STATE-OWNED ENTERPRISE REFORM *Dag Detter and Sue Anne Tay*

Bringing China into the world market

The failure of CNOOC's bid for Unocal opens up a debate on the real nature of large, reforming state-owned enterprises in China. How do we reduce the role of the "state" in SOEs and make them more market-orientated, with good corporate governance and less political interference?

China has been selling off, privatising and advocating corporate governance within its SOEs for the past decade. Still, the sector will remain dominant for the near to medium term – SOEs supervised by the State-owned Assets Supervisory and Administration Commission (Sasac), accounted for 40.7 per cent of gross domestic product last year. While sources have indicated that they have grown more profitable since 2000, others point out that only 20 per cent of the top 200 SOEs are profitable.

Clearly they face massive problems, and are in critical need of reform.

Success will depend very much on progress on three fundamental pillars, as put forward by the Organisation for Economic Co-operation and Development's corporate governance policy.

First, Beijing must effectively communicate a single and clear objective. This means giving a clear mandate, performance benchmarks and guidance on trade-offs.

The second pillar, transparency, is key to instilling valuable public confidence in the economy. The existing legal foundation for corporate governance in China remains fundamentally weak.

The third pillar, political insulation, is often the hardest to achieve. This requires a clear, consolidated ownership structure, with an oversight board that distances itself from the political structure.

Established in March 2003, Sasac was intended to fulfil this role, but its broad mandate raised concerns. Critics argue that it should function as a corporate vehicle operating on a commercial basis rather than maintaining such expansive political power.

In a time of growing demand for scarce resources and pressing domestic social challenges, the option of privatisation in strategic sectors is not always desirable for Beijing. Thus, the SOEs must strike a balance between state-ownership and competitiveness and efficiency.

China's progress in SOE reform has enormous implications for the US and the world. Instead of the suspicion that marked the bid by China National Offshore Oil Corp, the US Congress and administration should show Beijing encouragement to move faster and more boldly to improve the corporate governance structure of SOEs – including through their operation in the competitive international marketplace.

Implementation of the necessary reforms will reduce the suspicion of being perceived as state corporatist giants implementing a nationalist agenda without commercial foundations. By bringing Chinese SOEs into the rules-based market system, Americans will soon be able to invest in better-performing Chinese firms. Moreover, a prevailing culture of good corporate governance in China will be nothing but beneficial for its domestic business and political environment.

Dag Detter is a former director of the division for state-owned companies within the Ministry of Industry in Sweden. Sue Anne Tay was formerly a research assistant with the Freeman Chair in China Studies at the Centre for Strategic and International Studies in Washington