



*The Nexus of State-owned
Enterprise and the Local
State: Origins and
Pressure Points during
Privatization*

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April 11, 2005



Presentation Outline

- The origin of company towns in the petrochemical sector: Historical dynamics driving the formation of the political economic nexus between the state-owned enterprises (SOEs) and the local state.
- Recasting the role of the local state during enterprise reform: Main objectives of the central state and the corporate headquarters in dismantling the SOE-LS nexus since 1998.
- Illustrations of local state's counter-responses: How local officials have leveraged their remaining authorities to exact sidepayments for going along with reform. Cf: econ. diversification in Daqing and Karamay.
- Conclusion: The continuing importance of local political economy in the process of privatization and foreign involvement

I. The Origin of Company Towns

Oilfield discoveries:

- A. Waves of discoveries
- B. Periodic workforce expansion increased population

Enterprise-begotten cities:

- A. Enterprise expansion led to the local state's status upgrade
- B. Intertwined personnel management

Legacy of enterprise-local state nexus:

1. Local state as an implicit stakeholder in the SOE
2. Negotiated process of marketization
3. Co-governance and co-production of public goods

II. Dismantling the SOE-LS Nexus

Market Pressures:

- A. Macroeconomic shift in 1996
- B. Financial market incentives

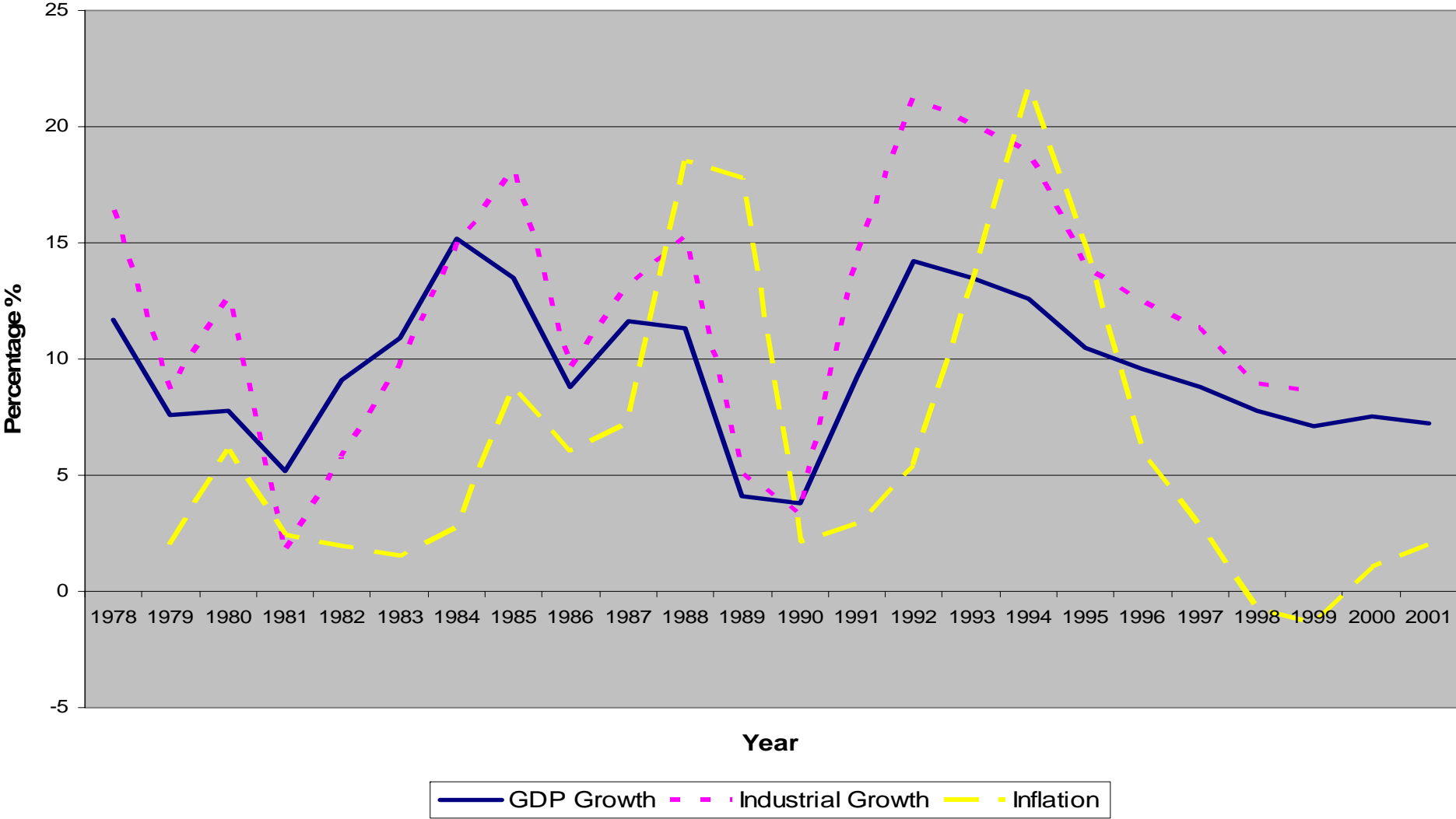
Political and Institutional Pressures:

- A. Central-local state fiscal federalism
- B. Central state policy entrepreneurship
- C. Recentralizing governance over oilfields/refineries

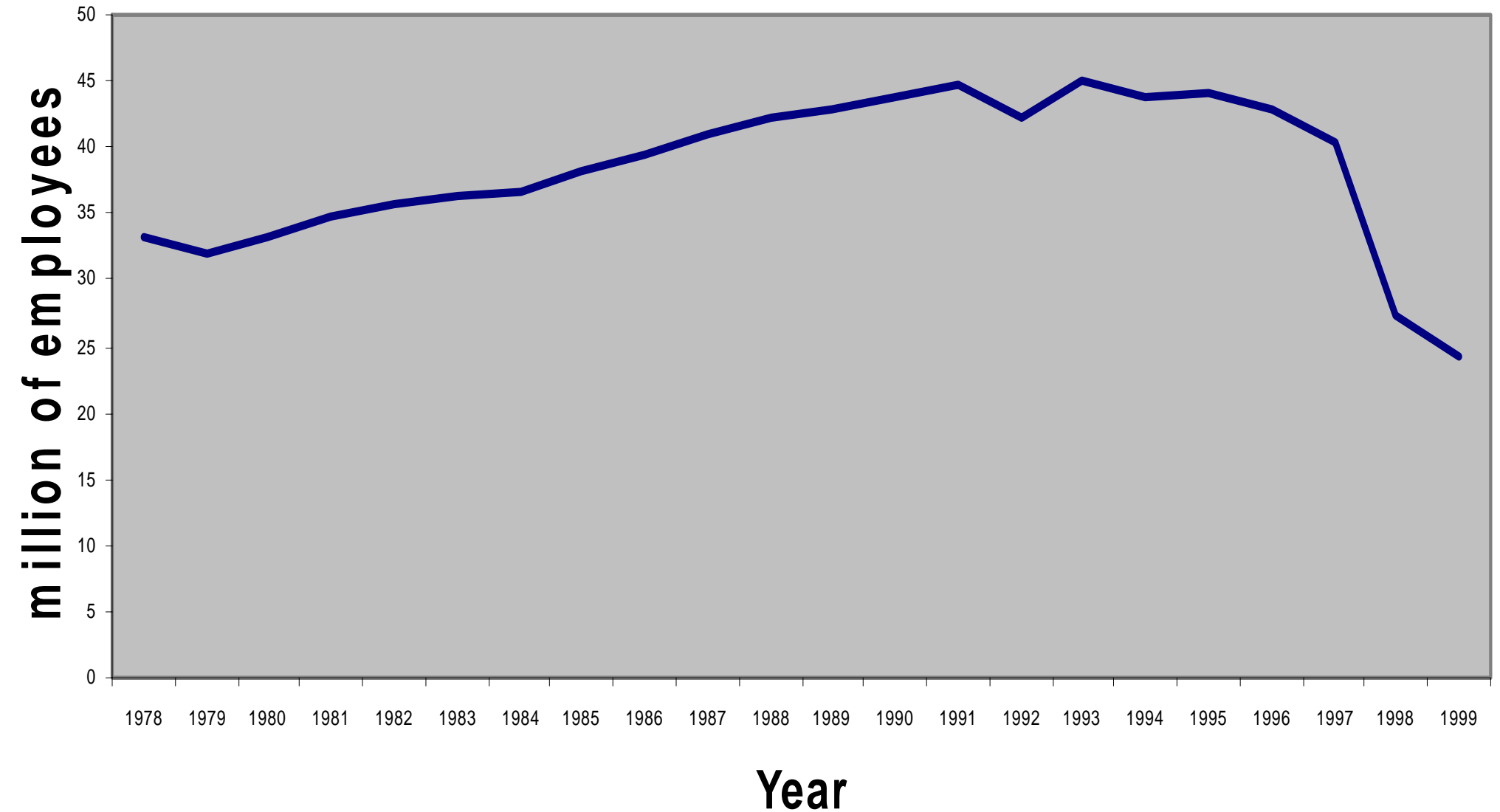
Policy Adaptations:

1. Cutting off local state stakeholding
2. Implementing massive layoffs and wage differentiation
3. Changing social welfare and public goods regimes

Inflation, GDP and Industrial Growth



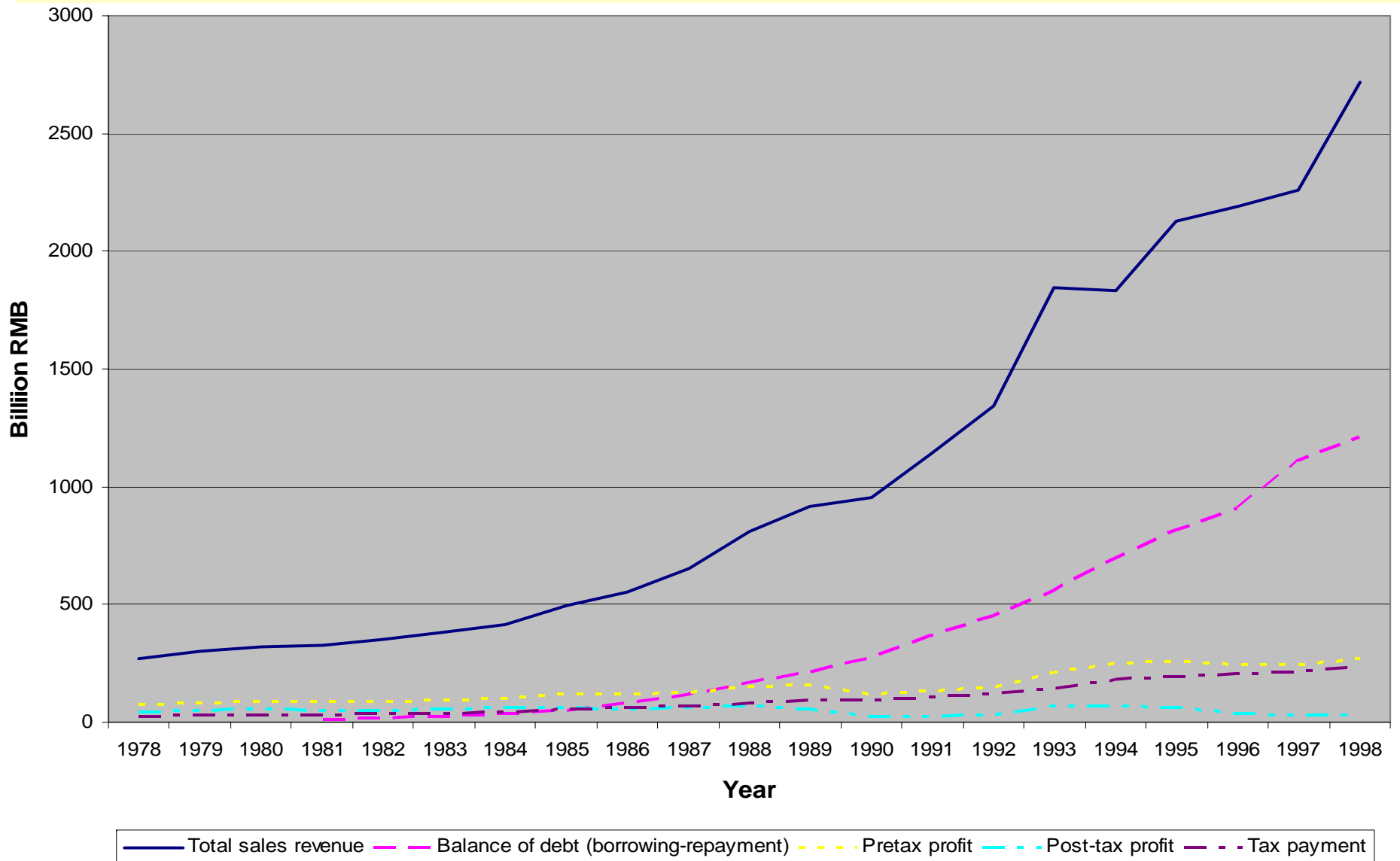
SOEs as Iron Rice Bowls



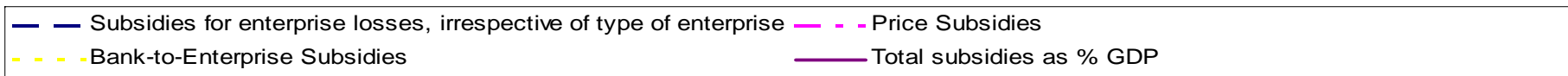
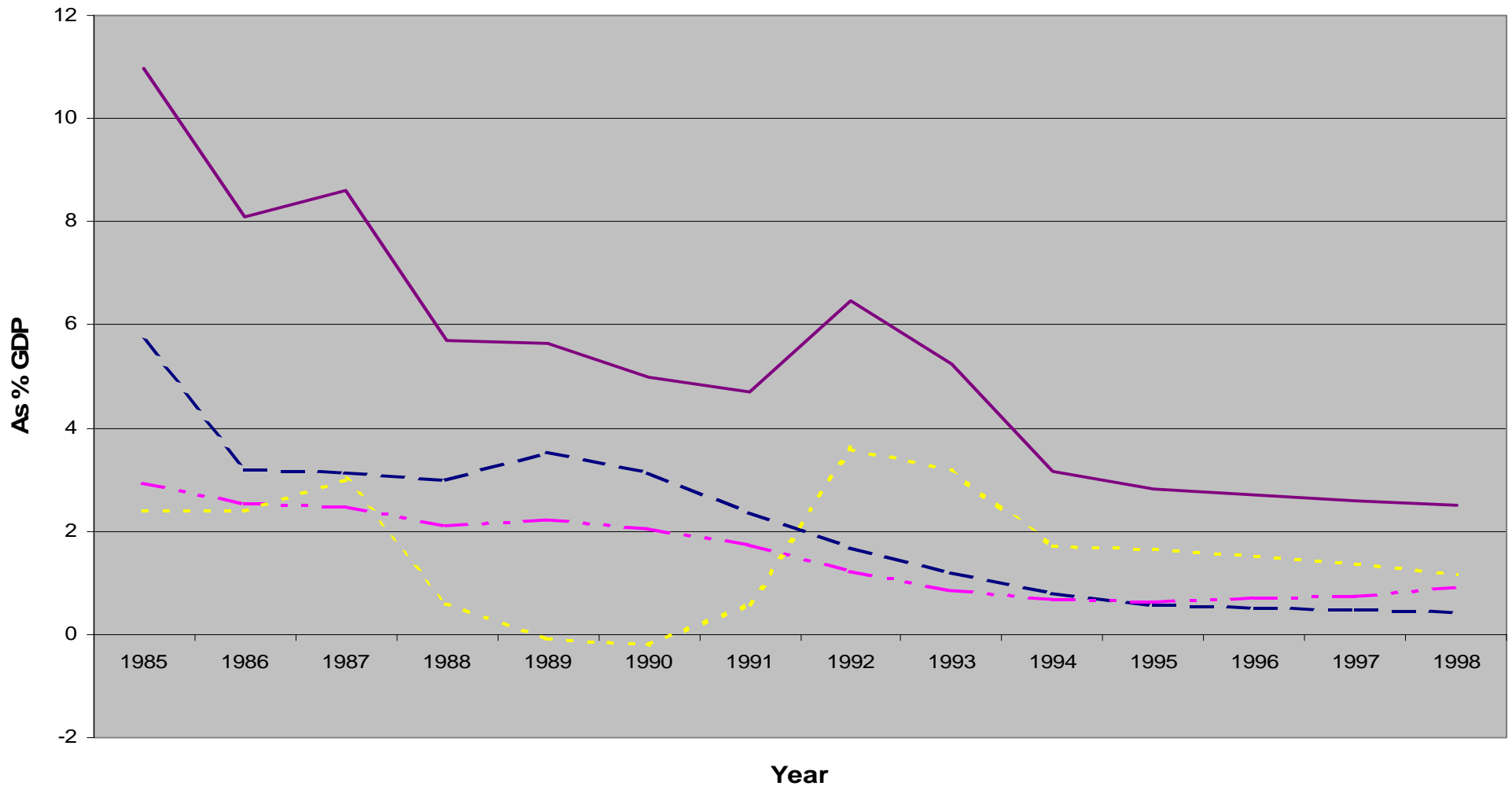
SOE Balance Sheet



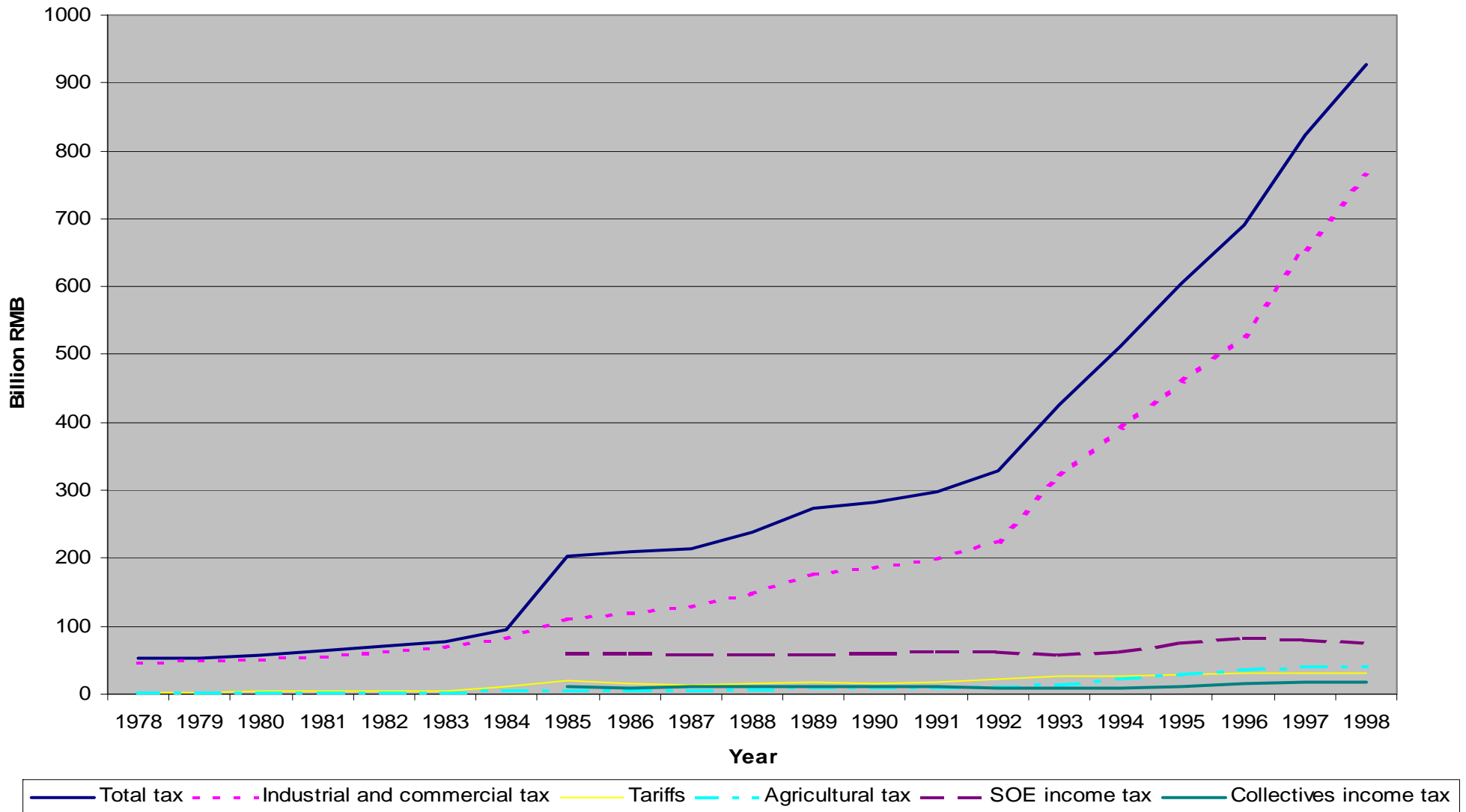
Industrial Un-Profitability



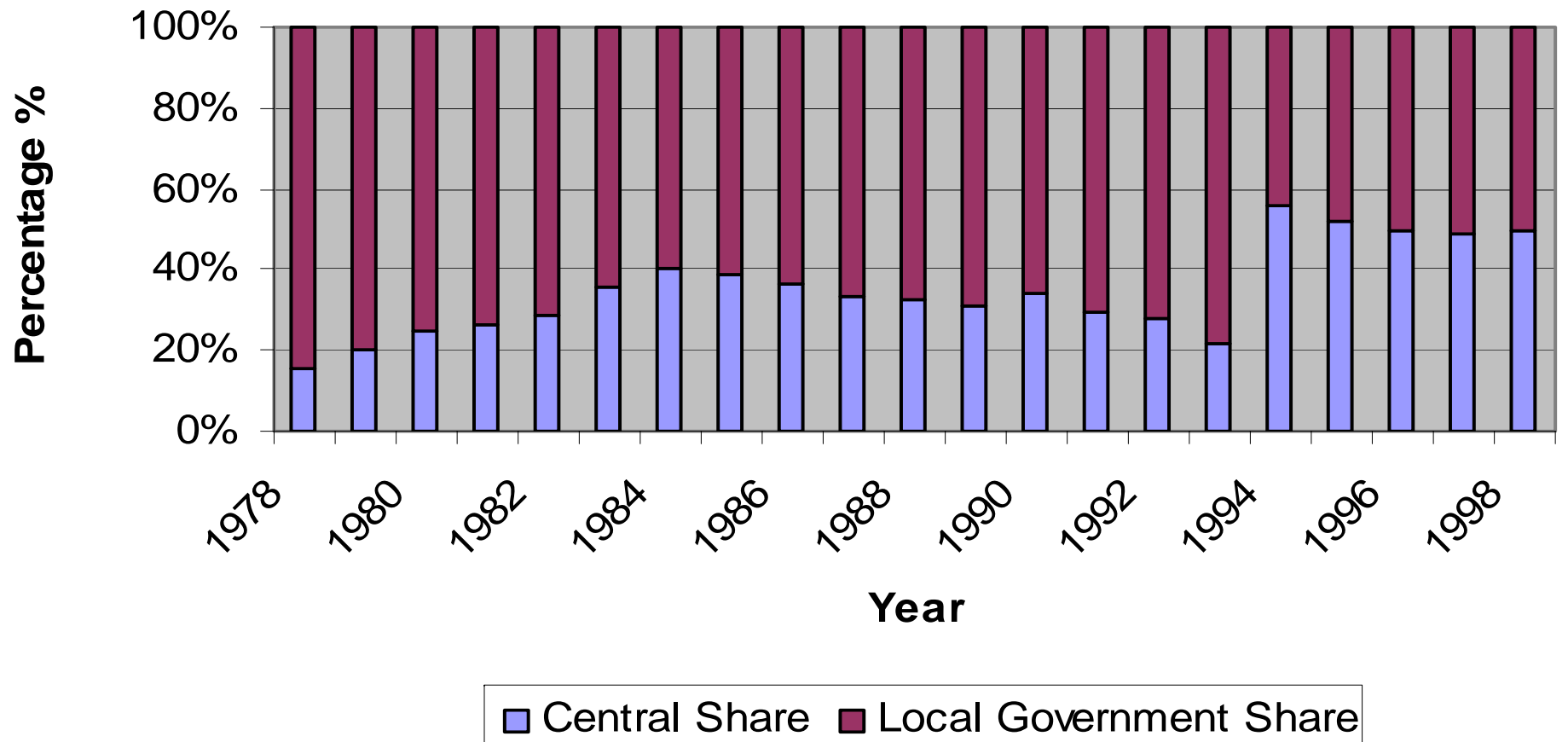
Diminishing Government Subsidies



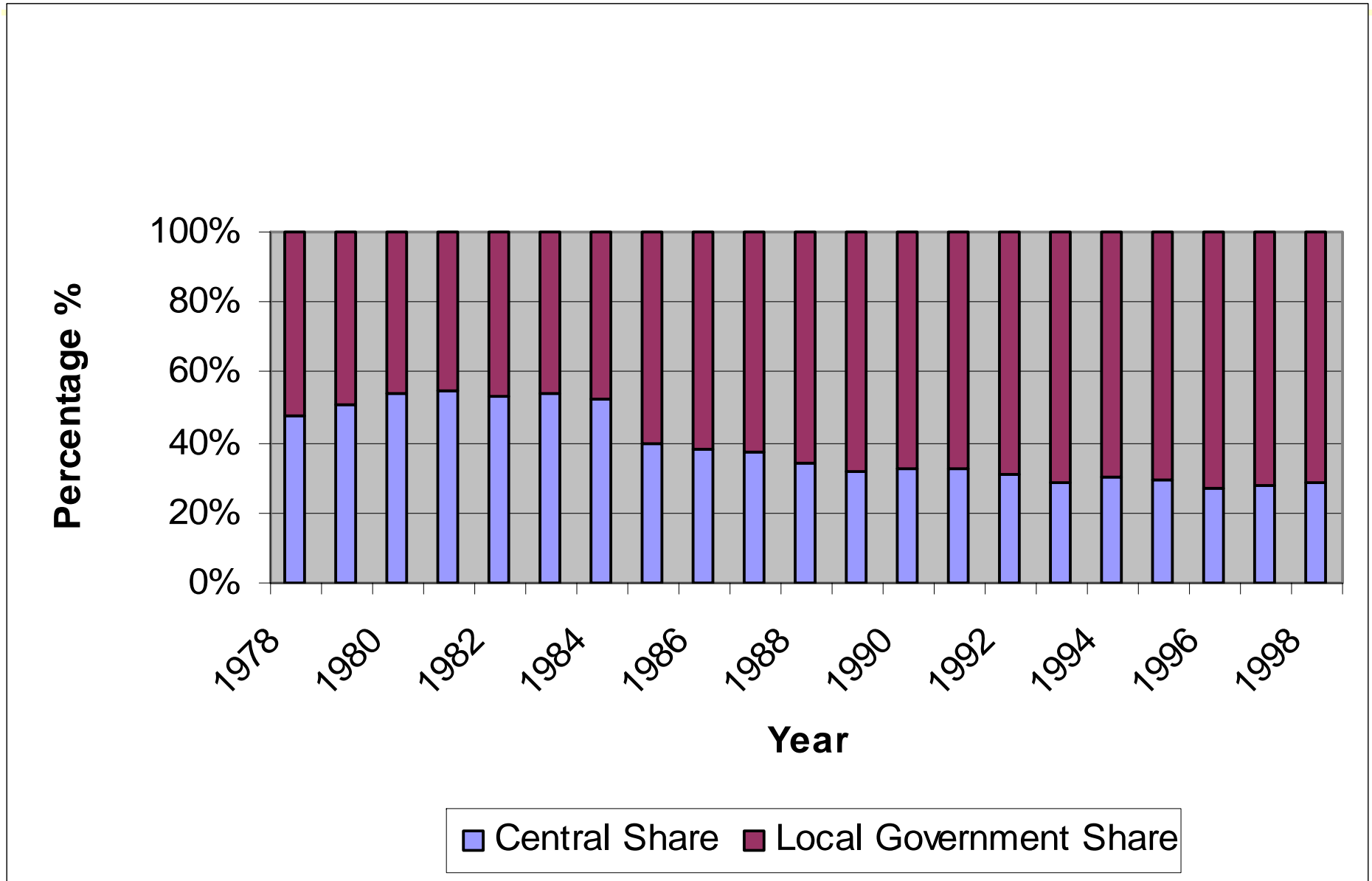
Composition of Government Revenue



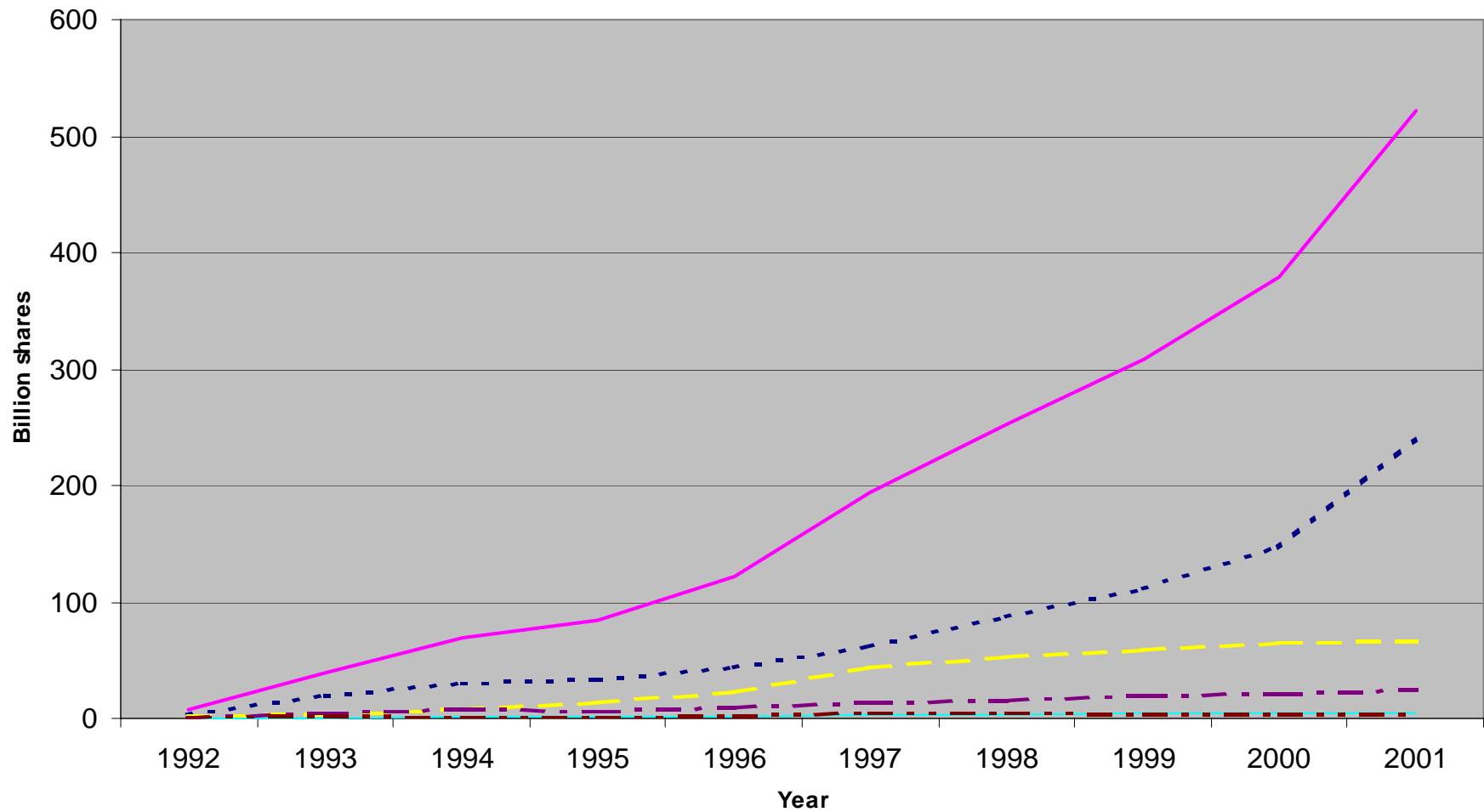
Central-Local Shares of Total Revenue



Central-Local Shares of Total Spending

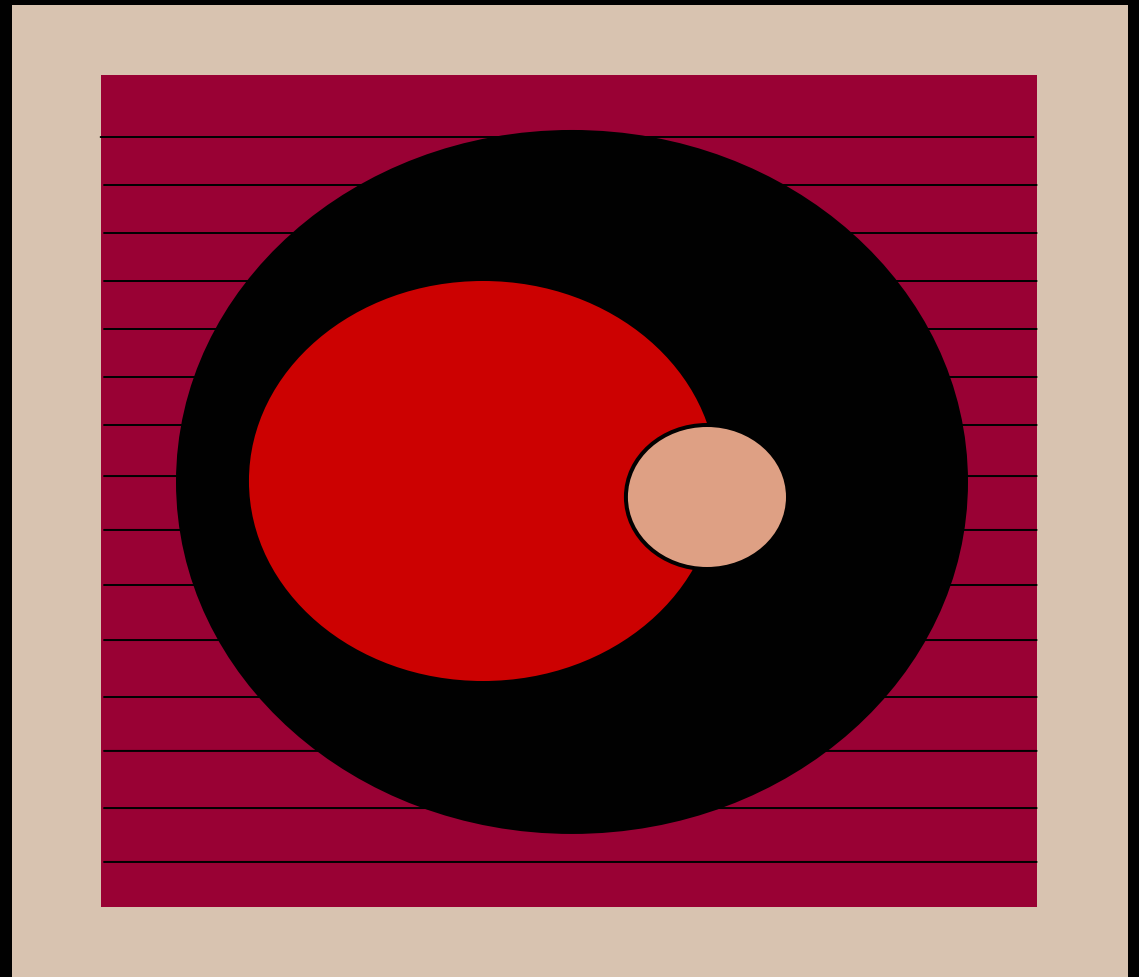


State Share of Stockmarket Expansion



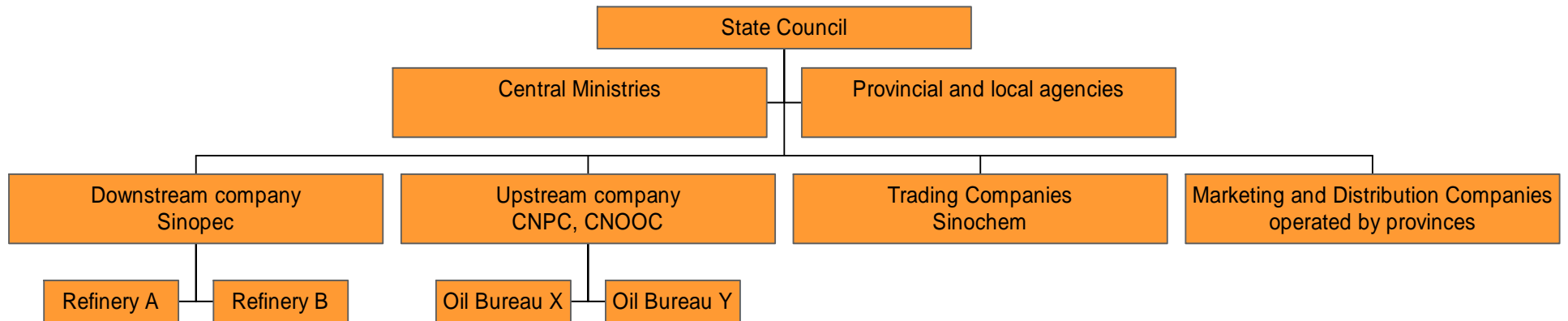
Reorganizing the State Sectors

- Privatization
- Corporatization
- Cartelization

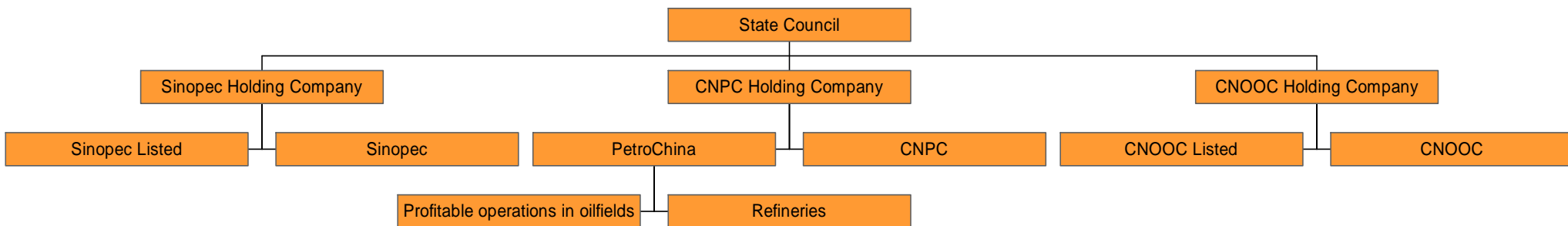


Reorganization of the Oil Sectors

Functional Division and Administrative Coordination



Integration and Corporate Governance



Major Organizational Characteristics of NOCs

Organizational characteristics	Listed-Core (“oil companies”)	Nonlisted-Noncore (“oil bureaus”)
Asset profile	$\frac{3}{4}$ of total profitable assets	$\frac{1}{4}$ of total profitable assets
Labor cost profile	$\frac{1}{4}$ of total labor force	$\frac{3}{4}$ of total labor force
Market orientation	National or international	Local
Organizational goal	Profitability and cost reduction	Stability and restructuring
Sources of revenue	Production and sales; dividends	Contractual earnings for services to the listed part; gov’t transfers
Financial principles	Production units as cost centers; simplified, transparent, centralized accounting	Former administrative units as profit centers with legal-person status; “creative” accounting
Principal-agent relations	State-asset holding company as the dominant shareholder of the listed company; other shareholders including foreign investors do not control decisions	State-asset holding company as the sole shareholder of the nonlisted company; local governments maintain claims over the enterprise
Role of price signals	Taker of state-administered prices	Set by contract with listed part
Organizational form	highly centralized M-Form	decentralized M-Form

III. Patterns of Local State Response

Leveraging local fiscal and regulatory authorities to hold hostage the struggling enterprise:

1. Charging for taking over education and healthcare provisions
2. Keeping the same taxation level or higher
3. Increasing non-tax and irregular extractions
4. Exploiting zoning, urban planning, labor, health and safety codes.
5. Avoiding accountability and creativity in labor management

Financing Workforce Reduction

<i>Workforce Reduction as Financial Burdens on SOEs</i>	<i>Numerical reduction, as of 2002</i>	<i>Pecuniary terms of discharge</i>	<i>Net explicit cost, as of 2002</i>
<i>Daqing Oilfield (core and noncore)</i>	60,000, from 270,000	100,000 RMB per ex-worker	4 billion RMB
<i>Zhongyuan Oilfield (noncore)</i>	16,000, from 50,000	3000-4000 RMB per year employed	4 billion RMB
<i>Luoyang Petrochemicals (noncore)</i>	1800, from 5,000	3080 RMB per year employed, average of 240,000 RMB per ex-worker	432 million RMB

IV. Case Studies of Diversification: Daqing

The Daqing High- and Innovative Technological Enterprise Development Zone:

1. Production profile
2. Financing and entrepreneurship
3. Administrative and economic dependency on Daqing

Relative weakness of the local state:

1. Lack of involvement in financing and management
2. Limited human resource contribution



Case Studies of Diversification: Karamay

A major retailer and real estate developer:

1. The “tertiary sector” strategy of diversification
2. A visionary CEO
3. Poor economic outcome
4. Shareholding by the oil bureau

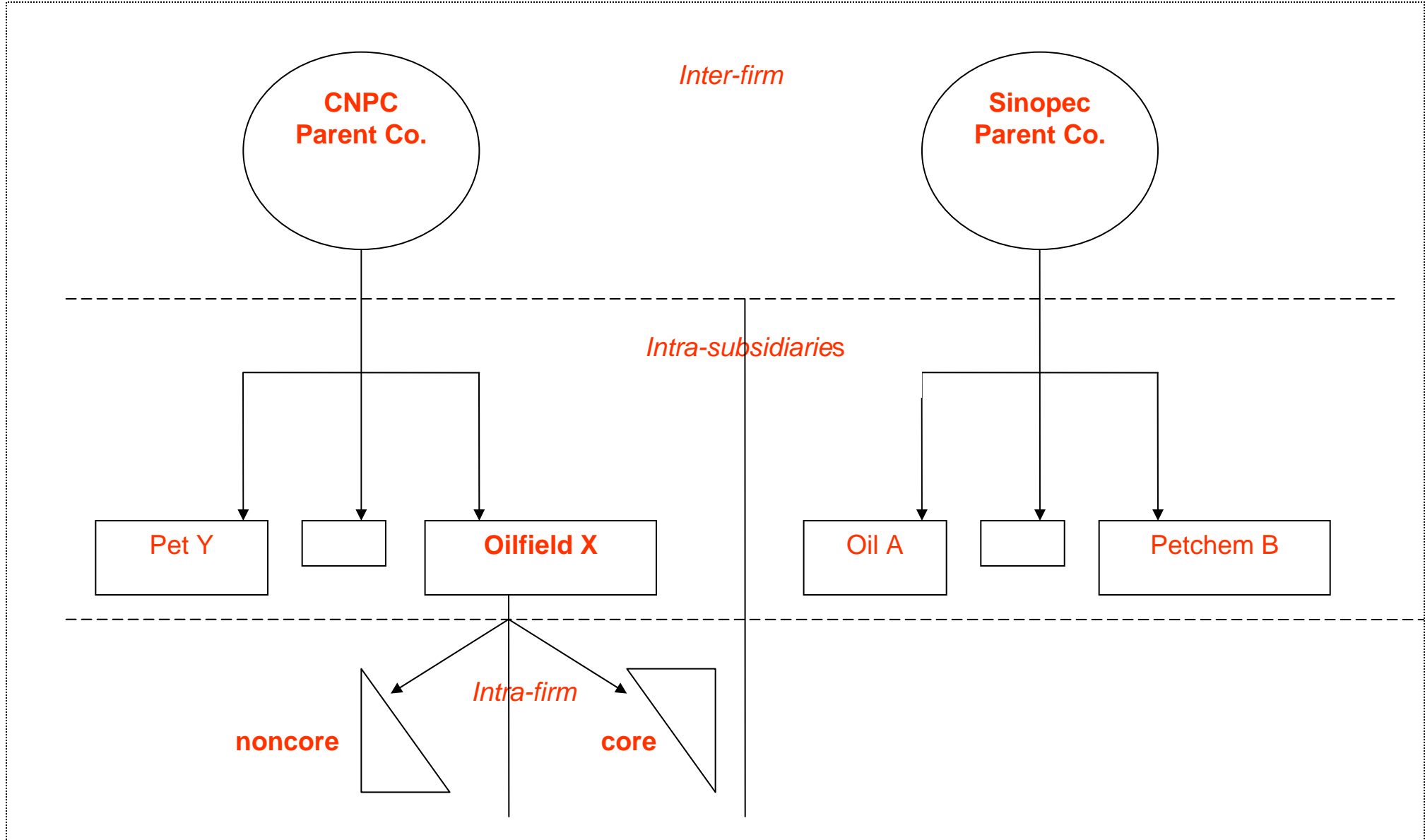
Local state as a source of handicap:

1. Over-taxing the inventory
2. Politicized bankers
3. Ethnic policies and concerns for social stability

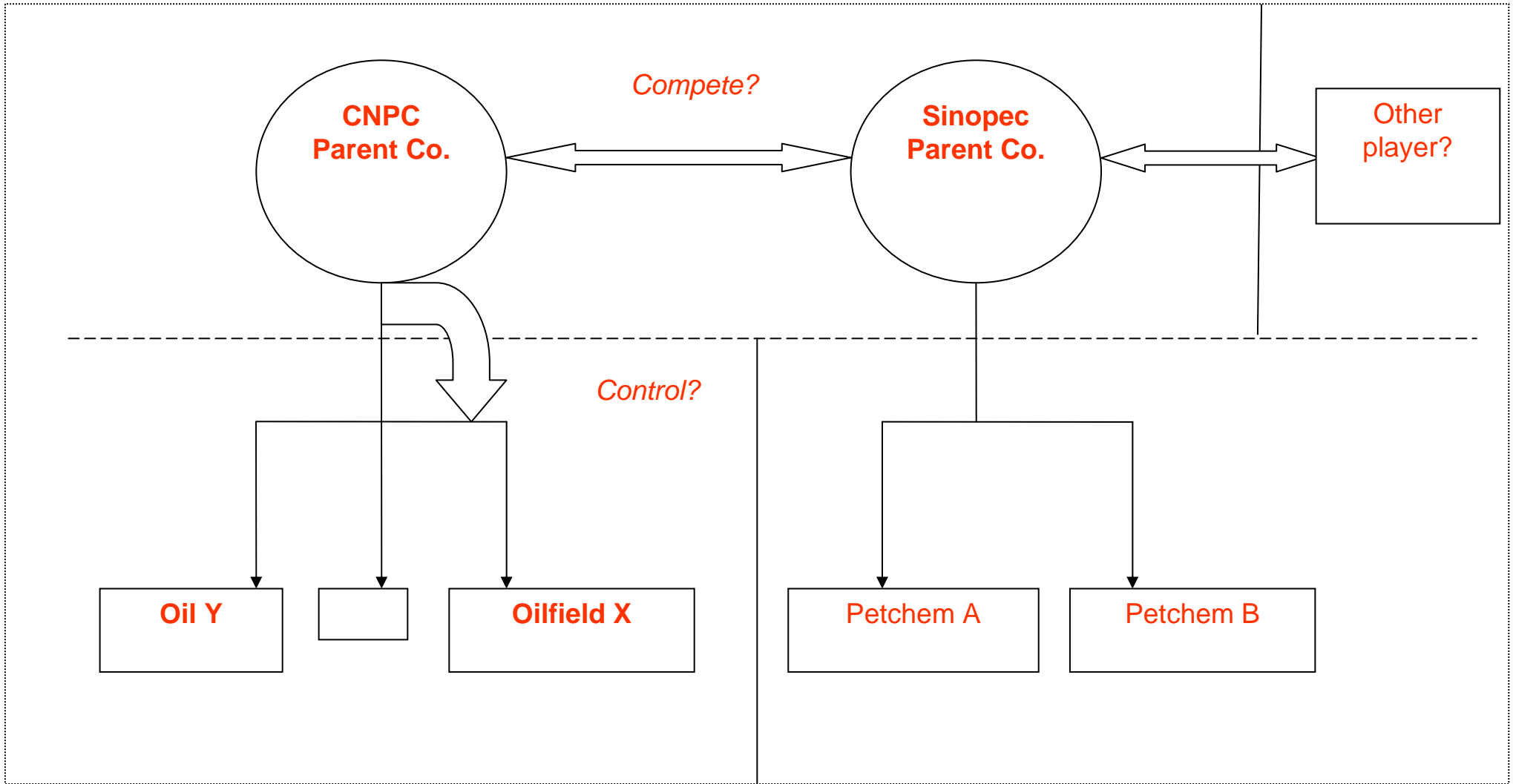
V: Conclusion

1. Formal institutional design cannot resolve the complex resource-dependency between the enterprise and the local political economy.
2. When faced with reduced stakeholding role in the enterprise, the local state may resort to predatory behaviors or developing “recombinant property” forms as a hedging mechanism.
3. The central state, NOCs, and foreign partners should find new means of obtaining consent and voluntary compliance from local officials, or face persistent resistance to enterprise reform.

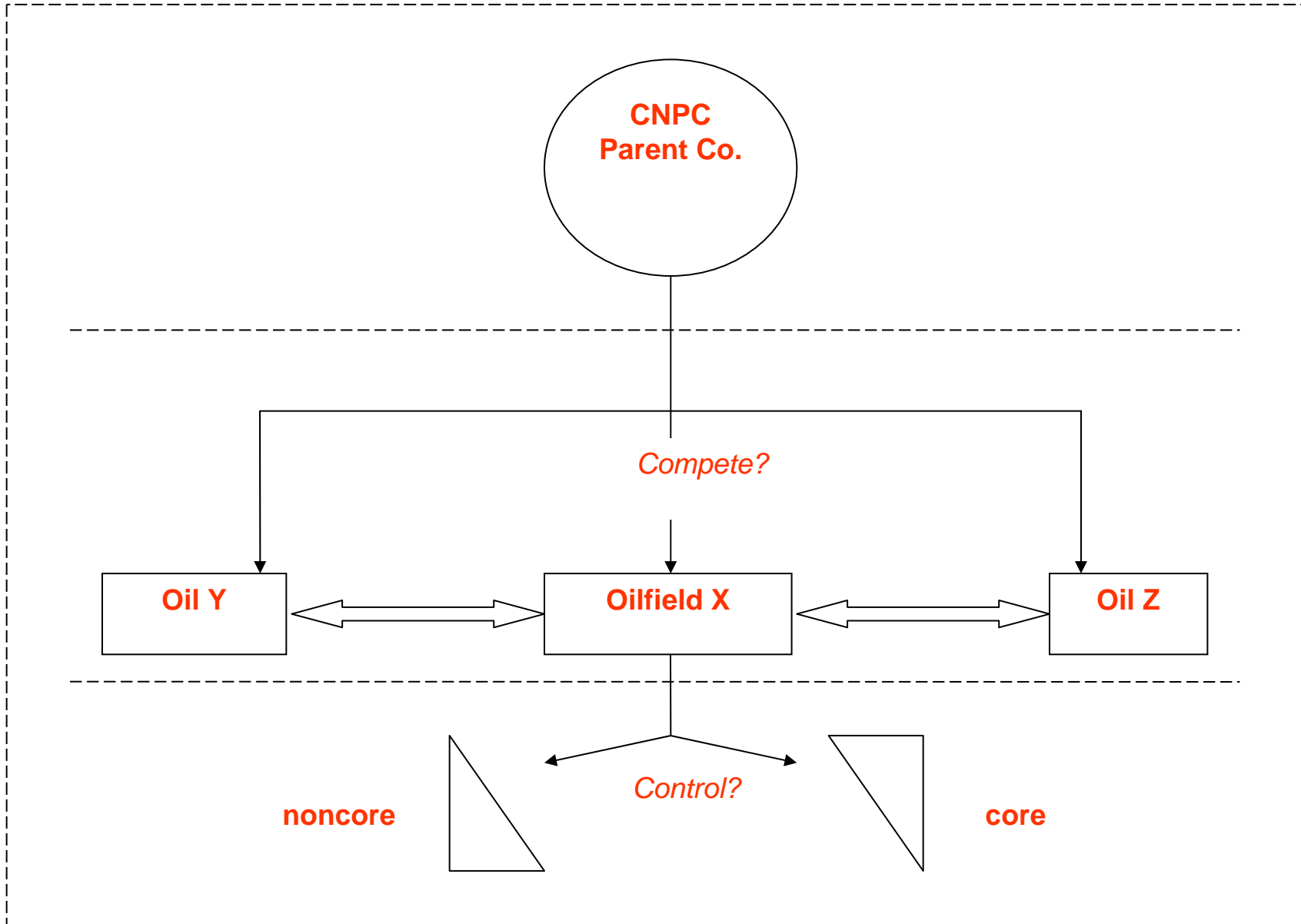
Industrial Structure of Chinese National Oil Corporations



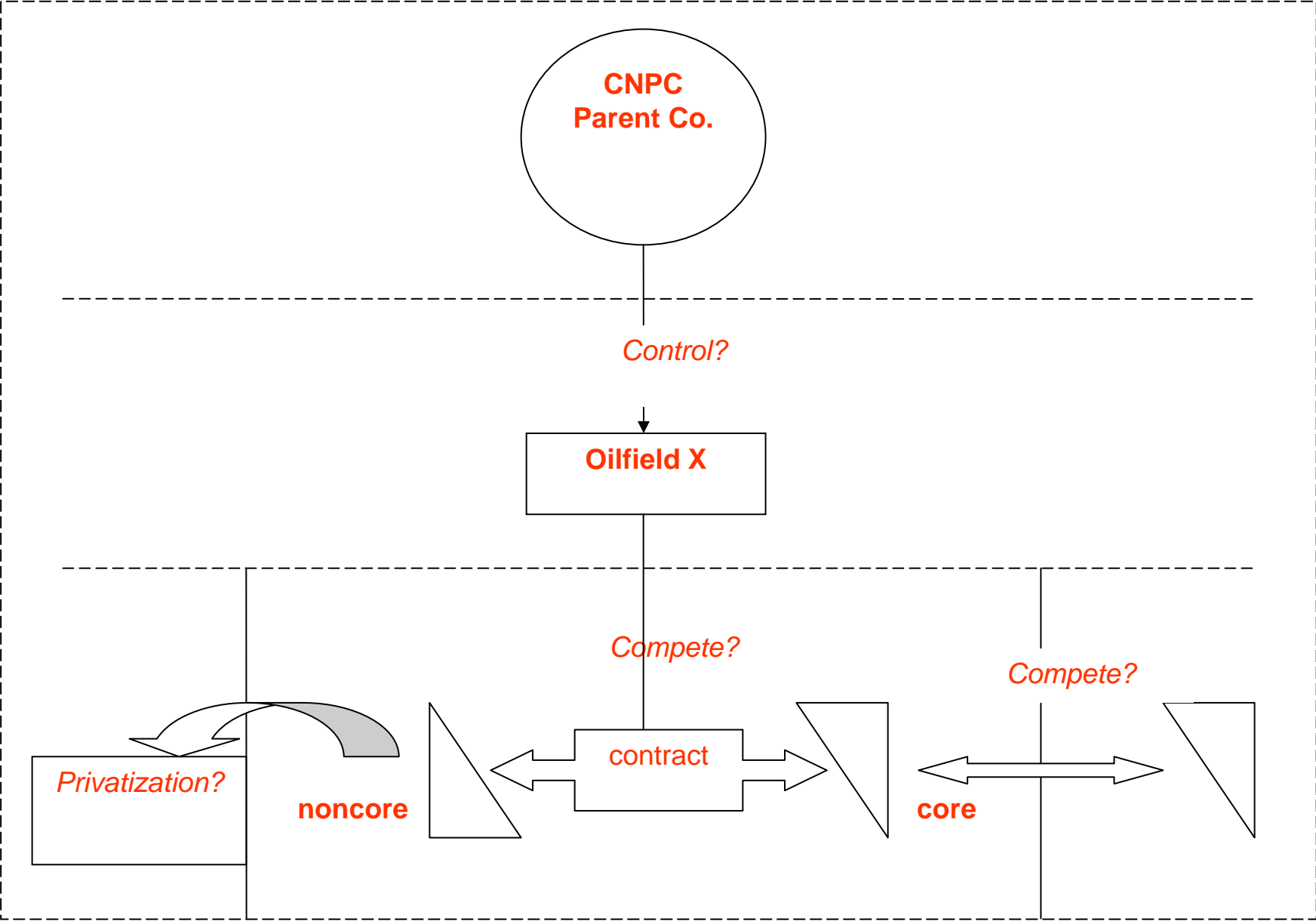
Why Oligopolistic Competition Depends on HQ's Control over Subsidiaries



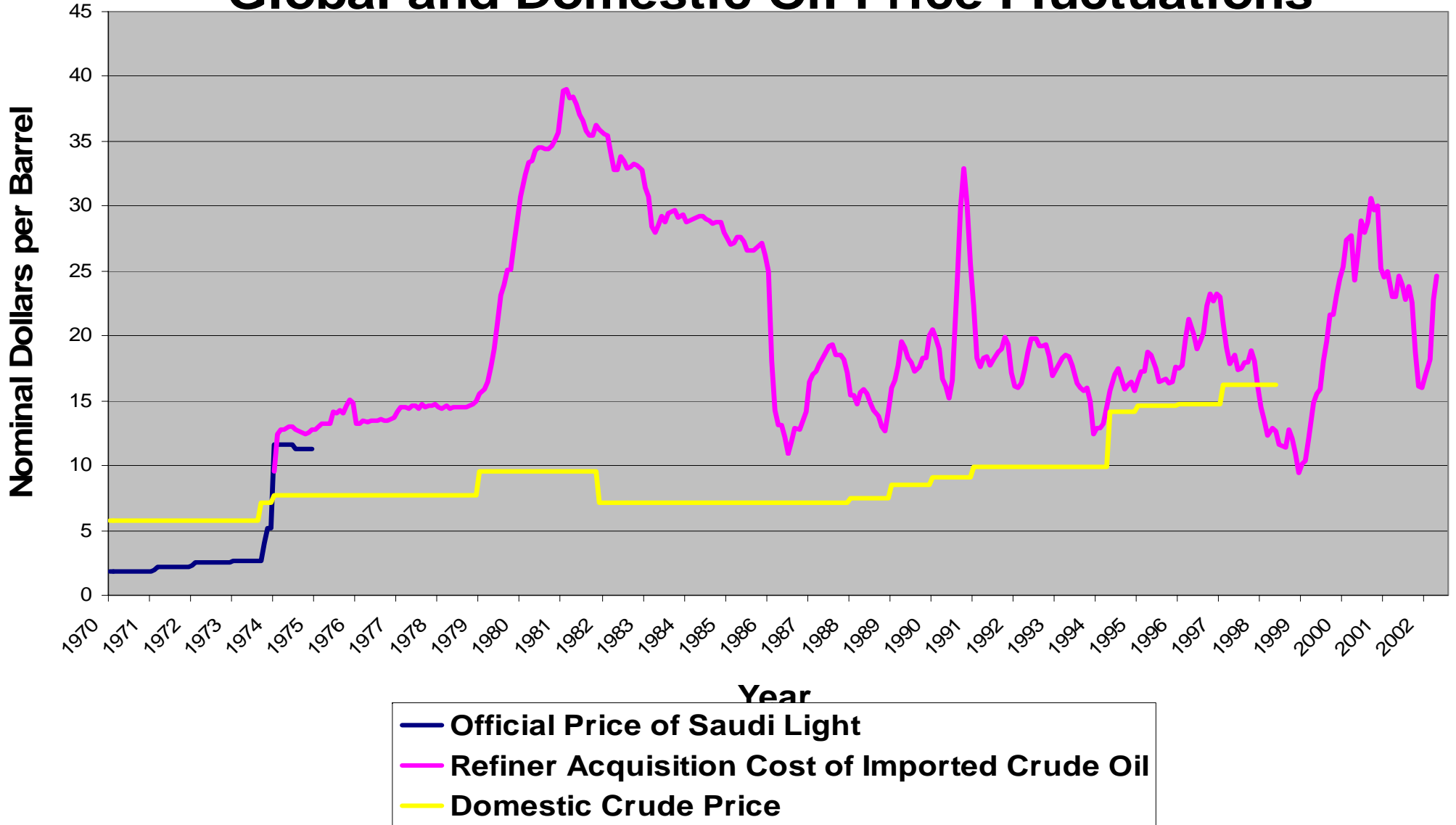
Why Inter-Subsidiary Competition Depends on Each Subsidiary's Control over Resource Dependency of Core, Non-Core Companies



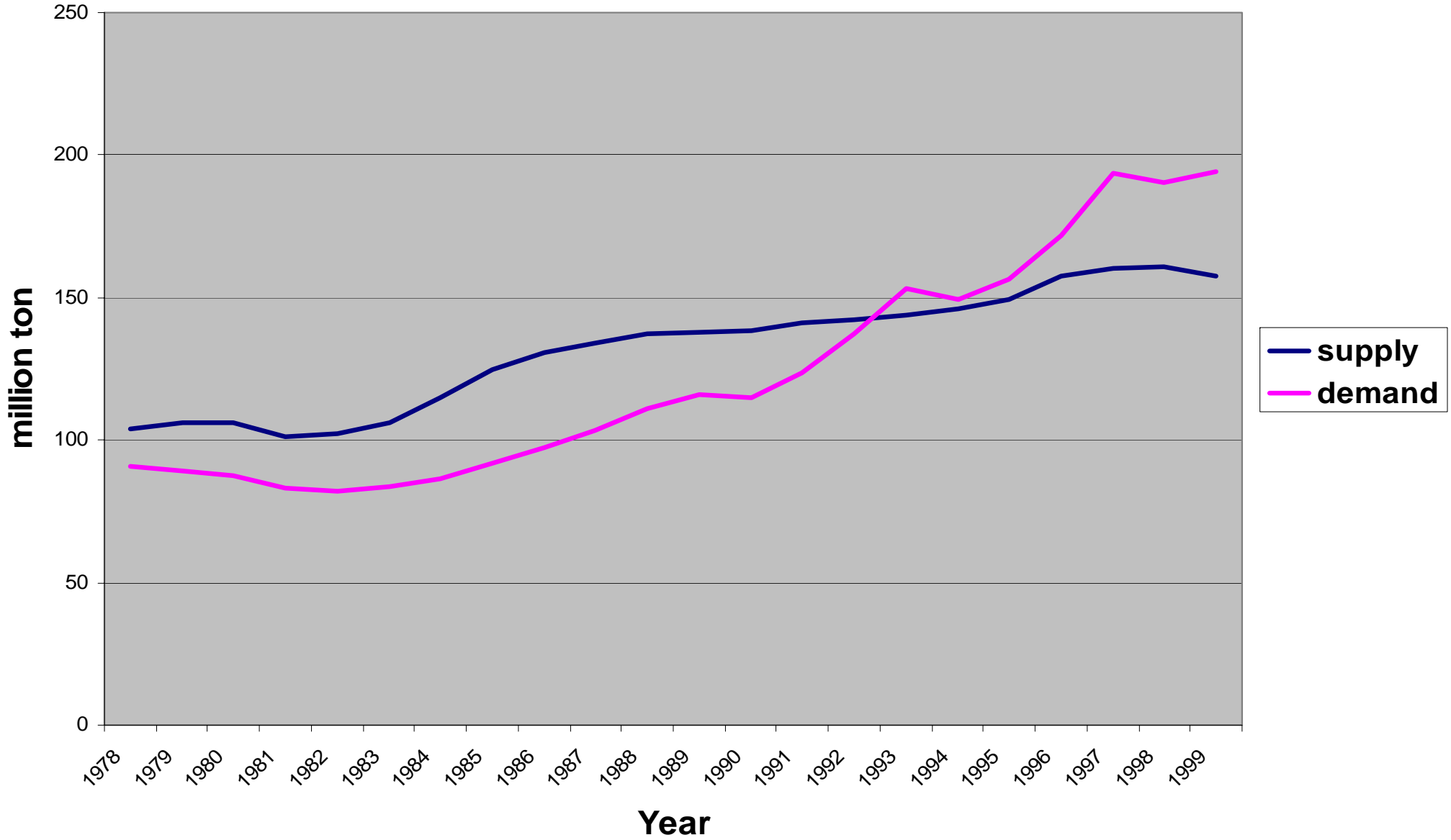
Why HQ's Control over Subsidiaries Depends on the Nature of Competition Between Core and Non-Core Parts in Each Subsidiary



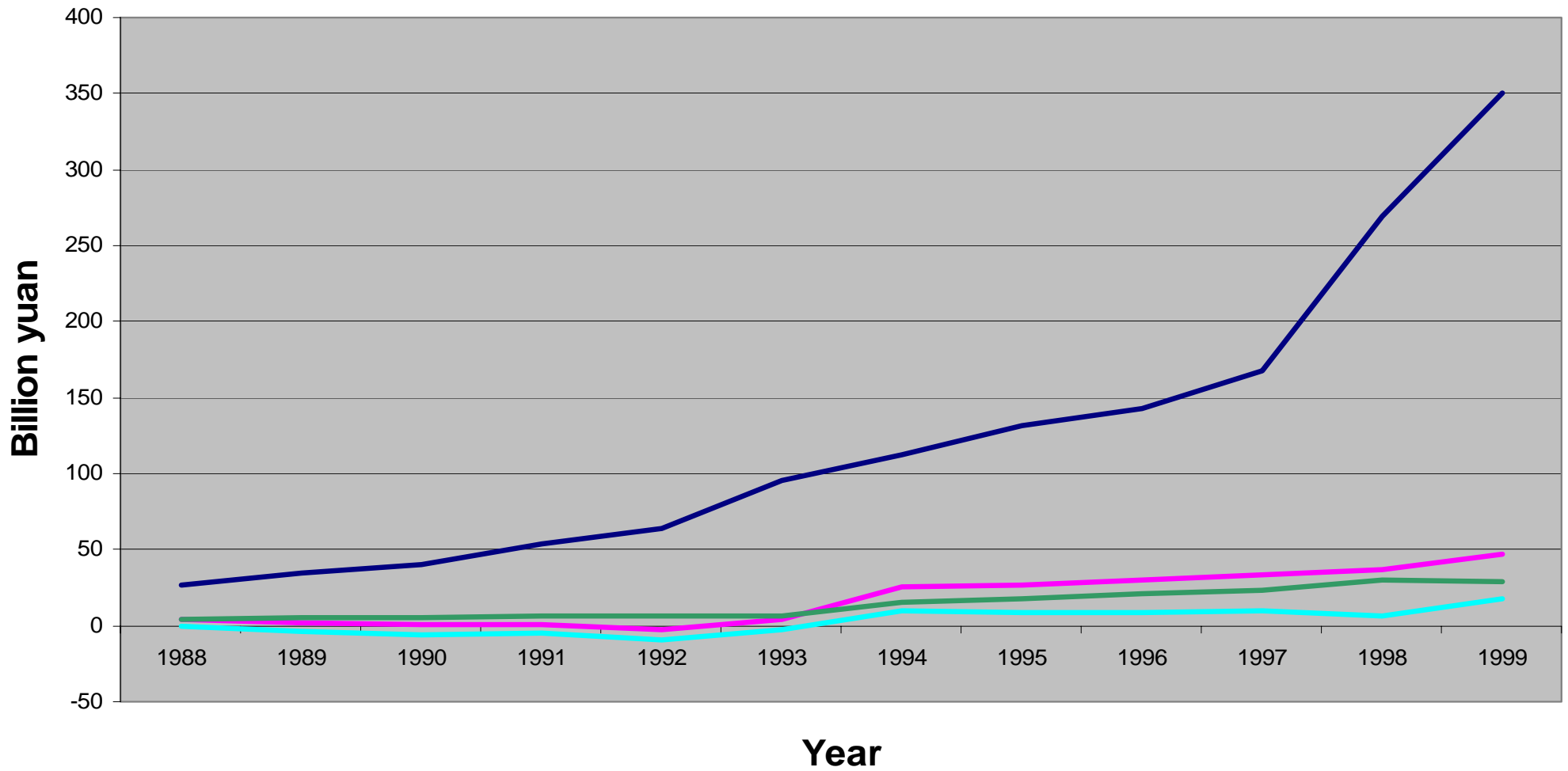
Global and Domestic Oil Price Fluctuations



1991-1998 Domestic Crude Demand and Supply



CNPC Finance



— Total revenue — Pretax profit — Tax — Net profit

Sinopec finance

