

Government Function Transformation in the Private Enterprise Transformation and Upgrading: Literature Review and Theoretical Examination

Xuanzhao Wang

China University of Political Science and Law, China
Graduate School, China University of Political Science and Law, 25 Xitucheng Road, Haidian District, Beijing 100088, China

Abstract: Private enterprises in China have rapidly risen to become indispensable in creating Chinese miracles since the reform and opening-up. They also face the challenge of transformation and upgrading from high-speed to high-quality growth. In the paper, the paths of private enterprise transformation and upgrading are categorically elucidated through reviewing academic research on government function transformation and the pros and cons of different government industrial policies are analyzed to provide a reference for subsequent research.

Keywords: Private Enterprise Transformation and Upgrading; Government Function Transformation; Industrial Policies.

1. Introduction

At the Third Plenary Session of the 18th CPC Central Committee, it was proposed that "economic system reform is the focus of deepening the reform comprehensively. The underlying issue is how to strike a balance between the role of the government and that of the market, and let the market play the decisive role in allocating resources and let the government play its functions better." China considers the relationship between the government and the market as the core of government function reform and emphasizes their organic unity rather than mutual negation. The market has transformed from a foundational role to a decisive one, creating a new pattern of complementary advantages between a proactive government and an effective market. The paper delves into the role of government functions in the private enterprise transformation and upgrading, and reviews relevant domestic and international literature for a comprehensive analysis of government functions.

2. Overview of Research on Private Enterprise Transformation and Upgrading

2.1. What is private enterprise transformation and upgrading?

The academic community has studied this problem for a long time and has drawn conclusions from various perspectives. Generally, it defines transformation and upgrading as two interrelated yet distinct concepts according to definitions. Muzyka (1995) held that "transformation is to achieve a fundamental change in the logic of organizational operation through fundamental changes in organizational behaviors." Gereffi (1994) held that "industrial upgrading is a linear improvement and enhancement process of OEM-ODM-OBM, allowing economic actors, including nations, enterprises, and workers, to ascend from low value-added to high-value-added links in the global value chain." Ernst (2002) held that "the essence of upgrading is specialization and integration, which can be categorized into industrial, factor, demand, and functional activity upgrading, as well as

structural transformation from commodity production to knowledge-intensive services." From the perspective of products, Professor Zhao Lina held that transformation and upgrading means changing the previous low-end product strategy to focus on creating a high-end product strategy boasting brand, technology, service and quality. Professor Ren Ailian, from a management transformation perspective, emphasized the need for private enterprises to break away from the past dominance of family-style management and advocate for the full flow of property rights. Professor Fu Baozong, from an industrial perspective, defined the goals of transformation and upgrading as a shift from extensive and inefficient industrial growth to intensive and efficient growth, from factor-driven to innovation-driven industrial development, from outward to inward growth in industrial structure, and from environmentally depleting to environmentally friendly development mode[1].

2.2. Paths of private enterprise transformation and upgrading

According to scholars' research on multi-faceted aspects of enterprise transformation and upgrading, it's evident that such transformation has become an essential link in China's new phase of high-quality economic development, an inevitable outcome to adapt to new circumstances, and a necessary choice for sustainable economic development. Professor Ren Ailian, from a management perspective, suggested that enterprises refine their internal property structure, ensure the property right mobility, and define clear rules for property rights of enterprises to attract technical talent and high-quality investors and accelerate their transformation and upgrading and development. Experts from the think tank in Wuhan University analyzed the transformation and upgrading of enterprises from a development strategy perspective, emphasizing the importance of seizing the historic opportunities of industrial upgrading, urbanization, green development, social informatization, and economic globalization. From an industrial system perspective, Professor Zhao Lina emphasized optimizing the internal structure of industries to drive the industrial chain development. This involves nurturing emerging industries

and elevating the positioning of traditional industries, phasing out outdated and unsustainable old industries, seizing the new wave of technological revolution, and adapting to the new normal of economic development to enable China's industries to face international market competition competently. From the standpoint of business philosophy, Professor Zhao Meilan suggested strengthening an enterprise's awareness of its social responsibilities, anchoring it in China's unique cultural traditions, defining internal core values, cultivating entrepreneurial spirits representing Chinese corporate culture and establishing a unique business philosophy to create new enterprise cultures with Chinese characteristics and responding to social needs. Transformation and upgrading, as the impetus for enterprises' sustainable development, contribute to enterprises' diversification and specialization and improve their international competitiveness.

2.3. Types of private enterprise transformation and upgrading

2.3.1. Direct government guidance

The process of China's transition from a highly centralized planned economy to a market economy is led by the government, which requires the government to possess a high level of capability to compensate for the inherent systemic deficiencies in the transition economy. In the early stages of reform, the government functions in the market establishment, supervision, guidance, and participation, which gradually shift from strong to weak in turn. Accelerating the development of the socialist market economy with Chinese characteristics requires the strengthening of government functions at all levels and a clear function delineation of governments at all levels in the market resource allocation for neither overstepping nor falling short. Professor Lin Yifu believed that there should be a proactive government that adapts to the situation to address the externalities of pioneers and coordinate the improvement of soft and hard infrastructures. Professor Wang Hongjian's empirical research indicated that the government resource allocation through industrial policies can significantly promote the enterprise transformation and upgrading, and this impact varies among enterprises with different nature of property rights.

2.3.2. Indirect government protection

China adheres to the development of the socialist economic system with Chinese characteristics, with the market mechanism as the core, and regulates the market through the market price mechanism. Professor Shi Yajun held that enterprises, as market subjects, pursue the maximization of economic benefits while considering relevant political and social benefits, so we should take the supply and demand relationship as the benchmark, and equity and performance as the characteristics to set consistent enterprise goals and determine the industrial development direction and structure. Professor Kang Lingxiang believed that under the market mechanism, the marginal and risk incentives formed by the market economy operation will directly affect the enterprise input in transformation. Marginal incentive means that the market mechanism drives the enterprise transformation and upgrading from low- to high-profit industries due to profit differences. Risk incentive means differential risk returns across various fields in the market mechanism, guiding enterprises to transform. Both incentives work simultaneously in the process of enterprise transformation, the fundamental reason of which lies in the fact that, under the market mechanism, enterprises decide their investment

behaviors to maximize their interests[2].

3. Research on Government Functions in the Private Enterprise Transformation and Upgrading

The academic community has long delved into government functions in the enterprise transformation and upgrading, and elucidated government functions, particularly in the domain of industrial policies, based on the socialist market economy with Chinese characteristics with an effective market and a proactive government as the core. China's industrial policies were formulated by the government to facilitate industrial development, which can address industry overcapacity and guide the industrial structure upgrading through governmental intervention. Since 2000, industrial policies have emphasized both harnessing the fundamental role of the market in resource allocation and reinforcing the guidance of industrial policies. However, the reality has seen a further strengthening of administrative and direct government intervention measures, while specific policy measures that deepen market system reforms to better leverage the function of the market mechanism in resource allocation are relatively few. We classified industrial policies based on the research conclusions of Li Wenjing, who categorized two types of industrial policies concerning enterprise transformation, i.e. "functional industrial policies" and "selective industrial policies".

4. Historical Evolution of the Government Roles in The Market

In the research on government-market relations, there are diverse perspectives regarding government roles in the academic community. Early theories, such as the "night watchman" and "limited government", representing the bourgeois revolution era, considered the government as an organization safeguarding private properties with limited roles, functions, and powers. Locke even advocated the safeguarding of private properties as the primary or sole purpose of government. By the late 18th century, Bentham and John Stuart Mill advocated that the government should additionally take on a wide array of tasks such as ensuring people's health, price management, food supply, and citizen education, and promote social well-being through incentives and penalties. This was followed by Adam Smith's well-known "invisible hand" market economy theory, where the government functions were outlined as defense mechanisms and the provision of public goods and services, but the core was still safeguarding private properties. In the mid-to-late 19th century, British sociologist, Spencer, advocated that the government function should be limited to protecting individual freedom. Obviously, these theories were inadequate to meet social needs. With the intensification of wealth disparity, increasing class conflicts, and sharpening class struggles, proletarian parties emerged and rapidly developed. Some bourgeois philosophers, political scientists, and economists sought to improve the government image by government intervention and social welfare, leading traditional liberalism into modern liberalism. Notable figures include Thomas Green, the founder of neoliberalism, who believed that the function of state is to exercise powers rather than compel its members to undertake moral actions. Subsequently, political scientists worldwide began to focus on

how to improve government functions. Friedman believed that the primary purpose of government activities is to maintain the regular operation of the market. He categorized government functions into the following three major types, i.e. formulating rules and acting as an arbitrator; taking actions due to technological monopolies and neighboring effects; and taking steps based on paternalism reasons. Even in modern times, scholars of neoliberalism view the government as a "helmsman", define its functions as "steering" and term the role played by government functions as a catalytic role[3].

4.1. Selective industrial policies

Selective industrial policies focus on issues such as "market failure" and international competition. These policies involve government choices to encourage enterprise innovation. In order to obtain late government subsidies, enterprises unilaterally pursue the innovation "quantity" to cater to government policies, which is a strategic innovation. It is characterized by a tendency to use preferential measures such as preferential support and strong market intervention. Its policy tools involve market access restrictions, investment scale control, credit fund allocation, tax preferences, fiscal subsidies, import and export tariffs, non-tariff barriers, and preferential land prices.

4.1.1. Roles of selective industrial policies

Under the guidance of the "Twelfth Five-Year Plan", industrial transformation and upgrading has become a key focus for each local government. Song Lingyun believed that during the initial stage of economic development, when China's economic growth was slow and resource allocation efficiency was low, the government should optimize key industries through reasonable industrial policies to guide the enterprise transformation and accelerate the economic development. Lin Yifu suggested that the role of the government lies in providing incentives to compensate for the externalities of pioneering efforts and coordinating related enterprises' investments in improving the soft and hard infrastructures needed for the industrial upgrading. This can reduce transaction costs for enterprises and turn the country's potential comparative advantage into a real one, making the industry a competitive advantage for the country[4]. Professor Yang Xingquan views industrial policies as an effective means for a proactive government. He argued that when the government leans towards supporting industry resource orientation, it can also compel backward enterprises to achieve transformation and development through diversified operations. Jiang Feitao believed that selective industrial policies play a guiding role in the enterprise transformation and upgrading, which can provide sufficient guarantee mechanisms for enterprises, encourage and guide them to engage in technological innovation and overcome uncertainties in their scientific and technological research investments. Chung (2004) found that the success of Japanese and Korean enterprise transformation and upgrading is attributed to industrialization policies in their countries, where governments support enterprises to enter more different sectors and achieve transformation and upgrading through necessary capital, tax preferences, and industry access permits. Li Shanmin believed that industrial policies directly promote the transformation and upgrading of supported enterprises and indirectly affect non-supported enterprises, restricting their development space and compelling non-supported enterprises to undergo transformation and upgrading by the resource support for

supported enterprises. However, in the academic community, there are also many opposing views concerning selective industrial policies. Economists like Krugman (1983) argued that industrial policies are unnecessary as they may lead to significant misallocation of market resources. From a macro perspective, the direct intervention, competition restriction, and selective support of industrial policies are believed to reduce the production efficiency of relevant industries. The micro-analysis concluded that the benefits brought about by industrial policies are short-term and cannot enhance the efficiency and sustainable development capabilities of enterprises.

5. Actual State of Selective Industrial Policies

Although most developing and developed countries have endorsed or are still using selective industrial policies, the results have been significantly varied. Powell (2005) suggested that the core reason lies in the information asymmetry during the policy formulation, such as limitations in specialized knowledge and uncertainties in technological development, which results in a phenomenon in the Chinese market where innovation support policies lead to enterprises' reverse selection of subsidies by focusing on the "quantity" of innovations while neglecting the sustainable competitiveness brought about by innovation "quality". Consequently, the market experiences explosive but short-lived technological innovations. Despite a substantial increase in innovation investment by Chinese enterprises in recent years, their technological levels remain relatively backward. Most enterprises are confined to low-tech and low-value-added sectors, and their innovations are not effective. The overall technological capability of enterprises is not competitive at the international level, which is contradicted to the formulation purpose of selective industrial policies. In addition, China's unique "promotion competition" governance model also has a negative impact on selective industrial policies. Promotion competition, as a model of administrative governance, is designed by the superior government for chief executives of governments at lower levels, where the winners will be promoted based on criteria determined by the superior government, which may be GDP growth rates or other measurable indicators[5]. This assessment system based on economic performance in China and the average term of office of 3-4 years indirectly leads to a cycle of bribery and rent-seeking between officials and entrepreneurs. Shleifer & Vishny (1994) judged that in order to enhance political performance, officials are motivated to require enterprises in their jurisdictions to increase innovations in the short run, and reciprocate by providing enterprises with financial subsidies and tax preferences. In order to make achievements in a short time, officials will vigorously support enterprises with many and fast scientific and technological achievements. Similarly, this short-term focus on political needs contradicts the long-term nature of substantive innovation. To meet the political needs of officials, enterprises are compelled to pursue innovation "quantity" rather than prioritizing breakthroughs in "quality". This cycle, driven by officials' political goals, restricts the innovative development of enterprises and significantly impacts China's international competitiveness, thus widening the technological gap and increasing the pressure on economic growth. Therefore, while the central government has set

favorable policies for the enterprise transformation and upgrading in the macro level, the micro-level execution by local governments falls short at crucial points. Consequently, the actual results of selective policies diverge significantly from the intended state, leading to various differences between the actual and expected state of the policy implementation.

6. Functional Industrial Policies

Functional industrial policies refer to government initiatives that promote technological innovation, uphold fair competition, reduce social transaction costs, create an efficient market environment, and formulate industrial policies that allow the market to function effectively. This involves selecting supported entities on a fair basis while ensuring free trade and fair competition[6].

6.1. Roles of functional industrial policies

Functional industrial policies employ market competition and early-stage support to stimulate substantive innovation and upgrade by enterprises. Some research on this topic is based on the opposition to selective industrial policies. Professor Jiang Feitao held that there is severe "government failure" when implementing selective industrial policies, while functional industrial policies can support enterprises' innovation and diffusion of industrial technologies, establish a systematic and effective public service system, and improve the skills of workers to meet the needs of industrial development by improving the market system, optimizing the market environment and maintaining fair competition. Professor Zhang Yunwei held that functional industrial policies involve the government's rational indirect intervention in the factor supply, such as talent, land, and funds, to achieve high-quality regional economic development. It emphasizes that the government is symbiotic with the market. According to Mazzucato (2016), in the context of global efforts to lead economic growth through innovation, universally applicable industrial policies of "market-creating" are more conducive to innovation than policies of "market-fixing". Functional industrial policies, compared to selective industrial policies, are more innovative and dynamic. Mainstream economists generally believed that functional policies can compensate for the losses caused by market failure through the government's "visible hand". The competitive effects of market mechanisms can advance the enterprise transformation and upgrading. Under such environment, enterprises will take initiative to engage in reform and innovation, and the economic development trend is positive. Different from selective industrial policies, the economic landscape under functional industrial policies is always dynamic. Though it may not exhibit explosive growth, it is sustainable.

6.2. Actual state of functional industrial policies

In the 21st century, China's industrial policies placed a growing emphasis on the utilization of market mechanisms, advocating for the implementation of more functional industrial policies. However, there are still a considerable number of selective industrial policies upon examining the actual formulation and implementation of policies, such as market access, project approval, land supply approval, catalogue guidance, and mandatory elimination of outdated

production capacity, which directly interfere with the market. Since the 18th National Congress of the Communist Party of China, China has vigorously taken measures of "streamlining the government, delegating power, and improving government services", accelerating the government function transformation. This has resulted in a series of innovative measures that have significantly stimulated market vitality and social creativity and promoted economic and social development. While streamlining the government and promoting market-oriented reforms are the core of government reform, the development of local economies and the creation of industries with local characteristics require the central government to delegate more powers to local governments, allowing them to possess economic autonomy and formulate industrial policies tailored to the resources and environment of their respective regions. However, under the established government management system and the promotion competition, the delegation of powers has led to vicious competition for economic resources among local governments. Due to the limitations of the vertical administrative management structure and the flow of resources, the competition among local governments does not necessarily result in positive economic growth. Protective and predatory strategies may be chosen, increasing transaction costs among regions and harming economic growth[7]. Functional industrial policies are formulated to break the market failure caused by market monopoly and oligarchy, and provide a free and fair platform for economic development and enterprise innovation. Consequently, it can be found that the impediments to sustainable economic development in China are not functional industrial policies but rather the influence of various negative external factors on local governments, such as the promotion competition system and vicious competition between local governments. Functional industrial policies may diminish the effectiveness of local government functions to varying degrees due to the pre-existing disparities in marketization. Therefore, even though China has decided to adhere to the path of a socialist market economy with Chinese characteristics, the challenging process requires the government to undergo profound reforms within its internal departments and timely transform the government's responsibilities and functions in the market, in order to promote private enterprise transformation and upgrading and the sustainable development of China's economy.

7. Analysis and Insights on the Government Function Transformation

In light of the above research, it can be concluded that two industrial policies have their own advantages and theoretical foundations, but the actual outcomes of their implementation have not met expectations. Despite the theoretical feasibility of the policies, they were subject to external systems, and deviated and distorted in the implementation, mainly due to the ambiguity and uncertainty of government functions. Professor Liu Xirui suggested that the future direction of China's government function transformation should be to ensure a government function system that facilitates the sustained and healthy development of the economy and society, embodies socialism with Chinese characteristics and allows the government to collaborate with the market. Future government functions in the new era should no longer focus

solely on macro-level decisions about "what to control and what not to control". Instead, they should be detailed down to specific measures each government department should undertake in fulfilling its responsibilities, emphasizing the roles of departments in their respective management domains[8]. This approach should align with the principles of "collaboration government", "results-oriented accountable government", and "sustainability". Looking forward, government functions need to be precise regarding how the government engages, in what role, and at which stage in the market. The well-known Parkinson's Law reveals that blindly increasing functional departments and staff in the bureaucracy fails to enhance government efficiency but significantly diminishes the operational capabilities of government departments. Adhering to Parkinson's Law, government departments should streamline personnel and processes, strengthen government capabilities, and simultaneously study the responsibilities of each department to adjust their hierarchical relationships. Combining the theoretical advantages of different industrial policies can guide the future government function transformation. For example, the government needs to be forward-looking when formulating strategic plans from a macro level for the transformation and upgrading of private enterprises, which are restricted by many factors and believe that transformation is contradicted to economic benefits. After determining strategic plans, the government should consider problems faced by private enterprises in advance, and formulate corresponding preferential policies to encourage their transformation and upgrading. In dealing with emerging industries spawned by market mechanisms, which are dynamic and differ significantly from traditional sectors in their market model and definitions of commodities, the government involvement should be delayed. If the government regulates the emerging industries with the "visible hand" used for traditional industries, the vitality of the emerging industries will be greatly inhibited. Therefore, after these emerging industries take shape, the government should swiftly identify issues they bring to the market, analyze their pros and cons, and subsequently formulate

targeted regulatory policies to effectively protect the market and prevent market failure. In the future socialist market economy with Chinese characteristics, the government should delineate the functions of each department and require greater flexibility than before. It does not mean blurring the responsibilities among departments but rather involves each department formulating positive and "differentiated" policies for different industries to ensure the effective and sustainable market development.

References

- [1] Xiaochun, Liu, Ziming, Liu. On the Function of Government during the Economic Transformation in Our Country [J]. 2003, 002(001): 13-1659.
- [2] FAN Hongxia, JIANG Xiuhua, LI Man. The Evaluation and Analysis of the Government's Entity Responsibilities of Promoting Gender Equality and Women's Development[J]. 2019, 018(3): 336-350.
- [3] JoaoJalles. Wagner's law and governments' functions: granularity matters[J]. Journal of economic studies, 2019, 46 (2) :446-466.
- [4] Dongfang CHEN. On the Government Function Orientation in China's Agricultural Management Reform[J]. 2016, 000(004): P.9-11.
- [5] Yancheng Wang. Reconstruction of the Township Government Functions in the Process of Urbanization[J]. Research journal of applied science, engineering and technology, 2012, 4(21): 4497-4502.
- [6] Shivraj Kanungo,Vikas Jain. Analyzing IT-enabled Effectiveness in Government Sector: A RBV and Dynamic Capability Perspective [J]. The data base for advances in information systems, 2011, 42(4):p.38-62.
- [7] Jess B. Roberts. Inherently Governmental Functions: A Bright Line Rule Obscured by the Fog of War[J]. The army lawyer,2014,(apra):3-12.
- [8] JAY EUNGHA RYU. Legislative Professionalism and Budget Punctuations in State Government Sub-Functional Expenditures [J]. Public Budgeting & Finance, 2011, 31(2): p.22-42.