STATE-OWNED ENTERPRISES IN CHINA: REGIONAL COMPETITION AND CHALLENGES

YU Hong

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Executive Summary

1. State-owned enterprises (SOEs) dominate China's strategic and pillar industries, thus giving them a hold over the big commercial banks. The 120 centrally administered SOEs (CSOEs) are directly supervised and administered by Beijing via the State-owned Assets Supervision and Administration Commission (SASAC) and regarded as the backbone of the national economy.

2. The 2008 global financial crisis has been an important factor behind the rapid expansion of SOEs in recent years. Beijing responded to the crisis by boosting domestic economic growth via a 4 trillion *yuan* stimulus package. The SOEs are the main beneficiaries of this package.

3. Some SOEs have been making huge profits because of their monopoly position in their particular sector and the absence of external competition, rather than their strong profit-making capacity. State policies have created an unfair and less competitive market by favoring SOEs.

4. China's developed coastal regions as well as the underdeveloped central and western provinces are competing intensively to attract CSOEs or to develop local SOEs to boost economic development and accelerate industrial upgrading.

5. The SOEs have actively expanded their activities in many areas to compete with the private sector which is gradually marginalized by the sheer economic power and size of the state sector. While attracting the CSOEs or developing local SOEs increases local government revenue, the long-term sustainability of the SOEs is questionable.

6. Due to biased state industrial policies and interventions, SOEs receive much larger allocations of land, bank loans, raw resources and intermediate

materials than the non-state companies. However, the value-added industrial output of SOEs is smaller than that of the private firms.

7. With reforms blocked by powerful vested interest groups within the SOEs, the state's continued dominance of China's key industries has interrupted further productivity improvements, and discouraged innovation and creativity said a 2012 World Bank Report.

8. The SOEs' rapid ascendency is largely attributable to preferential treatment from the state over the years. State banks tend to favor SOEs but limit loans to the small and medium-sized enterprises.

9. As SOEs are responsible for providing public goods and services and fulfilling state responsibilities, their profit-making capability tends to be much lower than that of private enterprises. According to World Bank estimations, the average returns on equity of SOEs were 9.9% lower than those of private firms in 2009.