

Research on Privatization Reform of China's Loss-making Public Utilities

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Abstract

In this paper, an exposition of the background of China's privatization reform in public utilities, along with an analysis of the reform's content and effectiveness is presented and organized based on relevant public administration theory and practice. Secondly, a thorough examination of the factors constituting the primary obstacle in China's privatization reform of public utilities is undertaken. Addressing issues arising from private companies pursuing profit while public utility entities seek to avoid losses, it is argued that the incomplete reform of government functions, the constraints of traditional ideology, and the lack of supervision in the privatization of public utilities contribute to these challenges. Finally, recommendations for loss-making public utilities in the privatization reform are put forth. These involve further reforms in the utilities' business model, the establishment of new operational and service paradigms, and the enhancement of government support, regulatory measures, and coordination during the reform process. These measures aim to address the existing challenges in China's loss-making public utilities during the privatization reform.

I. Introduction

Advancing the privatization reform of loss-making public utilities in China, further transforming governmental functions, fostering social harmony and development, strengthening social management capabilities, and elevating the standards of public services to provide more and improved services to meet societal needs, pose a new challenge for the Chinese government and society.

This paper, grounded in relevant theories of public management and the practical situation in China, conducts a thorough analysis of the issues and causes within the reform and puts forward rationalized recommendations. The privatization reform of loss-making public utilities in China can significantly alleviate the financial burdens imposed on the government due to high government subsidies. It contributes to enhancing operational effectiveness of enterprises by introducing competitive mechanisms and reinforcing incentive mechanisms, thus improving the efficiency and service quality of public utilities. Furthermore, the privatization reform of loss-making public utilities in China is beneficial for the stability and development of the Chinese capital market. Additionally, leveraging private capital for the development of urban public utilities can

also improve the investment environment, consequently attracting more foreign investment. The underlying purpose of propelling the privatization reform of loss-making public utilities in China aligns closely with the endeavor to construct a harmonious society, bearing significant theoretical and practical significance.

Research Background

Since the early 1980s, many Western countries have witnessed a wave of Public Utility Privatization Reforms. In the mid-1980s and beyond, as many socialist countries embarked on market-oriented reforms, privatization became the preferred direction for reforming public utilities in these nations. Over the long term, China has pursued a policy of low pricing and high fiscal subsidies for public utilities, resulting in prices that are generally unaffected by supply-demand dynamics and cost fluctuations. However, due to the development of the market economy and the improvement in social standards, the demand for essential public utilities has steadily increased, placing significant fiscal pressure. In order to rectify the shortcomings of the old system, stimulate the development of public utilities, and diversify investment entities and channels, Public Utility Privatization naturally became the primary choice. Hence, it is imperative for the government to prioritize the Public Utility Privatization Reform and assist private enterprises in managing utility products and services.

Nevertheless, a practical analysis reveals that the public utility sector is one of the least reformed and least changed industries. The drawbacks of the traditional system have not diminished or disappeared with the expansion of public utilities. Presently, the ongoing Privatization Reform of Loss-Making Public Utilities in China faces a series of challenges: Firstly, while many local governments have increased their investments in urban public utilities, the growth in investments falls short of meeting the rising demand from the public. The Government Monopoly still fails to provide comprehensive solutions. Secondly, although local governments have recognized the inefficiencies in urban public utilities, such problems remain prominent, and no Effective Reform Strategy has been found within the framework of State Ownership Monopoly. Thirdly, in recent years, the government has intensified efforts to privatize Loss-Making Public Utilities. Yet, public utilities with good profitability and substantial profits are pursued by numerous private enterprises, whereas those with poor performance and financial losses struggle to attract the interest of private enterprises.

Analysis of Key Obstacles in China's Privatization Reform of Loss-Making Public Utilities

After a period of theoretical and practical exploration of privatization in public utilities, China's understanding of privatization in the public utility sector has gradually deepened. Due to significant differences between the privatization background in Western countries and the ongoing privatization of loss-making public utilities in China, merely adopting Western privatization theories and practices is insufficient to address the needs of such reform in China. The challenges in the development of privatization in China's loss-making public utilities are becoming increasingly evident.

Incomplete Reform of Government Functions

As China is undergoing a period of social transformation, the reform of the administrative system is still in progress, leading to an incomplete transition of government functions. The separation of government from enterprises in China's public

utilities has not been fully realized, and the government has not completely transformed into a regulatory body. Influenced by vested interests and traditional ideologies, some government departments have been relatively passive in terms of property rights and privatization reform. Therefore, recognizing the incompleteness of government function transformation and finding solutions are essential for the government to effectively fulfill its significant responsibilities in the privatization reform of urban public utilities. This is of great significance for the smooth progress of urban public utility privatization.

Confinement of Traditional Ideologies

Over the years, the prevailing notion in China has been the state ownership of public utilities, leading to a certain misunderstanding of privatization in public utilities. Under the influence of ideological constraints, people often assume that privatization will lead to private monopolies, resulting in a concentration of assets, wealth, and the removal of the inherent public service and compassion associated with government projects.

Lack of Regulatory Framework in Privatized Public Utilities

Following the privatization reform of public utilities, the establishment of an effective regulatory system is a common demand of both the public and businesses. However, due to the imperfect regulatory framework in China, the government's regulatory role has not kept pace, and a proper regulatory framework is yet to be established. While the Chinese government has actively introduced various regulations and policies to support the reform of public utility privatization, the actual role of the government in terms of regulations and policies has not been fully realized. Various corruption issues have frequently occurred in the management of public utilities, leading to a compromise of public interests. The root cause can be traced to the lack of a corresponding accountability system within China's public utility regulatory framework.

Enterprises' Reluctance to Invest in Unprofitable Public Utilities

Enterprises tend to pursue a profitable public utility, which implies that they may avoid investing in unprofitable public utilities, as, in general, private enterprises must operate profitably. Although the government has made commitments to encourage private enterprises to participate and has offered subsidies for the loss-making segments, the enthusiasm of enterprises to enter this sector has not significantly improved. Enterprises still tend to avoid loss-making public utilities and instead focus their attention on profitable public utilities.

Suggestions for Reforming the Models of Privatizing Loss-Making Public Utilities in China

Transformation of Business Models for Loss-Making Public Utility Enterprises

Specialized Development Model

Most small and medium-sized enterprises face significant challenges when entering the competitive market for profit-driven public utility operations. Therefore, these enterprises may opt to engage in loss-making public utilities with growth potential and government subsidies. They can focus on specialized areas like sewage treatment, waste management, foundational infrastructure, and follow a path of "specialization and efficiency." This approach helps them avoid intense competition with financially robust

companies and allows them to tap into markets that align with their existing technological and construction capabilities.

Diversified Business Model

Enterprises already involved in profit-generating public utilities, due to stable industry demands and established economies of scale, may have already completed integrated operational transformations. To broaden their business scope, these enterprises can diversify their operations. They can implement the successful strategies used in profit-generating public utilities to reform the operations of loss-making public utilities, thereby changing their business model, improving efficiency, reducing losses, and eventually turning them into profitable ventures.

Joint Venture and Cooperative Business Model

This model involves separating a department or operational segment of a public utility company and partnering with foreign investors, selling it to other enterprises for operation, or adopting a Build-Operate-Transfer (BOT) approach to establish construction and operation entities. Loss-making public utilities typically face operational bottlenecks, limited scale, and challenges like funding shortages and insufficient research and development capabilities. When operating loss-making public utilities, adopting a joint venture and cooperative business model allows leveraging the strengths of each party for mutual benefit.

Business Model Reform for the Establishment of Loss-Making Public Utility Enterprises Participation in the Formation of Large-Scale Public Utility Groups

Enterprises involved in operating loss-making public utilities can proactively participate in the establishment of large-scale public utility groups. Through the creation of these groups, business models for loss-making public utility enterprises can be restructured. For example, Changchun Water Corporation Limited is a typical large-scale public utility group. Its operations encompass long-distance water supply, water production, water supply, drainage, sewage treatment, pipeline management, instrumentation, construction, and other production and operational activities. This public utility group manages profit-driven public utility projects and also engages with loss-making public utilities. By investing in and restructuring numerous loss-making public utility enterprises, it integrates them into its development plans, capitalizes on complementary strengths, and employs its effective management methods to address the existing problems and contradictions of these loss-making public utility enterprises, contributing to collective growth.

Establishment of Shareholding Enterprises

This model involves assessing the assets of loss-making public utility enterprises and then opening national assets for public bidding. Some state assets are transferred to interested enterprises in the form of equity, raising capital to create new shareholding enterprises. These new enterprises operate in accordance with modern corporate systems. The proceeds from asset transfers are centrally managed by the government and primarily allocated for internal technological research and facility development within the industry. This model addresses the issue of insufficient capital for the industry's development and facilitates the adoption of advanced foreign technologies

and management practices, ultimately enhancing the overall industry standards.

Reforming the Service Models of Loss-Making Public Utility Enterprises

Enhancing Service Quality

Loss-making public utility enterprises should change their mindset, swiftly improve service quality, reduce service costs, enhance service efficiency, and recognize that services must be based on the needs of the public, rather than being seen as mere benevolence. Establishing a virtuous cycle in the operational activities of enterprises will enable them to turn losses into profits.

Increasing Public Participation

Loss-making public utility enterprises should encourage greater public participation, conduct effective publicity, gain public attention, understand the needs of the public, and use this information to guide the reform of their service models. Public concerns are likely to attract government attention, and the government may also provide more supportive policies for loss-making public utilities to improve the external environment for these enterprises.

Leveraging the Government's Role in the Privatization Reform of Deficit Public Utilities in China

Maximizing the Government's Facilitative Support Role

In the process of reforming the privatization of deficit public utilities, the government's intervention plays a particularly significant role. The government should actively create an enabling environment by attracting and motivating private capital participation through authorizations, the formulation of preferential policies, and providing government subsidies. This is to enhance the efficiency of urban public utilities, improve service quality, and emphasize government objectives such as equity and democracy, underscoring cooperation between the government and the private sector. Government authorities can offer preferential financing to privately-owned enterprises facing financial challenges and provide policy support and subsidies to deficit public utilities. Based on industry characteristics, they should enact regulations and refine systems to incentivize proactive engagement in operating deficit public utilities.

Gradually Enhancing the Government's Macroeconomic Governance Role

While sectors such as urban water supply and pipeline gas initiated privatization earlier, the pace of privatization reform in other domains like waste management and irrigation and sewage facilities has been relatively slower, often due to the under-emphasis or lack of coordination among stakeholders. The government's establishment of an effective administrative oversight system is pivotal in overseeing the privatization reform of deficit public utilities. The government is strengthening its role in macroeconomic governance. Firstly, it should formulate industry service planning policies, service standards, quality requirements, and fee standards, establish a public service qualification certification and registration system, implement a national treatment system for public services, ensuring equitable access to public services for all citizens and regions, regardless of whether they are urban or rural, with a specific focus on the needs of marginalized groups. Secondly, the government should develop regulations for fee collection in relevant public utility sectors to facilitate prompt fund

recovery by enterprises. In addition to policy support for relevant businesses, the government should allocate a portion of its budget to subsidize public expenses in these areas, alleviating the financial burden on the public.

Striving for the Government's Equitable Balancing Role

In the privatization reform of deficit public utilities, the government's balancing role is also of paramount importance, requiring the simultaneous consideration of the interests of both the public and the enterprises. Firstly, the government should maintain policy consistency, synchronizing policies for profitable and deficit public utilities, enhancing the legal and regulatory framework for deficit public utility sectors to ensure that these enterprises have a legal foundation, improve their business environment, and provide a fair and competitive business environment. Secondly, incentivizing deficit public utility enterprises to engage in technological research and development, facilitating the introduction of relevant experts or technical personnel, and providing appropriate subsidies to encourage enterprises to enhance their technological capabilities, improve production efficiency, and reduce costs. Additionally, through price regulation, conducting a scientific and rational analysis of the feasibility of price setting by deficit public utility enterprises, taking into account public opinions, and providing appropriate guidance to enterprises. Finally, effective communication and public relations are essential to ensure public understanding and support for price increases. Raising prices should not be a unilateral announcement; it should be explained from the root causes, and public participation should be encouraged.

In the reform of privatization of loss-making public utilities, the governments, in addition to balancing the interests of the public and the enterprises, must also consider and coordinate various relationships among private enterprises, between private enterprises and state-owned enterprises, and between private enterprises and foreign-funded enterprises. This is essential to promote the harmonious and rapid development of the privatization of loss-making public utilities while ensuring alignment with the interests of all stakeholders.

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