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Corporate Power vs. State Power: Multiple Roles of the State in the Financialization Process of China's State Capitalism

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1. Introduction

During China's transition from the previous planned economy to a relatively opened economy, the state played a hegemonic role in the transition, either as a market regulator or as an owner of state-owned assets, although these multiple roles are quite debatable. Comparatively, private economy has contributed a large proportion of China's GDP and provides over half (around 70%) employment opportunities in the process of China's economic reform. For instance, the private sector corporations (non-SOEs including foreign companies) produced approximately two-thirds to three-quarters of China's GDP from 2010 to 2012, which was equivalent to 90% of China's exports.[1]

However, the private economy has not been treated equally as the state-owned enterprises or public sector. Under the 1982 Constitution, private economy was regarded as "supplement to the socialist state-owned economy." The amended PRC Constitution in 1997 redefined the private economy as an "important component" (Art. 11). In 1995, the Chinese government decided to reform inefficient state-owned enterprises (SOEs), following the principle of "seizing the large and freeing the small", which allowed private investors to acquire small SOEs. On the other hand, the state ensures the state-owned economy to be a leading force and play a dominant role in the national economy, under the PRC Constitution.[2]

The debate over "*Guo Jin Min Tui*", which literally means "state-owned enterprises approach and privately operated enterprises retreat", started from late 2001 and became red hot after 2008. On November 10, 2001, Wannan He published two articles titled "Restructuring: '*Guo Jin Min Tui'* Gradually Becomes Popular"[3] and "PT Companies Have to Turn to the Government When Facing Death."[4] In his articles, He analyzed the case of *PT MinMinDong*[5] and other cases that privately owned enterprises (POEs) were forced to exit due to takeovers conducted by

[1] Jonathan Eckart, "8 Things You Should Know about China's Economy" (23 June 2016) *World Economic Forum*, https://www.weforum.org/agenda/2016/06/8-facts-about-chinas-economy/.

[2] Article 7 of the PRC Constitution, "The State-owned economy, namely, the socialist economy under ownership by the whole people, is the leading force in the national economy. The State ensures the consolidation and growth of the State-owned economy."

[3] Wannan He, "Restructuring: '*Guo Jin Min Tui'* Gradually Becomes Popular" (Nov. 10, 2001) *China EEFII Net*, in Zhaosong Leng, "Red Flag Presentation: Summary on Major Differences of '*Guo Jin Min Tui*'" (10 January 2013), available at: http://www.sasac.gov.cn/n1180/n1271/n20515/n2697206/15065063.html.

[4] Wannan He, "PT Companies Have to Turn to the Government When Facing Death" (10 November 2001) *Cai Jing Times*.

[5] In the case of *MinMinDong*, Fujian Deya Group, a *Minying* enterprise, signed share transfer agreement of PT *MinMinDong*, a state-owned listed company, with the SASAC Fujian Bureau and then the chairman of the board of Deya Group was appointed as the CEO of PT *MinMinDong*. One year later, the Department of Finance of Fujian Province suddenly announced a free transfer of all *MinMinDong*'s state-owned shares (equal to 36.32% shareholding) to Fujian Electronics & Information (Group) Co., Ltd., another state-owned enterprise. The *Minying* enterprise was squeezed out and lost control right of PT *MinMinDong*. There are many similar cases in the process of "*Guo Jin Min Tui*". See Zhaosong Leng, "Red Flag Manuscript: Summary on the Theoretical Differences of '*Guo Jin Min Tui*'" (10 January 2013), available at:
http://www.sasac.gov.cn/n1180/n1271/n20515/n2697206/15065063.html.

SOEs. These two articles initiated the controversy on this issue. Although left-wing economists applauded for "*Guo Jin Min Tui*", many economists hold negative views on the trend of "*Guo Jin Min Tui*." With regard to the "New Nationalization Movement" after 2009, Yang (2009) believed that "*Guo Jin Min Tui*" was the result of "capitalization of power," which deviated from the Chinese characteristic of marketization.[6] Wu (2009) believed that "*Guo Jin Min Tui*" would not benefit China's economic reform.[7] Feng (2010) called in question that the trend of "*Guo Jin Min Tui*" might not last long because "*Guo Jin Min Tui*," as a privileged operation, was anti-marketization and anti-competitiveness.[8] It is worth noting that Zhiwu Chen predicted the consequences of "*Guo Jin Min Tui*" in 2009 when China conducted a large scale nationalization movement. He believed that China would enhance the trend of "*Guo Jin Min Tui*" and the aftermath, such as deficits of inefficient SOEs, high unemployment rate, bad debts of banks and tight fiscal revenue, would arise in 2015 from the renationalization. He also predicted that, unlike East European countries, which carried out a "shock therapy," China had to start another economic reform from 2019 to 2049 in order to finish its "gradual reform path."[9]

2 Corporate Power vs. State Power: Multiple Roles of the State

2.1 *Guo Tui Min Jin* (from mid-1990s to mid-2000s)

At the preliminary stage of economic reform from 1980s to mid-1990s, the private economy started to bud. In 1995, China decided to reform its inefficient SOEs. The principle of "seizing the large and freeing the small" was implemented from 1992 to 2002.[10] The private sector thus got some space to accelerate development from mid-1990s to mid-2000s. This phenomenon is called "*Guo Tui Min Jin*", which means "the state-owned economy retreats and the private sector approaches." Take the example of the corporate control market, in 2004, the composition of controlling shareholders in 611 Chinese listed companies consisted of 426 state holding companies, 142 privately operated companies, three foreign owned companies, and 40 other types of owners. In 2005, the controlling shareholders of 752 Chinese listed companies were made up of 503 state holding companies, 211 privately operated companies, 4 foreign owned companies, and 34 other types of shareholders.[11]

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[6] Fan Yang, "*Guo Jin Min Tui* Is the Outcome of Capitalization of Power and Power Should Retreat from the Market" (13 November 2009), available at: http://business.sohu.com/20091113/n268192122.shtml.

[7] Jinglian Wu, "'*Guo Jin Min Tui*' Is Not a Good Situation; All Parties Should Take Care" (28 October 2009) *People's Daily*, available at: http://shehui.daqi.com/article/2726630_5.html.

[8] Xingyuan Feng, "The Phenomenon of '*Guo Jin Min Tui*' Is Spreading" (23 January 2010).

[9] Zhiwu Chen, "China's Reform Will Greatly Regress after 2009; State-owned Enterprises Face Losses in the Next Ten Years" (14 December 2009) *New Chinese Businessmen* (Xin Hua Shang), available at: http://business.sohu.com/20091214/n268942060.shtml.

[10] The principle of "Seize the Big and Free the Small" (meaning "restructuring of major state owned enterprises and leave minor ones to fend for themselves") was implemented between the third session of the fourteenth meeting of the CCP in November 1992 and the sixteenth National People's Congress of CCP in November 2002.

[11] Ho-Mou Wu, "Mergers Activities and Stock Market Valuation in China" (2008), online: http://www.nber.org/books_in_progress/FinancialSectorDevelopment-EASE18/MS_ch7_Ho-MouWu.pdf.

However, the economic downturn after 2008 apparently slowed down this trend. China's massive economic stimulus plan greatly bolstered state-owned economy; while the private sector was ignored or had to retreat from many areas of national economy.

2.2 The Turning Point: Establishment of the SASAC in 2003

After 2003, the government became reluctant in selling small SOEs to private owners. The turning point is the establishment of the State-owned Assets Supervision and Administration Commission (SASAC) in May 2003. The SASAC takes responsibility for the basic administration of state-owned assets in enterprises, such as the determination and registration of property rights, regulation of assets evaluation, clearing and verification of assets, statistics, and comprehensive appraisal.[12] It performs the contributor's duty relating to major investment and finance planning, development strategies and planning of the contributed enterprises.

The SASAC, as representative of the State Council, is responsible for the supervision and administration of state-owned assets. There are also state-owned assets supervision and administration bodies of the provinces, autonomous regions and municipalities represent local government to perform contributors' responsibilities.[13] The SASAC dominates the management selection and appointment of state controlling companies and state holding companies. The SASAC has the power: (i) to nominate directors and supervisors dispatched to the state controlling companies; (ii) to recommend the selected board chairperson, vice board chairperson, and the president of the board of supervisors of the state controlling companies; (iii) to suggest the selected general manager, vice general manager, and general accountant; and (iv) to nominate the selected directors and supervisors dispatched to the state holding companies.[14] In addition, the SASAC appoints shareholder representatives and directors to take part in shareholders' conferences and the board of directors of the state controlling companies and state holding companies. They represent the SASAC to exercise voting rights.[15]

In 2004, the SASAC enacted the *Management Measures on Central Enterprises' Development Strategy and Plan* as the blueprint of developing super large size central enterprises, such as three to five-year mid-term development plan and ten-year long-term development plan.[16] By 2014, there were 113 central state-owned enterprises which played a dominant role in the national economy.[17]

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[12] Ibid., Art. 30.

[13] See Art. 12 of the Interim Measures for the Supervision and Administration of State-Owned Assets of the Enterprises, which was promulgated by the State Council on May 27, 2003.

[14] Ibid., Art. 17.

[15] Ibid., Art. 22.

[16] See Art. 8 of the *Management Measures on Central Enterprises' Development Strategy and Plan*, which was promulgated by the SASAC on November 26, 2004.

[17] Refer to the name list of central enterprises of the SASAC, www.sasac.gov.cn.

2.3 The Mass Financialization after the Global Financial Crisis (GFC)

In response to the Global Financial Crisis, the Chinese government initiated the economic stimulus scheme of CNY 4 trillion[18] in 2008 and the *Ten Industrial Promotion Plan* in 2010,[19] which was to address problems of economic crisis and structural adjustment of internal needs, particularly strengthened the government guiding model of economic development. In the 2008 massive economic stimulus package and a series revitalization measures, SOEs got various resources and policy priorities; while non-SOEs encountered various difficulties in raising capital, bank loans and daily operations. Following the CNY 4 trillion stimulus plan in November 2008, the Chinese government launched the plan for ten revitalization industries in early 2009. These ten industries include: shipbuilding, automobile, electronics, textile, iron and steel, nonferrous metal, petrochemical, mechanical equipment manufacturing, logistics and light industries. Thereafter, there was a relief for domestic financial sector along with a massive financialization.

3 Financialization of State Ownership

The weight of financial sector has been increasing rapidly in the Chinese economy over the past decade. According to Epstein (2005), "Financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies." This trend lasts over the last two decades. In 1999, the State Council set up four asset management companies - Huarong, Cinda, Great Wall and Orient - to dispose of bad loans of big four state-owned banks. In 2004, the SASAC decided to develop super large size central enterprises, and the SASAC encouraged central SOEs to set up their own financial companies and develop their own strategy of industry and finance combination.

The state controls every key bank. The Ministry of Finance (MOF) and the Central Huijin Investment Ltd. (Huijin) have absolute control rights of four largest commercial banks (ICBC, CCB, BOC and ABC). Banking sector accounts for approximately 80% of China's financial services and provides loans to SOEs. Currently, the total assets of the banking sector has reached around US$40 (39.34) trillion, which equals to more than 3 times of China's GDP.

China's Stock market is another example of the state control. It has been a policy-driven market in its 27-year's history. Aside from administrative intervention, the government has deeply involved in the market's operation, since China's stock market was founded to raise capital for SOEs. State-owned listed companies have enjoyed priorities in public offerings, refinancing and takeovers.

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[18] Yanping Li and Chia-Peck Wong, "China Announces 4 Trillion Yuan Economic Stimulus (Update2)" (Nov. 9, 2008) *Bloomberg*, available at: http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aIpq7IF4BM9Q.
[19] Baike, "Ten Industrial Promotion Plan in 2010", http://www.baike.com/wiki/%E5%8D%81%E5%A4%A7%E4%BA%A7%E4%B8%9A%E6%8C%AF%E5%85%B4%E8%A7%84%E5%88%92.

4 Consequences of the State's Hegemonic Role in the Process of Financialization

Generally speaking, financialization may result in "profiting without producing" and financial expropriation. In the Chinese context, it has created a list of consequences. First, asymmetric development between finance and industry. Today, after the mass financialization, "more than 80 percent of economic profit comes from financial services".[20]

Second, excess money supply and exchange control. Oversupply of currencies has become serious after the global financial crisis (GFC). Accompanying the three rounds of Quantitative Easing in 2008, 2010, and 2012, inflows of hot money (massive liquidity) flushed into China and emerging markets. Meanwhile, China printed lots of currencies. At the peak point of newly printed surplus money in 2012, China accounted for almost half of new money supply and became the largest money printer.[21] Excess supply of RMB plus exchange control resulted in RMB's "External Revaluation and Internal Appreciation". In March 2018, China's M2 reached RMB 174 trillion.

Regarding the stock market, unlike many other common jurisdictions where institutional investors are the main market players, retail investors contribute approximately 85% of the turnover of China's A-share market.[22] Unfortunately, it is said that overall 90% of retail investors received no actual returns from 1992 to 2011.[23]

Another consequence is the housing bubble. In cities, property prices have almost quadrupled after 2000, which has greatly exceeded the US housing bubble before the GFC.

The fifth consequence is high leverage ratio and massive debts. Local government bonds and corporate bonds are highly risky. Debt defaults happened once in a while in the last few years. Shadow banking also accounts for the high leverage ratio.

The last consequence is financial expropriation and pervasive corruption. More than 1.3 million officials at various levels (including elite "tigers" and ordinary "flies") were caught in China's anti-corruption campaign. Recent cases such as Hainan Airlines (HNA), Wanda Group, Fosun Group, and CEFC China Energy, show China's graft fight in the financial sector.

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[20] McKinsey Global Institute, "Capturing China's $5 Trillion Productivity Opportunity" (June 2016), p. 30.

[21] Tyler Durden, "China Accounts for Nearly half of the Global Money Supply" (2 August 2013), available at: http://www.zerohedge.com/news/2013-02-08/china-accounts-nearly-half-worlds-new-money-supply.

[22] Y. Xun, 'A-share Market Examination: Structure of Market Players, Trading Characteristics, and Chip Allocation Decide the High Volatility of A-shares', *Caijing*, 18 May 2016.

[23] D. Fan, '90% Chinese Investors Lose Money: Retail Investors Suffered Losses of CNY 86,600 in Average', *Henan Business Daily*, 27 February 2015.