

ENTERPRISE REFORM AND SOCIAL SECURITY SYSTEM IN CHINA

Keun Lee

Seoul National University

Introduction

Reform of state-owned enterprise has been at the top of the policy agenda in China. Very recently it was recognized that reform of the social security system is a pre-condition for successful reform of the state enterprise system. So far, enterprise reforms in China tended to focus on property rights and the governance structure of the firm. However, another independent and important issue is the weighty "social burdens" of state enterprises in China. Those burdens include providing jobs, education, child care, health, and other cultural services for both incumbent and retired employees. These expenses have emerged as a serious burden to the enterprises.

The impacts of reforms on the social security system are regarded as substantial, having the following important implications for enterprise reforms (SCESR 1995).

First, more efficient resource allocation requires restructuring of industrial structure and related enterprises, especially the re-allocation of redundant workers. However, from the workers' point of view, if leaving an enterprise means giving up all the benefits of housing, pension, and medical services, then restructuring will not be accepted. Thus, it is necessary to separate social welfare benefits from enterprises and make them the responsibility of society, not enterprises.

Second, to promote fair competition, social burdens of enterprises should be equal regardless of location and the ownership of enterprises. At the moment, social burdens of state-owned enterprises are much greater than private-sector enterprises.

Third, to promote economic security of workers and social stability,

* This research was supported by the 1995 Research Funds for Area Studies provided by the Korea Research Foundation.

social security coverage should be extended to non-state owned enterprises as they absorb more and more labor forces.

Fourth, to promote labor mobility across industrial sectors, localities, and ownership types, social security system should be unified rather than segmented by ownership types, localities, and industrial sectors and not managed independently as it is now the case.

In sum, Chinese policy makers' position is that without successfully reforming the social security system, any attempt to reform enterprises would fail and the overall effects limited. Given the importance of this issue, this paper aims to analyze state enterprise reform in China, with a focus on the social security system.

The paper will start with documentation on performance and social burdens of state enterprises in China in section 2. Section 3 will review the progress of social security system reform in China. Section 4 discusses the experiences of several enterprises as case studies. Section 5 discusses the issue of what should be reformed and what should be kept, combining the information from case studies and social security reform policies presented in previous sections.

Performance and Social Burdens of State Enterprises in China

Over the past 15 years of reform, Chinese authorities undertook many measures to vitalize their state enterprises. However, up to now, the results have been mixed, with large and medium-sized state enterprises performing the worst.¹ The Chinese dilemma is that the profitability performance of the state sector was increasingly weakened despite the series of reform measures enacted over the last 15 years. Official statistics report that in 1992, about one third of the state enterprises were suffering losses; however it is believed that the actual proportion of the loss-making

¹ Out of about 100,000 state-owned industrial enterprises, large and medium-sized ones account for less than one tenth of the total and less than 3 percent of the total industrial enterprises in China (State Statistical Bureau, China, 1994). However, large and medium-sized state industrial enterprises produce roughly half the total industrial gross output and account for about 70 percent of the total fiscal revenue of the central government. Furthermore, if we accept that some industries are more important than others for a developing country like China, the importance of state enterprises is even greater than the level of their share of output. They are in charge of the so-called "back-bone" industries of energy, transportation, electricity, large-scale machinery, iron and steel, chemical, and so forth.

enterprises was as high as two-thirds due to many hidden losses. According to the *China Economic Daily*, official statistics report that about a half of all the state enterprises are operating at a deficit (Sin 1994). In other words, it seems certain that the trend of deteriorating performance is ongoing.

Although the profitability of state enterprises has unquestionably worsened, there is still a relatively large volume of literature that report improving productivity of the state sector in China (Chen, et al. 1988; Dollar 1990; Jefferson, et al. 1992; Jefferson and Rawski 1994)², and a relatively small volume of literature arguing negligible productivity growth (Woo, et al. 1994; Lee 1990).³ Here, an important point to be noted is that falling profitability is not inconsistent with rising productivity (Naughton 1992; Lin 1995). In other words, the criteria for performance assessment should include not only physical TFP but also financial performance (profitability), intertemporal efficiency, and implications for macroeconomic stability. Increasing government burden in giving subsidies to loss-making enterprises have created a state fiscal crisis that has threatened China's infrastructure investments and macroeconomic stability. Financial performance of state enterprises is especially important because of the implications it has for macroeconomic performance. To the extent that the state sector's inferior performance results in lowering the nation's average growth rate and diverting investment funds away from infrastructural construction, we can say that China's state sector hinders economic growth. State enterprises are responsible for budget deficits, excessive and unprofitable fixed investments, and the relative stagnation of heavy industry in contrast to the booming light industry. It can be said that these enterprises are the real bottlenecks of a sound economic take-off or transition from a reform miracle to another East Asian miracle.

Deteriorating profitability is widespread throughout China's state sector. One direct reason for this is the shortage of operating capital, which has been confirmed by the enterprise visits in Shanghai and Guangdong

² Chen et al. (1988) found a total factor productivity (TFP) growth of 5.5 percent in the 1979-85 period, which was much higher than the pre-reform period of 1957-78 at 0.9 percent. Dollar (1990) reported basically similar results from enterprise data. For the 1984-87 period, Jefferson et al. (1992) found an annual TFP growth of 2.4 percent at the city/county level by estimating the gross-output production function. Jefferson and Rawski (1994) argued that TFP growth in state enterprises was just under about 2 percent from 1980 to 1984, and that it accelerated to about 3 percent from 1984 to 1988, and slowed down to about 2.5 percent from 1988 to 1992.

³ Woo et al. (1994) found that there was zero TFP growth in state-owned enterprises. They argued that the previous results confirm a positive TFP growth and reflect their underdeflation of gross output and overdeflation of intermediate inputs.

(Lee 1994) and other surveys including Sun et al. (1994). According to a survey of 443 firms in the Liaoning province, July 1993, more than 90 percent of the respondents answered that the lack of funds was the largest cause of production abnormality (Sun et al. 1994).

One of the many causes for this funds shortage is the excessive financial burden of the 'social services' provided by state enterprises, including lifetime employment, housing, education, hospital, social security, and food services. The consequence is that state enterprises have redundant workforce, amounting to 30 to 40 percent (national average) of the total (Broadman, 1995) or about 21 percent according to surveys carried out in February and March of 1995 covering 300 enterprises in Beijing, Shanghai, Tianjin, Guangzhou, and Shenzhen (China Daily, August 24, 1995). Another survey from Liaoning estimates that redundant workers comprised roughly 23 percent of the entire workforce, and that the number of retired workers was as large as 41.3 percent of the total workforce (Sun et al. 1994). These retired or surplus workers add to the increasing financial burdens of the enterprises. (since they are supposed to support these workers whether or not they produce at all.) One estimate suggests that the social services amount to about 6 percent of total costs and 40 percent of the wage bill in a typical urban state enterprise (MacMurray and Woetzel 1994; recited from Broadman 1995).

These heavy enterprise burdens have resulted in debts. The same survey in Liaoning reported that these firms have a cumulative total of 19.74 billion Yuan debts, which is roughly twice as large as the total realized profits by these firms during the seventh five year plan period (1986-90). The debts include operating losses, welfare benefits owed including those to retired workers, and over-due-loans from banks. Since the ratio of profits to operating funds is lower than the interest rates on loans charged by banks, enterprises do not have enough funds to pay back their loans. The survey reported that the amount used to repay interest and principal is as much as three times the amount of realized profits (Sun et al. 1994).

Reform of the Social Security System in China

In China's social security system, the four major items are housing services, retirement insurance, medical coverage, and unemployment insurance. These four items account for about 75 percent of total welfare-related expenses (table 1).

Table 1. Social Security and Welfare Related Expenses in China, 1993

	Total Expenses (million Yuan)	Share as % of total	Share in Total Wage Sum
Retirement Insurance	59542.7	18.79	12.1
Enterprises	45152.7	14.25	9.17
State Units	14390	4.54	2.93
Unemployment Insurance	940	0.3	0.19
Medical Expenses	45980	14.51	9.4
Work-related Injury	40	0.012	0.008
Family Planning Insurance	50	0.015	0.008
Other Insurance	59267.3	18.7	12.0
Public Social Security Expenses	7525	2.4	1.5
Public Hygiene-related Projects	12543	3.96	2.6
Sub-Total: All Social Security Related Expenses	185888	58.66	37.8
Housing Services	131000	41.34	30.0
Total	316888	100.0	67.8

Source: SCE SR (1995), p. 48.

Retirement Insurance⁴

China's retirement insurance system was originally established in the early 1950s. In the original system, not only insurance premiums but also its administration and execution were all handled by the enterprises. In other words, it was not a social insurance system but an enterprise insurance system. Beginning in 1984, the Ministry of Labor initiated reform of the retirement insurance system in state enterprises, the main direction of which was to integrate decentralized and fragmented administration and fund the management system. In 1991, the state declared "decisions on reform of the retirement insurance system for enterprise workers," and the reform got momentum.

The first reform policy was to build unified insurance system. At the current stage, the fund management and administration is unified up to the level of cities and counties. In 1993, a total of 83.02 million incumbent and 17.70 million retired workers were under the unified retirement funds, and they account for 71.8 percent of total incumbent workers and 81.2 percent of retired workers in China. 77.06 million incumbent workers and 16.28 million retired workers were under the unified insurance system by

⁴ The information here relies on SCE SR (1995) and Hu (1996a), unless noted otherwise.

the local government. The remaining workers joined the unified insurance of the central government. Financial burdens of retirement insurance are shared by the government, enterprises, and individuals. Individual workers pay between 2 to 3 percent of their wages as an insurance premium. Retirement insurance for government staff was also started, and coverage is being extended to peasants; 45 million peasants in more than 1000 counties joined the insurance system.

*Unemployment Insurance*⁵

The unemployment insurance system was first established in 1986, with the promulgation of the tentative provisions on unemployment insurance for workers in state enterprises. This provision deals with workers discharged from bankrupt enterprises with the enforcement of the bankruptcy law in 1986. In 1993, new provisions extended coverage of unemployment insurance and revised the worker's insurance premium. In the previous system, workers were supposed to pay 1 percent of the standard wages. Now, it changed to between 0.6 to 1 percent of total wages. Actual proportions were to be determined by a consideration of the conditions of different localities. By the end of 1993, 79.20 million workers were under the unified unemployment insurance system, accounting for 68.5 percent of total enterprise staffs. Workers in state enterprises composed 68.36 million, accounting for 89.6 percent of the total. The cumulated amount of the insurance premium was 4.18 billion yuan, and gave benefits to more than 1.5 million workers. In 25 provinces, the coverage of unemployment insurance is being extended to workers in non-state enterprises.

*Medical Insurance*⁶

According to the traditional system established in 1951 and in effect up to now, all medical expenses and income losses due to illness are to be paid by the enterprises. In the case of medical expenses of the workers' family members, half of the expenses are covered by the enterprises. Thus, it was an enterprise-oriented medical insurance system, with the enterprises taking all the burden. Although the rules state that medical expenses should be kept within the 10 percent of the wage total, it is often

⁵ Information here relies on SCESR (1995), unless noted otherwise.

⁶ Information here relies on Hu (1995), unless noted otherwise.

the case that these expenses exceeds the limit in many enterprises. Furthermore, medical resources tend to be wasted or not used efficiently.

As of 1993, state enterprises and units has established about 110,000 medical institutions, hired a staff about 1,400,000 for these institutions, which accounts about one-third of all medical-related staff. However, since these medical institutions take care of only state-unit related staff and their family members, these facilities tend to be under-utilized. More importantly, the relationship between the enterprises and these medical facilities are ambiguous. Thus, maintenance of these facilities diverts a part of the factory funds for basic capital construction and renovation.

The general policy direction for reform of the medical care system is a combination of "socialization" of service and "individual responsibility." For example, for minor medical expenses, individuals pay, while for major expenses society pays (so-called the "*dabing tongchou, xiaobing fenliu*" principle).

Housing Services and Other Welfare Services

Currently, building, managing, and renovating worker housing are the sole responsibility of enterprises. Since some enterprises do not have enough fund for such services, it is often the case that technological renovation and basic construction funds for productive capital are diverted to cover housing-related expenses in the enterprises. In this sense, maintaining housing service affects the production activities of enterprises. The impacts of housing services on production are associated not only with fund diversion but also with worker morales. When they are not provided with decent housing, they are less inclined to work hard for the enterprises.

The burdens also include in-house schools, restaurants, shops, hotels, kindergartens, public bathing facilities, barber shops, and so forth. In China, enterprises run about 18,000 elementary or middle schools, employing a staff of about 600,000 and its current budgetary expense amount to 3 billion yuan (Hu 1996). Many enterprises wonder why they still have to spend money to run schools when they already pay state taxes and education fees (*jiaoyu fujiashui*).

Regarding housing services, the long-term policy direction is to socialize housing services by establishing a national (both central and local levels) housing authority. However, recognizing that complete socialization is not an immediately feasible option, they are at the moment also taking several short term measures to "commercialize" (privatize) housing services. The

methods of commercialization can vary depending upon the sizes of the enterprises (for details, see Hu 1996). For example, for large units they can set up financially independent subsidiary enterprises, called "real estate development corporations," by integrating those parts in charge of building, allocating, managing, and renovating worker housing in enterprises. Middle-sized enterprises may set up, jointly with other enterprises, such corporations.

Schools, restaurants, kindergarten, and other numerous welfare-related services are also being commercialized and separated from the enterprises. The following four methods are considered and tried: 1) complete separation, 2) semi-complete separation, 3) joint operation by several enterprises, and 4) maintenance of several minor facilities (Hu 1996).

The Problems

The following are problems of the current social security system

First, the financial burdens of the state and enterprises are too heavy, whereas those of individuals are too light. Individual workers do not feel responsible. As you can see from table 2, the units (state and enterprises) paid 54.68 percent of the total wages as various kinds of social insurance premium, whereas individuals paid only 8 percent of total wages as an

Table 2. Projections on Workers' Burden in Social Security Insurance and Housing
(As percentage of total wage sum)

Year:	1993			2000			2030		
	Unit	Worker	Sum	Unit	Worker	Sum	Unit	Worker	Sum
Retirement Insurance	20	2	22	20	5	25	20	8	28
Unemployment Insurance	0.66		0.66	1		1	1.5	1	2.5
Medical Insurance	10		10	10	1	11	5	7	12
Injury Insurance	0.008		0.008	0.5		0.5	0.75		0.75
Family Planning Insurance	0.008		0.008	0.5		0.5	0.75		0.75
Housing Service	24	6	30	13	17	30	10	21	31
Total	54.68	8	62.68	45	23	68	37	38	75

Source: Taken from SCESR (1995), p. 49.

insurance premium.

Second, the coverage is too limited, including only workers in state units and a small number of workers in collective enterprises. Third, the administration was very little socialized and most of the load falls on enterprises. Fourth, the collection of insurance premiums is not implemented properly and uses of the funds are also inadequate with too much going into administration expenses.

Current and future reforms of the social security system are dealing with the above mentioned problems. Especially, for burden sharing, the relative share of individuals is planned to increase gradually. According to table 2, in the year 2,000, the total burden to individuals is expected to reach 23 percent as a proportion of total wages, a significant increase from the 8 percent in 1993.

Case Studies of Social Security and Employment System Reform

The following information on the enterprises below are collected by the author's visit to these firms in Hubei and Shandong in January and July 1996.

Jinan Automobile Works

This enterprise is typical of the inefficient large-and medium-sized state enterprises in China. I have visited one of the 18 factories belonging to this enterprise. The total employment of the firm is about 20,000, out of which approximately 3,000 work in the factory I visited. Like many other large-and medium-sized state enterprises in China, this company also recorded losses during the last year, but not more than 60 million yuan, the maximum loss point of the year.

This factory occupies a huge area in which diverse "unproductive" facilities are located, including restaurants, a kindergarten, primary and middle schools, a vocational school, shops, and a public bathing facility. Out of 3,000 workers of this factory, about 1,200 live inside this complex. It is lucky for this factory to have only 300 to 400 retired workers and this is due to the relatively short history of this factory. Thus with the proportion of the retired workers is only about 10 percent, which is fairly low compared to the proportion in average state enterprises.

The factory director I interviewed was very proud of the fact that there

have been many times more applicants than the number of the job openings in this company, and the fact that last year's losses had not surpassed the state-set limit. He even said that his company did not have to worry about the losses too much because it was a state-owned company. Given his age, manner, and style, it seems to be certain that his management is typical of that of the traditional state enterprise management, having not changed much despite the reform.

Although this factory operates in debt and has borrowed a lot from the bank for funds, strong initiatives for reform did not exist. Although the maintenance of diverse nonproductive facilities should be burdensome, such a situation was considered natural for state enterprises. I was not able to see any effort by the factory director or anyone else to separate those facilities from the enterprise or make them profitable or financially independent.

Weihai Rubber Manufacturing Group

This state-owned enterprise group consists of three companies. The main company is the Shandong Tire Factory and employs about 4,800 workers. The factory started production in 1978. Owing to the short history of this factory does not have many retired workers. This company plans to turn itself into a large "corporation."

The major "nonproductive" facilities include a restaurant, a hospital, a kindergarten, and apartments for workers. The restaurant is huge, clean, and well-maintained. It employs about 100 cooks and serves meals for about 2,800 workers every day. A rough calculation of the wages for cooks and food would be about 10 million yuan. This is not a small amount, given the company's total profit of 45.26 million yuan last year. The enterprise gives a subsidy of 25,000 yuan per year to this restaurant. Regarding the profitability of this restaurant, the vice-director of the factory said that their policy is to run the restaurant with neither profits nor losses.

The kindergarten has 20 teachers. Each child has to pay 25 yuan per month and meals are provided for free. Workers are provided monthly subsidies (a proportion of the basic wages) for medical expenses. The hospital charges worker-patients the cost of the medicine. Mr. Hou, the vice-director of the factory admitted that these facilities are additional burdens on the enterprises and that they have considered various options to solve this problem. One option would be to open those restaurant, hospital, and kindergarten to outside customers. However, this option was

not implemented because the factory is not close enough to a populous area.

Chengshan Rubber Shareholding Corporation Group.

This is a state-initiated enterprise group which consists of 20 member enterprises. Out of these, 16 enterprises are legally independent, and 4 enterprises are subsidiaries. The enterprises we visited are the Rongcheng Rubber Factory and the Rongcheng Guotai Tire Company, the core members of this group.

The rubber factory started production in 1976, and has only 27 retired workers. These retired workers are paid 5,000 to 6,000 yuan per year. When workers use a factory hospital, they pay only the cost of the medicine; of course, they receive monthly medical expense allowances. This factory also runs a kindergarten and a primary school, which are also open to the general public. Thus, charging higher prices for outside users, these facilities are said to be making profits. The factory director added that another reason for the profits should be various benefits given to these facilities by the company, including exemption of electricity fees.

Yantai First Paper Limited Corporation

This corporation was originally a state-owned enterprise and turned into a joint venture with Hong Kong in 1992. Currently, total employment is about 1,000; it was about 600 before it became a joint venture firm. Most of the 600 workers are still with the enterprise. However, the problem was how to deal with the retired workers. At that time, the number of retired workers was as large as 200, or one third of the total number employed. To solve the problem of the retired workers, the Chinese and foreign side made a special agreement that all the retired workers form a new collective enterprise associated with the joint venture so as to provide food and health services to the enterprise workers. The joint venture provided financial assistance of 6 million yuan per year, with a promised total of 30 million Yuan until 1996. This sort of arrangement is an interesting example of how to deal with retired workers when a state-owned enterprise turns into a joint venture with a foreign partner.

Most of the workers reside in an apartment, which is located 7 km from the company. Before the beginning of the joint venture, the company had a kindergarten and restaurant. After it became a joint venture firm, the new general manager from Hong Kong implemented a new management style

and emphasized the concept of "corporate culture." He thus established a new ping pong room and Karaoke bar, and renovated the old restaurant, and hoped that these changes would have a positive affect on worker morale.

The company now participated in the new retirement insurance plan and put aside 8 percent of the workers' average wages as a retirement and unemployment insurance premium. 8% of the insurance premium for a foreign joint venture is said to be low compared to that of state-owned enterprises.

Tianda Phamarceutical Limited.

This company is a rural enterprise located in Gaomi City in Shandong province. The total employed is about 190, out of which a 100 work in branch offices located other localities throughout the nation. The company was established in February 1994, and due to remaining intial investment, the company has not yet made profits. However, the business is growing and prospects seem to be good according to their briefing. The workers who are from all over the nation live in a nearby apartment. Apartment, medical services, and education for children are provided free by the company. The workers pay 2 percent of their average wages as premium for unemployment and retirement insurance, whereas the company contributes 23 percent of a worker's wage as an insurance premium.

Wuhan Battery Factory (Wuhan Dianzhichang).

With a 60 year history, this factory is a typical "back-bone" state-owned enterprise in China. This company produces both old manganise and new alkaline batteries, for household use which carries a "firebird brand." This factory uses mostly domestic technologies, with little technological licensing or tie-ups with foreign producers. It employs about 1400 workers with and additional 600 to 700 retired. Despite such high retired to incumbent staff ratio, this company is decently positioned.

According to Mr. Sheng Zequn, executive vice-director, this factory also recorded losses until 1991, like many other state-owned enterprises. Since 1991, the company started reforms with greater autonomy and extended investment loans of 14 million yuan for technological renovation over the 8th five-year plan period (1991-95). This renovation is reported to have introduced new products including alkaline battery, which now accounts for 60 percent of the company's total sales. With favorable market

conditions, this new product has sold well and production capacity has expanded enough to achieve economy of scale. Thus, over the 5 year period, from 1991 to 1995, production has increased fourfold. The vice-director attributed their success to this new product, which matched the market well. Other success factors were thought to be the aggressive management style of the firm decision makers in developing and moving into new products as well as promoting cooperative attitudes of workers and trust between workers and managers.⁷ Additional advantages have to do with special preferential loans from banks with the government's endorsement since 1991. In 1995 alone, they have received a loan of 5 million US dollars. They were able to get the loan because they proposed to develop a new product. Other than these privileged loans, tax-related benefits were negligible, according to them.

They have a long-term plan to change into a shareholding corporation, with its first stage already launched. Now, they run divisions as financially-independent units, are experimenting with leasing a part of the factory production facility to private entrepreneurs, and have established two joint ventures with foreign partners.

Changjiang Energy Enterprise Group, Wuhan.

This group comprises 8 enterprises with a total of 14,000 employed in various fields: electric generators, generator-related components, special use transportation vehicles, tractors, and beer bottles. This group was formally established as an enterprise group in 1986 via merger and acquisition of several enterprises and one new company. It appears to be a kind of vertically-integrated group with electric generators as its core business. Wuhan Generator Factory has a 100 year history dating back to the late 19th century. This typically huge Chinese state-owned factory has about 5,700 workers, 1,800 of whom are retired, and produces electric generators and special use automobiles, including double-deck buses.

Despite its high retired to incumbent worker ratio and long history, the factory is profitable and is considered one of China's 300 most "financially outstanding" enterprises in China. According to Mr. Zhao Guocong, executive vice-president, as of July 1996, they have already accomplished this year's production target of 600 million yuan. He identified as success factors high quality and worker productivity as well as their ability to

⁷ For example, according to the vice-director, the day I visited the company was a holiday. The workers however chose not to take the day off.

quickly adapt to the economic reform measures initiated by the state. Their status as one of the best 300 "financially outstanding" enterprises seems to give this factory some privileges. According to Mr. Zhao, the privileges is not so much with regard to the level of interest rates in getting loans as the fact that they actually get the loans which every enterprises wants. One additional privilege seems to be that they are not penalized even in case of a loan default. He added that there is no special treatment in tax-related matters.

Those employed at this factory are paid about 8700 yuan on average per year, which is at the upper-middle range. Employers are provided with housing, transportation to and from work, and even birthday cakes. Whereas per capita living space set for the year 2000 is about 8 m² in Wuhan area, the space allotted for those belonging to this company have already surpassed this level. The company runs an in-house kindergarten, restaurants, a hospital, elementary and middle schools and even a college. It was very interesting to listen to Mr. Zhao, proud of the good welfare conditions of his company. Such good conditions, he says, lead to high work spirit of his employees.

This company is also preparing to transform itself into a sharholding corporation (*guoyou duzi gongci*). Although it does not have a board of auditors, it is said to have a board of directors. Appointment to this board is designated by the Wuhan state property management commission. Chairperson of the labor union, a person representing ordinary workers, and three persons from the top management are included in the board.

Wuhan Wireless Electronic Factory

This company, established in July 1961, is said to be one of the first producers of semiconductors in China. They started with radios in the early days, and now produce wireless phones and audio systems including CD players, with the brand of "Changjiang." Last year, total sales revenue was 150 million yuan and annual before-tax profits were 20 million yuan. This company has three branch factories, and their products are distributed to over 160 nation-wide outlets. According to Mr. Yezhen Qio, senior economist of the company, due to the lack of international competitiveness, they do not export and focusing instead on domestic sales.

This company employs about 1760 workers, out of which about 212 are professional engineers. They have about 500 retired workers, which, they said, were marginal compared to other companies. These retired workers

are given between 70 to 100+ percent of what they were previously paid. They also get housing and medical expense coverage. Average labor compensation of ordinary workers is between 600 - 700 yuan per month, and managers are paid between 2000 - 3000 yuan per month. On a yearly basis, average labor compensation is said to be about 7,700 yuan. This amount does not include the value of housing, medical, and other welfare-related expenses. Most new workers are hired by open competition with some favoring children of incumbent workers. State-planned allocations are very small. All new workers are hired on a contract basis, and only after in-house training they are given actual jobs. Wage rates varies between departments with development and marketing departments paid the highest rates. This company has used some performance-based pay system.

The company saves about 29 percent of the workers' wages as retirement and unemployment insurance premium. This company does not participate in the medical insurance plan, and is responsible for about 25 percent of workers' medical expenses. For employee's children who are under 14, the company covers about 50 percent of their medical expenses. Similar ratios apply to other family members of workers. All employees are provided housing constructed out of the accumulated enterprise funds.

They pointed out three reasons for profits: support from the government and providing a flexible business environment, timely investment decisions, and high morale of workers. Specifically, government support seems to include generous depreciation allowances, flexible enforcement of laws and policies related to taxes and other fees, and preferential loan policies. For example, the senior economist said that when the company follows government initiatives in trying something new and fails, the government takes responsibility and compensates for losses. Mr. Qiu seemed to be very proud of such mutual trust between the city government and his company.

In other words, this company seemed to be under quite close supervision and control by the electronics bureau of the city government (actually, a city official was also present at the interview meeting). This bureau, not the city state property administration bureau, plays the role of the chairman of the board for the company, although this company does not have such institutions as the board of directors and auditors. In other words, this company is not formally given the status of corporation and is still called a "factory." They said they were preparing to become a corporation.

Thus, my impression was that despite accounting profits, true profits is likely to be much smaller or negligible, if we subtract hidden subsidies and special benefits given by the government. This does not mean that this company will stay idle and dependent on the government. Actually, they said they were facing fierce competition in the market, and since demand and preferences are changing rapidly, they are continuing to develop new models and items.. This reflects the very competitive nature of China's consumer electronics market. They said that average life expectancy of a new product is between 8 to 12 months, sometimes less than 6 months. In this respect, this company seems to be doing well, as reflected in continued growth of sales and profitability over the last two years.

What Should be Reformed and What Should be Kept: Perspectives and Prospects

The heavy financial burdens of state enterprises in China have to do with their social duties, such as providing not only jobs but also medical care, housing, food, social security, and education. Thus, without reform of the social welfare system and various insurance schemes, the lowering of these burdens on state enterprises and hence the revitalization of them will be very difficult. This is a separate issue from that of property rights and ownership, but also touches the ideological dimension of the reform.

The Chinese policy makers have recognized the importance of this issue and they have been pushing hard to implement the new systems of unemployment, retirement, health insurance and other social security schemes. However, the speed of the implementation and response by the enterprises seems to vary depending upon localities and the nature of the enterprises. Some enterprise, like the Jinan Automobile Works, are responding very slowly, whereas others, like Chengshan Rubber Factory, are responding quickly. Whereas the problem of redundant workers might be dealt by unemployment insurance and/or transfer to other newly growing sectors, the problem of retired workers seems to be more difficult to deal with. As the case of the First Paper Limited Corporation shows, the problem of retired workers make difficult the inducement of foreign or private capital as new partners or owners for the old state enterprises.

However, the cases examined in this paper indicate that some state enterprises are doing quite well despite heavy social burdens. These exemplar cases include Wuhan Battery Factory, Changjiang Energy Group,

and Wuhan Wireless Electronic Factory. Wuhan Battery Factory became profitable while many other state enterprises recorded losses. One common feature of these successes seems to be swift adaptation to the changing environment, especially market competition. Wuhan Battery and Wuhan Wireless were very quick in developing new products and introducing design and model changes to meet with very short life cycles of products and with increasing sophistication of consumer preferences. In the case of Changjiang Energy, the combination of vertical integration and diversification seem to work, and it was also very fast in exploring markets in other provinces.

These success stories reveal the one important point that although social burdens are serious it is also possible that they can be solved by the enterprises. They also suggest that a more fundamental dimension of the enterprise problem in China has to do with the fact that internal management practices have not improved to any great extent (Broadman 1995; Sun et al. 1994). State enterprises are not yet sensitive to economic efficiency in the management of physical and human resources. Distribution of bonuses and promotion is still more or less based on an egalitarian principle, and the same is true for hiring and internal placement. As the case of Jian Automobile Works suggests, these features combined with outdated machinery and equipment constitute the causes of the poor performance of the enterprises.

Of course, this observation does not mean that reform of the social security system can be postponed or put-off. My opinion is that we need a more flexible perspective on the issue. For example, it should not be case that all welfare-related services and benefits be abolished. Actually, successful and several mediocre enterprises examined above recognize that those welfare privileges give workers high work morale or at least prevent them from complaining. Especially in the case of profitable enterprises, they feel the need to pay back workers a part of fruits of their hard work. This is a natural thing and common in most successful corporations in capitalist economies including those in Japan and Korea. Japanese firms are famous for enterprise-oriented welfare systems and provides housing subsidies, meal services, and so forth.

The big differences between capitalist and Chinese enterprises have to do with housing and retirement insurance or the pension system. Housing and retirement insurance is too much enterprise-oriented and insufficiently socialized. These should be the main areas for reform. Other minor welfare services such as in-house restaurants, kindergartens, miscellaneous shopping facilities, and minimum hygiene services can be

kept or expanded. Of course, these services can be partially socialized by diverse options which are already being tried.

References

- Broadman, Harry. 1995. "Meeting the Challenge of Chinese Enterprise Reform." World Bank Discussion Paper, No. 283.
- Chen, Kuan, Wang, Hongchang, Zheng, Yuxin, Jefferson, Gary, and Rawski, Thomas. 1988. "Productivity Change in Chinese Industry, 1953-1985." *Journal of Comparative Economics* 12 (4): 570-591.
- Dollar, David. 1990. "Economic Reform and Allocative Efficiency in China's State-owned Industry." *Economic Development and Cultural Change* 39 (1): 89-105.
- Hu, Raoyi. 1996a. "Guoyouqiye, shixing shehuibaoxian he jianqing shehuifudan 3: tuixiuyanglao (state enterprises, implementing social insurance and reducing social burdens)." *Zhongguo shehuibaoxian*, No. 1.
- Hu, Raoyi. 1996b. "Guoyouqiye, shixing shehuibaoxian he jianqing shehuifudan 4: zhufang he fuli fuwu sheshi (state enterprises, implementing social insurance and reducing social burdens)." *Zhongguo shehuibaoxian*, No. 2.
- Hu, Raoyi. 1995. "Guoyouqiye, shixing shehuibaoxian he jianqing shehuifudan 2: yiliao feirong (state enterprises, implementing social insurance and reducing social burdens)." *Zhongguo shehuibaoxian*, No. 12.
- Jefferson, Gary and Rawski, Thomas. 1994. "Enterprise Reform in Chinese Industry." *The Journal of Economic Perspectives* 8(2): 56.
- Jefferson, Gary, Thomas Rawski, and Yuxin Zheng, 1992. "Growth, Efficiency, and Convergence in China's State and Collective Industry." *Economic Development and Cultural Change* 40(2): 239-266.
- Lee, Keun. 1994. "Economic Reform and Privatization in China: Case Studies of Enterprise (in Korean)." Working Paper, Economics Department. Seoul National University.
- Lee, Keun. 1996. "An Assessment of the State Sector Reform in China: Viability of Legal Person Socialism." *Journal of Asia-Pacific Economy* 1, No. 1.
- Lee, Keun. 1993. "Property Rights and Agency Problems in China's Enterprise Reform." *Cambridge Journal of Economics* 17: 179-194.
- Lee, Keun. 1990. "The Chinese Model of the Socialist Enterprise: An Assessment of its Organization and Performance." *Journal of Comparative Economics* 14: 384-400.
- Lin, Justin. 1996. "Fair Competition and China's State-Owned Enterprise Reform." mimeograph.
- MacMurray, T. and Woetzel, J.. 1994. "The Challenge Facing China's State-Owned Enterprises." *The McKinsey Quarterly*, No.2.

- Naughton, Barry. 1992. "Implications of the State Monopoly over Industry and Its Relaxation." *Modern China* 18 (1).
- Shanghai Economic Commission. 1994. *Laodong Gongzi baoxian zhidu gaige* (Reform of Labor, Wages, and Insurance System). Shanghai: Shanghai Renmin Chubanshe.
- Sin, Taiyong. 1994. "China trying hard to reduce the losses by state enterprises." *Silmul kyungje* (in Korean), October 26.
- Sun, Yaochan, and etc.. 1994. "shenhua guyouqiye gaige jidaijiejuede nantiyuduici (Several Difficulties and policies requiring prompt solution in deepening the reform of state enterprises)." *Jingji yanjiu*, No. 3.
- SCESR(State Commission of Economic System Reform of China 1995. *Shehui baozhang tizhi gaige* (reform of social security system). Beijing: Gaige Chubanshe.
- State Statistical Bureau, China. 1994. *Zhongguo tongji nianjian 1994* (Statistical Yearbook of China 1994). Beijing: Zhongguo tongji chubanshe.
- Walder, Andrew. 1987. "Wage Reform and the Web of Factory Interests." *China Quarterly* No. 109: 22-41.
- Wang, Wuyi. 1994. "Guanyu woguo gouyouqiye pochanqingquangde yinsu fenxi (On the Causes of Bankruptcy in China's State-owned Enterprises)." *Jingji yanjiu*, June 1994.
- Woo, Wing T., Hai, Wen, Jin, Yibiao, and Fan, Gang. 1994. "How Successful Has Chinese Enterprise Reform Been? Pitfalls in Opposite Biases and Focus." *Journal of Comparative Economics* 18 (3): 410-437.
- Wu, Jinglian. 1993. "Directions of Development and Prospects of Market Economy in China (in Korean)." Paper presented at the seminar hosted by the Korea-China Friendship Association, Seoul.