



China in Peaceful Development

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Chinese Enterprises in the 21st Century



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By Che Yuming, Han Jie and Zhao Xiaohui



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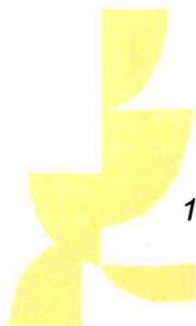
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Introduction

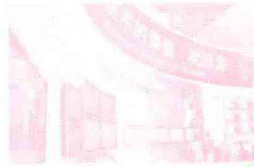
In December 1978, one of the most important meetings in contemporary Chinese history was convened: the 3rd Plenary Session of the 11th Central Committee of the Communist Party of China (CPC). At this meeting, Deng Xiaoping became the core of China's second generation leadership and advanced the idea of reform and opening up to the outside world. From that year on, the country regarded building up the economy as the primary ob-



jective of the CPC and the government.

Thirty years have passed but the miracles that China has produced in this relatively brief period of time have impressed the world. American economist Milton Friedman, who won the 1976 Nobel Prize in economics and who has visited China three times, said famously: "Whoever can correctly interpret China's reform and development will win the Nobel Prize in economics."

Of all the miracles that have transpired, the development of Chinese enterprises is the most impressive. They have not only succeeded in transforming themselves, but also advanced Chinese society as a whole through their changes and contributions. Their achievements can all be attributed to the powerful support of national policies.



Chapter I

State-owned Enterprises: The Leaders of the Pack



From the late 1970s to now, Chinese state-owned enterprises (SOEs) have caught up with the pace of world economic development, all the while experiencing difficult, unprecedented reforms. Ultimately, they have blazed a trail for Chinese-style modern enterprise development.

A breakthrough in SOE reform

“All the drawbacks in the current economic system are manifested in the fact that the enterprises lack necessary vigor. Therefore, invigorating them, especially the large and medium-sized state-owned ones, is at the core of the entire economic restructuring, with the cities as the focus.” (Excerpt from the “Decision on the Economic Restructuring,” adopted at the 3rd Plenary Session of the 12th CPC Central Committee held in October 1984)

On June 25, 1979, the Ningjiang Machine Tools Plant, an SOE in Sichuan Province, placed an advertisement in the national newspaper *The People's Daily* inviting direct product orders from Chinese and foreign customers. And advertisement like this isn't unusual today, but it represented a milestone 30 years ago, when the country was just beginning to push its



- ◆ The Hisense Group upholds the belief in "technology as top priority," making continuous breakthroughs in high-tech products. The picture shows various types of flat-screen color TVs exhibited in the showroom of the R&D Center of the Hisense Group in Qingdao.



reform program. It was the first product advertisement since the People's Republic of China was founded in 1949.

Liu Lunbao, then head of the plant, remembers the event like it was yesterday. "As soon as this ad was carried in the newspaper, the normally quiet Ningjiang Machine Tools Plant was bustling with activity as customers came from all over the country and lined up in front of the plant," Liu said. "Orders for more than one thousand machine tools were placed in less than two months, enough for the plant to fill for two years."

Ningjiang's bold move epitomizes the nationwide reform at the end of the 1970s in which SOEs responded eagerly to the policy of "granting decision-making powers to enterprises and allowing them to keep more of the profits." In those years, serious financial shortage the SOEs in China was closely linked with the planned economy, while non-state enterprises accounted for almost zero in the GDP. At that time, SOEs had no alternative but to produce according to the mandatory state plan, turning all profits over to the government, which in turn subsidized them when they ran into deficits. Without decision-making powers, SOEs did not know who their com-

petitors were — or if they had any at all.

In 1979, senior Chinese economist Dong Furen (1927-2004) said of the importance of SOE reform: “The most urgent task in the SOE reform in China is to give management decision-making powers back to enterprises so that the SOEs will not operate as dependants of government agencies any longer.” Dong’s opinion had wide repercussions in the academic community and official circles.

The policy to grant decision-making powers to enterprises and allow them to keep more of the profits was regarded as a breakthrough in the SOE reform and was an important way to free the SOEs of the shackles imposed by the planned economy. The policy also provided an incentive to enterprises to expand production and meet market demands. This reform was first introduced at the grassroots level.

In fact, as early as October 1978, the government of Sichuan Province already chose Ningjiang and five other plants for a pilot program. Under this program, these SOEs were to keep a certain portion of the increased profit for themselves and their employees were to receive a certain amount as bonuses; SOEs were allowed to produce beyond the state mandatory plan; and export enterprises were allowed



- ◆ A panoramic shot of the Dongfang 1-1 Gas Field of the China National Offshore Oil Corporation (CNOOC).

to keep a portion of foreign exchange earnings for their own disposal. These measures proved effective in encouraging the enterprises to expand production.

By the end of 1979, the 84 enterprises covered by the pilot program in Sichuan registered a 14.9 percent increase in total industrial output value over

1978, while profits rose by 33 percent and the enterprises turned 24.2 percent more in profit over to the state.

Sichuan's experience had a great impact on the industrial enterprises throughout the country. Yunnan, Beijing and other places followed suit in the experiment of granting decision-making powers to SOEs and allowing them to keep more of their profit. In July 1979, the State Council (the Central Government) issued a document titled "Several Rules on Expanding Decision-making Powers of State-owned Industrial Enterprises in Management" in a move to spread the experiment to all parts of the country. By the end of 1980, the experiment had been carried out by more than 6,600 large and medium-sized industrial SOEs across China, which accounted for 60 percent of the total output value of the industry in the state budget and 70 percent of its total profit.

The effort to expand decision-making powers of SOEs brought the conflict between the old and new management systems to the fore. Due to the lack of effective restraint in terms of property rights, market competition and the market-based pricing system at the time, enterprises depended mostly on a large input of funds for increased output value, resulting in



shrinking state revenue. In the early 1980s, the state began to wean the SOEs off the state financial allocations in terms of fixed funds and circulating funds, so that the SOEs had to raise money by themselves. On the one hand, the state stepped up the collection of profit from the SOEs and on the other made their profit formation costlier. The drop in profit sources that resulted then prompted those enterprises which had already had a taste of expanded decision-making powers into breaking their silence.

On March 25, 1984, Fujian Province held a forum of plant managers. During the meeting the 55 participants sent a letter of appeal to the provincial authorities which issued the plea: "Please remove the shackles from us!" This was the first public petition to the government from Chinese SOE leaders on the issue of decision-making powers.

In their letter, the plant managers complained that the rigid rules of the existing management system essentially had them hog-tied, so that they operated only under pressure and without any incentive or enthusiasm. The letter continued to say that the granting of decision-making powers must not be confined to a transfer of powers among regional departments at higher levels, but more importantly

should filter down to the enterprises at the grassroots so as to remove their restraints. As long as the enterprises' more urgent requests were fulfilled, the letter added, they would be able to make greater advances.

The plant managers requested that for the time being, the enterprises should enjoy at least some powers, such as the authority to: appoint and remove management personnel; use the bonus funds at their own discretion; sell independently those products which were made with the materials the enterprises had obtained on their own, provided that the state quotas were met; have a say in setting the prices for their products; and launch, on a trial basis, the system under which plant managers assumed full responsibility.

This letter had strong repercussions among enterprise managers throughout the country. "Removal of shackles" soon became a catchphrase when it came to discussing SOE reform. Amid the chorus of calls for greater decision-making power coming from enterprise leaders throughout China, the State Council issued a circular in April 1984 listing some rules for issuing bonuses in SOEs. Essentially it said that no ceiling would be set on the bonuses, but bonus taxes would be levied if the total amount of the bonuses issued in a year exceeded the standard payroll