**Chinese State Capitalism**

***What instruments of power and control are used by the Chinese Communist Party (CCP) to influence Chinese firm behaviour and China’s economy?***

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**Introduction**

The Chinese Communist Party (CCP) is present everywhere in China’s vastness, ubiquitous in all aspects of society, across the diverse regions of the country, and central to the economy. Moreover, as a developmental state (Witt and Redding 2014, 13), the Chinese government is heavily involved in coordinating the economy. Since China is a one-party state, the CCP occupies the top positions in the bureaucratic system and influences all areas of life (Kroeber 2016, 3; Brødsgaard and Beck 2021, 53-4). But just how does the party achieve this, on such a scale? What are the key political, financial, and legal instruments that the CCP utilises to exert such pervasive power and control over Chinese firm behaviour and China’s economy?

Following the logic of 'political governance pillars'(Jin et al. 2022, (2), I shall approach these questions from the overall vantage point of China’s state capitalism. I will do so by addressing three separate, but interlinked, issues: First, the Chinese proliferation of state ownership; secondly, China's nomenklatura system; and finally the country's one-tier corporate governance structure.

State-owned enterprises (SOEs) have traditionally been the “backbone” (Song 2018, 345) of the Chinese economy and act as conduits for delivery of key party-political objectives, such as the development of strategic industries and provision of social welfare (Jin et al. 2022, 2). SOEs encapsulate the link between the state and the economy, and as such by examining the state sector, reforms thereto, and the blurring lines between state and party, we can gain insight into how the CCP maintains political control over the firms and economy whilst still allowing market liberalisation and growth (Leutert 2018, 28).

State-owned enterprises (SOEs) have traditionally been the “backbone” of the Chinese economy and act as conduits for the delivery of key party-political objectives, such as the development of strategic industries and provision of social welfare . Put differently, SOEs encapsulate the link between the state and the economy. By examining the state sector, reforms thereto, and the blurring lines between state and party, we can gain insight into how the CCP maintains political control over the firms and economy whilst still allowing market liberalisation and growth Here the varying role of SASAC (the State-Owned Assets Supervision and Administration Commission of the State Council) as stakeholder and centrepiece of state capitalism (Lin and Milhaupt 2013, 745-6) will be examined alongside China’s ‘National Champions’ (Brødsgaard 2012; Lin and Milhaupt 2013; Nolan 2001).

Through the “nomenklatura system” (Brødsgaard 2012, 633), the Central Committee of the CCP (CCCCP) wields considerable influence over current and potential staff appointments, at all levels, within the civil service, the party political office, state and business administration and management, and SOE executive leadership. Under this nomenklatura system, party presence is manifest indirectly through cadres. With civil servants at the core, these cadres refer to bureaucratically and occupationally positioned persons who constitute both the partys and the state’s administrations (Brødsgaard and Beck 2021, 53-4). Herein, The nomenklaturas personel rotation and management between party, state, and business positions, within cadres and SOE executive leadership, help sustain, protect, and perpetuate CCPs control and influence (Brødsgaard 2012; Brødsgaard and Beck 2021; Leutert 2018; Lin and Milhaupt 2013).

Finally, the Communist Party’s active role in decision-making directly at the firm level is visible through China’s one-tier corporate governance system (Thomsen and Conyon 2019b, 118-9). China’s iteration of corporate governance allows party members on the board or in management to exact the CCP’s “collective will through their voting on corporate decisions” (Jin et al. 2022, 18). Thus, the party serves both political and leadership core functions of the state-owned firms .Here the history and statutory role of the party, as well as its party-regulation-based practice find expression in the party’s role in Chinese corporate governance (Beck and Brødsgaard 2022).

Concluding, this paper finds that alongside state ownership and nomenklatura management, corporate governance plays a key role in the creation of the state capitalist system in China where the CCP continues to exert control in a changing political and economic landscape (see Jin et al. 2022, 7).

**State Ownership**

**Understanding the Label ‘State Capitalism’: China’s Economic Development and SOEs**

To understand China’s state-owned sector, let us first discuss the label of ‘state capitalism’. Hall and Soskice’s seminal work on varieties of capitalism (VoC) posits that national political economies take two forms: liberal market economies (LMEs) or coordinated market economies (CMEs) (Hall and Soskice 2001, 5-9). LMEs take an ‘arm’s length’ approach, basing the economy on competitive market forces. In CMEs, firms typically depend more on non-competitive market forces and strategic coordination with other market actors (e.g., government, firm, finance institutions, etc.) “sets the equilibrium” (Hall and Soskice 2001, 8). VoC theory does not, however, adequately describe Asian economies (see Witt and Redding 2013, 295) and fails to capture aspects of China’s economy, leaving it “*hors catégorie*” (Zhang and Peck 2016, 59). SOEs is one of these aspects, intrinsic and crucial to China’s economy to an extent and with a complexity that is arguably unique even amongst other developmental economies. China’s SOEs are at the top of the industrial economic tier list, monopolising key industry segments like energy and resources (ibid, 60), actioning state and party policy objectives and “advancing national interests” (Song 2018, 365; see also Jin et al. 2022, 3).

Starting in 1978, fundamental economic reforms began to take place under the leadership of Deng Xiaoping, opening up China’s economy and adopting aspects of free market economics. However, despite moves towards market liberalisation, China’s industrial policy maintained the promotion of large rather than small firms during the economic transition, at odds with established neoclassical free market economics and in contrast to approaches seen in the former Soviet Union (Nolan 2001, 3). Influenced by what the West did during the industrial revolution and early 19th century – where firms grew strong protected by government policy – and, more contemporarily, by Japan whose firms, supported by policy and central coordination amongst state and business conglomerates, competed directly with these established Western firms, the party-state actively challenged the world’s leading industrial enterprises(ibid, 8-16). Chinese policy makers, moreover, were inspired by similar developmental state approaches seen in Taiwan, Korea, Singapore, and by the dominance of large firms in Hong Kong (Nolan 2001, 11-4). Reforms were trial-and-error, transitioning the economy like “crossing the river by feeling for the stones” (Kroeber 2016, 16) to deliver on economic growth. By 1986-7, policy makers began to draft policies that would promote further growth through jurisdiction aimed at developing enterprise groups based around SOEs and large firms (Nolan 2001, 18; see also Lin and Milhaupt 2013, 712-3).

**The National Champions**

Combined across 1991 and 1997, 120 large enterprise groups in key strategic industries[[1]](#footnote-2) were chosen by the State Council to be trial members of a team of globally competitive national champions (Brødsgaard 2012, 628). These national champions received preferential treatment from the state in the form of rights to make investments and of eligibility to engage in international trade, listing rights on domestic and international markets, rights of capital retention, and well as financial support from state owned banks (Nolan 2001, 18-19).

The national champions consolidated multiple SOEs into a handful of dominant vertically integrated business groups, concentrating economic activity to a handful of large consortiums. This removed regional players and centred industry around core firms controlled by the state, as with the case of China National Petroleum Corporation (CNPC) and Sinopec in the oil and gas industry (Brødsgaard 2012, 629). The core national champion firms would then relay state directives to the firms underneath them and ensure the implementation of party-state objectives (Lin and Milhaupt 2013, 714). Controlled, supported, and driven by the state, national champions perfectly exemplify state capitalism as “the global face of China Inc.” (ibid, 702). Further reforms under Zhu Rongji in 1998 dissolved the state’s industrial ministries to be reformed under the singular State Economic and Trade Commission (SETC). Now that national champion groups no longer had a direct industry-ministerial counterpart, this had the effect of substantiating the relative position of the national champion business groups in relation to the state (Brødsgaard 2012, 629).

Furthering the policy thus far of “grasping the large, letting go of the small” (Song 2018, 356), the Hu administration created the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) in 2003, and removed much of the national champions’ previous social welfare function, making them more market focused and competitive (Jin et al. 2022, 4). SASAC received the combined management and monitoring authorities held by SETC, alongside that of the Central Enterprise Work Commission and the ministry of finance (Brødsgaard 2012, 630). Representing the nexus of issues of state control, of party influence, and of business liberalisation, investigation of SASAC provides key insights into the development and nature China’s state capitalism (see Lin and Milhaupt 2013, 745-6). As 100% share controlling stakeholder in the national champion groups core companies, SASAC is positioned to enforce state policy adherence throughout the business groups (Lin and Milhaupt 2013, 700). Simultaneously, under the supervision of the Central Committee of the Chinese Communist Party (CCCCP) party committees (LPCs) were introduced to the firms within the business groups, allowing the party to spread its influence indirectly (this is discussed in detail in a later Corporate Governance section). The CCCCP gained the right to appoint and monitor SASAC leaders, and party members started to take key management positions, being allowed to serve as chair of the board of directors (ibid, 4-9). As such, the corporate hierarchy of the national champions control structure became two-fold: SASAC regulating on the legal basis as stakeholder, and the party who shadows it (Lin and Milhaupt 2013, 711).

To cultivate global competitiveness, SASAC encouraged national champions - who might compete domestically - to collaborate in foreign markets, typically under shared ownership or contractual partnership agreements (Lin and Milhaupt 2013, 723). The business groups became more diversified and autonomous on the back of their successes, cultivating an increasing political influence of their own. This shift in power dynamic between SOEs and the state was exasperated by a lack of fund remuneration back to the state (stakeholder dividends), SASAC understaffing, and SASAC having no direct say in board or senior member personnel appointments. The state’s control of the SOEs through SASAC became slack and the national champions began to effectively govern themselves (Brødsgaard 2012, 630; see also Leutert 2018, 27). Indeed, whilst centralisation under SASAC led to SOE performance improvements, indeed issues came with it. Other authors on the subject suggest that as both agent and principle, SASAC fundamentally lost the ability to effectively perform management and monitoring functions (Jin et al. 2022, 12; see also Song 2018, 360-1).

Liberalisation reforms to the economy, via and in combination with SOE reform, have transformed China into an economic superpower. Examination of these developments shows that Chinese leaders continually adapt to new challenges, finding new ways to simultaneously maintaining control. The party-state firmly rejects the choice between loosening political control in exchange for economic prosperity or maintaining economic control at the cost of stifling economic growth (Kroeber 2016, 24-5; see also Brødsgaard 2012, 625). Through state-capitalism they can indeed ‘have their cake and eat it’. Xi Jinping’s administration is no different. Since taking power, Xi Jinping’s drive to reclaim the authority lost during the previous administration has seen further reform to SOEs and SASAC, using the party as the key instrument. Under the 2013 ‘Decision on Major Issues Pertaining to Deepening Reform’, the CCCCP formed the State Capital Investment and Operating Companies (SCIOCs) and assigned to them much of SASAC’s stakeholder rights (Jin et al. 2022, 12). Taking over SASAC’s capital management and financing role has effectively limited SASAC to regulatory functions and given wholly state-owned SOE leadership and key personnel appointment rights to the Organisational Department (OD) of the CCP (Jin et al. 2022, 14). This effectively reinstates the control and influence of the CCP over the state in the state-owned sector, and a dominant proportion of the economy as a result. Alongside this Xi Jinping has strengthened the role of the party as a controlling element in several related ways (Leutert 2018, 27), key ones of which are discussed in later sections of this paper.

**The Nomenklatura System and Rotation**

The party is further able to embed political control into a more liberalised and diverse China through the “nomenklatura system” (Brødsgaard 2012, 633). Party control is orchestrated along a sprawling network of financial relays and relations (Zhang and Peck 2016, 64) through leadership appointments to the three intrinsic components of China’s “Iron Triangle” (Brødsgaard and Beck 2021, 57) power system: the party, the state, and business. Brødsgaard (2012) describes this system as consisting of two lists detailing current and future prospective leadership and management appointments to the aforementioned core three institutions at all levels (local, regional, central etc), as well appointments to some educational establishments (Brødsgaard 2012, 633). The first list is managed entirely by the Organisational Department at the party’s centre. In the second management is shared with other party-state bodies.

A key element to this system is rotation. The CCP has already established a presence in all aspects of the national political economy indirectly through cadres - bureaucratically and occupationally positions persons who constitute pillars of both the party and the state’s administrations (Brødsgaard and Beck 2021, 53-4) – which it rotates and transfers around party and government bodies. Under the nomenklatura system, this practice is extended to the business sector. As SOE CEOs are almost always party members, they are part of the nomenklatura which enables the party to rotate them around business, state, and governmental positions (Brødsgaard 2012, 633-8). The central powers of the CCP not only dictate who will take the top party and state positions, they coordinate the top executives of China’s leading state-managed companies, giving many of them high administrative rank (ibid, 634; Brødsgaard and Beck 2021, 55). To illustrate this concept of rotation, take the example of Xiao Yaqing. He was moved from China Aluminium Corp to be made vice secretary general of the State Council in 2009 and then made deputy director for a State Council leading group in 2013. Further he was appointed as a full member to the Central Committee in 2017 and was made minister for Industry and Information Technology in 2020 (Brødsgaard and Beck 2021, 63-4).

Rotation is a useful instrument of control and influence for the party in several ways. A key one being that it allows the upkeep of the party’s centralised authority and influence. Regular rotation prevents power concentrating around individuals in firms where corporate oversight is not developed or institutionalised (Lin and Milhaupt 2013, 741). In the same stroke, rotation of top positions scuppers the formation of “personal networks and autonomous bases of influence in their enterprises” (Leutert 2018, 30). This limits the emergence of powers that might oppose or compromise the party’s position and grip. At the same time CCP officials are also keen to develop, and capture, new talent for the party and see business leaders as prime candidates. Through rotation the CCP can capitalise on the extensive experience and competencies that business leaders have accumulated through work in various sectors of Chinese society and integrate them into the party system (Brødsgaard and Beck 2021, 68; Brødsgaard 2012, 638).

However, a major drawback of this system of nomenklatura and rotation thereunder is the resulting influence that business groups can then exert onto politics. Many state-owned sector business leaders are represented on the CCCCP (Brødsgaard 2012, 639) and can use their position to their advantage, influencing politics through corruption. The fact that SOE leaders and corporate management team members often hold ranks that are equivalent to top party leadership positions – such as exactly in the anticorruption office (Discipline Inspection Commission) – by virtue of the nomenklatura system, does indeed help the party mitigate this issue (Lin and Milhaupt 2013, 737). Xi Jinping has also made exactly this issue of corruption a key target for this administration since 2012, enacting ambitious anti-corruption campaigns (Leutert 2018, 32).

But how are we to understand this complex relationship between party, state, and business? How does the party use the nomenklatura system to maintain control over the economy? Brødsgaard (2012) proposes that we might better understand this power relationship through the notion of “integrated fragmentation” or “fragmented integration” (Brødsgaard 2012, 643). This concept seeks to define the situation we see, where powerful SOE business groups, with their own interests and global/domestic networks, fragment the party’s centralised control, whilst the party-state works to ultimately retain control, integrating the business groups into the party system and embedding the party into the business groups’ top positions.

**Corporate Governance**

In 1999 concepts of corporate governance were officially implemented in China (Leutert 2018, 30-1). Whilst practices of corporate governance varied, as of 2019 the standards first created by SASAC in 2004 are now used by the majority of SOEs (Beck and Brødsgaard 2022, 490-1). Alongside the USA, UK, and Japan, China can widely be classified as having a one-tier board system, whereby shareholders elect the board who in term appoint the executives (Thomsen and Conyon 2019b, 118-9). The board also acts as the intermediary between stakeholders and the management team of the firm, overseeing business strategy, hiring, and firing, auditing, and monitoring performance (Thomsen and Conyon 2019a, 623). Factors such as those discussed previously - with the state being ultimate stakeholder for SOEs and the party’s central committee owning the rights to appoint executives – create an approach to corporate governance which is uniquely Chinese. The stakeholders of SOEs are, of course, the people and ultimately the party.

Of fundamental import is the way in which decision-making authority is delegated, and how the party has influence, throughout the firm. Crucial in this, are party organisations. A big proportion of SOE employees are party members, and currently there are party organisations at each layer of national business groups’ organisational strata (Lin and Milhaupt 2013, 727-8). These party organisations (LPCs) were first introduced in 1997, with further guidance being given in 2010. The guidance comes from party guidelines, wherein the CCP made it explicit that the party must be consulted for opinion on important matters relating to SOE decision-management (Jin et al. 2022, 18). Important matters are defined in the 2010 regulations as relating to generally important matters, the hiring and firing of important cadres, important investment decisions, and to the use of large amounts of capital – also referred to as the “three-important and one-large” (ibid, 4). Additionally, under a system of two-way entry and cross-appointment, party members are currently allowed to sit directly on the board. With the voting rights that came with this, party members can advocate for and exercise the will of the party on internal firm decisions (ibid, 9; see also Beck and Brødsgaard 2022, 497).

Further CCCCP regulations set out in 2015 and in 2018 provide for a strengthened party position via party organisations and indeed tightened its influence. Doing so, the internal guidelines of the party took precedence over that of national or governmental law. Whilst the requirement to have party organisations in SOEs is stated in article 19 of the Company Law of the People’s Republic of China, the exact role as decision-making arbitrator and the powers allotted to party members is only stipulated in party regulations (Beck and Brødsgaard 2022, 492-3). Regulations in 2022 have further emphasised that final decision-making power lies with the party group, stipulating that all matters of major concern should be discussed through the party group before being taken to the board of directors. Theses regulations further mandated that party committees should be established in firms with over 100 members, a general branch should be incorporated in firms with 50-100 members, and party branches for firms with 3-50 party members employed (ibid, 495).

Xi Jinping has made it clear that the party, through organisations within the firm, “should serve a “leadership core” function as well as a “political core” function in state firms” (Leutert 2018, 31). By way of regulatory instruments enacted under his tenure, this is most definitely the case. With the party firmly placed at the centre of SOE firm decision-management, the party has significant and all-encompassing influence and control. Whilst Xi Jinping’s administration maintains a relatively clear separation of state and business, in terms of strategic decision making this separation does not carry over to the party (Beck and Brødsgaard 2022, 488).

**Conclusion**

Due to the deep, overlapping, and complex interconnectivity between the party and the state discussed throughout this paper, it is difficult to conclude anything but that the Chinese Communist Party has ultimate control over China’s economy, right down to the firm level.

“Rather than a tiny cabal of secretive leaders, it is a vast organization of some eighty-six million members (more than 5 percent of the nation’s population) that reaches into every organized sector of life including the government, courts, the media, companies (both state-owned and private), universities, and religious organizations. Top officials in all these organizations are appointed by the party’s powerful Organization Department” (Kroeber 2016, 3)

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1. Such as: electricity, coal, automobiles, electronics, iron and steel, machinery, chemicals, construction materials, transport, aerospace, and pharmaceuticals [↑](#footnote-ref-2)