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I. INTRODUCTON

The increasing economic globalization over the past two decades has raised considerable concern over the competitive capacity of public enterprises, which has, in turn, imposed pressure on the public sectors of all systems.[1] Thus, starting in the 1980s and prevalent in the 1990s, a new wave of liberating or commercializing public enterprises has occurred in many jurisdictions. This process involves the application of private sector management techniques and structures to public enterprises. The strategies of commercialization include corporatization, a scheme of approximating the private sector model of incorporation within the context of public ownership, and privatization, a scheme of total adoption of the private sector model by selling public ownership to private hands.[2]

The spread of the practice of commercializing the public sector is due to the following factors. First, corporatization and privatization have been widely promoted in the former socialist countries and some East-Asian economies as part of their reform packages to counteract the failures of their

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[1] Roger Wettenhall, *The Globalization of Public Enterprise: Some Australian Evidence*, 51 AUSTRALIAN J. PUB. ADMIN. 184 (1992). *See also* Randall Baker & Julie Bivin Raadschelders, *The Public Administration of Intellectual Sovereignty*, 49 AUSTRALIAN J. PUB. ADMIN. 77-80 (1990).

[2] *See* John H. Farrar & Bernard McCabe, *Corporatization, Corporate Governance and the Deregulation of the Public Sector Economy*, 6 PUB. L. REV. 24 (1995).

former highly interventionist systems.[3] Second, many developed countries have embraced the idea of increasing the economic efficiency of their public sectors by introducing an incentive environment, similar to the one in the private sector, into the public sectors.[4] Third, the World Bank has pushed hard for urging countries to take steps to privatize their public enterprises.[5]

Although the enterprise reform in China has its own causes, it conforms to the current movement of commercializing public enterprises in a global sense. Thus, over the course of its enterprise reform, China has the advantage of drawing lessons and gaining wisdom from the experience of other jurisdictions. Consequently, China may achieve two goals, commercializing its public sector and standardizing the practice of its corporatized enterprises, at the same time. Meanwhile, the Chinese enterprise reform will provide an interesting case for comparative study, since the country is pioneering a different path in the process of corporatizing and privatizing its public enterprises, i.e., by retaining the dominance of public ownership.

II. THE RATIONALITY OF CORPORATIZATION AND PRIVATIZATION

A. The Economic and Political Rationality of the Existence of the Public Sector

Before understanding the rationality of corporatization and privatization of the public sector, it is necessary to explore the rationality of the existence of the public sector in different systems. Why have most systems retained some degree of public ownership in their national economies in the first place? Will the current commercialization of the public sector lead to the extinction of the public sector in any jurisdictions?

The biggest public ownership regime in modern history existed in the former socialist countries. Those countries established their socialist economies according to the economic model advocated by Marxist literature. The prominent characteristics of the socialist economy were the domination of public ownership and administration of the national economy in accordance with economic plans. According to Marxism, the highly concentrated private ownership and the highly socialized production constitute the uncompromising contradiction of the capitalist system, which inevitably hinders the development of the productive forces of society.[6]

[3] *See* IAN DUNCAN & ALAN BOLLARD, CORPORATIZATION AND PRIVATIZATION: LESSONS FROM NEW ZEALAND 5 (1992).

[4] For example, the USA, the UK, Canada, New Zealand and Australia all embraced the practice. *See* Wettenhall, *Public Enterprise in an Age of Privatization*, 69 CURRENT AFFAIRS BULL. 4-12 (1993).

[5] *Id.* at 4-5.

[6] *See* KARL MARX, CAPITAL, 10-94 (1867).

Ultimately, socialist and communist systems will replace the capitalist system, in which public ownership combined with the heightened productivity achieved by capitalism will serve the common good of society.[7]

Since the rise of the former Soviet Union, many countries in Eastern Europe and Asia embraced communist doctrines by establishing communist governments. As a result, all these countries adopted the planned economy system based on the domination of public ownership. However, each of these countries experienced economic stagnation under the planned economy system. In the late 1970s, China pioneered economic reforms by switching to a market economy. Since the 1980s, most East bloc countries have launched their own political and economic reforms. This has resulted in the decrease of the proportion of public ownership in these countries' economies. All the reforms had the aim of increasing the proportion of the private sector in the economies. However, few had the objective of delivering a total extinction of the public sector. The reason is simple: the public sector has an irreplaceable role in all economies.

The public sector in every economy has the function of assisting the government in assuring public accountability and consistency in public policy.[8] Moreover, public enterprises are used to ensure the accomplishment of national goals.[9] In a non-socialist system, the government usually uses public enterprises as legal and social instruments for the public control of basic industries in an economy still based on private enterprises.[10] During and after World War I, with the rapid expansion of government responsibility for social and economic programs, the number of public enterprises in Western countries increased significantly.[11] In some countries, this expansion was achieved by extensive nationalization of the basic industrial sectors.

There are different types of public enterprises. At the one end, there are the public enterprises that exist in the form of an organization on the same basis as other government activities.[12] At the other end, there are the public enterprises taking the form of autonomous corporations with almost complete freedom from executive and legislative controls.[13] In the middle, a public enterprise may take the form of a public corporation, subject to

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[7] *Id. See also* RICHARD PIPES, PROPERTY & FREEDOM 55 (1999).

[8] Harold Seidman, *The Government Corporation: Organization and Controls*, 14 PUB. ADMIN. REV. 183 (1954).

[9] LLOYD D. MUSLOF, PUBLIC OWNERSHIP AND ACCOUNTABILITY: THE CANADIAN EXPERIENCE 5 (1959).

[10] W. Friedmann, *The New Public Corporations and the Law*, 10 MOD. L. REV. 233 (1947).

[11] Seidman, *supra* note 8, at 184.

[12] *Id.* at 183.

[13] *Id.*

specially devised executive and legislative controls.[14] Corporatization in this context usually refers to corporatizing public enterprises of the first category. Sometimes, it may extend to include the third category by further introducing corporate mechanisms into those enterprises.

Unlike a private firm that exists for maximizing the economic interests of its owners, a public enterprise is created to perform social objectives or to serve public purposes. Sometimes, the social goals may be achieved at an economic cost. Thus, in Western countries, despite the good that public enterprises have provided for the community, there have always been debates about the economic efficiency and the quality of the services delivered by public enterprises. There have also been substantial reports about the waste of the taxpayers' money caused by lack of managerial accountability and bureaucracy in the public sector in every system.

Efforts have been made to tackle the problems that existed in the public sector. The basic methods of curtailing the excessive bureaucratic control include introducing corporate autonomy into the public sector or abandoning the control altogether.[15] However, a high degree of autonomy and privatization means abandoning the existing controls of ensuring public accountability and responsiveness without providing adequate substitutes.[16] Hence, corporatization has been regarded as a more appropriate reform strategy, which could serve the purposes of limiting excessive autonomy and retaining political controls for promoting the public interest.[17] The logic behind this entails the following: if public ownership is inevitable, then it is wise to make a public enterprise as much like a private enterprise as possible.[18]

There have been many waves of corporatization of public enterprises to provide operational conditions of corporate flexibility and autonomy. Sometimes, these waves have been followed by counter waves of efforts to curtail excessive autonomy in the form of restorations of governmental control, which seek to ensure that the public interest is served in a real sense.[19] The current move of commercialization of public sectors in a global sense is triggered by a number of combined forces, including the increasing acceptance of economic liberalization, the collapse of the former planned econo-

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[14] *Id.*

[15] Roger Wettenhall, *Public Administration Newspeak*, 66 CURRENT AFFAIRS BULL. 14 (1990).

[16] Seidman, *supra* note 8, at 184.

[17] See DAVID E. LILIENTHAL, *TVA:* DEMOCRACY ON THE MARCH 53 (1944). *See* Wettenhall, *supra* note 15, at 15; Roger Wettenhall, *Corporations and Corporatization: An Administrative History Perspective*, 6 PUB. L. REV. 14-15 (1995).

[18] G. N. Ostergaard, *Labour and the Development of the Public Corporation*, 22 MANCHESTER SCHOOL OF ECONOMIC AND SOCIAL STUDIES 193 (1954).

[19] Wettenhall, *supra* note 17, at 15.

mies and the particular problems faced by public sectors in different systems.

B. The Economic Rationality of Corporatization and Privatization

A notable characteristic of the current movement of corporatization and privatization, which started in the 1980s, is that it has been under the influence of new economic literature regarding agency theory of the firm.[20] In this new move of commercialization, countries such as New Zealand and Australia have taken the lead. The public sectors have played an important role in the economic development of both countries.

According to agency theory, a principal-agent relationship exists where a party is entrusted to do a particular job on behalf of another party.[21] The former is the principal and the latter becomes the agent. The cost of using an agent is called the agency cost. This is because the interests of the agent are not necessarily identical to those of the principal. While the principal expects to extract maximum gains from the agent's activities, the agent may pursue extra benefits for itself from the job.

There are a number of terms describing the agent's abuse of its position, including shirking, slacking and theft.[22] The agent is able to do so because it is the party who has all the information relating to the job. The principal certainly wants to reduce such a cost. The measures adopted basically include bonding strategy and monitoring strategy. Bonding strategy is about to ensure the convergence of the principal's interests and the agent's interests by introducing incentive schemes.[23] Monitoring strategy means to introduce supervisory schemes to closely watch the performance of the agent in order to reduce or eliminate the opportunity of abuse of power by the agent.[24] However, these strategies also generate costs, which form part of the agency cost. The principal wishes to adopt these strategies, only when the adoption of them will reduce the overall agency cost.

High agency costs associate with the operation of the public enterprise. The agency problem that arises from the separation of ownership and control becomes more severe in a public enterprise. First of all, a public enterprise usually faces the problem arising from lack of well-defined property rights in its equity.[25] The economic behavior and performance are affected

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[20] *Id.*

[21] Michael C. Jensen & William H Meckling, *Theory of the Firm: Management Behavior, Agency Cost and Ownership Structure*, 3 J. FIN. ECON. 308 (1976).

[22] *Id.*

[23] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 10 (1991).

[24] *See* Jensen & Meckling, *supra* note 21.

[25] Eirik G. Furubotn & Svetozar Pejovich, *Property Rights and Economic Theory: A Survey of Recent Literature*, 10 J. ECON. LITERATURE, 1137-62 (1972).

by the manner of how the property is held, used and organized.[26] Where property rights are clear and well defined, the economic goals of the firm is likely to be clear, the costs of using economic incentives and monitoring mechanisms are likely to reduce and the economic efficiency of the firm is likely to increase.[27]

Although the State (or Crown in a commonwealth country) is defined as the residual claimant of the property of a public enterprise, the claims over the enterprise's property are either held by one or more government departments or ministers. As a result, it is not the owner but the agent of the owner who is in the position of exercising the property rights. Compared with a private owner of a private firm, the incentives of the government agent to drive for wealth creation in the public enterprise is weaker,[28] not to mention that a public enterprise is likely to entangle commercial objectives with other social goals.

Moreover, some of the monitoring mechanisms available to a private corporation are not available to a public enterprise. For example, a dissatisfied owner may sell his or her shares in the stock market. However, the property or shareholdings of public enterprises are usually not tradable. The government may want to devise some new incentives and monitoring mechanisms specially applicable to public enterprises. However, the result of the practice is not encouraging and sometimes, the cost may exceed the benefit.

Compared with the enterprise structure in the public sector, the modern corporate structure of the private sector is regarded as more adept in reducing the agency cost. A corporation, by assuming independent identity, obtains a bundle of clearly defined property rights over its property. It shields owners from liability and allows them to transfer their ownership. As a result, an external market for corporate control has been developed, which brings the accountability of management in line with the owners' interests.[29] Furthermore, by allocating powers among the major participants, the corporation offers an efficient internal structure to curtail the agency cost.[30] Because the modern corporation possesses the above merits, it has been employed by different systems to facilitate their economic reforms of restructuring their public enterprises in recent decades.

The difficulty of reforming the public enterprise does not lie in the adoption of the corporate form, but in realizing the economic efficiency of the public enterprise by embracing the corporate structure on the one hand

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[26] BARRY SPICER ET AL., TRANSFORMING GOVERNMENT ENTERPRISES 13 (1996).

[27] *Id.*

[28] *Id.* at 187.

[29] Magdi Iskander, *Improving State-Owned Enterprise Performance: Recent International Experience*, *in* POLICY OPTIONS FOR REFORM OF CHINESE STATE-OWNED ENTERPRISES 35 (Harry G. Broadman ed., 1995).

[30] *Id.*

and retaining public ownership on the other. A public-owned corporation could never become identical with a private-owned corporation. It is also unlikely to achieve the economic efficiency that a private corporation can achieve, as it cannot replicate all the benefits of a private corporation.[31] Therefore, if privatization indicates the full acceptance of the corporate structure at micro-economic level, corporatization only goes half way toward that direction. In other words, corporatization, at most, means creating a maximum degree of similarity with the corporate form of the private sector in corporatized public enterprises. Nevertheless, in the case where public ownership is determined to be reserved, corporatization is a step in the right direction.

III. CORPORATIZATION AND PRIVATIZATION IN CHINA

A. Massive Privatization Is Not Preferred

Although the public sector has played an important role in nation-building in many Western systems, there has been no ideological drive to sustain it, nor did it win the emotional allegiance of the people.[32] The situation in socialist countries has been different. Public ownership has been upheld as the final goal of human achievement. Public ownership is also regarded as the premise of delivering the common good and realizing high social values such as social justice, freedom and equality. With the collapse of the Soviet Union and other socialist countries since the 1980s, the reformist governments of many of these countries have abandoned the belief. As a result, privatization has been promoted aggressively in these countries.

By contrast, the economic reforms in China have followed a different path. The historical significance of public ownership and the contribution of state-owned enterprises to the nation's development have never been officially denied. The attachment of the public to public ownership has been strong.

In China, it is still a popular view that public ownership is superior to private ownership. People having this view believe that, in the course of the economic reforms, it is crucial to maintain social stability.[33] The economic reforms are means but not ends. The principal goal of the economic reforms is to develop the economy and improve people's living standards. In other words, the goal is to realize a common enrichment in China. For this purpose, there is the need to uphold social justice. As public ownership is the economic foundation of social justice, it is necessary to maintain the

[31] Michael Taggart, *Corporatization, Privatization and Public Law*, 2 PUB. L. REV. 80 (1991).

[32] MUSLOF, *supra* note 9, at 24-25.

[33] *See* Sun Sangqing, *The Dominance of Public Ownership is the Foundation of Fairness*, JINGJI CANKAO BAO (September 24, 1994), at 3.

dominance of public ownership in China. If the dominance of public ownership is eroded in the process of the economic reforms, polarization will become inevitable. This will result in the exacerbation of all types of conflicts including conflicts between different areas, different levels of governments, and different ethnic groups, and bring a disastrous outcome.

This ideological concern was a major factor responsible for the delay of introducing the "big bang" enterprise reform package. When the rural sector underwent a full-scale reform in the late 1970s and the early 1980s, the enterprise reform just made an experimental move. The reason why the reform in the rural sector was carried out aggressively was because the reform did not shake the ideology of public ownership supremacy. The Chinese land system allows the country to retain the ownership over land on the one hand and confers the right to use the land to farmers on the other. In the case of the enterprise reform, it was made clear that the enterprise reform should not challenge the foundation of public ownership. Thus, at an early stage, the enterprise reform effort only focused on decentralizing governmental authority in enterprises and on increasing the operational autonomy of enterprise managers.[34] Less radical reform measures such as the Contract Responsibility System, leasing and giving managers greater autonomy over allocating profits and resources were implemented in state-owned enterprises. However, the implementation of these strategies did not bring the expected outcomes.

The thought of reforming state-owned enterprises through corporatization came as early as in the early 1980s.[35] At the beginning, the idea caused considerable arguments. Some rejected this suggestion. They believed that corporatization would inevitably lead to privatization. They held that corporatization would dilute public/state ownership in state-owned enterprises, as selling the shares of state-owned enterprises to individuals could amount to selling state property to private hands.[36]

The ideological debate over corporatization became a major topic of economic, legal and political literatures from the mid-1980s to the early 1990s. During this period, policy makers took a cautious but firm stand in promoting corporate practice. Adjustments were made in corporate trials and efforts were made to improve the environment for corporatization. From 1990 to 1991, two stock exchanges were established in Shanghai and Shenzheng. In 1993, the People's Congress passed the first corporate code, the *Company Law*. The law has come into effect since July 1994. In 1997, the Fifteenth National Congress of the Communist Party of China made it clear that China would reform its state-owned enterprises through corpora-

[34] JIANMIN DOU, RESEARCH ON THE HISTORY OF CORPORATE IDEOLOGY IN CHINA 184 (1999).

[35] *Id.* at 108.

[36] See the remarks made by Guo Cai in WENMIN ZHANG, THE GREAT ECONOMIC DEBATE IN CHINA 133-34 (1997).

tization. The government's determination finally brought the debate on whether or not to reform the state-owned enterprise through corporatization to an end.

B. Approval for Reforming State-Owned Enterprises Through Corporatization

As mentioned, the decision of commercializing state-owned enterprises has taken a long time to be finalized. In this process, Chinese policy makers and intellectuals carefully studied modern corporate theories and the international experience of corporatization and privatization.

A literature on reforming state-owned enterprises through corporatization was initiated in the early 1980s and has become full-fledged after the enactment of the 1994 *Company Law*. Many discussions directly used modern corporate governance theories including corporate property theories and the agency theory to examine problems encountered by state-owned enterprises. In this literature, the rationality of the governance structure and norms in the modern corporate system were firmly recognized. Under this premise, the deficiencies of state-owned enterprises were found as follows:

Firstly, the ownership structure of state-owned enterprises did not facilitate the economic efficiency of the enterprises.[37] From a conventional view, the right of ownership was an absolute right that consists of a bundle of rights including residual claimant rights, the right of disposition, the right of control, and the right to interest.[38] This meant that the owner of the property had a complete and absolute right over the property. Such an absolute ownership right existed in a classic firm. The owner(s) of such a firm had the absolute right over his or her property.[39] However, in a corporation, the classic concept of absolute ownership right no longer applied. While shareholders had residual claimant rights over the property, the right to use and dispose of property was exercised by salaried managers.[40] According to modern corporate theory, the role of the manager was an agent in nature, and it was normal for a principal and an agent to have different interests.[41] Instead of maximizing the interests of the principal, the agent was likely to pursue other interests including their personal interests. The reason that a corporation could survive and develop lay in the fact that the modern corporate system exerted certain mechanisms to restrain the divergence of interest and bring the agency cost down to a reasonable degree.

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[37] *See* SHENSHI MEI, RESEARCH ON THE STRUCTURE OF MODERN CORPORATE ORGANIZATION'S POWER: A LEGAL ANALYSIS OF CORPORATE GOVERNANCE 32-37 (1996).

[38] ADOLF A. BERLE & GARDNER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 311 (1991).

[39] *Id.*

[40] *Id.* at 8-9.

[41] *See* ARTHUR A. THOMPSON & JOHN P. FORMBY, ECONOMICS OF THE FIRM: THEORY AND PRACTICE 260-61 (1993).

An important mechanism was to balance powers among the internal organs of a corporation. As a result, shareholders exercised their controlling power through the supervisory role of the board. However, in a state-owned enterprise, the owner of the enterprise was the State or the people as a whole. In reality, it was not practicable for the people as a whole to exercise monitoring functions in an enterprise. In other words, it was impossible for the owner, the people as a whole, to have real presence in the enterprise.[42] Hence, in such an enterprise, there was no sufficient supervision and control over the management from the owner.[43]

Secondly, the State played multiple and conflicting roles in a state-owned enterprise. The State was the owner, supervisor, manager and creditor of an enterprise at the same time. Moreover, the State exercised macro-economic functions including the social, regulatory and policy making function on the one hand, and engaged itself in micro-economic activities on the other. These two roles are inherently conflicting. The macro-economic role required that the State should concern itself with the overall economic performance of all enterprises; and the micro-economic role required that the State should only concern itself with the performance and economic efficiency of the particular enterprise.[44] Therefore, to break such an integration of conflicting roles was essential in relation to making the enterprise focus on the interests of its own.[45]

Thirdly, there were no discipline and incentive mechanisms for the managers of state-owned enterprises to maximize the economic efficiency of the enterprises. A manager of such an enterprise was a government official who had no authority to run the enterprise independently and was not personally liable for the failure in business decision-making. The administrative department, not the interested groups of the enterprises, decided the appointment and promotion of a manager.[46]

From the above analyses, it was concluded that to introduce corporate mechanisms into state-owned enterprises was necessary in relation to improve the economic performance of the enterprises. Public ownership was regarded as tenable by establishing state-owned companies or state-controlled companies. It was understood that the ownership right over a corporation was different from the ownership right over corporate prop-

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[42] The State (or the whole people) has to use agents.

[43] Relevant administrative personnel or institutions exercise this function. However, there are no incentives for these personnel and institutions to fulfill their duties diligently. Moreover, these people and institutions bring administrative interference, which violate economic rules.

[44] See Yiwei Jiang, *The Theory of an Enterprise Based Economy*, 1 ZHONG GUO SHE HUI KE XUE 29-36 (1980).

[45] *Id.*

[46] *See* MEI, *supra* note 37.

erty.[47] As the owners of a corporation, shareholders exercised their ownership rights in a different fashion.[48] They could not directly dispose of corporate assets, but had the right to vote on decisions over corporate affairs. By investing in the corporation, the shareholders received share ownership rights. Share ownership rights included the rights to receive dividends, to vote on important matters of the corporation, and to claim residual profits and assets upon termination of the corporation. Shareholders' voting rights were an efficient and important monitoring instrument.[49] It was the residual power to make decisions over corporate affairs.[50] Therefore, it was believed that, after corporatization, state ownership could still exist in the corporatized enterprises. A more sanguine view was that corporatization would strengthen state ownership as a whole, because by exercising the controlling shareholder's rights in the enterprises, the State's overall capacity to control and utilize capital would be enhanced.[51]

Today, it is generally perceived that, for the sake of economic efficiency, it is desirable to have different shareowners in corporatized state-owned enterprises. This is because a company with the State as the only shareholder may not easily overcome the problem of administrative interventions, which happened in the past. Thus, it is advantageous to invite other corporate and individual shareholders to take a part in the company's affairs.[52] The participation of outside shareholders can enhance the supervisory capacity of shareholders. Hence, many suggest that only those state-owned enterprises that are important to the national economy should be reformed into state-owned companies. The rest of them, except a small number of them that are subject to privatization, should be corporatized as state-controlled or state-invested companies, where the State holds controlling shareholdings or non-controlling shareholdings.[53]

C. The Development of Corporatization and Privatization in China

In 1997, the Fifteenth National Congress of the Communist Party of China sketched out the blueprint for the enterprise reform. The Congress confirmed that the next stage of the economic reforms should focus on reforming large and medium-sized state-owned enterprises into modern corporations so as to set up the modern enterprise system in China. Corporatization and privatization of state-owned enterprises are to be carried out at an ever-large scale.

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[47] Jinlei Shi, *The Protection of Share Ownership Right*, 1 FA LU KE XUE 49 (1997).

[48] *Id.* at 49-50.

[49] *See* EASTERBROOK & FISCHEL, *supra* note 23, at 70-72.

[50] *Id.* at 66.

[51] Li Yining, *The Thought on Ownership System Reform*, PEOPLE'S DAILY, Sept. 26, 1986, at 2.

[52] XIANGYI XU, ORGANISATION AND MANAGEMENT OF MODERN COMPANIES 180 (1999).

[53] *Id.* at 118-23.

In September 1999, the Fourth Plenum of the fifteenth CPC Central Committee further defined the major objectives and guiding principles for the reform and development of state-owned enterprises. According to the *Decision of the CPC Central Committee on Major Issues Concerning the Reform and Development of State-Owned Enterprises*, the objectives for the state-owned enterprise reform and development up to the year 2010 are: completing strategic readjustment and restructuring, bringing into form a more rational layout and structure of the national economy, establishing a relatively perfect modern corporate system, improving economic performance, remarkably promoting scientific and technological development, market competition and risk management, and making the state economy play a better, dominant role in the national economy.[54]

The guidelines for the reform and development of state-owned enterprises include: maintaining public ownership as the dominant form; strategically readjusting the layout of the state economy and restructuring state-owned enterprises; establishing a modern corporate system; and fostering a competitive mechanism of survival of the fittest.[55]

Under the current policy, except some important sectors, public ownership can be reduced to non-dominant proportion.[56] As later official documents clarified that state-owned enterprises will remain the dominant position only in the following industrial sectors: (1) pillar industries and backbone enterprises in high technology sectors; (2) non-renewable natural resource sectors; (3) public utility and infrastructure service sectors; (4) sectors vital to the country's national security.[57] This has shown the government's determination to introduce a diversified ownership structure into the enterprise system, so as to bring in outside competition into state-owned enterprises.

At a time when China decided to draw lessons from the international experience of public enterprise reforms and to apply them to the Chinese practice, China joined the global movement of commercialization. Like many other countries, China has embraced the new economic literature as the theoretical guidance, and has striven to introduce the internal and external incentives applied by the modern corporation into its enterprise sys-

[54] *See* Decision of the CPC Central Committee on Major Issues Concerning the Reform and Development of State-owned Enterprises (Sept. 22, 1999).

[55] *Id.*

[56] The Fourth Plenum of the Fifteenth Party Central Committee clarified this policy in a 1999 decision; the State Development Planning Commission also issued a clarification statement in 2000. *See* Harry G. Broadman, *China's membership in the WTO and Enterprise Reform: The Challenges for Accession and Beyond*, SSRN JOURNAL, *available at* http://papers.ssrn.com/paper.taf?abstract_id=223010, at 3-6 (last visited Jan. 20, 2002).

[57] *Id.*

tem.[58] The objectives of the Chinese enterprise reform at the microeconomic level include:

> (1) Separating government from enterprise operations, including the introduction of "hard" budget constraints and market-based governance systems;
>
> (2) Restructuring state-owned enterprises in terms of their social burdens, financial and employment structures, physical plant and equipment and managerial systems; and
>
> (3) Enhancing the enabling environment for non-state enterprises to participate in the market.[59]

Looking at international experience, one finds that the above objectives, as the basic goals of commercializing the public sector, can apply universally. For example, the Minster for Finance of New Zealand announced five general principles for reorganizing the country's state trading activities in 1985. They were: (1) Non-commercial functions would be removed from trading organizations; (2) Managers would be required to run the trading organizations as successful businesses; (3) Managers would be responsible for using inputs, for pricing and for marketing products within performance objectives set by Ministers; (4) The enterprises would be required to operated without competitive advantage or disadvantage so that commercial criteria would provide the assessment of managerial performance; (5) Enterprises would operate under the guidance of boards modeled on private sector organizations.[60] Although there are differences in detailed focus, the basic contents of the reform agendas of the two countries are comparable.

In relation to the task of separating the government from enterprise operations, in 1988, China established the Administrative Bureau of State Assets, which exercises the function of the owner of state property. This arrangement is designed to separate the government's role of administrative control and its role as the owner of state assets.[61] The Administrative Bureau of State Assets decides to increase or reduce its shareholding in different state-owned or controlled companies according to their share performance in the securities market. It delegates the responsibilities to its

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[58] *See* Qiangui Jiang, *State Asset Management Reform: Clarified Property Rights and Responsibilities*, *in* POLICY OPTIONS FOR REFORM OF CHINESE STATE-OWNED ENTERPRISES, *supra* note 29, at 91-100. *See also* Jia Heting, *On Corporatization of Enterprises and Corporate Governance*, *in* POLICY OPTIONS FOR REFORM OF CHINESE STATE-OWNED ENTERPRISES, *supra*, at 109-20.

[59] *See* Harry G. Broadman, MEETING THE CHALLENGE OF CHINESE ENTERPRISE REFORM 32 (1995) (summary of the Chinese government's development agenda).

[60] Wettenhall, *supra* note 19, at 9.

[61] Jiang, *supra* note 58, at 93.

agents in different state-owned or controlled companies according to the share sizes and share structures of those companies.[62]

However, the Bureau only exercises the function of supervising the use of state assets. It does not take part in the management of state assets – a task that it delegates to state asset management companies.[63] It is understood that the managing companies take the form of a corporation and are subject to the supervision of the Administrative Bureau of State Assets. There is not an official model for the establishment of management companies. Academic discussions have recommended three methods of structuring these institutions. Firstly, the State can turn some existing large enterprises or holding companies into state asset management companies. Secondly, the State can authorize the government departments in charge of different industrial sectors or the "general companies" of different industrial sectors to exercise the function of management companies.[64] Thirdly, the State can also authorize local governments to turn some local state-owned enterprises into management companies. The third method is designed to reduce the possibility of trade monopolies that the first two methods may bring. At present, the three methods are all adopted in practice.[65]

In terms of restructuring social burdens, financial and employment structures, physical plants and equipment, and managerial systems of state-owned enterprises, corporatization and privatization provide effective mechanisms for ensuring that the restructured enterprises will be able to combine capital and labor efficiently. Restructuring state-owned enterprises requires the management of the enterprises to have clear objectives. It also requires increasing the managerial autonomy of the enterprises, so that the management has the liberty to make decisions on allocating resources and to market products. To fulfill these tasks, apart from commercializing the enterprises, a range of policy support is needed. The government should provide mechanisms that enable the enterprises to pass many of their social service burdens to the government who will finance these services through public revenues. The government should also provide policy guidance and financial support for creating a favorable environment for a market economy, which allows enterprises to freely consolidate, diversify, exit and engage in asset sales and purchases and enable them to shed redundant labor and recruit high quality employees in the labor market.

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[62] Xu, *supra* note 52, at 114-15.

[63] Jiang, *supra* note 58, at 58.

[64] The general company is another unique aspect of China's enterprise system. It is also a remnant of the old system. In the past, different industrial sectors were administered by different government departments or general companies that were not "modern" in the current sense. These general companies are administrative organizations of the government and exercise functions similar to state administrative departments.

[65] Jiang, *supra* note 58, at 95.

The policy of enhancing the environment for non-state enterprises to participate in the market is aimed at removing all the policy disadvantages and advantages associated with state-owned enterprises, so as to create a commercial environment where all types of enterprises will compete fairly.[66] Thus, the managerial accountability and performance of the enterprises can be assessed more accurately.

There have been different suggestions on a range of issues relating to commercializing state-owned enterprises and the governance of the corporatized enterprises, including how the State will exercise its supervisory power in the corporatized enterprises, and how to design a system of rewarding and punishing directors and managers. In academic discussions, foreign experience is frequently referred to. However, given the size of the Chinese economy and China's special social and economic situations, the process of corporatization and privatization in China will have to encounter some unprecedented complexities and difficulties.

In summary, to fulfill the objectives of the enterprise reform is a complex and lengthy process. It needs a comprehensive overarching strategy to deal with all the issues involved. At present, China has set up very clear goals for the reform. However, the strategies regarding physical implementation of the reform objectives are still in the process of debate and experiment. Before a comprehensive approach is developed, one can expect to see a variety of approaches being taken in a process of trial and error across localities, sectors, and institutions.[67]

IV. CONCLUSIONS

The waves of corporatization and privatization in many countries in the past years illustrated the difficulty of devising an acceptable form of control over public enterprises.[68] It seems that profit making and the maintenance of public accountability pose a dilemma to every government in deciding how to deal with the public sector. Over many years, mechanisms aimed at improving the firm's economic efficiency are devised for and introduced into the public sector. Although the improvement has been visible, the task is far from complete.

The process of corporatization and privatization in China is still at an early stage. In this process, China has drawn on international experience for initiative and inspiration. Chinese policy makers see the enterprise reform as a crucial step toward the success of a full delivery of the economic reforms. Given the size of the public sector and the important role of the enterprise reform in China, it can be predicted that the Chinese experiment

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[66] *Id.* at 94.

[67] WORLD BANK, CHINA, WEATHERING THE STORM AND LEARNING THE LESSONS 7 (1999).

[68] MUSLOF, *supra* note 9, AT 23.

of corporatization and privatization will become an important event in the history of corporate development.

The special situation of China's commercialization is that there has not been in existence a mature corporate system for a long time. Many other systems possess well-developed corporate systems in their private sectors. Hence, their commercialization only needs to establish "an operating environment for appropriate public sector enterprises which replicates the internal and external conditions that successful private enterprises face."[69] However, China' situation poses greater difficulties for Chinese policy makers in relation to designing a commercial environment for their corporatized enterprises, as they do not have much opportunity to draw lessons and experience from 'the successful private sector" in their own system. Hence, the current commercialization in China is a reform that needs to achieve multiple goals, *ie*, to carry out the reforms in law and practice for both the private sector and the public sector.

[69] *See* Percy Allan, *Corporatization: The NSW Experience* (paper presented at National Accountants in Government Convention 1989 – Privatization and Corporatization, 2-4 March 1989), at 2.