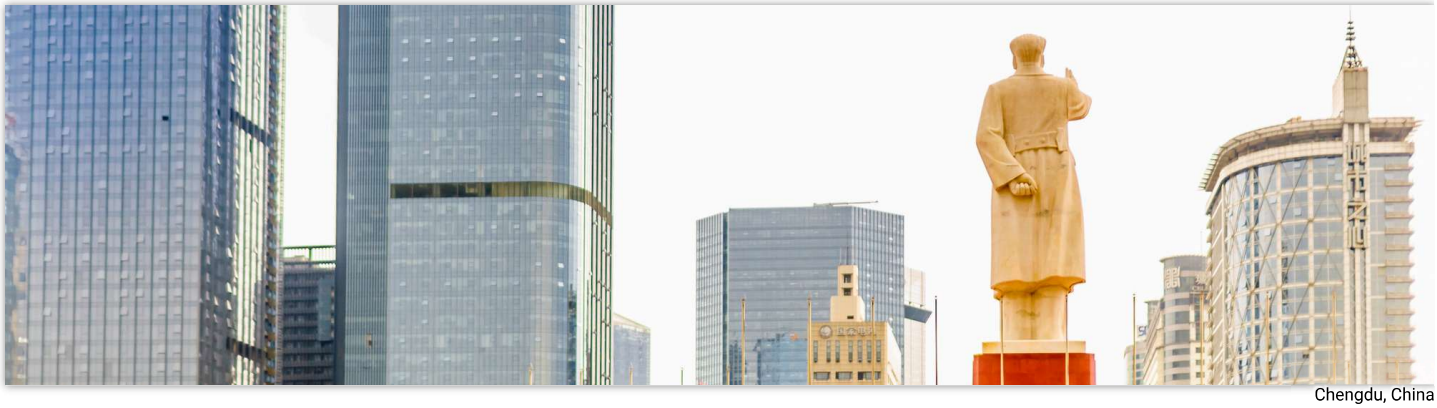
PREVAILING WINDS

Party Committees in Chinese Companies

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Prevailing Winds



Chengdu, China

- The Chinese Communist Party has renewed its efforts to establish party organizations in Chinese companies, both state and private.
- There is a lack of transparency about the influence of party organizations within Chinese companies.
- Absent a concerted pushback from foreign and domestic businesses, China is likely to continue pushing for a more expansive role for party organizations in companies.

Prevailing Winds is a China-focused blog written by Nicholas Borst, Director of China Research at Seafarer. The blog tracks the economic and financial developments shaping the world's largest emerging market.

One of the most contentious issues between China and the United States is the role of the Chinese Communist Party (CCP) in the economy. The CCP has become increasingly strident that it should play the leading role in guiding China's economy. Xi Jinping has revived Mao Zedong's mantra that "east, west, south, and north, the party leads everything."[1] Rather than reducing political intervention in the economy, Xi has declared that CCP leadership is the essential feature of Socialism with Chinese Characteristics, the formulation that describes China's unique economic system.[2]

> The notion that a political party, especially one dedicated to communism, should seek to embed itself in companies and exert control from within is antithetical to American notions of capitalism.

A troubling manifestation of this effort to reassert control over the economy is a renewed push to develop CCP party organizations within companies, both private and state-owned. The notion that a political party, especially one dedicated to communism, should seek to embed itself in companies and exert control from within is antithetical to American notions of capitalism. American companies operating within China and American investors in Chinese companies are

faced with the unsettling prospect of a CCP organization inside their company with an unclear agenda and overlapping lines of authority with the company's managers. There is limited transparency over how party organizations make decisions, what aspects of a company they seek to control, what accountability – if any – they have to a company's shareholders, and what information they may be sharing with outside parties.

While the CCP's efforts to control companies is not new, the Xi Jinping administration is undertaking an unprecedented effort to achieve this goal.

A Long-held Goal Unfulfilled

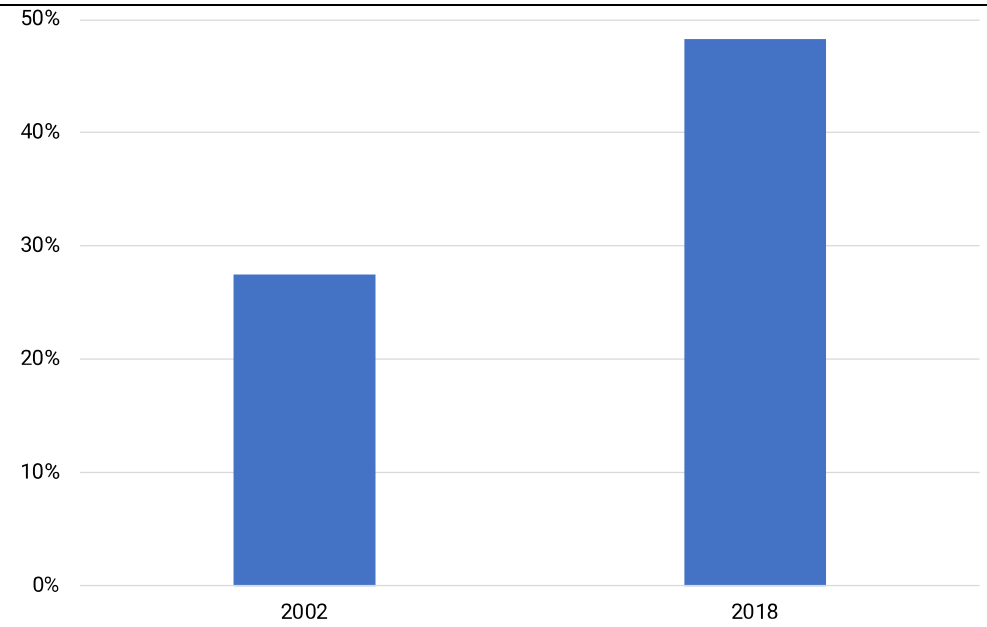
A defining characteristic of modern Chinese policymaking is the CCP's effort to counterbalance its loss of control over a more open and market-based economy. The CCP has sought to harness the dynamism and wealth creation of the market, while intervening frequently to guide the economy towards policy priorities and preventing private companies from becoming competing sources of power.

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In the wake of the Tiananmen Square protests and violence of 1989, the CCP undertook a massive effort to reassert its control over China, including the economy. In 1993, the CCP first laid out the legal requirement for all companies to allow the establishment of party organizations.[3] In the early 2000s, the CCP underwent a major ideological shift and formally invited private entrepreneurs into the party. This was a recognition of the rising importance of the private economy and that co-option was the only viable path going forward.

While party membership became common for many private entrepreneurs, the goal of establishing strong party organizations in companies languished. Penetration of private companies by party organizations was low in the early 2000s and those that did exist had limited influence, doing little more than studying new party policies. **Figure 1** shows the prevalence of party organizations in private companies during that period (2002) compared to the most recent data available (2018). The prevalence of party organizations in state-owned enterprises (SOEs) was substantially higher. However, high-level CCP officials complained that even in SOEs many party organizations were disorganized and ineffective. During a speech in 2000, President Jiang Zemin decried "lax and powerless" party organizations in SOEs and vowed to address the problem.[4]

FIGURE 1
Share of Private Companies in China with Chinese Communist Party Organizations



Source: All-China Federation of Industry and Commerce.[5]

Tightening the Screws

Since the start of the Xi Jinping Era, there has been a general resurgence of the Party's efforts to entrench itself in all aspects of Chinese society, including the economy. China's leaders believe that only by revitalizing and strengthening the Communist Party can China achieve its goal of "national rejuvenation."

In this context, the CCP has renewed its efforts to establish party organizations in Chinese companies, both state and private. In 2015, Xi Jinping's signature SOE reform plan, the "Guiding Opinion on Deepening the Reform of State-owned Enterprises," cited the weak role of party organizations in many SOEs and called for strengthening the CCP's leadership over these companies.[6] Subsequent government proclamations have called for the promotion of party organizations within private companies, albeit with less intensity than the policies aimed at SOEs.

China's Company Law states that companies shall permit party organizations to be established and provided the necessary conditions to operate.[7] Beyond that, there is no formal legal requirement that party organizations be given operational influence within a company.

As detailed in **Figure 2**, the CCP Constitution outlines more specific powers for party organizations within companies. It calls for party organizations to be formed in any company that has three or more party members. For SOEs, party organizations should "participate in making decisions on major questions in the enterprises."[8] The CCP Constitution sets a lower bar for party organizations within private enterprises, stating that they should "guide and oversee their enterprises' observance of state laws and regulation."

In a 2017 revision of the CCP constitution, the role for party organizations in SOEs was further strengthened. For SOEs with a Leading Party members' group, the party organization shall "play a leadership role" and "discuss and decide on major issues of their enterprise in accordance with regulations."[9]

FIGURE 2

Excerpts from Article 33 of the Constitution of the Communist Party of China Detailed Directives for the Role of Party Organizations within Companies

State-owned Enterprises	■ The leading Party members groups or Party committees shall play a leadership role, set the right direction, keep in mind the big picture, ensure the implementation of Party policies and principles, and discuss and decide on major issues of their enterprise in accordance with regulations. ■ Primary-level Party organizations in state-owned or collective enterprises should focus their work on the operations of their enterprise. ■ Guarantee and oversee the implementation of the principles and policies of the Party and the state within their own enterprise and shall support the board of shareholders, board of directors, board of supervisors, and manager (or factory director) in exercising their functions and powers in accordance with the law. ■ Wholeheartedly rely on the workers and office staff and support the work of workers' representative congresses; and they shall participate in making decisions on major

	issues in the enterprise. ▪ Strengthen their own organizational development and lead work on political thinking, efforts toward cultural-ethical progress, and work on trade unions, Communist Youth League organizations, and other people's group organizations.
Private Companies	▪ Implement the Party's principles and policies. ▪ Guide and oversee their enterprises' observance of state laws and regulations. ▪ Exercise leadership over trade unions, Communist Youth League organizations, and other people's group organizations. ▪ Promote unity and cohesion among workers and office staff, safeguard the legitimate rights and interests of all parties, and promote the healthy development of their enterprises.

Source: Constitution of the Communist Party of China.

Action and Reaction

Since the launch of Xi Jinping's SOE reform campaign in 2015, China has made a concerted push to formally give party organizations greater influence within SOEs. For listed SOEs, a primary avenue for this effort has been to require SOEs to revise their corporate charters to formally empower party organizations. In 2018, this requirement was formally incorporated into the China Securities Regulatory Commission's Code of Corporate Governance for Listed Companies.[10]

Two studies looking at the adoption of charter revisions by SOEs in the years immediately following the new requirement found differing levels of compliance so far.[11] Some SOEs have only adopted symbolic provisions that acknowledge the importance and leadership of the CCP. In other SOEs, the board of directors is expected to consult with the party organizations prior to important strategic decisions. In more extreme implementations, the management of a company may be forced to consult with the party organizations on important operational decisions. Many also require the chairperson of the board to simultaneously serve as the head of the party organizations. Chinese SOEs that were cross-listed on an overseas exchange were less likely than only domestically listed firms to incorporate party committee amendments.[12]

While private companies were not required to incorporate party organizations into their charters, some have undertaken these changes voluntarily. Private firms with party members on their management team or board of directors were more likely to incorporate the charter changes.[13] However, relative to SOEs, private companies have been reluctant to adopt provisions that grant party organizations operational control and generally favor only symbolic changes.

> The push to establish party organizations in companies has generated a strong backlash from foreign companies operating in China.

The push to establish party organizations in companies has generated a strong backlash from foreign companies operating in China. The European Chamber of Commerce has been vocal about its opposition to an expansive role for party organizations within European joint ventures with local SOEs.[14] At present, there are only scattered reports of foreign companies in China facing pressure to establish party organizations or give existing ones more influence.[15] However, it is difficult to gauge the true influence of party organizations because many foreign businesses may be reluctant to complain for fear of damaging their relationship with the Chinese government.

For Chinese companies overall, there is a lack of conclusive evidence about the influence of party organizations. Chinese companies have been eager participants in a range of government policy efforts, ranging from the Belt and Road Initiative to the campaign to develop domestic sources of technology. The motivation for joining these efforts likely stems from a mix of financial incentives, a desire to maintain good relations with the government, and possibly behind-the-scenes pressure from a party organization.

Company Case Study – Xiaomi

In 2015, Xiaomi made headlines when it announced it had upgraded its internal party organization to a full-fledged party committee.[16] At the time, it was relatively unusual for a fully private Chinese technology company to publicly make such an announcement. A representative from Xiaomi asserted the party committee would not be involved in business matters, but that the company would give full play to the role of the party organization in publicity, education, and cultural leadership."[17]

When Xiaomi went public in 2018, its offering prospectus did not provide information about the role of the party committee. Moreover, a review of the company's subsequent announcements reveals very little about the activities of its party committee.

Xiaomi became a lightning rod for attention in January 2021 when it was targeted by the Trump Administration's "Communist Chinese Military Companies" executive order for alleged ties to China's People's Liberation Army. The company denied the allegation and successfully challenged the U.S. government in court to be removed from the list.

Despite its reprieve from the executive order, Xiaomi's lack of transparency about its connection to the CCP continues to create a cloud of suspicion around the company.

What can be said definitively is the government is not yet satisfied with the influence of party organizations, particularly in private companies. At the end of 2019, the Central Committee of the CCP and the Chinese State Council encouraged private companies to strengthen their efforts in establishing party organizations.[18] In 2020, the Vice Chairman of the All-China Federation of Industry and Commerce called for a renewed push to establish party organizations in private enterprises, describing private entrepreneurs as the "helmsmen of a ship" and party organizations as the "compass" that guides the ship's direction.[19] Absent a concerted pushback from foreign and domestic businesses, the Xi Jinping government is likely to continue pushing for a more expansive role for party organizations in all Chinese companies.

A Line in the Sand

On the issue of party organizations, U.S. policymakers are justified in taking a hard line and offering limited scope for compromise. The CCP has overreached beyond the legitimate purview of modern market economies by seeking to establish and strengthen party organizations in private and listed companies. Western governments would be correct in classifying China as a non-market economy and establishing countervailing economic restrictions. If party organizations are left unchecked, it could also have disastrous consequences for the Chinese economy, strangling the dynamism and entrepreneurialism out of China's best companies.

The CCP has overreached beyond the legitimate purview of modern market economies by seeking to establish and strengthen party organizations in private and listed companies.

Party organizations may have a role to play within SOEs as a representation of the state's ownership interest. Regardless, in listed SOEs, the activities, membership, and expenses of party organizations should be fully disclosed to minority investors. SOEs should clarify the areas of corporate activity that are subject to control by the party organization, publicly identify the leadership of the party organization, and provide regular reporting to shareholders on its activities. By choosing to raise outside capital, listed SOEs have forgone their right to unfettered political control. Listed SOEs that cannot comply with these requirements should be converted back into fully government-owned enterprises.

For private Chinese companies and foreign companies operating within China, the CCP must make clear that party organizations have no legal basis to demand influence over a company's operations or personnel appointments. Formal action taken to influence a company must come via the official organs of the government. Private companies that opt not to empower party organizations should not face retaliation or discrimination from the government. Anything less than this will undermine the notion that China should be treated as a modern and rules-based economy.

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