Problems with Chinese SOEs

1. SOEs are highly over-leveraged (i.e. have taken on too much debt) and structurally less efficient than their private peers. Stagnating growth throughout China's public sector has led to a shrinkage in its overall asset holdings. The combination of numbers 60/70/80/90 are frequently used to describe the private sector's contribution to the Chinese economy: they contribute 60% of China's GDP, and are responsible for 70% of innovation, 80% of urban employment and provide 90% of new jobs. Private wealth is also responsible for 70% of investment and 90% of exports. The portion of exports from private enterprises might diminish as SOEs undertake more infrastructure projects in countries involved in the Belt and Road Initiative (BRI), increasing their public stakes in China's exports. The success of China's private technology sector is also worth noting. Huawei is leading the global 5G revolution and the company is eager to spread its innovation globally.
2. SOEs are often criticized for abusing their preferential access to loans, and for lobbying for regulations which drive out competitive private companies. It is widely argued that the SOEs would not survive in an innovation-driven market environment without the perks they currently enjoy. A key indicator is the relative shares of fixed-asset investments (investments in machinery, land, buildings, and the like) by state-owned enterprises and private firms. In 2010, each accounted for around 42.5 percent of China's total fixed-asset investment. By 2015, according to the National Bureau of Statistics, the private share had surged to 50 percent and the state had plummeted to 32 percent.a key indicator is the relative shares of fixed-asset investments (investments in machinery, land, buildings, and the like) by state-owned enterprises and private firms. In 2010, each accounted for around 42.5 percent of China's total fixed-asset investment. By 2015, according to the National Bureau of Statistics, the private share had surged to 50 percent and the state had plummeted to 32 percent
3. The inefficient management of government corporations has also worsened thanks to a high turnover rate among executives sparked by President Xi's anti-corruption campaign. On one hand, the companies are relieved of corrupt executives – but on the other, SOEs are left with management who lack a coherent strategy.
4. One of the major issues with local government debt is that local governments have been taking on new debt in order to repay old debt, rather than investing in new infrastructure projects. This is because a long period of time is required before infrastructure projects, such as shanty town renovations or park constructions, can become profitable. Refinancing bonds accounted for about 56 percent of the newly issued local government bonds, up from 20 percent in the past two years. Bonds used for refinancing have crowded out bonds used for infrastructure projects to some extent. Already, infrastructure investment declined 3.6 percent year-on-year in May.

Reforming Chinese SOEs

1. The State-owned Asset Supervision and Administration Commission (SASAC) is making great strides in implementing the government's 'zhuada fangxiao' (grasp the big, release the small) policy, which has greatly reduced the number of SOEs through privatization, asset sales, and mergers and acquisitions. The Commission, which was established in 2003, is currently concentrating on restructuring the remaining SOEs into modern profit-oriented corporations. Practically all of the entities overseen by SASAC are structured as corporations and are legally separate from the government with their own boards of directors, effectively delegating more authority to the executives. There is also substantial work being done to improve SOEs through reorganization, restructuring and enhancing their internal governance standards. The government went as far as introducing mixed ownership in telecoms company China Unicom, by selling shares worth around $11 billion to 14 private investors. This was done as a step towards making China Unicom more accountable and more focused on generating returns on equity, while retaining state control.
2. The Chinese government is still keen on supporting SOEs and is committed to making them bigger, stronger and more efficient. This is particularly relevant to certain strategic sectors where government oversight is essential - specifically in defense, energy, telecom, aviation and railway systems. Conversely, the state is encouraged to divest from other industries by decreasing its ownership.
3. SOEs are frequently utilized as a mechanism for implementing policy, providing socioeconomic stability and building infrastructure. This coherent strategy has led to the emergence of megacities such as Hangzhou and Shenzhen, which have demonstrated the potential of entities operating collaboratively under state guidance. The CPC sees these types of cooperation as worthy of the costs of centralized governance. The government has proved its commitment to market-oriented reforms by boosting support for entrepreneurship through tax cuts worth around $300 billion. The state is also encouraging innovation in 'deep tech' through state-funded venture capital funds, establishing start-up accelerators and high-tech business parks.

Reform doesn't work

1. Central state-owned enterprise leaders are far from passive Party agents. They possess vice-ministerial or ministerial ranking, and in some cases have authority on par with the very government agencies that monitor them. Executives also wield deep personal networks they can leverage to resist change. A lucky few possess family or political connections with top leaders, further insulating them from government pressure.
2. Many executives lack incentives to prioritize Party orders over their personal interests. During the Hu Jintao era (2002-2012), more than half of the leaders of central state-owned companies were late-career appointees and retired directly after their posts ended. With no prospect of political promotion, many executives are deeply reluctant to

implement reforms and change a status quo from which they personally profit—legally or otherwise.

LGFVs

Lots of SOEs in China are "local government financing vehicles." It's very hard for local governments to directly take on debt (for instance, they're not allowed to issue bonds) to fund infrastructure projects. Most local governments get around this by creating special state-run firms known as LGFVs (local government financing vehicles). These state-run infrastructure firms are allowed to raise debt and subsequently use that debt to build infrastructure

Some problems:

1—Most of this debt is secured, i.e. backed by physical collateral, but there's a ton of obscurity that makes it very difficult for external investors to know how valuable that collateral is, so there's speculation that if more of these LGFVs start to fail, investors will get screwed over when the collateral they seize is way less valuable than the underlying loan, which could cause economic crisis

2—Local and regional governments are becoming increasingly unwilling to bail out LGFVs that default on debt. This is for a variety of reasons, but most importantly it's because many local governments in China, especially those in rural areas, are cash-strapped particularly during the pandemic and don't have the money to

3—Chinese banks are becoming increasingly skeptical of the long-term financial viability of LGFVs; a leaked memo from several months ago circulating between major Chinese banks revealed that most state-run banks are opting to not provide further loans to LGFVs out of fear of an impending default crisis. This isn't just true for local SOEs, but for the $19.3 trillion Chinese bond market, i.e. investors fear impending collapse/recession (especially given the struggles of even private firms like Evergrande)