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Introduction

State Capitalism and the Chinese Economic Miracle

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A driver circling central Beijing on the Second or Third Ring Roads today passes scores of shiny modern towers, twenty or thirty stories high. The earliest of these towers, built in the 1980s and 1990s, were international hotels and foreign company offices. Since 2000, however, the bulk of the prestige projects and glass towers on the inner ring roads have been built by Chinese state-owned corporations. They stand like the ramparts of a mighty modern fortress where the ancient city walls once stood. To the east, they are mainly industrial companies, and to the west, predominantly financial. On the east side, when the sun is going down, you can see through the multistory glass atrium connecting the two halves of the China National Petroleum Corporation building, and see employees in the upper floor basketball court, seemingly playing in mid-air. For sheer display, though, nothing can match the towers of China Central Television, which bring a note of brutal elegance to the city. These buildings testify to the continuing, indeed increased, importance of state-owned enterprises in the Chinese economic model. The physical shape of Beijing increasingly exhibits the configuration of economic power in China, even as it asserts China's economic importance and modernity.

The prominence of state business in what is overwhelmingly a market economy inevitably raises questions about the nature of China's system. Among the global spectrum of political and economic models, which are most relevant to China's future? Is China following in the footsteps of its developmental state neighbors in East Asia? Or is the socialist rhetoric a façade for a reality more similar to the oligarchic capitalism seen in some other postsocialist countries? Or could it be that, as Chinese "New Left" intellectuals hope, a more equitable mode of government-shaped capitalism is going to be fashioned out of socialist values and institutions? To even begin to address these big questions, we need to understand much better the current configuration of government and business in China. This volume is based on the proposition that a reasonably stable and mutually reinforcing arrangement of political and economic institutions has now emerged in China, after almost fifty years of constant change in both Maoist and reformist China. Of course, the sustainability of China's economic achievements under state capitalism cannot be assumed. However, today's configuration has been sufficiently consistent since the early 2000s that a provisional assessment of some of the key aspects of the system can be attempted.

This volume focuses on the rise and remaking of Chinese state-owned businesses. State-owned businesses have always played an important role in the People's Republic of China, but since about 2004 there has been a renewed emphasis on the desirability of maintaining a strong and robust state sector for the long term. We provisionally call this system "state capitalism." No label is perfect, but the term "state capitalism" captures China's combination of a predominantly market economy, emerging capital markets, and large and important government-owned corporations. Moreover, "state capitalism" has a nationalistic connotation, which we believe is appropriate in the current Chinese political environment. The position of Chinese state capitalism in the spectrum of possible political-economic systems is discussed later in this introduction. The volume maintains an explicitly interdisciplinary perspective, combining history, economics, politics, and sociology. The context throughout is the Chinese economic growth miracle that followed 1978. Our overarching analytic task is clarifying the contents and implications of state capitalism in China's contemporary political economy.

I. THE EVOLUTIONARY TRAJECTORY OF THE STATE SECTOR

Until very recently, state-owned enterprises (SOEs) in China have been viewed primarily as an economic burden: How do we reform these inefficient dinosaurs? How can the financial system withstand their nonperforming loans? By contrast, this volume treats state-owned enterprises as an enduring feature of the Chinese economy, whose interests, evolution, and impact merit both micro- and macrolevel analysis. After 2003, the position and role of state firms stabilized, and, crucially, profitability soared. Central government control was rationalized for the largest and most important state firms, while smaller state firms continued on the "restructuring" path of commercialization and, for many, outright privatization. Today, understanding state firms is important for interpreting virtually every aspect of China's economy and politics.

The importance of state enterprises in China is not universally recognized. Many people prefer to treat state firms as if they had already become predominantly independent commercial entities, indistinguishable from profit-oriented firms in a capitalist economy.[1] For some purposes, that may be appropriate. However, for understanding the defining features of China's political economy,

[1] Consider, for example, Sull (2005), which discusses cases drawn from both state and private business but never mentions the potential differences between the two classes.

it most certainly is not. China is not transitioning teleologically from state socialism to market capitalism. Instead, reform-era China has developed a distinctive form of state capitalism in which state-owned enterprises remain central to its evolving model of political economy. The state retains direct control of strategic sectors, engages in industrial policy, and holds a dominant position in the banking sector and equity markets. At the same time, Chinese state capitalism emerged in the contemporary era of globalization, and it incorporates significant elements of today's globalized and financialized capitalism. Integration into global production networks, adoption of contemporary capitalist incentive systems such as stock options, and the widespread use of corporate restructuring techniques pioneered by American investment banks and buy-out funds all characterize China's system today. It is a twenty-first-century version of state capitalism, with similarities to systems in contemporary Brazil or Russia; different as these three countries are, they all have elements that can be labeled "contemporary state capitalist."

Given this context, contrasting perspectives on China's state sector today usually derive from different conceptions (or preconceptions) about the evolutionary process driving the state sector. Those who overestimate the prevalence of private firms often see ownership transformation as just one component of an inevitable march toward a market economy. This view is mordantly criticized by Yasheng Huang (2008) who points to the reality of government control in a number of businesses often mistakenly viewed as private, and the reinforcement of government ownership in some sectors in recent years. Each of the chapters of this volume contributes to a concrete understanding of the evolution of the state sector. None of our authors have a grand overarching theory of the evolutionary process, but all agree that it is not unidirectional and is composed of many intersecting political and economic factors.

The following sections thus highlight the key dimensions of this evolving complexity. First, at the macrolevel, considerable *sectoral variation* in state control and regulation can be observed. This differential management of industrial and commercial sectors reflects in part the government's *pragmatic approach toward competition*, as private and foreign businesses have been allowed to enter areas in which they have a comparative advantage. This pragmatism has also given rise to new patterns in the *corporate governance* of state firms with more technocratic managers and greater clarity in ownership rights. Ultimately, however, transparent governance is mediated by adaptive expansion of the *purposes of public ownership*, and enduring *political and ideological factors*. Taken together, these characteristics of the evolutionary process in public ownership present a stable yet politically constrained form of state capitalism that may yield decreasing economic returns over time.

Sectoral Effects on Evolution

The evolutionary path of state firms has a very strong sectoral component. SOEs control most of what used to be labeled the "commanding heights" of the economy. That is to say, SOEs dominate sectors that are either strategic, or not "naturally" competitive – meaning sectors frequently characterized by regulated monopolies or state ownership in many countries in the world. State ownership has been consciously and unconsciously adopted as an alternative to government regulation by Chinese policymakers. Pearson, in Chapter 2, shows that ownership and regulation have co-evolved, and that as a result, regulation and government–business relations both differ systematically according to economic sector. Pearson describes three "tiers" of the overall economy, each characterized by a distinctive pattern of regulatory institutions. The top tier, consisting of natural monopoly sectors and other strategic industries, has pervasive state ownership and weak and redundant regulatory institutions. Moreover, the state firms in the top tier are typically managed directly by the central government.

The concentration of centrally managed state firms in top-tier sectors is to some extent the direct result of the central government's policy in the late 1990s of "grasping the large and releasing the small" (*zhuada fangxiao*). All but the largest SOEs were restructured, merged, or shut down, but the largest firms were given renewed attention and their capabilities reinforced. Subsequently, the establishment of the State Asset Supervision and Administrative Commission (SASAC) in 2003 represented an important movement toward an "ownership agency" and further condensed the number of centrally owned state enterprises that constitute the Chinese economy's "commanding heights." Naughton, in Chapter 3, describes the creation of this important central government "ownership agency" and describes the concentration of its firms in Pearson's "top tier" of the Chinese economy. On establishment, more than two-thirds of SASAC's assets were in four sectors: oil and petrochemicals; electricity; telecommunications; and military industry. Since then, SASAC has sought to focus its large enterprises even more closely on their primary businesses. Given the volume's focus on the state sector, most of the following chapters analyze businesses in the top and middle tiers of the Chinese economy. Top-tier firms are also typically the firms that inspire international anxiety about China's growing economic prowess and geostrategic intentions.

In Pearson's "middle tier," where there are no natural monopolies and few strategic concerns, regulation is light and regulatory institutions close to nonexistent. State ownership has become much less prominent in those sectors in which production is efficient at a less than gigantic scale; in which entry barriers are modest; and in which no immediate national strategic interest is at stake. Middle-tier firms operate in important sectors, such as machinery and autos, chemicals, and pharmaceuticals, which are less immediately strategic or entwined with regulatory issues than are top-tier sectors. Middle-tier firms are exposed to global competition and, at the same time, these are sectors in which technological dynamism and relations with foreign firms are critical to China's future. As a result, the government tends to treat them with a light touch. Chapter 6 covers three middle-tier sectors – autos, construction machinery, and machine tools – and each shows dynamism and a mixture of ownership forms, including both national and foreign actors. Despite the state's relatively light touch, state ownership is by no means absent in these dynamic middle-tier sectors. The state firms in the middle tier are much more likely to be owned by subnational levels of government, such as provinces and municipalities. Individual state firms that have shown themselves able to survive competitive pressures, and which are viewed as having accumulated significant specialized expertise, are preferentially supported as potential national champions. Brandt and Thun, whose emphasis is on performance outcomes, show that in many cases these champions have achieved substantial medium-term success.

The "middle tier" is also where we see China's recent experiments in reviving "industrial policy." Industrial policies have less direct relevance in the top tier, where they are just one set of instruments that compete (and sometimes conflict) with hierarchically exercised control, budgeting and financial tools, and occasional ambitious planning targets. But in the middle tier, where local state firms mix and compete with private firms, China increasingly seeks to shape development and accelerate technologic improvement through industrial policies. The track record of those policies – such as the automobile industry mentioned by Pearson – has so far been extremely mixed, and the policies are controversial. Since 2009, when China stepped up support to state firms in response to the global financial crisis, there has been debate inside China about whether "the state is advancing at the expense of the private sector" (*guojin mintui*) since preferential government policies have given state firms apparent competitive advantages that private firms do not have. Also since 2009, China has launched a program of across-the-board support for the so-called strategic emerging industries, a list of cutting edge sectors – environmental, new energy, electronics, and machinery – that would make the most advanced economy proud. These are virtually all middle-tier sectors. If China were to attempt to implement the strategic emerging industries program predominantly through reliance on state firms, there would surely be many more failures than successes. However, Chinese policymakers try to combine selective reliance on large state firms with support for market-driven emerging private firms, and they have a chance of making good on a portion of their ambitious agenda. For now, the middle tier is strongly characterized by light regulation, competitive markets with an important role for state firms, and a nascent effort at governmental steerage through industrial policy.

State firms have largely retreated from Pearson's "bottom tier." The preponderance of businesses in China – small and medium enterprises – are in this bottom tier, which dominates the consumer-oriented, light manufacturing, and export-oriented sectors. The rise of private business in China is extremely important and in some respects even more compelling than the consolidation of state business. Private firms have developed new management systems and already have global impact in a number of areas (Tsui, Bian and Cheng 2006; Wagle, Gregory, and Tenev 2000). Moreover, the rise of private business and private wealth has created some pressures – but little actual mobilization – for political and social liberalization (Chen and Dickson 2010; Dickson 2008; Tsai

2007; Krug 2004). Since the existing literature treats private business in China extensively, and from a variety of disciplinary perspectives, we feel free to focus this volume on state firms, without thereby implying that any comprehensive perspective on China's economy, politics, and society can neglect the vibrant private sector.

Pearson shows that the bottom tier is predominantly private and that it has distinctive institutions of "social regulation," particularly those involved with health and food safety. Like the regulatory institutions in the upper tiers, bottom-tier regulatory bodies have a troubled history in China, but the context and challenges are quite different. The problem for bottom tier social regulatory bodies is their short histories, weak powers and information-gathering ability, and limited credibility. Moreover, the existing local power-holders compete for resources with new institutions, a situation that sometimes leads to "regulatory chaos" as new regulatory agencies have been layered on old supervisory bodies – which have not been dismantled. Local protectionism poses further challenges because subnational governments have economic incentives to be more lax in the area of social regulation (e.g., consumer protection and worker safety), given that local businesses generate local revenue. Scandals and tragic accidents carry more weight in disrupting local resistance by making social regulation a short-term political priority. This ongoing competition between local interests and broader social needs is also a major theme of Chapter 8 on nascent welfare institutions.

This sector-specific analysis disrupts expectations of another unidirectional trajectory, which was the hope that China would move steadily toward a "regulatory state." Dali Yang (2006) described the promising initial steps in this direction. The outcome has been rather different, and quite varied by sector (Hsueh 2011). State ownership has emerged as the most common alternative to regulation in the Chinese context, at least in the top tier. The airline regulator, for example, has achieved substantial improvement in airline safety, but by being a tough and authoritative "boss" rather than by establishing an arms-length relationship with the airlines. The financial sector regulators are by far the most competent and serious in the economy, and even here Pearson demonstrates substantial differences in capability and effectiveness. To a certain extent, the record on regulation represents the costs of China's otherwise fairly effective approach of gradualist reforms. Typically, existing organizations have been treated as bodies of expertise and have been repurposed to achieve new tasks. But in the field of regulation, this means old management bodies crowd the field and make it more difficult for new and independent regulatory bodies to establish themselves. This outcome may reflect pervasive short-termism, in which a short-run effective method of achieving one of the government's interests is utilized, at the expense of putting in place the institutions that would be much more effective in the long run. The lack of regulatory independence is certainly a characteristic of the Chinese system. In earlier work, Pearson (2005) pointed out that worldwide, no effective alternative to the model of the independent regulatory agency has emerged. Thus, it seems unlikely that China will be able to avoid reviving the earlier movement toward regulatory independence, probably in response to the inevitable scandals and accidents.

Competition and Pragmatism

The sectoral structure of ownership and regulatory institutions reflects the interaction between government efforts at control and the forces of market competition. Government firms were driven out of the bottom tier by the forces of competition. Before the epochal downsizing of the state sector in the late 1990s, the losses of loss-making state firms were predominantly incurred by small firms, most of which were in the consumer goods and light manufacturing sectors. Once the state "let go," those state firms were virtually eliminated by more competitive private firms. Conversely, in the top tier, the state never eliminated the entry barriers that protect incumbent state firms. This is most obvious in sectors like telecom operations and petroleum and gas extraction, where the state's monopoly is absolute, but it is also true to a lesser or greater extent in other sectors. In these top-tier sectors, state firms have been restructured and subjected to market competition, but only from a small number of other state firms, and in a carefully controlled manner.

In the middle tier, the interplay between market competition and government control is more subtle and complex. Brandt and Thun make clear in Chapter 6 the exact processes through which market competition is driving technological dynamism, which in turn is transforming Chinese industry. In sectors where government policy is more open to different forms of ownership, it becomes apparent that the size of China's domestic market creates considerable advantages for Chinese firms, and the competition for this market drives the creation of capabilities within the Chinese economy: Chinese firms (both state and private) must upgrade their capabilities in order to escape the intense competition in low-end segments, and foreign firms must localize activities and transfer technology to Chinese partners in order to be cost competitive. In the competitive middle-tier sectors, we see a concentrated version of a more general observation about the evolution of Chinese industry: much of China's economic dynamism comes from the pragmatic way in which different ownership forms are deployed in different economic sectors. China certainly seeks to support state firms, but it will accept, at times reluctantly, the dominance of private, including foreign, firms when the benefits are greater, and where the costs of supporting state firms is high.

Corporate Governance

The position of state enterprises in China's economy today reflects substantial improvements in their corporate governance. In its minimum form, this assertion should be unexceptionable. The fact that China's state enterprises have survived, and converted a condition of essentially zero aggregate profitability in the mid-1990s into large profits in the mid-2000s, indicates that corporate governance has become less inadequate, where it was once deeply inadequate. Even after taking account of the remaining market barriers and government preferences that tilt the playing field in favor of state-owned firms, there is no doubt that the remaining firms are far better managed than they were twenty years ago. Ownership rights are more clearly specified than before, and incentive systems have been clarified and rationalized. Managers are better educated than before and are much more familiar with the needs of a market economy. As Chapter 3 shows, the creation of SASAC at the central level was part of a drive to create better corporate governance institutions at all levels of the hierarchy.

Guthrie, Xiao, and Wang, in Chapter 4, go far beyond the minimum assertions about improving business management and argue that improved performance is being driven by a sea change in the overall philosophy of enterprise management in China's state sector. In their sanguine view, China's state firms have shifted from business management to asset management. As the government has comprehensively stepped back into the role of asset holder for the public, corporate managers have been given more freedom and also clearer direction about how to maximize value. The Chinese government seeks to maintain and increase the value of a range of public assets. It is not just SASAC: there are many organizations in China that serve as asset managers, including sovereign wealth funds and the public pension fund. For Guthrie, Xiao, and Wang, this is the fundamental shift that unites many specific improvements in corporate governance. They show, moreover, that this shift has an impact on the bottom line of performance, which improves when the asset manager's responsibilities are formalized.

Corporate governance reform is ongoing, though, and far from perfect. In some respects, corporate governance reform has been painfully slow (as Naughton shows in his discussion of SASAC's agenda). In a different sense, the governance of SOEs has evolved precisely to fit the interests of the "principals," the party-state hierarchy that rules China. While those "principals" prioritized economic reform in the 1990s, they have begun to ask different things from state firms in recent years (see following section). One simple generalization might be that the governance system protects the interests of "insiders" while providing points of access and influence for outsiders (without, however, giving outsiders legally defensible rights). Dylan Sutherland and Lutao Ning, in their extremely innovative analysis, describe the emergence of pyramidal business groups with multiple tiers of listed companies. In these pyramids, the state retains majority ownership at the apex of the pyramid, while minority shareholders provide the bulk of financing for lower-tier subsidiaries. While this system of pyramidal control has many parallels in the structure of private business groups throughout the capitalist world, it is also unique in the sense that the controlling interest in China is "the state." An interesting question for future research is, "Who exercises the state's control in a typical pyramidal business group?" In other words, who are the insiders? Should these be analyzed in terms of the Communist Party managed hierarchy, or should they be conceptualized in terms of interest groups that work through the party/government structure?

The improvement in Chinese corporate governance coincided with a wave of disillusionment with the U.S. model of corporate governance following the global financial crisis of 2008–9. Developing country policymakers are now willing to give further scrutiny to the experience of state-owned firms, particularly in China, and analysts in developed countries are less dismissive. The world is watching China to see how successful its unique institutions can be. Since the governance system shapes incentives, behavior, and productivity in complex ways, it will be crucial in determining the sustainability of the Chinese economic miracle and the level of performance and productivity that the system can support.

The Purposes of Public Ownership: Is there "Mission Creep"?

We argued earlier that the position of state enterprises has stabilized, and the role that state firms play in the overall economy has changed in important ways. An essential corollary of this view is that the purposes of public ownership have also changed. For decades, the justification for public ownership was essentially "stability." That is, state firms were only slowly privatized and restructured because the public ownership form provided a way to buffer urban workers from the deleterious effects of overly rapid change. The justification for state firms was that their excessively rapid disappearance would leave workers unemployed and unprotected by a social safety net during a period of disruptive change. Some argued that public ownership combined the productive enterprise with a social welfare function in a way that suited China's transitional needs (Lin, Cai, and Li 1998). This justification made sense during the 1990s, but now that social welfare institutions are being put in place (see Chapter 8), and their responsibilities hived off from enterprises, this justification is irrelevant. Moreover, today's state firms employ a small proportion of the urban labor force, and overall unemployment is low. What, then, is the point of having state-owned firms?

In fact, political leaders have developed new justifications for state firms, which have been emphasized with increasing vehemence in recent years. Security – including traditional national defense and now "economic security" as well – is increasingly invoked as a rationale for public ownership. Government control of telecommunications is routinely justified on these grounds. More broadly, China's state-owned resource giants have been drafted into service in supporting China's energy and resource security. The state oil companies seek to diversify China's petroleum resources. Of course, this is not inconsistent with their goals as profit-oriented corporations. Diverse forms of security are now a crucial part of the justification for public ownership.

In general, it seems that China's leaders are happy to use state firms as instruments for a variety of policy goals (as Naughton argues). This may reflect a certain "mission creep," as leaders assign new missions to existing agents, given that they are already on the ground in any case. Most obviously, China's state-owned firms are being ordered to become technologically dynamic, foster the adoption of "indigenous innovation," and lead China on its way to becoming an innovative society. Are SOEs well suited to this task? Few people actually think so. But SOEs are there, they have resources, and they have organizations in place. So it is not surprising that leaders use them as convenient instruments to achieve political goals, particularly given that they assign enormous long-run social and economic importance to those goals.

Political and Ideological Factors

Each of our authors acknowledges the importance of purely political factors, and in particular the continuing importance of the Communist Party, its history, and its hierarchy intertwined with the government and business hierarchies. Chapter 7 points out that state firms have deep roots in China's historical experience, and that the pre-1949 Nationalist government on the mainland was nearly as committed to state enterprise and national planning as was the post-1949 Communist government. Bian reminds us that state firms can draw on some reservoir of goodwill among the Chinese population because of a tendency to see them as part of a national response to crisis over the past century. Unlike in the United States, where there is an instinctive antipathy to government firms, SOEs in China are widely seen as having a legitimate place in the Chinese economy. Exactly what that place should be – and how large a share of the total economy those firms should have – remains highly contested in China. But no matter what direction economic policy takes over the next few decades, a significant state firm presence will almost certainly continue to be a defining feature of China's political economy.

Today, although the state sector has undergone substantial organizational restructuring and downsizing, the party-state continues to view state enterprises as tools of not only government policy but, arguably, regime identity and legitimacy. State firms remain at the core of what Beijing officially calls "market socialism with Chinese characteristics." In other words, the emerging Chinese system is not simply "state capitalism"; it is a peculiar strain of Communist Party–managed state capitalism (cf. Lin 2011). To be sure, the Chinese Communist Party has discarded most (but not all) of the Marxist and Maoist dogma to which it once adhered. The Communist Party hierarchy has not merely endured: it has been revitalized and in some ways strengthened as it remakes itself into a "governing party" and steward of the nation's assets. The Communist Party has managed an astonishing comeback as it remolds itself into a professionalized human resources department of the economy. David Shambaugh (2009) outlines many of the steps of this painstaking reinvention. From this standpoint, state-owned firms have emerged as a crucial component of a