery, electronics, steel and transportation. The formation of SOE business groups was inspired by the perceived role of Japan's *keiretsu* and South Korea's *chaebol* business groups in the rapid growth of those economies. The purpose of their formation in China was to achieve economies of scale, facilitate inter-firm collaboration, and create national champions to compete internationally. The groups also had the advantage of streamlining control over the economy: a small number of major firms would serve as conduits through which policy could be transmitted to vast numbers of enterprises organized under the core firms. China's stock markets were established principally to provide a means of funding SOE restructuring. State-run businesses were hived off of government bureaus, cloaked in corporate form with the standard set of attributes provided by a newly adopted Company Law, arranged into groups, and the best assets were packaged for listing on the stock exchanges (Walter & Howie, 2011).[7]

(ii) Structure

The ownership structures of the listed Chinese SOEs that eventually emerged from this process bear resemblance to those of private business groups found in many developing countries, with several additional features reflecting the party-state's role as controlling shareholder. The SOEs are structured as business groups under a parent holding company. The parent company (organized as a special form of limited liability company under the Company Law) has only one shareholder: the State-owned Assets Supervision and Administration Commission (SASAC), located directly under the State Council (cabinet), which ostensibly acts as an investor on behalf of the Chinese people. As of this writing, SASAC is the sole shareholder of 96 parent holding companies. The parent holding company, in turn, owns shares of downstream subsidiaries, coordinates strategy and resource allocation within the group, and serves as an intermediary between SASAC and other group member firms. One or more of its major subsidiaries, serving as the

[7] "Where did such *Fortune* Global 500 heavy hitters as Sinopec, PetroChina, China Mobile and Industrial and Commercial Bank of China come from? The answer is simple: American investment bankers created China Mobile out of a poorly managed assortment of provincial posts and telecom entities and sold the package to international fund managers as a national telecommunications giant" (Walter & Howie, 2011, p. 10).

public face of the business group, is listed on a stock exchange in mainland China and often cross-listed in Hong Kong or a foreign stock exchange.

A single SOE business group under SASAC's supervision may have a labyrinthine network of hundreds of subsidiaries, several of which may be linked through equity ownership to firms in other SOE business groups (Lin & Milhaupt, 2013). In this sense, the ownership structure of China's central SOEs might be loosely analogized to a single massive, diversified Korean *chaebol* business group where the party-state (acting through SASAC) plays the role of founder and controlling shareholder. As of the end of 2017, 395 A share companies were under the ultimate control of SASAC, representing 36 percent of total market capitalization (Rosen et al. 2018). SASACs were established at the local level as well to hold shares in local SOEs – firms controlled by provincial or municipal governments. As of the end of 2017, 706 A share companies were under the ultimate control of local SASACs, representing 25 percent of total market capitalization (ibid.)

Thus, the creation of the contemporary state sector was largely the result of a deliberate policy decision to corporatize, organize and list state assets on stock exchanges rather than nationalizations of private enterprise or government bailouts of failing private firms.

(iii) Scale

The sheer scale of China's state sector is impressive. The OECD (2017) reports a total of 159,000 SOEs in China with 40 million employees. Sixty-nine Chinese SOEs were in the Fortune Global 500 in 2018, as compared to nine in 2000 (Bloomberg 2018). The SOE share of employment as of 2017 was 14.3 percent, with SOEs accounting for 26.8 percent of industrial sales, 38.8 percent of industrial assets and 40 percent of total industrial liabilities as of 2018 (IMF 2019). At the central SOE level, manufacturing accounts for the largest number of enterprises (10,463) followed by electricity and gas (4,308), transportation (3,865) and real estate (3,847). By value of enterprises, finance (105 trillion RMB) dwarfs all other sectors, followed by primary sectors (16.8 trillion RMB), transportation (12 trillion RMB) and electricity and gas (11.3 trillion RMB) (OECD 2017).

The listed SOEs with mixed ownership that are the focus of this essay comprise 31 percent of the total number of A share companies, 71 percent of their revenues, and 61 percent of total market capitalization as of the end of 2017 (Rosen et al. 2018). Total employment in these listed firms is about 10 million (OECD 2017), weighted toward manufacturing (2.5 million), finance (1.9 million), primary sectors and telecom (1.3 million each).

(iv) Financing

China's SOEs are in the main financed through borrowing from state-controlled banks. In recent years, the share of new bank loans going to SOEs has actually increased significantly: 80 percent in 2016, up from 32 percent in 2012 (Lardy 2019). Similarly, the corporate bond market to date has overwhelmingly served as a source of funding for SOEs and local government financing vehicles rather than privately owned enterprises (POEs) (Lin & Milhaupt, 2017). Molnar & Lu (2019, 8) report that as of mid-2018, 82 percent of total corporate debt in China was attributable to SOEs. They note that "[t]his is not surprising in the context of still prevailing implicit government guarantees to SOEs…, the tough lending conditions for private enterprises and the significant state shareholding across the economy." About 1100 central and local SOEs have accessed equity capital by listing on the A share market (Rosen et al., 2018). While this represents about 30 percent of the total number of listed firms, it is a small fraction of the roughly 170,000 SOEs in China.

(v) Performance

By a variety of measures, China's state sector significantly underperforms the private sector, and the performance gap is widening. For example, according to Crom & Wagner (2018), relative to the non-state sector, a higher percentage of state-sector firms have negative cash flows, while the state sector has lower returns on equity and lower cumulative earnings growth.[8] Return on equity of listed SOEs declined by half from 2007-2017 (Cho & Kawase, 2018).[9] Rosen et al. (2018) report that SOEs have a lower return on assets and higher leverage than POEs. Lardy (2019) surveys a variety of studies finding inefficient resource use by Chinese SOEs and a growing gap in economic performance between SOEs and private firms.

(vi) Corporate Governance

China's listed SOEs have several puzzling and problematic features from a corporate governance perspective. Their governance calls into question the significance of the standard attributes of the corporate form given that (as explained in more detail below) significant governance rights run with the Chinese Communist Party rather than with equity owners *qua* owners. Moreover, the massive scale of the state's corporate network calls into question the ability of SASAC, or any other group of government supervisors, to effectively monitor the managers of all the firms under its ostensible control (Milhaupt & Zheng, 2015).

It is widely recognized that China's SOEs suffer from two major agency problems. One exists between the party-state in its role as controlling shareholder and the minority public (non-state) shareholders of listed SOEs. As Chinese law scholar Nicholas Howson (2017, p. 970) notes,

> To the present day, the PRC Party State remains absolutely committed to retaining control over converted enterprises in the broadest range of sectors … [including] non-key infrastructure sectors that are extremely profitable for central or local Party State insiders

[8] For purposes of the report, a private (or "ex-state-owned") firm is defined as a firm with less than 20% state ownership.
[9] For purposes of the report, a state-owned enterprise is defined as one in which the state owns a majority of the equity, directly or indirectly.

> especially when financed by largely passive and information-deprived public investors, Chinese and foreign.

A second agency problem, common to all SOEs but exacerbated in an authoritarian regime, is the absence of a true "principal," given that the citizens on whose behalf SOEs are theoretically owned by the state are unable to monitor or influence the government agents charged with overseeing the state sector (Clarke, 2003). From this perspective, SASAC is an especially problematic entity – described by Howson (2017, p. 971) as an "empty bureaucratic box." Best practices under the OECD Guidelines for Corporate Governance of State-Owned Enterprises require the state to separate as completely as possible its dual roles as regulator and investor. Ideally, this should occur by placing the SOE shares owned by the state in a holding company insulted from political influence. The gold standard for this approach is Singapore's holding company for state-owned shares, Temasek, which is managed under the supervision of an independent professional board and safeguarded from political interference through a variety of measures enshrined in the constitution (Milhaupt & Pargendler, 2017). SASAC, by contrast, has been assigned a long list of regulatory and investor functions,[10] and enjoys no safeguards against political influence. Quite to the contrary, by intention and design, China's state sector is infused with Communist Party influence. SASAC thus might best be viewed as a conduit for party influence over the SOE sector. As such, it is not well situated to play an effective role in corporate governance.

(vii) Party involvement and policy channeling

Evaluating the efficacy of China's SOE regime from the perspectives of scale, corporate governance, and the maximization of value at the firm level, however, overlooks its value to the party-state as a mechanism of policy channeling and rent-generation for party elites. The SOE business groups are extensively linked with institutions of the central government and the Chinese Communist Party.[11] Despite the organizational transformation and public listing of firms in China's SOE sector, control over the SOEs has remained with the party-state, not principally as a result of its equity ownership or through the functioning of corporate governance organs such as shareholders meetings and boards of directors, but through political mechanisms.

[10] SASAC's formal functions and responsibilities include preserving and enhancing the value of state-owned assets, appointing and removing top SOE executives, setting remuneration for SOE personnel and regulating income distribution among senior SOE managers, dispatching supervisory panels to the SOEs, and drafting regulations on the management of state-owned assets. *See* SASAC, Main Functions, available at http://en.sasac.gov.cn/n1408028/n1408521/index.html. The legal foundation for SASAC's role in the SOE system is the Law of the People's Republic of China on State-Owned Assets of Enterprises ("SOE Asset Law"). Zhonghua Renmin Gonghe Guo Quiye Gouyou Zichan Fa (promulgated by the Standing Com. Nat'l People's Cong., Oct. 28, 2008, effective May 1, 2009). The SOE Asset Law was enacted for the purpose of "consolidating and developing the state-owned economy, strengthening the protection of state-owned assets, giving play to the leading role of the state-owned economy in the national economy, and promoting the development of the socialist market economy." Ibid, art 1.

[11] For an extensive treatment of the subject, see Lin & Milhaupt (2013), from which the discussion in text is drawn.

Party committees are established within SASAC and, pursuant to the Company Law, within each SOE group member corporation. (In fact, the Company Law contemplates that party cells be established in all corporations, including private firms, to "carry out activities of the Chinese Communist Party pursuant to the [Party's] Constitution.") The degree to which these committees are operational as opposed to symbolic varies among SOEs. The committees may at times perform supervisory and personnel functions, and may have overt political dimensions, such as building allegiance to party principles and disseminating campaigns announced by senior government leaders. A dual corporate and party personnel system in SOEs ensures that senior SOE managers show fealty to the party. Overlaps between the two systems are rather uniform, such that a corporate manager of a given rank typically holds a position of equivalent rank in the party system.

The party, working through SASAC and the company-level party committees, is able to influence boards of directors in the appointment, removal, remuneration and supervision of senior managers, and with respect to major business decisions. Institutionalized party penetration of the corporate form thus mirrors the Leninist practice of creating a shadow party governance structure vis-à-vis the organs of the state.

This is not to say that the party-state exercises complete and effective control over the entire SOE sector. Milhaupt and Zheng (2015) argue that the party-state exercises less control over the state sector that is commonly assumed, due to agency problems and the span-of-control challenge posed by such an enormous corporate network. The SOE sector is not monolithic and the power relationship of a given SOE to SASAC varies depending on the governmental rank of the SOE's top executive and the number of layers of ownership between the firm and SASAC. (Fan et al., 2013 and Lin & Milhaupt 2019) show that SOEs farther down the corporate ownership pyramid enjoy greater levels of independence from the government and party than SOEs owned directly by the state.

As is apparent from the discussion thus far and as noted by Clarke (2003), maximizing shareholder value is not the ultimate goal of this state system of corporate ownership. While profitability of the state sector is of course a relevant consideration, China's leaders evidently view SOEs as a means of maximizing the state's utility in nonpecuniary as well as pecuniary ways, and at the *country level*, rather than at the firm level. President Xi Jinping has been explicit about the policy-channeling role of the SOE sector. He has declared that SOEs are "the basis for socialism with Chinese characteristics," serving as "supporting forces for the party to govern and prop up the country" (quoted in Cho & Kawase, 2018). In a 2016 speech, Xi urged SOE managers "to bear in mind [that your] number one role and responsibility is to work for the party" (ibid.).

What policy goals beyond accumulation of state assets are advanced by the SOEs? They range from maintaining employment to serving as transmission belts by which important economic and industrial policies are carried out. For example, in the wake of the 2008 global financial crisis, investments by the SOE sector, mostly financed by debt from state-owned banks and a state-centered corporate bond market, were heavily relied upon to provide stimulus to the economy.[12] A second example is the role of SOEs in the Chinese government's "going out" policy of encouraging foreign investment. China has become a leading source of outbound FDI, and the early phase of this policy push relied heavily on foreign investments by SOEs. That strategy was eventually adjusted to rely more on private enterprises due in part to the scrutiny that acquisitions by Chinese SOEs have received from foreign governments on national security grounds (Gordon & Milhaupt, 2019). A third example is the central role of SOEs in Xi Jinping's ambitious Belt and Road Initiative (BRI), which seeks to build infrastructure along both land and sea routes linking China to dozens of countries across Asia, the Middle East and Africa. BRI is not simply an economic project to expand markets and trade, but a means of extending China's sphere of influence and military presence in Asia (Economist, 2018). These projects pose a range of legal and political risks for the firms involved, and their profitability is not assured (Baltensperger & Dadush 2019). Most of the contracts for BRI projects have gone to Chinese SOEs, financed by loans to the host countries from Chinese state-owned banks (ibid).

(viii) Current reforms

Recent developments highlight the challenges facing the Chinese party-state as it seeks to improve corporate governance in SOEs by enhancing capital market discipline through ownership reform without undermining the ability of SOEs to serve as tools of policy channeling. Since the Chinese Communist Party's Third Plenum in November of 2013, SOE reform has been a centerpiece of the Xi Jinping administration's agenda. A central aspect of the strategy is "mixed ownership reform" – a plan to convert more SOEs into mixed ownership firms in which the state and private shareholders hold joint equity stakes. In September of 2015, the State Council adopted detailed guidelines on the implementation of these mixed ownership reforms.

What happens to policy channeling when state ownership is mixed with larger doses of private ownership? This question is of obvious concern to China's leaders. In recent years, high-level government and party organs have issued policies seeking to reinforce the party's leadership in SOEs, and the principle of party leadership in SOEs has recently been enshrined in the Constitution of the Chinese Communist Party.[13] Guidelines issued by SASAC and the Ministry of Finance provide a template for SOEs to amend their Articles of Association so as to weave the principle of party leadership into their constitutive documents. The amendments in the template range from the purely symbolic ("refer to the Constitution of the Communist Party of China" in the Articles) to ones that interweave party and corporate roles of senior managers and require prior consultation with the party committee by the board of directors and senior managers before taking

[12] The overhang from these unprofitable investments is one of the main causes of the current low profitability and earnings growth of the SOE sector discussed above.

[13] See, e.g., Guiding Opinions of the Central Committee of the Communist Party of China and the State Council on Deepening State-Owned Enterprise Reform, item I.2. ("Insist on the leadership of the State-owned enterprises by the party"); Constitution of the Communist Party of China, revised and adopted on Oct. 24, 2017, art. 33 ("The leading … Party committees of state-owned enterprises shall play a leadership role, set the right direction…and discuss and *decide* on major issues of their enterprise in accordance with regulations.") (emphasis added).

major decisions. As of the end of 2018, about 90 percent of publicly listed SOEs (and almost 6 percent of listed POEs, although they are not subject to the party-building policy) have adopted these amendments in some form (Lin & Milhaupt 2019). For firms adopting the full panoply of recommended charter amendments, the company's internal party committee is now effectively superior to the board of directors with respect to material business decisions and senior management appointments.[14]

The Chinese party-state's attempts to balance tensions between capital market development and policy channeling go beyond the state sector. To be sure, the boundary between public and private enterprise is blurred in China due to the weak rule of law and the pervasive role of the party in all large organizations (Milhaupt & Zheng, 2015). One indication of the gravitational pull of the party-state even in private firms is widespread membership by the founders of large private firms in government and party organs, in the same way that high-level SOE executives are affiliated with these organs.[15] But the rise of China's tech titans such as Alibaba and Tencent has presented the Chinese government with an acute version of the dilemma posed by changing corporate ownership structures and policy channeling: how does the regime foster the growth of innovative firms operating in critically important new sectors of the economy (particularly ones using technology to link people and provide alternatives to state-dominated functions such as finance) while maintaining party influence over the largest and most successful of these firms?

These two background forces driving the proliferation and transformation of SOEs – increased reliance on the capital markets and strengthened devotion to policy channeling – interact in complex ways. On one hand, they are mutually reinforcing because policy channeling increases the demand for capital market tools to expand the capacity of the state sector, while resort to the capital market increases the scale of SOEs. Yet the introduction of private capital and market discipline into SOEs creates a potential constraint on the ability of governments to pursue public policy objectives for a broad set of stakeholders at the expense of public (non-state) investors. Lin and Milhaupt (2019), for example, show that SOEs facing more significant capital market constraints in the form of larger non-state shareholders and cross-listing in Hong Kong refrained from adopting the most politically intrusive of the charter amendments pursuant to the party-building policy.

IV. Questions and Potential Implications

China's experience with the state as owner has significant potential implications for its domestic economy as well as for policymakers around the world, and perhaps even for the corporation as an organizational form.

(i) China's domestic economy

[14] Song (2017): "decision-makers now favor putting the Party committee atop the board as the ultimate authority in an SOE."
[15] Milhaupt & Zheng (2015) find that 95/100 founders or chief executives of the largest POEs in China are members of party and government organs; same for 8/10 of China's largest internet-based firms.

A major puzzle of China's unprecedented period of high growth is how the system just described provided incentives conducive to (or at least not overwhelmingly disruptive to) the transformation of its economy since the 1980s. While corruption and clientelism undoubtedly exist in this state-centered ecology, China has managed to avoid the fate of most other developing countries pursuing nationalist industrial policies. Ang (2016) and others have suggested that empowering local governments to experiment with innovative policies allowed China to escape the "poverty trap" despite its weak institutional structures. As noted previously, China drew inspiration from the state-led economies of its East Asian neighbors during their developmental heydays. Close connections between political leadership and favored business groups to transmit economic policy, secure financing for industries deemed critical to national development, and manage competition were major facets of Japan's and South Korea's developmental paths, although levels of state ownership in those countries were far below that in China (see Evans 1995). It is plausible that these institutional structures are conducive to economic development during a country's take-off phase of growth (see, e.g., ibid.; Amsden 1989).

Yet there is still much work to be done in examining the linkage between China's sustained development and firm-level incentive structures. Gilson & Milhaupt (2011) offer the tentative hypothesis that there are high-powered incentives uniting business success with political advancement in China – incentives that find loose parallels in the western private equity firm. A complementary hypothesis by Lin & Milhaupt (2013) suggests that the managerial elite in the Chinese SOE system have a large enough stake in the country's economic success that they constitute an "encompassing group" (Olson 1982) with incentives to grow the pie rather than simply seeking a larger slice for themselves. But these are tentative hypotheses, and much work remains to be done to understand whether and precisely how China's SOEs have contributed to the country's economic development. The incentives within the SOEs themselves remain obscure due to the difficulty of conducting research at the firm level.[16]

Whatever the contribution of the SOE system to China's period of high growth, the question remains whether continued reliance on the state sector is an optimal strategy going forward, as China faces lower rates of growth, demographic challenges, accumulated debt problems and the potential middle-income trap (see Magnus 2018). SOEs remain deeply embedded in the economy and highly intertwined in the structures of public governance in China. They continue to receive special treatment across a range of regulatory domains, and they are recipients of considerable state largess, ostensibly on the ground that they are the foundation of China's "socialist market economy." SOEs have a built-in seat at China's legislative and deliberative bodies, and exert extensive influence on the courts. China's leadership is plainly reluctant to relinquish the policy-channeling role of SOEs and is in fact reinforcing the role of the state sector in the economy.

[16] See Cao et al, (2018) for an example of this type of research (finding correlation between political promotion of CEOs of Chinese SOEs and firm performance). By contrast, Fan et al., (2007) find that newly partially privatized Chinese firms with politically connected CEOs significantly underperform those without politically connected CEOs.

But in a global economy in which technological innovation is a fundamental source of national competitiveness and influence, doubling down on SOEs seems like a risky strategy (Lewis 2018; Hancock 2019). In the contemporary economy, Chinese SOEs look less like engines of development and suppliers of public goods for an emerging market than the interest groups Olson (1982) analogized to barnacles on a ship's hull, accumulating in number and influence over time and slowing the nation's economic progress. Huang et al. (2019) for example, find that renationalizing firms by local governments leads to higher leverage and lower profitability and labor productivity. The ongoing policy of formalizing and increasing the role of the Chinese Communist Party in the corporate governance of the SOE sector would appear to further complicate the outlook for the Chinese economy. So too the growing trend for the government to take equity stakes in private enterprises (Hong 2019).

(ii) Policy makers outside China

The scale and global reach of China's SOEs pose a host of dilemmas for policymakers around the world, because the Chinese SOE is a form of business enterprise that was not contemplated at the time multilateral and domestic economic regulatory regimes were created (see Wu, 2016). Across a range of regulatory regimes from international trade to antitrust, policymakers are struggling to resolve issues raised by competition with China's national champions, whether SOEs or POEs.

The most recent manifestation of this phenomenon is rising concern over Chinese outbound direct foreign investment. Gordon & Milhaupt (2019) argue that China's entry into the global mergers and acquisitions market, principally as an acquirer, threatens a fundamental assumption of the current, permissive approach to this market – namely, that governments and industrial policy considerations are not directly involved in the buy-side motivation for a transaction. High levels of state ownership in China, the murkiness of ownership even in some private firms, and the party's extensive levers of influence over the corporate sector have created concerns that some Chinese acquirers may have non-economic motives for pursuing an acquisition – in effect, concerns that the deals are mechanisms of policy channeling by the Chinese government. These concerns have led to the recent expansion of the national security screening regime for foreign investments in the United States, and prompted creation of such a regime at the EU level.[17]

Concerns of this sort are likely to persist across the entire range of market governance regimes, both multilateral and domestic, as long as the Chinese party-state continues to rely heavily on policy channeling and to formally infuse corporate governance organs with party influence.

[17] The scope of the U.S. screening regime, known as the Committee on Foreign Investment in the United States (CFIUS) process, was expanded in 2018 to include not only foreign acquisitions of control over U.S. firms as in the past, but also non-controlling investments that give a foreign investor access to "critical technologies" or "sensitive personal data." The new EU regime empowers the European Commission to review foreign investments that may affect "security and public order" and make recommendations to the affected member states. It does not require member states to establish screening regimes, but it creates an enabling framework and set of basic principles for member states seeking to create such a regime.

(iii) The corporation

China's developmental experience is highly suggestive of the importance of the corporate form to economic development. The corporatization process was central to the hydraulics of industrial organization in the reform era: separating (incompletely and problematically, to be sure) the regulatory from the operational aspects of business enterprises in the corporatization process was a crucial first step in the development of a functional state sector. The corporate form has proven to be extraordinarily useful in providing the Chinese party-state with a scalable, adaptable, and relatively anonymous[18] vehicle for investment and economic activity. It provided a template for the structure of the state sector and its scaling to globally important proportions. Its inherent features have provided an off-the-rack organizational device no less serviceable to party-state strategists than to entrepreneurs in other economies.[19] In a similar vein, note that the current mixed ownership SOE reform plan promoted by the Xi Administration draws upon a standard corporate turnaround strategy – obtaining capital injections from investors with the capacity to improve managerial and financial performance.

Yet throughout the reform period, Chinese economic strategists have chosen selectively from among the menu of corporate attributes, making extensive use of the corporation's hierarchical governance structure and separate legal existence in building networks of firms responsive to influence from party-state organs, and leveraging the power of the state in its ostensible role as controlling shareholder. At the same time, the universal, supreme decision making and oversight organ provided by the corporate form – the board of directors – has at times been sidelined by the party's own political governance organs. Here again the contrast with Singapore's experience with state ownership is instructive. Temasek functions as a professional asset management company with structural safeguards against political intervention in its investment strategies or downstream governance of its portfolio companies. Temasek pursues superior financial performance of these "government linked companies," albeit in service of political legitimacy and preservation of national wealth. The ruling party seeks to maximize financial returns on its portfolio and uses those returns to carry out it social policies. By contrast, SASAC functionally serves as a vehicle for the pursuit of two conflicting objectives: enhancing the performance and global reach of Chinese SOEs, and facilitating the ruling Communist Party's direct influence over, and rent extraction from, many of the most important firms in the economy.

[18] Anonymity of the corporate form may be useful to state capitalists in masking the state operating behind the corporation. At the same time, however, this very masking may stigmatize all firms operating out of a state capitalist system with the assumption that they are linked to the state and have non-commercial motives. This has been most apparent in the case of two globally successful Chinese telecom equipment suppliers, Huawei and ZTE, which have been the subject of investigations and blacklisting by the U.S. government.

[19] This is particularly the case because as Clarke (2016) notes, China developed its corporate law with SOE reform, and the state as controlling shareholder, very much in mind.

Given China's selective adoption of the corporate form, it may be instructive to briefly analyze how the universal attributes of this form (see Armour, et al., 2017) have been affected by the Chinese party-state in its role as owner:

Separate legal personality/limited liability: One of the principal concerns with SOEs everywhere is that they operate under a soft budget constraint (Kornai 1979). That is, their managers do not fear financial failure because the state implicitly guarantees their debts and stands ready to cover deficits that arise in their operation. Under a soft budget constraint, and particularly given the personnel overlaps and rotations between Chinese SOE managers and party officials, one might conclude that neither separate legal personality nor limited liability has the same import in China as in other forms of corporate capitalism. However, as noted above, the separate, universally recognizable legal personality of the corporate form played a role both in the internal re-arrangement of organizational forms during China's economic reforms and their scaling to global proportions. Limited liability has proven useful in cabining liabilities with respect the SOEs' foreign investment activities. It may yet prove to be an important feature of Chinese SOEs domestically, as Chinese growth slows, the debt burden builds, and budget constraints harden.[20]

Delegated management: As noted above, the role of the board of directors in the governance of Chinese SOEs is affected by the party system. Developing functional boards of directors of Chinese SOEs has been a relatively slow process. As long as Communist Party organs continue to parallel and shadow corporate organs in the state sector, and as long as the party-state retains direct influence over SOEs, Chinese corporate governance in the state sector will retain a distinctly shareholder-centric (that is, party-state-centric) bias in tension with the principle of delegated management. The party-building campaign, a central feature of current SOE reform policy, threatens to move the board of directors even further from the central role contemplated for it in most other systems of corporate governance.

Transferable shares: Until about a decade ago, China maintained a share classification system that effective rendered two thirds of the shares of listed SOEs non-transferrable to non-state organs. Today, while all shares are transferrable as a formal matter and despite mixed ownership reforms to encourage more private investment in SOEs, the Chinese government shows no signs of relinquishing control over firms in "critical" and "pillar" industries, categories that extend well beyond sectors related to defense and national security. Ownership in China's capital markets remains highly concentrated, such that a market for corporate control remains little more than a theoretical aspiration of academics. On the other hand, creation of stock markets in the early 1990s in a bid to attract capital to China's then-nascent and struggling state corporate sector was a major institutional step in China's developmental process. Moreover, liquidity facilitated by transferability of shares has undoubtedly encouraged

[20] Molnar & Lu (2019, 7-8) find that "China's non-financial corporate debt soared in the past years from an already very high level in the mid-2000s, and amid slowing economic growth…. A peculiarity of corporate debt in China is that it is mainly accumulated by SOEs, as of mid-2018, roughly 82% of total corporate debt.)

foreign portfolio investments in China's state sector, including the banking sector. These investments are set to grow significantly with the recent inclusion of A Share companies in the MSCI Emerging Market Index.

Investor ownership: SOEs, like all corporations, feature "ownership" by the providers of one factor of production – capital. But as noted in the Introduction, the state is unlike any other shareholder; and the Chinese party-state is unlike any other state. The distinctiveness of the party-state sets Chinese state capitalism apart from that practiced in other countries, at least as a matter of degree.

China's experience thus far indicates that party-state actors view the corporation as an integral facet of the country's *political* governance apparatus. (In that sense, "corporate governance" in China is deeply connected to "real" governance.) As such, the objectives of the corporation in China are not limited to serving the interests of its immediate stakeholders, but also encompass political and policy agendas for the country as a whole. As a consequence, in Chinese state capitalism the firm is influenced by, and influences, public governance considerations to a larger extent than in other systems of corporate capitalism, and the unit of maximization is not the individual firm, but state interests as a whole (at least as those interests are defined by party elites). In this sense, state ownership of the corporation in China may be thought of as an extreme version of *stakeholder capitalism*. Distinctiveness along this dimension suggests a potentially key tension between China's variety of capitalism and other forms. Yet it is a tension that at least one other country with extensive state ownership of business enterprise, Singapore, has managed to resolve without major adaptation of the corporate form itself.

It is of course possible that the Chinese Communist Party will find ways to continue improving the governance and global reach of SOEs while using their profits to expand social expenditures for Chinese citizens – in other words, to replicate and scale up Singapore's version of state capitalism. But this sort of transformation would require, if not a complete withdrawal of the party from the internal workings of SOEs, then at least the creation of a professional, arm's-length relationship between the party-state in its role as controlling shareholder and the SOEs whose shares it holds ostensibly for the benefit of the Chinese people. But as noted, presently, China is moving in precisely the opposite direction, equating an increased role for the Communist Party in SOE decision making with improved corporate governance.

Summing up, China's experience with the state as owner can be seen as reinforcing the importance of the corporate form to economic development. The corporation has a chameleon-like ability to take on the characteristics of the political economy in which it operates. It has proven capable of adaptation to both shareholder-centric and stakeholder-centric forms of capitalism in different parts of the world. Perhaps it is not surprising, then, that the corporate form has also been readily adapted to a state-centric form of capitalism with Chinese characteristics.

V. Conclusion

The state's involvement in the corporation is as old as the corporation itself. The most extensive form of this involvement is outright equity ownership. From its inception to the present day, state ownership of business enterprise has undergone repeated cycles of favor and disfavor. Having survived a near-death experience at the end of the twentieth century, the SOE has reemerged as a powerful global economic actor. Its reemergence is attributable in significant measure to the remarkable rise of China in the first two decades of the twenty-first century.

Relying on a strategy of mixed ownership and extensive use of the capital markets, coupled with non-corporate, political governance mechanisms, Chinese SOEs represent a novel take on an old form of economic actor. They raise important questions about the future direction of China's domestic economy and the ability of global economic regulatory regimes to accommodate this new-old form of economic organization. And Chinese SOEs prompt reflection on the corporate form itself, highlighting its adaptability and utility as a platform for business organization across a wide range of political economies, including that of an authoritarian developmental state.

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