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Socialization of Property Rights: A Strategy for SOE Reform in China

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Abstract

We propose a new strategy for the reform of the property rights system of state-owned enterprises (SOEs) in China, a strategy based on the socialization of property rights and surrogate owners, and one that is in accord with the historical trend of modern enterprises. This reform strategy should enhance the market competence and competitiveness of SOEs on the one hand, and should ensure that the wealth and profits of SOEs will be beneficial to and enjoyed by all people and the whole society on the other hand, thus providing a sound economic foundation for a socialist "harmonious society."

Keywords

socialization of property rights, surrogate owners, strategy for SOE reform, the management system of national wealth

We all know that since the First Industrial Revolution, the structure and formation of enterprises has changed significantly and fundamentally: from the small and simple workshops in the early stage to today's very complex and multifunctional corporations. The property rights of enterprises have also

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undergone several transformations, becoming increasingly diversified, pluralized, and socialized. Because of these important and profound changes, the property rights of modern corporations in the West are totally different from the clearly defined proprietorships that Adam Smith and Karl Marx witnessed. In most modern corporations, we can hardly find individual controlling shareholders; instead, their stock equities are held by numerous institutions and individuals, including more and more socialized institutional holders. As a result, in modern Western corporations, capital ownership, capital operations, and business management have become separated, forming a tripartite power structure. The adaptive institutional arrangements for capital management to suit this transformation of ownership involve professional capital managers assuming the role of a real capital owner as a surrogate owner.

In light of this trend of the transformation of property rights in modern Western enterprises, we need to consider a new strategy for the reform of the property rights system of state-owned enterprises (SOEs), a strategy based on the socialization of property rights and on surrogate owners. This reform strategy should enhance the market competence and competitiveness of SOEs on one hand, and should ensure that the wealth and profits of SOEs will be beneficial to and enjoyed by all people and the whole society on the other, thus providing a strong and enduring economic foundation for a socialist "harmonious society."

Drawbacks of Current Reform Approaches

There are two proposed reform approaches for SOEs now debated in China. One is privatization, and the other is the State-owned Assets Supervision and Administration Commission of the State Council 国务院国有资产监督管理委员会 (hereafter State Assets Commission) approach to clarifying property rights.

Privatizing SOEs Runs Counter to the Trend toward Socialization

According to mainstream property-rights theory, the low efficiency of SOEs is the result of the so-called absence of definite property owners. Therefore, the solution is privatization: that is, changing the property rights of SOEs to clearly defined private ownership through private contracting or public auction. This approach may work for small- and medium-sized SOEs, but it will not work for large and super-large SOEs because obviously privatization runs counter to the trend of socialization of property rights in modern corporations. As we have noted, pluralization and socialization of the property rights system in modern enterprises are the historical sublation of classic private ownership. The reason for this is that the narrow framework of private ownership can no longer accommodate ever growing and ever expanding socializing factors in modern enterprises and modern social economic activities. Privatization of large SOEs will only intensify and aggravate the conflicts between private ownership and socializing factors in modern enterprises, the exact opposite of the goal of SOE reform. Privatization will not allow the social sharing of reform benefits, and thus it does not conform to the goal of social equity. Furthermore, private enterprises usually prefer short-term financial gains to long-term development. This will weaken enterprises' ability to innovate and undercut their economic competitiveness.

In modern enterprises with pluralized and socialized property rights, since owner absence is unavoidable, to raise efficiency, we must search for effective surrogate owners for SOEs, instead of seeking the clarification of property rights.

The State Assets Commission Cannot Serve as the Capital Manager of SOEs

Since its founding in 2003, the State Assets Commission has proposed an approach to SOE reform that is contradictory to the privatizing approach at the policy level. However, both approaches share the same theoretical assumption of mainstream property-rights economics: that is, both seek to clarify property rights in order to solve the problem of the absence of owners in SOEs. So far the reform policies introduced by the State Assets Commission include corporate reorganization, capital budgeting, paying dividends, strengthening the role of the board of directors, tightening the hiring procedures for senior management, and so on. The essence of these policies is that the State Assets Commission identifies itself as the capital/asset manager of SOEs, because in developed economies, all these policies involve the normal functions of a capital/asset management company.

However, the State Assets Commission, due to its nature as a government agency, cannot play the role of the capital/asset manager of SOEs. First, as a government agency, the staff of the State Assets Commission is not allowed to share in the profits from the appreciation of capital management; to do otherwise would conflict with its nature as a government agency. We know that the core incentive to surrogate owners is to share in capital appreciation. Without this incentive, there will be no institutional guarantee that the State Assets Commission staff will work exactly like surrogate owners. Second, capital management is a highly professional job, requiring very specialized training, continuous learning and creativity, and long-term service. The requirements for this profession are quite different from those for government employees. Such professionals can only be recognized and selected based on their market performance, rather than be appointed by the government. Third, capital management involves highly sensitive and confidential operations such as company mergers and reconstruction, and major investment requires quick decision-making. These must be strictly confined within the board of directors. But according to the current regulations of the State Assets Commission, all major decisions of SOEs must be approved by the commission. Following these regulations will only cause a leak of business secrets or the loss of valuable business opportunities. Thus these regulations simply will not work.

Some people have argued that the State Assets Commission should follow the example of Singapore's Temasek and become the capital manager of large SOEs. The State Assets Commission probably has the same consideration when it defines its own role. However, the scale and quantity of large SOEs in China are so great and the extent of their operations is so broad—without parallel in the world—that no single capital management company can handle them. The task the State Assets Commission has assigned for itself is practically a mission impossible.

Besides, if the State Assets Commission as a government agency performs the role of capital manager, the result will be conflicts of interest and malpractices such as the government dictating business decisions and bureaucratism. These will only lower the efficiency of SOEs, undermine the long-term development of SOEs, and compromise the integrity of SOE management.

We believe that in considering the function of the State Assets Commission, it is necessary to distinguish between assets management and trade management. The former is a highly professional undertaking involving selecting investment projects, making capital investment decisions, appointing board directors, taking part in the corporate governance of the invested companies, and guiding liquidation and disinvestment. The latter is a quasi-government domain, whose responsibilities include setting rules and regulations for as well as supervising the capital management industry. Obviously, as a government agency the State Assets Commission ought to assume the role of trade management but not the role of capital management. As a matter of fact, in the area of trade management, the State Assets Commission can give full play to its capacities.

In short, we believe that both privatization and the State Assets Commission playing the role of capital management are wrong—wrong because they are based on a misunderstanding of the pluralization and socialization of property rights in modern enterprises. Since the pluralization and the socialization of the ownership system are part of the general trend of the transformation of modern enterprises and since the absence of actual property owners is the result of such evolution, the correct approach and right choice of strategy for SOE reform should be the socialization of SOE property rights. And here the key is choosing and nurturing effective surrogate owners.

Surrogate Owners: The Key to SOE Reform

How can enterprises be made to operate effectively and maintain their innovative capacity and competitiveness in the absence of an owner? The key is to find effective surrogate owners. Here, effective means that surrogate owners will behave like real owners when it comes to their interests and will participate vigorously in the governance and management of the enterprise, pursuing the growth of the enterprise and capital appreciation. The question then becomes, how can we make surrogate owners into effective assets managers? The key is to make their interests align exactly with those of real owners, thus the two parties will share both benefits and risks. To achieve this goal, there must be three binding conditions: incentives, pressures, and liquidation mechanisms.

In modern capital markets, the way to motivate surrogate owners to pursue capital appreciation of the assets under their management is to allow them to share in the benefits of capital appreciation. For example, according to industry practice in private equity markets, the capital manager can receive about 20 percent of capital appreciation as a reward. Under this incentive, a surrogate owner will strive to pursue the projected goal of capital appreciation in order to ensure his or her own gain. In this way, the surrogate owner simulates the real owner in pursuit of his or her interests, thus effectively performing the role of a real property owner.

In terms of pressures, modern capital markets ensure the competence of surrogate owners through fierce competition. It is a market in which the fittest survive. Who is qualified to manage the assets of others? Who can manage more customers and assets? Only the market will tell—there is no other selection mechanism. The entry barriers in capital markets are low; thus competition is intense. In order to win more and more customers and manage larger and larger funds, capital managers must establish a record of superior performance. For example, when the famous private equity company Warburg Pincus was launched in 1971, it had a single equity fund of $40 million. In 2005, it raised its ninth fund, worth $8 billion. The company's success was because of its outstanding performance in the preceding three decades of bringing lucrative capital returns to its investors. Hence, more and more investors entrusted their capital to the company. This is an example of the market choosing effective surrogate owners through competition rather than designation.

For capital managers, both incentives and pressures are ultimately measured in cash. This has to do with liquidation mechanisms. If you are managing several billion yuan of capital and have invested it in several projects, after a number of years, you will have to report whether the value of the assets under your management have increased or not, and how much they have appreciated. The difficulty here is how to appraise assets. In modern capital markets, "cash is king." Therefore, the common practice is for both parties, the owner and the manager, to arrange a time period in advance for the custodial capital to be managed. When the term matures, all custodial assets will be liquidated as far as possible in cash, in order to determine the net value of capital appreciation. Capital managers who achieve the projected goals of capital return will be rewarded; those who fail to achieve the goal of capital appreciation, or whose performance is below the market average, will be eliminated by the market.

Of course, building a healthy and orderly capital market requires a sound legal environment and effective government regulation.

An SOE Reform Strategy Based on Socialization of Ownership

At present, there are several hundred large and super-large mainstay SOEs that constitute China's state-owned economy. They are controlled either by the central administration or by provincial governments. Though their number is small, these SOEs are huge in scale and dominant in strategic industries as well as in infrastructure. Although the absolute scale of the private economy and foreign investment has already overwhelmingly surpassed that of the state-owned economy, the strategic dominance of the state-owned economy in China's national economy is still unchallenged. The prosperity or decline of SOEs therefore will have a great impact on the national economy. By the same token, the assets and equities accumulated in the state-owned economy have reached an unprecedented magnitude. Thus how to protect and increase the value of this state-owned wealth will directly affect China's economic strength and the well-being of its people. Because of this, SOE reform has to take into consideration two dimensions: economic efficiency as well as social welfare. For the sake of economic efficiency, the goal for the reform of large SOEs should be to build a pluralized and socialized national system of equity capital, thus greatly raising the management standards and economic competitiveness of these large SOEs, and to sustain their long-term growth and development. For the goal of social welfare, we believe China should build a socialized modern system of managing national wealth that is beneficial to all people and will provide a strong, solid, and sustained economic foundation for a socialist harmonious society. Following this reform strategy, SOE reform should transcend the dichotomy between fairness and efficiency, and achieve sustained economic growth and comprehensive social sharing.

As we know, pluralized and socialized property rights of modern enterprises in the West are the result of several hundred years of economic and social development, of wealth accumulation and middle-class expansion, as well as of institutional and cultural development. In China, the history of capitalism is very short. Moreover, there has been no longtime accumulation of social wealth. Though after more than thirty years of reform and development, the Chinese economy has grown and expanded significantly, the urban middle class is growing, and the pension insurance system is expanding, nonetheless the economic and social gap between China and Western developed nations is still huge. Different histories and different levels of development between China and the West make it impossible for China to simply copy Western systems. Instead, while referring to the experience of developed countries, China must set out from its own history and reality to innovate its own institutions.

Nonetheless, China now faces a rare historical opportunity: as a latecomer, it does not have to follow the exact route of Western countries—from small proprietorship gradually transformed into socialized ownership. Instead, through SOE reform China can realize the socialization of property rights and also through reform develop a capital market and nurture surrogate owners. In this way, China can make sure not only that the benefits of SOE reform will be shared by all people and will benefit the whole society, but also that its reform path will conform to the evolutionary trend of the property rights system of modern enterprises.

Three Types of Socialized Capital Converted from SOE Assets

Thus our approach to SOE reform is through the capitalization of SOE assets, the socialization of capital, and the pluralization of capital managers. The concrete method is to convert SOE assets into three different types of socialized capital: *public benefit capital, national equity capital*, and *national annuity capital*. These three types of capital will be managed by different capital/asset managers, while profits will be shared by the whole society via various channels and arrangements.

Public benefit capital is converted from SOE assets through allocating them to nonprofit social organizations for public benefit. These social organizations will assume the role of capital owner, and all dividends and capital returns from these equities will be used to provide relevant public goods and services. Public goods and services such as education, healthcare, scientific research, environmental protection, culture and art, social welfare, humanitarian services, and charities serve and satisfy the interests and needs of the large majority of society. Nowhere in the world can these goods and services be provided solely by the market; instead, they are largely supported by social donations and public finance. It is fully justified to allocate SOE assets to these social organizations to support public projects and undertakings that are enjoyed by and beneficial to all people. Such reform can reduce government annual financial allocations to those social organizations and can help those organizations become truly independent corporate bodies, rather than quasi-administrative agents, because at least part of their revenue will come from sources of their own, independent of government finance. This reform will benefit the whole society permanently. Moreover, since the social organizations that receive SOE equities will become the shareholders of SOEs, and the performance of their portfolio companies will directly affect the dividends and appreciation of their assets, they will have an immediate interest and incentive in maximizing the effectiveness of the management and governance of their portfolio companies. Obviously, this reform therefore will also help to develop a competitive capital management industry.

National equity capital is converted from SOE assets through contracting them out to professional capital management companies. It will be liquidated periodically to determine the amount of capital appreciation. The net will be infused into government revenue. The State Assets Commission will evaluate these capital management companies based on their market performance, and these companies will serve, on behalf of the State Assets Commission, as shareholders and the board of directors of their managed SOEs.

National annuity capital is monetary capital converted from the liquidation of SOE assets. This capital will be used to invest or purchase assets that can return a fixed income, which will be added to government revenues. We call this annuity capital because it is capital that can return a stable cash flow—although its rate of return is not high, it is stable. Most of the infrastructural sector, such as energy, transportation, electricity, and public utilities, is qualified to be an investment target of national annuity capital. These infrastructural facilities and projects will then be tender offered to professional companies to manage and operate.

There are now proposals to privatize at least part of the infrastructural sector, the reason being a capital shortage on the government's side. We disagree. Return from infrastructure should not be high. Infrastructural facilities should not pursue high returns. Otherwise, manufacturing costs will increase while competitiveness will decrease. Privatization of infrastructure will cause exactly this result. At the present, the government gives export rebates to subsidize enterprises, while it allows infrastructural enterprises to set their own prices. As a result, we see price hikes everywhere, from water, electricity, highway transportation, to communication and energy. This is contradictory to what the government intends. Facing intense international competition, it is necessary for the state to support domestic enterprises to enhance their international competitiveness, but direct financial subsidies do not conform to the World Trade Organization's regulations and will easily arouse international disputes. A better way to help enterprises is to lower fees for infrastructural usage. Thus enterprises can enjoy the same benefits but cannot be accused of receiving government subsidies. Infrastructure is an effective vehicle for keeping value. Through investment in infrastructure, national annuity capital can not only keep its value, but also reduce the use-cost of infrastructure, thus benefiting all enterprises as well as the whole society.

Of course, the State Assets Commission should hold a certain amount of SOE shares in order to keep informed of SOEs' performance and also to maintain the ability to directly intervene in corporate management and governance at critical moments.

The reform of SOE property rights through the creation of three types of socialized capital will result in a pluralized and socialized ownership structure of SOEs.

We believe this is a reform plan that can create a win-win situation and provide benefits to be shared by all the people. First, it can solve the problem of "incumbent property rights" in SOEs,[1] thus changing nominal state ownership into real socialized ownership, and making sure that the income and profits of SOEs will be shared by the whole society to the greatest extent possible. In addition, the reform can also solve the problem of "owner absence" in large SOEs by providing surrogate owners. Through the reform, shareholders, especially institutional shareholders, will have a substantial financial interest in the performance of their portfolio companies and in participating in corporate governance of these companies. At the same time, the pluralized and socialized ownership structure that will emerge from the reform will help improve and optimize the corporate governance structure of SOEs.

Second, the reform can help to greatly reduce government expenditures, substantially increase government revenue and improve government finance, and ultimately reduce the system risk of government finance. The reform will allow the government to greatly reduce financial allocations to education, healthcare, scientific research, and social welfare; it will also guarantee public organizations a stable source of funds, little affected by the fluctuation of government revenues. The reform can also bring substantial capital returns from national equity capital and annuity capital, thus increasing government revenue. In addition, the reduction of infrastructural fees will significantly reduce business costs, thus enhancing international competitiveness.

Third, this reform maximizes the principle of social equity. It ensures that the wealth of SOEs and the benefits of SOE reform will be shared by the whole society, and it can help to build a strong and permanent material foundation for the construction of a socialist harmonious society.

Fourth, the reform will promote a new breakthrough in the reform of public institutions such as education, healthcare, scientific research, and social welfare, all of which have been sluggish and lagging behind. Because the reform will make these institutions truly and financially independent corporate bodies, it will necessitate relevant reforms of these institutions, requiring them to learn investment and asset management, as well as to participate in the corporate governance of their portfolio companies. Therefore, SOE reform is not limited to SOEs, but will have a wide social impact and set in motion larger scale social reforms and promote a wider range of social participation. Furthermore, this reform will help enhance self-organization and self-governance within society, expand public space, promote the freedom and prosperity of scientific and academic research, and finally, propel the construction and development of pluralism, democracy, and a harmonious society.

In brief, the socialized reform of large SOEs can help extract China from the difficult situation of the current SOE reform and can help build an array of energetic and efficient large enterprises that can compete, and indeed excel, in the global economic arena. The reform can also drive a chain reaction in social reforms, can expand social participation, and can achieve a win-win situation and promote the goal of sharing national wealth, thus laying a strong and permanent material foundation for the construction of a prosperous, harmonious, and rich and equitable society, and supporting sustained economic and social development.

The Two Types of SOEs and Their Reform

The reform of SOEs of course should consider the different business natures of different SOEs. With regard to the business nature of China's large SOEs, we can distinguish two different types: one has a definite primary business, such as Petro China, China Mobil, and Baosteel; the other consists of multi-industry and investment holding companies, such as CITIC and China Merchant Group. Reform should differentiate between these two types of SOEs and treat them accordingly.

For SOEs with predominantly one type of business, such as Petro China, the reform would follow the above discussed three ways of converting their assets into three different types of socialized capital. If the net market value of an SOE is, say, 100 billion yuan, that can divided into three equal parts of 30 percent each, thus yielding 30 billion yuan as public benefit capital to be given to qualified social organizations, 30 billion yuan of national equity capital to be delegated to capital management companies to seek a long-term capital return, and the remaining 30 billion yuan converted into national annuity capital to purchase or invest in infrastructural assets that can return a fixed income.

For multi-industry and investment holding companies, reform would be two-sided: on one hand, the controlling company would be transformed into a capital management company; on the other hand, assets of its subordinate companies would be devoted to public benefit capital, national equity capital, and national annuity capital. Public capital would be allocated to social organizations; annuity capital would be invested in infrastructure; and equity capital would be managed by the capital management company transformed from the original controlling company. Of course, the capital management company thus transformed not only can manage its own equity capital, but also can and should manage other, custodial capital.

Take China Merchant Group as an example. One could first transform its controlling company and the management team into a professional capital management company, say China Merchants Capital Co., Ltd. Then one could take out part of the assets of its holding companies such as China Merchants Bank, China Merchants Securities, China Merchants Energy Shipping, and China Merchants Property, and entrust them as national equity capital to the newly founded China Merchants Capital Co., Ltd. The company would manage and operate this equity fund as well as other entrusted capital. Such a company, due to the incentive mechanisms introduced by the reform and its professional experience and skills, will be made more effective. The company would very likely become a leading enterprise in the industry of capital management, and could play a dominant role in the development of capital markets in China.

Three Players and the Development of a Capital Management Industry

It is obvious that the development of a capital/asset management industry is vitally important to the socialized reform of the SOE ownership system. The three types of socialized capital should all be entrusted to a capital/asset management agency. For example, when a social organization receives public benefit capital, it would set up its own capital management agency to manage and operate its assets and to seek capital appreciation. Similarly, for national equity capital to achieve sustainable growth there must be a healthy and effective capital management industry. Finally, the operation of national annuity capital also requires an effective asset management market. Therefore, the development of a healthy capital/asset management industry is the key to the success of the socialized reform strategy.

To develop a capital management industry in China, the reform can and should depend on three players. One major player will be former SOE holding companies transformed into professional capital management companies. These companies, due to their scale, their experience in capital management and operations, and their position in the industry, can be expected to become large-scale and leading companies in the industry. Examples of such companies included China Merchants Group, the State Development and Investment Corporation, and China Resources.

The second player would emerge from the social organizations that receive public benefit capital. To manage this capital these organizations would set up an endowment fund and hire management professionals. Thus we would soon see a group of endowment funds active in the capital market, such as, for example, a "Qinghua Endowment Fund," a "Peking University Endowment Fund," a "Chinese Academy of Science Endowment Fund," and so on. Of course, this would not be an overnight process; rather, it would take time to grow and develop. In light of the experience of developed societies, this type of fund managed by social corporate bodies would become an important and active player in the industry, and would provide financial support to the healthy and sustained development of social organizations for public welfare.

The third player would be domestic private equity companies like those that have emerged in recent years. They could easily, and should be allowed to, extend their business into the management of socialized capital. In addition, a certain amount of foreign capital should also be allowed and encouraged to do business in China's capital management industry. As long as we have appropriate regulations and supervision, their participation and competition will have a positive impact on the development of this industry in China. The key is to work out the strategy and formulate industry regulations as early as possible so as to speed up the growth and development of the industry.

An Estimate of the Results of the Socialized Reform of SOEs

In order to have a clear understanding of this reform strategy as well as its effects, it is necessary to have a quantitative estimate of the scale of wealth and the financial effects involved in the reform. Of course, such an estimate cannot be precisely accurate, but it can help us to gain a general idea of the results of the reform.

Since most large SOEs are listed companies or at least their main businesses have been listed, we can estimate the value of SOE assets in terms of "market value" following the common practice of capital markets instead of looking at "net assets," an index system of official statistics. We estimate that in the next several years the total market value of SOEs in China will remain about 50 trillion yuan.

Suppose that the State Assets Commission will retain 10 percent of SOE assets after the reform, and the rest will be divided equally among the three types of socialized capital. The result will be the following allocation percentage:

1. The State Assets Commission will hold 10 percent of total assets, which is 5 trillion yuan;
2. Public benefit capital will hold 30 percent, 15 trillion yuan;
3. National equity capital 30 percent, 15 trillion yuan;
4. National annuity capital 30 percent, 15 trillion yuan.

Let us further estimate what the return on these types of capital will be once the system is in operation.

Public benefit capital, which as we have noted would be allocated to social organizations for public welfare: If each qualified organization receives 50 billion yuan, there will be 300 such organizations receiving capital. If we suppose that the average annual return on this capital is 6–8 percent; the total return would thus be 900–1,200 billion yuan. Thus the government can reduce its financial appropriation to these organizations by at least half of that amount, which means the government can reduce its annual expenditures in this regard by between 450 and 600 billion yuan.

National equity capital, entrusted to professional capital management companies to manage: If each company manages 10 billion yuan, 15 trillion yuan in total will be needed to fund about 1,500 companies (this number is big enough to make a healthy and competitive capital/asset management industry). Suppose the appreciation rate of this equity capital will be the same or slightly higher than the growth rate of the national economy, say 10 percent annually, the value of this capital will double in seven years.

National annuity capital, which would be used to purchase or invest in infrastructural assets that can return a fixed income, can be entrusted to professional management companies, or be managed by state-owned holding companies. Since the use-cost of infrastructure will directly affect the competitiveness of the national economy, profit making should not be the purpose of infrastructural assets like these. Considering the financial cost, we can set an annual yield rate of 5 percent for these assets; thus we will have 750 billion yuan in annual revenue. Moreover, the value of these assets will appreciate along with general economic development. More importantly, because of this, we can create tremendous savings for the real economy. Take highways as an example. The current high toll fees can be greatly reduced after tolls are taken over by national annuity capital. This can not only save enterprises as well as society as a whole a great deal, it can also facilitate a change from the system of charging tolls to a surcharge on fuel. All toll booths can be demolished, and the enormous waste in fuel, labor, time, road space, and so on, due to toll-payment stops can thus be avoided.

In summary, after the reform, SOE assets would be turned into three types of socialized capital. These types of capital will not only provide financial support to various social organizations but also help reduce costs for enterprises. Thus their benefits will be enjoyed by society as a whole. At the same time, government finance will also greatly benefit. The government can cut its allocations to social organizations by about 450–600 billion yuan, and can have a fixed annual income of 750 billion yuan. In total, the government will increase its revenue by 1,200 billion yuan or more. This would be a fifth of government revenue in 2011. Additionally, 15 trillion yuan of national equity capital and 15 trillion yuan of national annuity capital would continue to appreciate along with the growth of the national economy. All this will be of great significance to the improvement of the government's financial situation.

Construction of a New Management System of National Wealth

The above analysis shows clearly that the SOE reform not only involves enterprises, but also has a significant impact on the whole situation of national wealth. In fact, in order to build an economic foundation for a socialist harmonious society, China must not only build a social sharing system of property rights through SOE reform, but also go further by building a system for managing national wealth.

This important task involves a wide range of issues. A detailed and full-length discussion is needed to explore its significance, necessity, and possibility. Here we will only draw a tentative sketch as a starting point for further study.

1. *The potential value of China's national wealth is huge, unprecedented, and exceptional in the world*. The value of SOE property discussed in this article is already tremendous; however, this is only a part of the potential value of China's national wealth. The potential national wealth includes land and other real estate, resources, and market access and entry, and so forth. The value of this potential wealth is in proportion to economic development, especially industrialization and urbanization. It is easily to see that the industrialization and urbanization China is currently undergoing are transforming several hundred million rural farmers into workers and urban residents. Their needs for housing, transportation, education, healthcare, and cultural and recreational facilities will be huge, and will be no different than building another urban China. The original increment of land value due to rapid and large-scale urbanization is an astronomical figure. In the nations of the West as well as in most other nations of the world, the original increment of land value has been basically enjoyed by private landowners, because in these countries, historically, privatization and marketization took precedence over industrialization and urbanization. In contrast, in China the reform and opening in the past 30 years has pursued the path of industrialization and urbanization first, followed by the reform of the property rights of SOEs. Thus the original increment of land value is owned by the state and the whole society. This is a special bonus of Deng Xiaoping's model of "socialism with Chinese characteristics." It is also the good luck of the Chinese nation. The long-term significance of this potential astronomical wealth to China's development cannot be overestimated.

2. *The realization of this potential national wealth will provide strong material support for building an assets-based public policy system, and will surpass the revenue-based mixed economy model of the West*. More importantly, it will provide a sustained economic foundation for building a socialist harmonious society.

In order to counteract the drawbacks of a typical market economy, developed nations in the West established a mixed economy with macro-policies and income redistribution as a supplement. However, as experience has shown, without support based on public wealth, a mixed economy will inevitably face one crisis after another. Income redistribution can temporarily redress the gap between the rich and poor, but will lead to problems such as welfare dependency, a drop in incentives, high taxes, and the like. Macro-policy may have short-term effects in stimulating demand, but will easily lead to wage and welfare rigidity and stagflation. With the long-term support of China's huge national wealth, we can envision that the Chinese government can develop strong capital-based policy tools and can be much less dependent on a purely income distribution policy. Moreover, it can achieve social fairness and equity on the one hand, and can ensure the energy and efficiency of society on the other; it can keep the macro-economy stable and can also keep prices stable as well as achieve sustained economic growth. Therefore, to construct a new management system of national wealth, to effectively manage and use this huge amount of social wealth, will be extremely important and of long-lasting significance as China builds a new economic model surpassing the mixed economy of the West and builds a socialist harmonious society.

3. *To build a management system of national wealth China must replace the current framework of public finance*. Obviously, the system of managing national wealth discussed here involves a much wider and deeper issue than the existing concept of public finance. The contents of public finance as it now exists are tax revenues and budget expenditures. Its main issues include the scale, structure, procedures, and regulations concerning revenues and expenditures. While the management of national wealth concerns mostly the management and appreciation of national wealth, its main task is the management of assets and liabilities. How to expand the framework of public finance to integrate a dimension of asset and liability management, thus creating a management system of national wealth "with Chinese characteristics," will be not only a challenging theoretical task, but also an important practical task for building a "socialism with Chinese characteristics."

We have before us a historic opportunity. Much depends on our present choice, which will in turn affect the historical trend of China's development in the coming decades. By socializing SOE property rights, we can unite to the greatest extent the consensus and strength of the whole society to build a socialist harmonious society.

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Note

1. So-called "incumbent property rights" refers to the situation where SOE property rights are actually controlled by managers, while the profits are mostly enjoyed by SOE managers and employees through bonuses and benefits. An obvious example is that the income and benefits enjoyed by many SOE employees are much higher than the national average.

Biographies

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