From State-Owned Enterprise to Joint Venture: A Case Study of the Crisis in Urban Social Services

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One of the most important and difficult issues facing urban China’s market transition is how to provide the social services that constituted core parts of the state sector under socialism — education, health care, retirement benefits, and unemployment insurance — which the new market-oriented businesses shun as unprofitable. China has been developing new policies, including new unemployment and pension schemes, but these policies have been easier to proclaim than to implement. Many workers who should in principle be covered must in fact largely fend for themselves.

This essay addresses only a small corner of the problem; it is primarily a case study of the conversion of part of a city-owned steel plant (City Steel) in Sichuan into a joint venture with a European steel company. Our research was conducted in early 1997, when the International Finance Corporation (IFC, the commercial lending sister of the World Bank) asked us to evaluate whether the continued provision of essential social services would be assured, as part of its decision about whether to loan money to the proposed joint venture.1

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The factory's management was initially very reluctant to let us interview workers directly, even though the IFC loan was at stake. The enterprise director had not revealed the possibility of the joint venture to the workers until just before we came, even though the in-principle agreement had been signed several months earlier, nor had he mentioned any potential redundancies that would result. He said he could not "guarantee our safety" if we spoke to workers about such things. We insisted, however, and the management ultimately agreed to allow us to interview workers of our choosing. During our fieldwork at the factory we had excellent access to data and interviews, although only for about three weeks. Our findings at City Steel have been supplemented by information from further interviews in 1997 in cities with longer experience of such ownership changes, especially Beijing and Tianjin.

State-Owned Enterprises in Crisis

China's move toward a market-oriented economy has jeopardized the continued existence of many of the state-owned enterprises. The government understands the need to reduce this sector of the economy and has created a legal structure that allows for privatization and even bankruptcy of state-owned firms. The Fifteenth Communist Party Congress in September 1997 strongly reaffirmed this direction. In practice, however, China also recognizes that state-owned enterprises are complex work communities and providers of social services, whose transformation to other forms of ownership threatens serious social disruption. The enterprises typically have provided their employees with medical care, housing, subsidized heating and pensions. Both workers and management tend to believe deeply in this responsibility. At City Steel, for example, managers have continued to build subsidized housing for newly married workers and to employ workers' children, even though the company could not afford to subsidize housing and already had far too many employees. They tried to guarantee cradle-to-grave welfare, from providing creches to taking care of retired workers.

1 Due to the nature of the research, we do not use the actual names of the plant, the foreign investor, the city in Sichuan, or our informants. The opinions expressed here are, of course, our own and do not represent the IFC. Our interviews at City Steel included the director, two deputy directors and several other members of the senior management staff. We also conducted five extended household interviews with worker families chosen by us, and numerous shorter interviews with workers. We also spoke with the city's mayor, the department heads of the city's Bureau of Labour and the Employment Services Administration, and leading officials from the district government in the area of City Steel.

2 As one example, 66 of the young employees are "exchanged workers" (huan gong), children who had taken their parents' places in the factory when the parents retired early.
Newly privatized companies do not necessarily take on such responsibilities. They often also hope to lay off large numbers of employees they consider economically redundant. Without the social supports of state-owned enterprises, urban China needs new mechanisms to find jobs or provide welfare benefits to laid-off workers, new ways to care for aged workers, and alternative sources of medical care and housing. The joint ventures that are established with foreign companies are no exception, but they complicate the picture in two ways. First, the foreign investor is likely to be pressured to foot part of the bill for these social services. Second, the Chinese side of the joint venture typically holds a significant number of shares in the new enterprise, often through a hollowed-out remnant of the old state enterprise. The potential profits from these shares can be earmarked for social provisions, although the owner of the shares (which can be the city, provincial or national government) will have to balance competing demands on the funds.

Enterprises with these enormous social welfare responsibilities can rarely compete on the open market with private companies that look only at the bottom line, especially in an economy with a great surplus of labour. Struggling state-owned enterprises try to survive by pulling in subsidies through connections in the government and by cutting their financial outflows in every way possible. At certain times the government has actively promoted bankruptcy as a way of dissolving firms that cannot compete on the market. By 1996, however, officials became worried that more workers were being laid off than unemployment support systems could handle. They thus stopped encouraging bankruptcies in the hope of minimizing urban unrest. The result was that many firms which were technically bankrupt continued to function by cutting back on payments to workers, gradually cannibalizing their assets, and increasing their debt burdens. The Fifteenth Party Congress, with its renewed emphasis on

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3 Corinna-Barbara Francis, “Reproduction of Danwei Institutional Features in the Context of China’s Market Economy: The Case of Haidian District’s High-tech Sector”, *The China Quarterly*, No. 147 (1996), pp. 839–59, argues that some large and successful private firms are reproducing such welfare functions in the coastal regions, but so far this is not a standard expectation, nor is it integrated into the political system the way the older work-unit system was.

4 The term “laid off” used here includes a range of Chinese practices. Some workers become fully unemployed and lose their ties to the enterprise. None of the City Steel workers fell into this category. Other forms of redundancy in China allow the workers to retain some claims on the enterprise, minimally a pension at retirement age and sometimes also a partial salary and other benefits. We discuss the specific categories used by City Steel below. For more detail, see Linda Wong, *Marginalization and Social Welfare in China* (London: Routledge, 1998), pp. 170–1.

5 The increasing difficulties that these changes create for ordinary workers are comparable to the new kinds of labour discipline discussed in Zhao Minghua and Theo Nichols, “Management Control of Labour in State-Owned Enterprises: Cases from the Textile Industry”, *The China Journal*, No. 36 (July 1996), pp. 1–21. The factories they discuss are
privatization and bankruptcy, may change this direction again, but only at the risk of aggravating the social problems that result from the demise of the state-enterprise social system.6

Several state-owned enterprises in the vicinity of City Steel had laid off workers, been unable to pay salaries, experienced serious triangular debt problems, or were on the verge of bankruptcy. One laid-off worker from a nearby factory reported to us that her factory could not pay its redundant labour anything at all (in spite of contractual requirements), and that she in fact had to pay the factory a monthly fee in order to keep up her health and old age insurance. Another local state-owned factory with 10,000 employees had reportedly been unable to pay workers’ salaries for the previous three months.

Under the bankruptcy law the proceeds of sold assets go first to support retired workers, then redundant workers, and only then to other debtors. Companies that gradually bleed off all asset value by delaying bankruptcy, however, will essentially have no resources left to deal with the social repercussions of business failure. Local governments do not have the capacity to assume the burdens of retirement pay, job creation, housing, education and health care that these enterprises now carry. While China is attempting to set up new health, old age and unemployment insurance programs, these systems are not yet complete, nor are they sufficiently funded to deal with the potentially massive scale of the problem.7 The city government in the area of City Steel is no exception.

City Steel appears to be following a path of delayed bankruptcy. The factory has a high and increasingly heavy debt burden. It has not paid into the health and old-age insurance programs for three years. The factory is still paying worker salaries, but not the medical and home-utility subsidies that are also supposed to be part of the remuneration package. It does not even pay the firm’s own

6 Recent news reports illustrate the public unrest that can result from these problems. The largest was a demonstration of thousands of workers in Mianyang, Sichuan province, in July 1997. They were laid-off employees of three bankrupt state-owned enterprises who claimed that their unemployment insurance funds had been embezzled. Another case in Zigong, also in Sichuan, apparently involved a combination of laid-off workers from bankrupt companies and workers whose health insurance compensation had not been paid. When we were there just before the Chinese New Year in 1997 we learned of street demonstrations by retired people (who demonstrate more willingly because they have less to lose) in Tianjin, the medium-sized city in Sichuan where we were working, and elsewhere. For these and other examples see China News Digest — Global, 23 July 1997 (GL97-103), 15 October 1997 (GL97-141), 5 December 1997 (GL97-164), and 12 December 1997 (GL97-167).

7 See, for example, the discussion in Wang Yunzhu, “Jiejue qiye fuyu renyuan wenti de duice fenxi” [Analysis of Strategies for Solving the Problem of Surplus Employees], Jingji wenti [Economic Issues], No. 11 (1995), p. 7.
electricity bill regularly, and power was cut off for several days while we were there. Walking through the frigid factory complex, we saw cavernous spaces with idle machinery and few workers. It is difficult to know whether the city government would allow the factory to go officially bankrupt, but it is clear that social support systems for workers are deteriorating steadily.

The steel works had 4,642 employees on its books in early 1997, the time of our research. Of these, City Steel reported to us that 554 had retired and another 386 had “left their posts” (li gang), that is, made an ostensibly voluntary choice to retire in their forties, receiving significantly reduced pay until they qualify for a full pension at retirement age. Those in this li gang category are supposed to receive the factory’s minimum wage of 236 yuan per month (plus medical and home-utility subsidies that were not in fact being paid). Another 69 were on long-term rest (changxiu), meaning they had benefits but no salary. Most of these 69 ran small businesses of their own, but maintained their relationship with City Steel so as to have access to health and retirement benefits, for which they paid a fee to the factory. As of early 1997, notably, no worker at City Steel was classified as officially laid off (xiagang) or unemployed. The li gang and changxiu designations were being used instead in order to place workers in what seemed, on paper, like less problematic categories, although in practice they had no work and were paid only a little more than the unemployment system pays out.

Yet another 131 of the staff worked for the semi-independent Enterprise Company (discussed below). The remainder of the City Steel staff — some 3,500 personnel — were ostensibly actively employed as of 1997, but in practice many of them had little work. The new joint venture that would take over City Steel’s steel production planned to retain only 1,200 of these employees, thus adding over 2,000 to the 500-plus workers already effectively unemployed but on the books. The joint venture in principle planned to hire at least one worker from each factory family, as a way of minimizing the impact of unemployment on families. Beyond that, the firm had not yet established principles for deciding who would be employed by the joint venture.

We found that most families relied on two incomes. Usually both of these incomes derived from City Steel. A typical family of three had, at an absolute minimum, monthly expenses of about 600 yuan. Families earning less than this (usually because they had only one income or because they had elderly parents to support) were barely able to survive. Few had extra jobs outside the factory. Some of these workers lived in harsh conditions. The poorest we interviewed was a retired manager who received 480 yuan per month. His wife and disabled son, however, had no income, and they lived in great poverty. A more typical case was a skilled worker who earned about 500 yuan and whose wife earned 260 yuan a month with the Enterprise Company. This would have been sufficient, except that they had to support both their mothers at an additional cost of about 150 yuan a month. As a result they could barely make ends meet and lived in a
squalid apartment with broken-down furniture, with running water and toilet facilities available only in the courtyard.

In comparison, the middle-management families, if both husband and wife worked, tended to live comfortably. They were able to buy apartments in some of the enterprise’s better buildings and possessed some savings. Some could even take on extra expenses, like the high tuition (140 yuan per month) to send a child to a better high school.

Hollow Remnants — The General Company

Old state enterprises frequently do not disappear after becoming joint ventures. The joint venture typically only wants the assets of the major product line — in this case the joint venture will take over all of City Steel’s steel-making facilities — leaving behind various non-manufacturing sideline ventures, public security functions, social services, and the Communist Party and trade union apparatus in hollow remnants of the original enterprise.\(^8\) In addition, these remnant companies usually hold shares in the new joint venture, which promises to pay (but does not guarantee) some future income. The firm’s management refers to the remnant of the old enterprise as the General Company (Zong Gongsi).

This rump General Company will initially sell gardening, janitorial, food preparation and security services to the new joint venture. Some of the old firm’s other non-manufacturing sidelines will also come under the General Company’s wing. The General Company was planning to take a percentage of any profits that these sideline enterprises might possibly generate, by providing them with a contract that would stipulate a fixed percentage and that let each enterprise keep any additional profits. The most hopeful of these new enterprises was the transport division, which was the only sideline of the old state enterprise that showed any profits. Other ventures in the rump General Company will come from existing resources in mechanical and electrical repair, and construction. Transport and construction, however, are areas that nearly all state-owned enterprises can move into, and the market is tight. But this is the least of the General Company’s problems. Its chances of survival have been undercut by two manipulations carried out by City Steel’s management: first, the General Company will start off with a high burden of debt; and second, some of the best parts of what will remain of City Steel, after the joint venture’s formation, have already been cleaved off into a new semi-privatized firm partially owned by the managers themselves.

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\(^8\) Such models also occur in other transitional economies. See, for example, Camilla Seth (ed.), “Nizhny Novgorod: A Russian Success Story?”, *The Harriman Review*, Vol. 8 (1995), p. 15.
Debts and Debentures

In general, after a joint venture has been carved out of the choicest parts of a state enterprise, the remnants inherit the debts and debentures of the original enterprise, and these can be massive. City Steel plans to follow this model, which is fairly new in Sichuan but not unusual on the east coast of China.

The major burden of City Steel’s debts and debentures stems from the tide of triangular debt that has swept China in the last few years — companies cannot pay debts to other units because they cannot collect the debts owed to them. The result is a spiral of increased borrowing with little hope of repayment. The joint venture partner insists that these debts and debentures must be legally cleared from the joint venture’s books. Yet if the General Company has to pay off all the debts it cannot possibly survive. Management told us that receivables and debts are about equally balanced on the books. But the enterprise and the municipal government admitted that in practice much of the money they are owed cannot be collected.

In addition, the enterprise owes debentures directly to its workers. These are a form of bond, and total around 10–12 million yuan. The factory agreed that workers will have to be repaid, unlike the situation with some of the external debt. Management plans to accomplish this in part by selling off the remaining raw materials after the joint venture is created. The value of this is hard to judge, but it may meet about half the value of the total debentures. They will use all receivables collected to pay off the remaining debentures before dealing with other debts. They already had in place a commission system whereby accountants who chase down debts earn a bonus of 0.5 per cent of the payment.

It was clear from our discussions that the municipal government can go a long way toward negotiating much of the external debt away. It had already made significant strides in that direction with another local factory. Both the General Company management and the local government claimed that the debts could be handled without jeopardizing the financial viability of the General Company. As with some of the other problems, the issue of triangular debt will ultimately have to be dealt with by national policy, and is not unique to the dynamics of privatization. Nonetheless, the General Company will start off hobbled by such debts.

Making a Tidy Profit on the Side

The plans for the General Company are further complicated and undermined by a nominally independent offshoot that had already been established by the old state enterprise. It is appropriately named the Enterprise Company (Qiye Gongsi). The Enterprise Company is a “shareholding collective enterprise” (gufen jiti qiye), which makes it a legally independent entity. Its initial capital, however, derived from a loan from the steel factory, many of its shares are held by upper and middle managers of the factory, and its top leadership overlaps that of the
factory. The director of City Steel is chairman of the board of the Enterprise Company, and a deputy director is its general manager. Both men are also large shareholders, along with much of the rest of the top management of the factory. In addition, the Enterprise Company depends on City Steel’s connections for most of its market. The arrangement is an example of what Sachs and Woo call “spontaneous privatization”, which occurs widely in socialist transitions.9

As of 1997 the Enterprise Company employed around 1,000 people. Some highly skilled employees of City Steel had been seconded to the Enterprise Company, and 170 less-skilled employees of the Enterprise Company worked as contracted labour in the steel works, mostly in cleaning services. The Enterprise Company also runs a restaurant and owns some real estate (apparently for speculation), runs a machine shop, and casts small steel parts. Its casting shop is by far the most lucrative sector. Many employees of the state enterprise were unhappy because the casting could be done directly at City Steel. They said that management uses its connections with other companies to pull the best contracts into the Enterprise Company. This allows the managers to profit personally from the contracts; meanwhile workers in the original state-owned enterprise are left barely employed.

The Enterprise Company has aroused deep resentment among the factory workforce. Among the accusations that we heard during interviews with workers were that the initial loan from the factory may never have been repaid, and that bribes pass to the top managers in exchange for access to the most lucrative Enterprise Company jobs (like leadership of the casting shop). Workers also accused top managers of living lavish lifestyles — buying expensive cars and having mistresses — while workers in the factory faced problems making ends meet. All of this information is hearsay, but suggests a widespread attitude among workers about City Steel’s management. Such arrangements, and the tensions they create, are not unusual in China under the current combined economic system.

**Soldiering On**

With City Steel’s best assets diverted into the steel-manufacturing joint venture and into the managers’ Enterprise Company, the rump General Company naturally was in serious trouble even before it started operations. The managers assigned to it made its prospects bleaker still. They continued to think more in terms of a centrally planned state enterprise than a market-oriented company. Their plans to continue building subsidized housing, for example, can only lose money. They are also assuming that the joint venture will be a captive market for their janitorial, gardening, security, canteen and other services. This is a)

dangerous assumption — the joint venture is willing to contract with them for a year, but has made it very clear that after that year it would look to the broader market for the best services at the best rate. The General Company’s management instead hopes that it can draw on its historical connection with the joint venture to continue the contract indefinitely. This was a clear case where the European capitalists and the Chinese managers had very different views of how the market would work.

Even assuming continued contracts from the joint venture company, no debt liability and no retired and redundant workers to support, the General Company as it is planned will probably experience large losses (probably over 2 million yuan annually). The General Company and its many other parallels across China are a hidden side of privatization, which has shunted off their most productive parts and preserved the least productive aspects of the state-owned sector in this new form. While a few of these hollowed-out state enterprises do well,10 it is difficult to imagine how most will make ends meet.

On the positive side, retaining the General Company buys some time, keeping some workers employed and some social services intact while the system as a whole adjusts. But at the same time, it is also planned that the General Company will retain a very large administrative structure, even further reducing its ability to survive for long. This large administrative staff derives in part from the fact that the General Company will have to take over the Party and trade union apparatus, and partly because City Steel wanted to help a substantial number of the old firm’s middle-level managers who would be hit particularly hard by redundancy. The General Company will shoulder the high bureaucratic and social-services costs inherited from the period of central planning, but will be left with few of the viable assets.

**Coping with Retired Workers**

State-owned enterprises had full responsibility for paying retired workers until the new retirement insurance (yanglao baoxian) system was established in 1987. Between 1987 and 1994 the retirement costs were split between the enterprise and the local government’s Labour Bureau, which runs the insurance fund. This fund in principle completely covers all those who retired after 1994, but the

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10 One of the few successful ones has been the Beijing Automobile Factory, which continues to employ the 6,000 people laid off by the joint venture with Chrysler that became Beijing Jeep. It still runs the schools, hospital and cafeteria, and pays retired workers. It has succeeded primarily by becoming a primary supplier of parts to Beijing Jeep, and from its shares in the joint venture, with dividends of about 30 million yuan in 1996. Beijing No. 2 Offset Printing Factory provides another kind of example. The manager turned down a job with the joint venture to direct the remnant company. He initially raised money to subsidize redundant workers by renting out excess space. He then sold shares in the old factory to workers, used the money to buy new printing machinery, and competed directly with the joint venture. The old factory is now doing much better than the joint venture.
system can function properly only when companies have regularly paid their retirement insurance taxes. City Steel, however, has not paid its proper amount into the system for at least three years. The Labour Bureau therefore refused to take on any of these retired workers, even though the city is the nominal owner of the enterprise. Such problems recur in many places across China.

The city government offered a negotiated solution. On the condition that both the joint venture and the General Company pay the appropriate taxes, the municipal government agreed to cover all of the people who retired under the "new system" (i.e., after 1994). The city also agreed to accept immediate responsibility for 20 per cent of the employees who retired under the "old system", and to take over responsibility for the other 80 per cent after three years. This is significantly more generous than what is legally required from the city, given that the factory has not paid into the system. The city was probably financially capable of going further, but it also had to consider the precedent it was setting for several other factories with comparable problems. The European investor also put funds forward (partly as a grant and partly as an interest-free loan with some of the Chinese shares of the joint venture as collateral) to help cover the difference. In return, the investor received guarantees that it would have no legal responsibility for the retired workers.

Although the negotiations over this issue involved some recriminations between the city government and the enterprise's management over who should hold this financial responsibility, there was a general feeling that these workers were owed some kind of minimal support in return for their many years of service. This made pension payments a more tractable problem than the problem of new unemployment. For one thing, the city government felt that the pension problem was inherently short-term. As long as retirement taxes are paid in the future, the number of retired employees who fall between the cracks of the old and new systems will decrease over time. The city also felt that the income from its shares of the joint venture, at least after a few years, would help to cover this transition period. Problems of paying retired workers are not so easily resolved when foreign investors are less interested in helping, or when local governments have even fewer resources to draw on. In many parts of China, street demonstrations by retired people may continue for many years to come.

Redundant Labour

Estimates vary on the number of workers who have been effectively laid off in China. Official statistics put the active urban unemployment rate at 7.5 per cent in early 1997, but about 15 per cent of state-enterprise employees may in fact be laid off (xiagang). Over 5.6 million people were made redundant in the first six

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11 Wang Yunzhu, “Jieju qiye fuyu renyu wenti de duice fenxi”, p. 6. Note that even this figure would not include the various categories of idle workers at City Steel.
months of 1997 alone, even before the Fifteenth Party Congress paved the way for a further reduction of the state sector.\textsuperscript{12}

Policies are in place to deal with this problem, but they generally have been difficult to implement on the ground. The official Beijing municipal government policy in early 1997, for example, was to pay redundant workers 270 yuan per month, but in fact individual cases were negotiated each time they arose. The Beijing city government has been putting increasing pressure on foreign investors to take on the financial responsibility for redundant workers when joint ventures are established. This began around 1994, when the city government recognized that it could no longer handle the demands to support retired and redundant labour. Tianjin has a similar policy. Both cities offer support for only two years.\textsuperscript{13} Neither Beijing nor Tianjin has devised official guidelines on these issues, nor is there an official national policy in place, apparently to maintain negotiating flexibility and to allow room for experimentation. Much of what we heard from officials and managers, however, represented best practice, not typical practice. Several Chinese studies show that many cities cannot provide sufficient funding to redundant workers due to the widespread financial problems of the local state enterprises.\textsuperscript{14} Compounding these problems, due to the influx of people from the countryside, new market-based opportunities for redundant workers are developing only slowly, especially in inland regions like Sichuan.

Even in Beijing, a redundant worker from a state-owned electronics factory told us that the factory paid 150 yuan a month for a maximum of three months — well under the figure the Beijing Labour Bureau gave us. After two years the workers’ contracts were terminated, rights to subsidized housing were revoked, and their personnel files (\textit{dang’an}) were transferred to the city’s local residential committee. Nor does the Beijing factory cover medical insurance. In fact, the factory has been able to pay retired workers only by gradually selling off its assets. Another method to end the employment relationship has been the one-time buyout option, giving the worker a lump sum to terminate his or her contract. In Tianjin we were told that some joint ventures had used this method,

\textsuperscript{12} China New Digest — Global, 5 November 1997 (GL97-150).

\textsuperscript{13} Our interviews in Beijing and Tianjin on these topics included representatives of the Joint Venture Department in the Commerce Bureau of the Beijing Municipal Government; the Labour Bureau in Tianjin; the Administration Office of Heping District, Tianjin; and managers from Beijing Jeep Co., Beijing Electronic Instrument Co., Beijing No. 2 Offset Printing Co., Tianjin 721 Television Factory, Tianjin Refrigerator Factory, and Tianjin Carpet Factory.

\textsuperscript{14} See, for example, Han Zhitang, “Fenliu anzhi qiye fuyu renyuan baozheng gaige shunli jinxing” [Local Settlement of Surplus Employees to Guarantee the Smooth Operation of the Reforms], \textit{Zhongguo Laodong Kexue} [Chinese Labour Science], Vol. 4 (1996), pp. 33–6; and Wang Yunzhu, “Jiejue qiye fuyu renyuan wenti de duice fenxi”, pp. 6–10.
but the amount of compensation was unsatisfactory and eventually led to street demonstrations.\textsuperscript{15}

Many of the workers have been unwilling to risk the financial and social uncertainties of the labour market or the plunge into petty commodity production. We found this a typical attitude among most of the employees at City Steel.\textsuperscript{16} While evidence from other parts of China suggests that these attitudes will change due to a combination of market opportunities and pressures to break the iron rice bowl, the transition will not be easy. The legal institutions are in place for City Steel to terminate contracts after two years of unemployment benefits (or when workers find alternative employment), but it remains to be resolved how and when in reality to terminate connections between workers and their former employers when almost all social services remain tied to employment.

Primary responsibility for helping redundant workers from City Steel lies with the municipal Employment Bureau (\textit{Jiuye Ju}), but the bureau faces a demand far greater than it can meet. The bureau director told us that, like many other cities, the municipality has an influx of unemployed rural people in addition to an increasing number of workers laid off by struggling state-sector enterprises. The Employment Bureau proposed a number of partial solutions to ease the burden of redundant labour from City Steel. First, it felt it could generate over a hundred jobs over two years by a combination of administrative pressure and tax incentives for new large enterprises in the area to hire laid-off workers. Second, it can arrange for 200–400 people to emigrate to jobs elsewhere in China by the end of the second year, through the bureau’s established connections with coastal factories and city governments. The bureau is willing to offer such posts twice to laid-off employees with the requisite skills. After the second refusal (or the second return from such a job) the bureau will consider the contract terminated.

The third form of help from the Employment Bureau is the city’s unemployment insurance system. Like in the retirement insurance scheme, an unemployment insurance tax (1 per cent of the payroll) was established some years ago,\textsuperscript{17} though, once again, many state-owned enterprises (including City Steel) have not paid into it. Nonetheless, the Employment Bureau agreed to cover 10 per cent of the redundant workers even though such taxes had not been paid.

\textsuperscript{15} As one study of redundant labour in China pointed out, it is easy to remove workers from their work posts, but very difficult to remove them without resistance from the embrace of the enterprise, where they retain needed social-welfare guarantees (\textit{li gang rongyi, lichang nan}); Han Zhiang, “Fenliu anzhi qiyeruyuan”, p. 35.

\textsuperscript{16} This is consistent with the findings in Alex Inkeles, C. Montgomery Broaded, and Cao Zhongde, “Causes and Consequences of Individual Modernity in China”, \textit{The China Journal}, No. 37 (July 1997), pp. 31–59. This identifies a “basic conservatism and lack of dynamism” in the state sector (p. 51).

\textsuperscript{17} The system was created in 1986 for state enterprises only, and was revised in 1993.
Payments are computed as 70 per cent of the local average wage, but this computation includes wages in surrounding poorer rural areas: currently this is only 150–180 yuan a month. This is very low by City Steel standards, and a family with no other income would struggle to survive.\textsuperscript{18}

**Housing**

Like most state-owned enterprises, City Steel originally supplied subsidized housing for all its workers. The quality varied widely, from fairly new and modern facilities with about 100 square metres of living space per family to old and shabby housing with no indoor plumbing and only some 20 square metres per family. As national housing policies changed over the last few years, the enterprise sold ownership of much of this housing directly to employees. The company still retains fourteen apartment buildings that it is legally unable to sell. These constitute the worst housing, and it might not be possible to sell them even if the law changes. Rents in these buildings are heavily subsidized.

About 40 per cent of the workers had already bought their apartments, while another 40 per cent rented the very low quality housing that the steel plant still owned. The average rent for a typical apartment of 20 square metres was only 8 yuan per month. The rents have been set by government policy and will very gradually rise toward a market rate. The average rent was expected to be about 20 yuan per month by the end of 1997, which is still very cheap. The final 20 per cent of the workforce (usually young couples for whom the factory has not yet built housing) rented rooms from local families. Rents on the private market were about 50–60 yuan per month plus electricity. The steel plant was in the midst of constructing three new apartment buildings to be sold to workers, and these buildings will house some of these young people.

In general, the privatization of housing has been the least problematic area because so much of it has already been accomplished. No-one’s quality of housing will decline as a result of the joint venture, because they either live in private apartments or their subsidized rents will be moving slowly to market rates no matter what.

**Education**

City Steel runs a full range of schools, from a daycare centre to a high school. The joint enterprise, of course, has no interest in taking them over. The daycare centre appeared well equipped and well staffed. It charged 20 yuan per month (30 yuan for non-enterprise families) in 1997, and had 41 teachers and 250

\textsuperscript{18} It is standard practice in much of China to pay a settlement fee (of about 15,000 yuan in this area, and one month’s salary for each year of service in Beijing and Tianjin) to workers who take out a business license and thus end their contracts. In this case, no such funds were available.
children. The elementary school had 356 students and 34 teachers. City officials considered the quality very good.

The middle school and high school were combined in a single facility, with 259 students and 48 teachers. The very high student-to-teacher ratio (5.4:1) reflected declining enrolments over the last few years: even though some of the teachers have been laid off, most remained in place.\footnote{Three years earlier there were 373 students and 57 teachers; while the schools retained only 70 per cent of their previous enrolment, 85 per cent of the teachers remained.} Total fees for the middle school were about 60 yuan per semester. The high school can charge tuition fees as well as other fees (since national regulations mandate only a middle school education) and the total came to about 150 yuan a semester. A handful of students got need-based scholarships, and two or three in each class received merit-based ones. Nearly all of the students came from the steel mill, while a significant number of the factory's children went to other local schools. This is a reflection of the quality of the high school, which is roughly in the middle of the local range. The problems in attracting more students stem from four factors: relatively low salaries (350–600 yuan per month) have made it hard to retain the best teachers; the high school offers only a curriculum for science majors; laboratories and other facilities are not up to the quality of some of the other local schools; and there are no dormitories, which makes it impossible to attract rural students.

The middle schools and high schools that are run by the local district government and by the Water and Electric Bureau (one of the few really wealthy state enterprises in the area) are clearly superior. The district government school has new facilities, large labs, a language laboratory, and dormitories. Other local schools (all run by state-owned enterprises) are struggling even more than the City Steel school.

Government regulations allow up to 30 per cent of a school's income to be earned on the private market and the principal of the high school tried to earn some extra income for the school by offering night classes, as is done frequently in eastern China. However, parents at the factory criticized the idea as inappropriate, as draining away teachers' energy from their children’s education. Yet the school may have no other choice in the future.

The plan adopted for City Steel would leave the daycare centre and both of its schools open, at least for now. The schools will try to survive by raising tuition and other fees to the market rate; they would prefer not to lay off any more teachers to avoid adding even more to City Steel's unemployment problem. The district school rates (including tuition and all other fees) are about three times higher than what the City Steel schools charge. The daycare centre and elementary school may still be competitive at that higher rate, but the middle school and high school will have to improve in quality.
A semester in the district high school costs almost two months’ salary for a low-skilled steel-mill worker, and the City Steel workers will clearly face this added burden in the future. This is part of the transition in China toward having education rely on the market rather than remain a service paid for by the government. There is little reason to believe that this strategy will lead to an effective broad-based education, but it is part of a general national trend rather than a specific result of privatization.

Health Care

The steelworks operates a small 60-bed hospital, which is shabby and obsolete even by local standards. All of the beds were empty during one visit, and about a dozen were occupied during a second. An upper floor is reserved for patients from outside the factory, and appears to be unused. In principle, employees can use their medical subsidies at any clinic. In practice the benefit is moot, because the factory cannot pay for this. Many in fact apparently use other clinics, especially for serious problems, although they pay higher fees. Unlike the steelworks’ clinic, the local district government hospital is centrally located in a bright new building; it has two large operating rooms, more modern equipment and a better staff. The Water and Electric Bureau hospital is reportedly even better.

The local district government reported that it has the highest density of hospital beds per capita in the country (with 800 beds in an urban district of 40,000). Consolidation of medical services seems likely in the long run, with the steelworks’ hospital ultimately closing. Several factors, however, make immediate closure unlikely. First, the City Steel hospital employs 78 people who would almost surely have to be laid off. Second, the basic fees at the other hospitals are very high. All told, the remnant of the old state-owned enterprise will probably run the clinic for a few more years until it can no longer afford to continue doing so. The local government recognizes that consolidation of health services makes more sense in the end, but also has no power to tell state enterprises to shut down clinics that form part of their identity. This ghost of the state-owned enterprise will be allowed to limp along in the hopes that the market will provide something better eventually.

The Implications for Social Services

It is becoming increasingly urgent for China to find solutions to fix the underfunded pension system, to re-employ unemployed workers and to deliver social services outside the old work-unit system. The general pattern at City Steel includes a commitment to paying retired workers and to paying off debts owed directly to workers. This case also suggests a welfare system that will try to help workers find certain kinds of jobs, but where unemployment benefits will be low and will not last more than a few years. This is consistent with the claim we
heard from officials that workers would only be motivated to enter the labour market by "fighting with the river at their backs" (bei shui yi zhan). Finally, there appears to be a tendency to let housing, medical care and education drift toward the free market, although it is doubtful such a policy can provide adequate education and health for the population.20

The privatization of much of the housing stock and the end of rationing have decreased the scope of the auxiliary responsibilities of state enterprises. Yet urban social life remains firmly embedded in the work unit. In the case of City Steel, employees primarily still occupy a single neighbourhood, go to the same schools, and see the same doctors. The neighbourhood is a company town within a larger city. The partial privatization of housing has not yet made much of a difference in social life, because most workers still live in apartments originally built by the work unit. Even after the partial privatization of City Steel, employees will still rely on the remnants of the earlier system for education, health care, and social benefits. Even though new provisions are supposed to exist to address these needs, the old socialist unit is often salvaged in the vain hope that it can continue successfully to provide such social services.

The most fundamental problem in this case is one that all economies have to address — how does one meet the needs of people who do not work because they are too old, too young, too sick or simply cannot find a job? As the systems of education and health care are privatized, they will become more expensive than many families can afford. Given time, China will continue to cobble together solutions like the partial ones that were developed in this case. The ultimate success of this endeavour depends on steering a course between two threats. On the one hand China must avoid the danger that too rapid a transition or a serious economic downturn will overwhelm its support services and lead to serious unrest. On the other hand, too slow a transition will continue to encourage apparent abuses of the transitional system, as in the case of the Enterprise Company, and will multiply the debt crisis that is already whittling away at workers' livelihoods.

Each of the policies we have just outlined shares some core features. First, each relies heavily on the power of the municipal government to pay benefits, find jobs for redundant workers, and ultimately attract enough new business to soak up the excess labour. Second, the enterprise and the city are buying time by allowing many of the functions of the old state enterprise to limp along for a few years, hoping that the market will somehow take over in time. This is the local version of China's broader policy of allowing the private sector gradually to dwarf the state sector, instead of trying to kill off the slowly haemorrhaging parts

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20 Poor rural areas of China are already suffering from a decline in education, medical care, and veterinary services. China has not, however, been interested in investing in education even though several poverty-relief education projects have been proposed by the World Bank. Chinese officials apparently see such investment as an inappropriate form of welfare rather than as enhancing future economic capacity.
of the state sector all at once. So far this stalling strategy has largely worked, at least from the vantage point of the city government and the new joint venture. The partial privatization of City Steel went smoothly, and there has been no unrest. If the economy continues to expand, the excess labour will be soaked up, thriving companies will eventually pay their share of unemployment and retirement insurance systems, and the market will hopefully create alternative education and health systems, as it has already begun to do for housing. In the kind of expanding economy China has been experiencing, stalling for time — putting up with cobbled-together mixtures of market and socialism — may in fact allow a relatively smooth and successful transition. The process is already well underway in many of China’s eastern cities.

This strategy also has its risks, however. If China’s economy falls into a recession for a few years, perhaps as a result of the current Asian financial crisis or a future global economic downturn, these arrangements could easily leave a very large part of its urban core unable to make ends meet. Even with China’s current economic stability, education and health care are becoming problematic for parts of the urban population, and cases like City Steel show that little potential exists for improving that situation.

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