Redundancies in Chinese State Enterprises: A Research Report

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This article examines how the problem of surplus labor is being dealt with in some of China's state-owned enterprises. Primarily using interview data from the period 1995–1997, as well as published sources, the article looks at the main methods employed by large state-owned enterprises to reduce the level of surplus labor in their workforce. It also considers how smaller state-owned enterprises are coping in an era where mergers, closures, and bankruptcies are becoming much more common as a means of dealing with loss-making firms, resulting in widespread redundancies in the state-owned enterprise workforce. The article illustrates that the potential political repercussions of job losses, as well as direct intervention by local authorities, continue to hinder the freedom of enterprise management to adjust employment levels in the interests of efficiency and productivity. The article also notes the importance of how decisions about downsizing and redundancy are communicated and justified to employees if resistance and social instability are to be minimized. The employment treatment of production workers will be considered separately from that of cadres, since these two groups are subject to different employment regulations and political constraints.

Introduction

The economic reform process in China, with all its organizational implications, is multifaceted. Included is state-sponsored marketization,

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INDUSTRIAL RELATIONS, Vol. 39, No. 3 (July 2000).
Published by Blackwell Publishers, 350 Main Street, Malden, MA 02148, USA, and 108 Cowley Road, Oxford, OX4 1JF, UK.

the infusion of foreign capital, and reform of state-owned enterprises (SOEs). The reform process has been lauded particularly in comparison with the "rush to market" approach taken in the ex-Soviet Union and eastern Europe (Child, 1994; Nolan, 1995; Hannan, 1998). Despite progress, the third element of the *troika*—the reform of SOEs—remains problematic, largely because of the scale of the task at hand and its implications for the whole Chinese social and politicoeconomic system. It is no coincidence that reform of this segment of the economy has been delayed until last. Early problems identified were the codification of ownership and property rights and its implications for organizational structure and form (Boisot, 1987; Boisot and Child, 1988; Nee, 1992; Bolton, 1995; Boisot and Child, 1996). While these problems persist, reform of these enterprises is also considerably hampered by factors that are in the labor relations arena and which have widespread implications for the future of such relations on a China-wide basis and for the Chinese social welfare system. To this end, this article reports on research carried out between 1995 and 1997 in the Chinese SOE sector, concentrating on the "surplus labor" problem and attempts at resolution.

The material presented is based on mini-case studies of eight SOEs in the metallurgical industry, primarily iron and steel producers, carried out between 1995 and 1997. The industry was chosen largely for reasons of ease of access (notoriously difficult in China). The enterprises varied in size from the relatively small (20,000 employees) to the large (200,000 plus employees). The mini-case studies consisted of interviews with a total of 28 directors and senior managers (between two and five per enterprise) over a period of 1 to 2 days per enterprise. Documentary evidence (in English and Chinese) supported our interviews (company reports, etc.). In addition, we interviewed 9 experts in the field, including industry officials, ministry officials, and Chinese academics, and drew on English and Chinese language secondary sources.

Surplus Labor Problem: Definitions and Extent

It is widely acknowledged that a significant proportion of China's state-sector workforce is surplus to requirements, although precise definitions and quantification of surplus labor vary. Kuehl and Sziraczki (1995) offer a definition of surplus labor as "the difference between actual and desired levels of employment" or, more specifically, as the number of workers over and above what the enterprise requires to operate at its maximum profit capacity, at its maximum production capacity, or at its standard level of production and capacity utilization. In May 1997, the

State Commission for Economic Restructuring (SCER) predicted that 15 to 20 million surplus workers in the state sector would lose their jobs by 2000 and in turn estimated the total number of surplus workers in SOEs at 54 million, close to half the total workforce (*South China Morning Post*, May 7, 1997). The proportion of surplus labor in SOE workforces, of course, varies across enterprises and is affected by factors such as enterprise size, industrial sector, geographic location, and so on. The interviews conducted by us in eight large SOEs, mostly in the steel industry, located in north, east, central, southeast, and southwest China reveal that these enterprises plan to reduce their core workforces by between 15 and 50 percent during the period of the Ninth Five-Year Plan (1996–2000). Similarly, a survey of enterprises in Dalian with a sample biased toward the same sort of large SOE found estimates of surplus labor of between 10 and 60 percent of total employees, in line with our own findings (Kuehl and Sziraczki, 1995). Clearly, this is a substantial problem, and it is one that still largely falls to SOEs themselves to solve (Lin and Sziraczki, 1995); the role of other institutions, such as local government and employment services, will be touched on later.

Workforce Reductions in Large-Scale SOEs

In recent years, enterprises have made some significant gains in autonomy over the recruitment and retention of employees, and the flexibility allowed to individuals in moving between jobs also has increased. However, the results of the reforms to date are still very far from representing the emergence of a real labor market in China (Hussain and Juzhorg, 1987; Child, 1994; Warner, 1995; Hussain, 1994). Enterprise managers are acutely aware of their responsibility to avoid the social disruption associated with large-scale redundancies and rising urban unemployment in China at a time when the development of a nonenterprise welfare safety net is still at such an early stage (Rawski, 1995; Selden and You, 1997). It is not possible at present for the "small society" (*xiao shehui*) of the state enterprise to shift the burden of its excess employees completely onto society in general, so large SOEs must find other ways of relocating surplus members of their workforce. The result has been the development of internal labor markets within many large SOEs, as workers are shifted out of overmanned core production units and into new subcompanies set up for the purpose of absorbing surplus labor (Kuehl and Sziraczki, 1995; Hassard and Sheehan, 1997; Morris et al., 1998; authors' interviews).

As one director indicated to us:

> 120,000 were originally employed in the main production line, but 70,000 of these have been separated out into service subcompanies. This type of change is very sensitive in China and can only be done gradually.

A manager at a different enterprise confirmed this:

> Only gradual progress can be made with such a sensitive reform, creating separate companies and service departments and increasing their autonomy. WCo employees are only being moved around the group at present, not forced out of it.

Many large SOEs now typically contain within them subcompanies running such businesses as shops, hotels, restaurants, and travel agencies, as well as social service companies and companies engaged in any kind of manufacturing or service provision where profits can be made; the products and services of these companies may have no connection at all with the core business of the parent company itself, although they also may act as subcontractors to the core business. Considerable numbers of workers are involved in these shifts. In one of the large state-owned steel companies studied by us, the number of employees transferred out of core iron- and steel-producing units into subcompanies now exceeds the number remaining in iron and steel production by 40 percent (authors' interviews). In theory, subcompanies have autonomy over their own levels of employment and recruitment of new staff from outside the group, but in practice, there is strong pressure on them to take up surplus labor from within the group rather than recruiting from outside (Byrd, 1991; Chen, 1995; authors' interviews). Some large SOEs also have set up a labor pool for surplus employees where they can undergo retraining for vacant posts elsewhere within the group (authors' interviews). Surplus workers may remain in the group labor pool for up to 2 years but ultimately may have their employment terminated by the corporation if no suitable post is found for them within that time (Hassard and Sheehan, 1997; Morris et al., 1998). Alternatively, they may retain their employment status within the enterprise once the 2-year period has passed, but instead of continuing to receive their basic salary, they will only be paid the monthly amount calculated by the local government as the minimum necessary to cover basic living expenses (authors' interviews).

While workers are being transferred to a variety of functions, it is evident that a substantial proportion of workers are moving from semiskilled work to unskilled service jobs. As one manager noted:

> They can be let go, having no further contact, with the company group. This is known as *liang bu zhao* ("two don't look for's"); the former employee won't look for any further help from the company and the company will have no further call on the employee.

The introduction of contract employment in Chinese industry from 1986 is one of the reforms that has contributed to SOEs' greater flexibility in hiring and firing workers (Bolton, 1995; Chen, 1995; Parker and Pan, 1996). However, the actual proportion of workers employed on fixed-term contracts has consistently fallen short of targets since the reform was introduced, and at present, contract employment is far more common in the nonstate sector than in SOEs, where it remained below 20 percent of the total as of 1993 (Warner, 1995). Indeed, some large SOEs have been replacing contract workers at the end of their contract period of employment with otherwise redundant permanent workers from within the group (authors' interviews). Given the relatively small proportion of contract employees in the workforce, this is not a viable method in itself of making the large cuts in core employment that many large SOEs aim to complete by 2000, but alongside the formation of subcompanies, it is a useful supplementary means of reemploying surplus permanent workers. As one manager indicated:

> Traditionally, all SOE employees had lifetime employment security, but short-term (3-year) contracts have now been adopted for managers; these include specific performance targets. Managers can be dismissed even before the 3-year term is up if they are not performing satisfactorily. Otherwise, they are assessed after 3 years and the decision taken to renew the contract or let them go. The subcompany concerned takes this decision itself.

This contrasts with the former situation, as described by an enterprise director:

> This is a very important problem in the Chinese economic reforms. The party-cadre system of appointment has a long history; in the past, it was common for managers to be appointed on the basis of, for example, their war record. If an individual didn't perform well, s/he was judged simply to be in the wrong post, and would only be moved sideways. The cadre system must be reformed, ending the "iron arm-chair" and the "iron rice-bowl."

A manager at another plant, however, was less sanguine:

> China has carried out extensive HRM reforms, and some managers are now aware of their greatest responsibilities. But only some—there has been no real breakthrough in this area. Poorly performing managers are still generally only moved sideways (within or between enterprises), and many are still only aware of their rights, not of their accompanying responsibilities.

Contract employment was introduced in 1986 and was intended to apply to all new entrants to the workforce, across the whole range of SOE posts, but not to existing SOE employees. Actual implementation has been more limited in the state sector, with less than 20 percent of SOE employees on contracts by 1992–1993 (Warner, 1995), hence the limited benefit to corporations of replacing permanent employees with contract workers. Some contract posts are skilled—here, their contracted period typically will be longer than the usual 1 to 3 years, generally 5 to 7, which reflects the difficulty SOEs still face in getting and keeping skilled employees. Obviously, less-skilled workers cannot fill these posts, but other contract workers are doing similar jobs to many established permanent employees. Older women, often unskilled, are bearing the brunt of the redundancy program.

Besides creating vacancies elsewhere within the enterprise for surplus workers and restricting entry from outside the group, large SOEs are also attempting to increase the number of workers exiting from the group (Kuehl and Sziraczki, 1995). One major method of doing this is to encourage and facilitate early retirement (authors' interviews). In some cases, employees taking advantage of early-retirement schemes can receive a lump-sum investment from the group company to help them start up their own business. To make voluntary severance for workers of any age more attractive to those wishing to change jobs or go into business on their own, the requirement on these employees to pay back the costs of their training if they leave the corporation has been removed. Inevitably, companies have found that it is not necessarily the right employees, from the enterprise's point of view, who volunteer for this sort of scheme, and some have had to introduce various incentives to ensure the retention of key technical personnel in particular. One manager noted:

> Yes; some plants are especially short of technicians. New regulations have been drafted by the group company to provide incentives so that the necessary talent can be retained within the group. Staff may be offered more favorable conditions, better pay, better housing, promotion, etc. to get them to stay.

Although the preceding measures are aimed at increasing the number of surplus workers leaving the enterprise altogether, to date many large SOEs have been very reluctant actually to force out any surplus employee who does not wish to go. Compulsion is a last resort, but since SOEs are setting themselves employment-reduction quotas for various levels within the enterprise, ultimately, compulsory redundancies may have to be on the agenda (authors' interviews).

Continued Government Intervention

Although the role of government in determining SOEs' levels of employment has been reduced under the reforms (Hay et al., 1994), local governments and labor bureaus do still have some influence or authority in some respects (Lin and Sziraczki, 1995), and some managers in large SOEs continue to complain of government interference in areas where they should have autonomy. One enterprise director commented:

> WCo still suffers from interference by its "mothers-in-law"—the central ministry and local government. The local government actively interfered in the decision to put the HCo Steelworks into the WCo Group against our wishes, with the ministry more reluctant to push it through. There is an intersection of vertical (*tiao-tiao*) and horizontal (*kuai-kuai*) lines of control, in which WCo is trapped.

This was echoed at another enterprise:

> Government still interferes in management, and there is therefore a need to separate management and government functions.

Enterprises may still be compelled to employ workers (often those laid off by other enterprises) whom they do not need or want, or loss-making enterprises may be merged with more successful ones against the latter's will to safeguard jobs in the struggling firm (Kuehl and Sziraczki, 1995; authors' interviews). Some enterprises seem better able than others to fend off unwanted impositions of this kind by local government either because of variations in policy between different cities or regions or because of the particular circumstances of the enterprise concerned and its past relationship with local authorities (Solinger, 1996; authors' interviews).

On the positive side, since 1995, the labor law has shifted some of the responsibility for helping the unemployed to find work onto local government institutions rather than leaving enterprises to bear the whole burden (authors' interviews). The national government also, in 1997, introduced a period of 1 to 3 years of compulsory training for all new entrants to the labor force, a measure intended to ease employment pressures. In addition, some local authorities are prioritizing employees laid off from SOEs in certain sectors of employment or self-employment. In Beijing, for example, certain occupations, including accountants, secretaries, bus conductors, and sales clerks, have been reserved for permanent city residents rather than rural migrants in an attempt to vacate tens of thousands of posts for laid-off urban residents (*South China Morning Post*, May 1, 1997). The municipal government also has reserved 20,000 taxi licenses for laid-off workers, asking bankrupt SOEs in the capital to submit lists of recommended workers for this scheme. Beijing's program, in turn, is modeled on that of Shanghai, which has pioneered efforts to help surplus workers from SOEs go into business on their own by easing registration procedures and offering tax holidays to new small businesses (*South China Morning Post*, May 7, 1997). Local government is also slowly, in certain cases, picking up the welfare burden (i.e., education, housing, medical care), but clearly this is an enormous task. A director of a Beijing-based SOE noted:

> To avoid the risk of chaos in this sensitive area of reform, SCo policy is to "establish the channel before the water comes in," i.e., to have opportunities ready and waiting for surplus workers when they are laid off. But SCo's scope for such reductions is restricted by its particular status and location in the capital —it can't dump too many people on society as some other cities (especially those in the bankruptcy pilot program) have been able to do, for the sake of political stability—can't have workers on the streets in Beijing of all places. So our special status brings certain disadvantages as well as benefits. The concept of the enterprise as a "society in miniature" has had to be changed. It is planned that SCo schools, clinics, etc. will be handed over to local government to run in the near future, although we will continue to provide some financial support to them during a 3-year transition period. These entities have to receive some support and guidance in their first few years in the market.

A manager at YCo endorsed these sentiments:

> To release the social burden of enterprises was one of most difficult issues in Chinese economic reform. There are two important factors. One was that there were so many staffs, workers, and their dependants. The other was the financial crisis. Many stated-owned enterprises had run into heavy debts. The practical measures to solve the "burden" problem were to restructure the labor force and to establish social security as soon as possible.

Thus the picture is a mixed one as far as government is concerned, with continuing complaints of interference and impositions from SOE managers set alongside local government schemes designed to help SOEs divest themselves of some of their surplus workers.

Workers' Reactions to Downsizing

The caution exhibited by management in large SOEs when dealing with workforce reductions is understandable. The prospect of labor unrest fueled by discontent over job losses and other aspects of China's economic reforms is a real one. Employees of large SOEs in the past enjoyed the "iron rice-bowl" benefits of lifetime employment and extensive welfare provision by work unit (*danwei*) and were thus bound to their employers in a system that has been termed "organized dependency" (Walder, 1986). Thus, as a relatively privileged section of the urban workforce, state-sector workers traditionally were regarded as the least restive segment of the Chinese working class under CCP rule. However, by the 1980s, the situation had changed; SOE workers seemed to have valued the security offered by these arrangements more highly than the choice to earn higher wages in a less secure employment arrangement (Sheehan, 1998:205–7) and the loss, under the reforms, of the security this group previously enjoyed has been long recognized as a likely cause of unrest. State workers were in the vanguard of the 1989 democracy movement as a newly aggrieved group suffering significant relative deprivation under the reforms and angry in particular about high levels of official corruption and inflation (Walder and Gong, 1993; Sheehan, 1995). Given the social and political risks involved in reducing workforce numbers, enterprise managers have made great efforts to, as one put it, "make the channel before the water comes" or, in other words, to have schemes for reemploying or otherwise dealing with surplus workers in place well before they are needed by large numbers (authors' interviews).

There are plans for social welfare provision to be transferred from *danwei* to local government, with the SOE providing 3 years of transitional funding for the schools, hospitals etc. that it previously ran, but at the time of this writing, this transfer was still only at the discussion stage in most of our case study enterprises. Thus SOE workers subject to downsizing often are faced with leaving the welfare safety net of the *danwei* behind before any alternative sources of these social services are in existence, hence the potential for resentment and unrest among those forced out of the SOE. "Downsized" ex-SOE workers are, by and large, operating in a local, not national, labor market. Many of the workers in our case study enterprises will remain tied to the same city by virtue of their partner remaining employed in the SOE while they seek work or self-employment outside it. This allows the couple the option of remaining in *danwei* housing while allowing one partner to seek a higher income outside the state sector. Subcompanies, after initial successes, are indeed themselves in difficulties as the markets they are attempting to enter become saturated, since every SOE is using the same methods to reduce its workforce (*South China Morning Post*, January 6, 1998). Other research confirms that this route of shedding workers often just delays their unemployment rather than being a successful means of reemployment (Hannan, 1998). Given this, it is unsurprising that one manager commented:

> The breaching of the iron-bowl led to workers' fears over job security and hostility to reform. Managers are happy with their increased autonomy, but are also concerned about their responsibilities, including that for employees.

Enterprise managers also have put considerable effort into justifying the reductions and persuading workers to accept them. A stress has been placed on the new opportunities available to some workers in the new reform environment; the chance to change jobs, and in particular to set up in business independently, is genuinely welcomed by some state employees. Success stories of former SOE workers making their fortunes are widely publicized in an attempt to overcome workers' fears of losing the security of permanent state employment (authors' interviews). Again, managers stress the importance of beginning this process of persuasion well in advance of any actual job losses. It is evident, however, that not everyone who leaves state employment is going to do better elsewhere (Warner, 1995:162). The task of managers, then, is to convince employees that some have to leave the enterprise if any are to prosper, since in the new "market socialist" environment, enterprises cannot continue to carry present levels of surplus labor indefinitely while attempting to restructure themselves the better to compete in national and world markets (authors' interviews). This approach seems to have been relatively successful if not in creating real enthusiasm for downsizing among state employees, then at least in engendering a mood of resigned acceptance of the end of the "iron rice-bowl" for some (Warner, 1985; authors' interviews).

Large SOEs have benefited from the greater financial resources at their disposal, compared with the smaller SOEs, to carry out gradual reductions of surplus labor in their workforces without prompting serious protest or disruption. This reflects a number of factors. First, it is the smaller SOEs that are loss-making; the larger ones are more likely to be in profit and are also thus more able to cross-subsidize loss-making components of the group so as to postpone the need for compulsory layoffs. Second, the larger SOEs have a greater call on state resources (both directly and through the state-owned banks) by virtue of their size and the potential threat to social and politically stability posed by their workers should large-scale layoffs be undertaken without acceptable transitional arrangements and reemployment opportunities. Third, the policy announced by the Fifteenth CCP Congress in 1997 made clear that all but the largest and strategically significant SOEs would be left to the vagaries of the market.

By contrast, the smaller SOEs, and in particular those running at a loss, often do not have the necessary resources to follow the same path. Their lack of funds also can prevent them from being able to participate in the medical and unemployment insurance programs now operating in some regions of China (*Far Eastern Economic Review*, October 16, 1997). Events during 1997 illustrated that where workers are not given advance notice of job losses or eased through a transitional period before actually being thrown out of work, the mood of acceptance that seems to prevail among employees of large SOEs can shift quickly to one of angry protest. Common features of recent reported outbreaks of unrest (it is very likely that more have been contained locally and gone unreported) have included rumors about SOE closures and abrupt declarations of bankruptcy without forewarning to employees. This is a cause for concern for Chinese authorities, since Jiang Zemin's report to the Fifteenth Party Congress in September 1997 made clear that the survival of all except 500 of the largest and most important SOEs in China will now be a matter for the enterprises themselves and that those which cannot compete in the market will face merger or bankruptcy. These events therefore will become much more common in the next few years and are likely to give rise to further unrest.

Sichuan was the site of at least four outbreaks of labor protest by SOE workers during 1997. The province is a major supplier of migrant workers to the rest of China, the so-called Sichuanese army, and there are some specific features of the province's economic history and geography that disadvantage it in comparison with other parts of China. It is burdened with a large amount of unproductive defence-related industry located there as part of the Third Front project begun in the 1960s (Hong, 1997), as well as being located well inland and distant from the export markets successfully tapped by such coastal provinces as Guangdong and Fujian. However, it seems to have been the pace with which the provincial government pushed ahead in dealing with loss-making SOEs in 1997 that was behind the high level of discontent among the workers affected. In several incidents, abrupt declarations of bankruptcy by SOE management caused workers to go to local authorities to demand an explanation of events, and when this was not forthcoming, sometimes violent street protests ensued (*South China Morning Post*, July 17 and 18, 1997, August 5 and 6, 1997, October 13, 1997).

In the provincial capital in August 1997, workers at the Chengdu Shoe Factory first heard that their enterprise was on the verge of bankruptcy when the factory director was quoted in the local newspaper as saying so; bankruptcy proceedings had not been formally started but seemed from his comments to be a foregone conclusion. The situation worsened when workers' redundancy terms also were announced after "informal discussion" by managers but without any consultation of workers, and compensation was set at a very low level. No representative from the enterprise workers' congress was prepared to meet disgruntled workers, so instead they took to the streets with their grievances (*South China Morning Post*, August 6, 1997). Trouble also has flared in SOEs where wages have not been paid for a number of months, the sudden announcement of the closure or merger of such enterprises being the last straw for their already aggrieved workforces (*South China Morning Post*, October 13, 1997). The lack of communication with employees over the fate of loss-making SOEs and the taking of crucial decisions behind closed doors seem to be key factors causing these protests to escalate rapidly from the sending of delegations to officials to street demonstrations and sit-ins. The protests have helped to focus central government attention on the problem of reemploying the workforces of bankrupt SOEs, and local authorities have been criticized for contributing to protests by not taking workers' grievances seriously in the first place (*South China Morning Post*, September 25, 1997).

The intention is that the rapidly expanding nonstate sector in China will be able to absorb a large proportion of the surplus workers shed by SOEs over the next few years. China has in fact been extremely successful in generating employment and keeping down the urban unemployment rate since the beginning of the reforms (Lin and Sziraczki, 1995:8), and the growth of nonstate employment has played a large role in this success. However, the next phase of employment restructuring will be the most difficult. The sheer numbers involved in the present round of workforce reductions among SOEs, amounting to up to 20 million workers in total by 2000, mean that continued success cannot be taken for granted. Jiang Zemin stated in his report to the Fifteenth Party Congress that temporary difficulties for some workers were inevitable as loss-making SOEs were merged or closed down but that workers would have to change their attitudes toward employment and rely more on their own initiative than on the state, and many seem to accept this, having had some years to become accustomed to the idea of the breaking of the "iron rice-bowl" of job security and enterprise-provided welfare.

However, these very large cuts in the state-employed workforce will need to be handled with care and sensitivity on the part of enterprise managers and local government officials. If news of redundancies is given to workers suddenly, or if it leaks out to them without any official announcement being made, then protests are bound to occur again. Unfortunately, arrangements for consultation with workers have tended to be undermined in recent years by reforms that have stressed managers' prerogative almost to the exclusion of all else, with many managers now actually hostile toward consultation with workers (Warner, 1995:130) and others regarding the concept of workers' political status as the masters of the enterprise with unconcealed amusement (authors' interviews). The same reform processes have tended to undermine the position of the official trade unions and bodies such as the workers' congress through which consultation and communication are supposed to be carried out. These institutions have seldom functioned properly since the early 1950s when they were first established (Sheehan, 1998), and the absence of any effective, approved channel for workers' requests for information and expression of grievances is thus likely to contribute to discontent. Unrest also may be fueled by suspicions of official corruption where enterprises are abruptly closed down or where compensation to redundant workers is not forthcoming (*South China Morning Post*, July 17, 1997).

Downsizing SOE Management

It is not only members of the rank-and-file workforce who are now surplus to requirements in SOEs; many state enterprises are also seeking to reduce management numbers and streamline their administration (authors' interviews). This has proved even more difficult than getting rid of production workers and is also an area where enterprises themselves do not have complete autonomy, since the party itself still has ultimate power over SOE managers' appointments above a certain level, as well as great influence over the many managers who are party members (Child, 1994:169; Warner, 1995:153). The long-standing "iron arm-chair" of lifetime employment for cadres is proving more durable than workers' "iron rice-bowls," and the tendency to move underperforming managers sideways rather than down also persists (authors' interviews).

However, under the Modern Enterprise System (MES) and Group Company System (GCS) reforms now being piloted nationally in 176 large and medium-sized state enterprises (Hassard and Sheehan, 1997; Morris et al., 1998), managers are now being employed on 3-year contracts that can be terminated at any time if they do not meet certain set performance criteria (authors' interviews). Given the unintended consequences of the Contract Responsibility System in force in many SOEs from the early 1980s until 1994–1995, the targets specified in managers' contracts under these new reform models are not limited to ensuring certain levels of profit. They also include an obligation to increase, or at least maintain, the value of state assets. Systems of audit and appraisal, both internal and external, are being developed to check that assets are not being run down or disposed of improperly, as had happened in the past (authors' interviews). However, although managers *can* have their contracts terminated at the end of the 3-year period, this does not mean that they necessarily *will*; top managers at the group level still speak of the difficulty of dealing with the vested interests of enterprise cadres. Efforts to convince surplus managers of the benefits of self-employment, backed with startup funds in some cases, are continuing, and as with production workers, the importance of widespread advance consultation to maximize acceptance of the changes is strongly emphasized (authors' interviews).

The restructuring of large SOEs taking place under the MES and GCS pilot programs also provides some scope for reducing managerial numbers as subcompanies gain autonomy over many aspects of their operations, enabling the parent-company administration to be streamlined. One of the large state steel companies in the sample visited by us has increased efficiency and achieved a 30 percent reduction in staff numbers at the corporation level through reorganization of functional departments, and other enterprises are progressing toward their goal of simplified administration resulting in staff reductions of around the same level. In some enterprises, administrative departments with duplicated or overlapping functions have been merged and reorganized. For example, one steel corporation in eastern China has merged four separate departments previously responsible for different aspects of construction projects into one entity (authors' interviews). Separate human resources management departments and training centers for production workers and managers also have, in certain of our case studies, been combined successfully. In some cases, management centralization has been adopted to achieve staff reductions, as finance and other departments have been abolished at the subcompany level and their responsibilities taken over by delegated personnel from the parent company's administrative departments. This can only be done in subcompanies engaged in the group's core production area, however; for others, it would cause an unacceptable reduction in managerial autonomy.

SOEs ought to enjoy greater flexibility in managerial appointments and dismissals under the MES. Under the MES, a board of directors chosen by shareholders ought to be the highest level of decision making, but this was always the role of the party in the past, and it is proving reluctant to give up its power. As government continues to be the only—or overwhelming majority—shareholder in many large SOEs, it still carries as much weight in management appointments at the highest levels as it did in the past. In fact, many enterprises involved in the pilot program have fudged the issue entirely by appointing the enterprise party chair as chair of the board of directors as well so that the same person can give orders using one or the other role as suits. Similarly, existing managers have, overnight, been transformed into a new "board of directors" by a stroke of the pen, and party and union organizations also have found a place on the board of supervisors, allowing power to remain in essentially the same hands but under different titles.

Given the entrenched position of state-sector managers already in post, the "iron arm-chair" looks likely to pose a continuing challenge to reform, with the ideal of shareholder control falling prey to continued direct government interference (authors' interviews).

Conclusions

The redundancy or redeployment of surplus production workers and managers in state industry in China is fraught with practical and political difficulties. Despite this, it has started on a large scale and has been moderately successful. However, there is a grave danger of unacceptable costs in terms of social and political upheaval. While China has won praise in the past for its gradualist approach to such sensitive areas of reform (Child, 1994) in contrast to the countries of eastern Europe and the former Soviet Union, urban unemployment is already at higher levels than during previous phases of reform, and the numbers involved in the latest phase of restructuring are unprecedented. Indeed, it is not exaggerating the argument to say that this particular reform process possesses an enormous destabilizing influence on the whole labor relations situation in China, which in turn threatens political and economic stability. As such, the SOE reforms are intimately intertwined with social welfare provision, which is enterprise-based, rather than society-wide.

The Chinese ruling elite is thus caught between the proverbial rock and a hard place. The reforms are essential to stem enormous financial losses, but the potential for mass unemployment and potential social unrest is real and threatens the legitimacy of the elite.

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