

## ZOMBIE COMPANIES IN CHINA:

## POLICIES OF CREATIVE DESTRUCTION AND THEIR IMPLEMENTATION

REBECCA PARRY &amp; JINGCHEN ZHAO

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**Abstract**

*Zombie companies are a legacy of China's industrial heritage and its planned economy. Recent government policies have emphasized the importance of businesses based on technology and the elimination of unviable zombie companies in efforts to transform China's image. Paralleling Schumpeter's idea of creative destruction, in which new ways of doing things replace old established ways, the elimination of zombie companies has been the subject of ambitious implementation targets for local governments. Ostensibly these targets are to be met in market-driven ways, however, much of the Chinese infrastructure requires further development if this is to be the case. This article outlines the approach that has been taken to the resolution of zombie companies as well as the challenges presented by such cases that have so far militated against market-driven resolution. The paper adopts a structure that will consider how state policies decided at the macro-level have been implemented by local governments at the meso-level and will also consider potential impacts on communities at the micro-level. It also considers how achievements in zombie company withdrawal have been reported, identifying narratives of creative destruction, as well as potential impacts of state policies.*

I. INTRODUCTION

Recent years have seen China moving towards a balance between administrative approaches to insolvent companies based on state intervention and the development of market-based approaches.<sup>1</sup> Zombie companies are among the categories of companies where state intervention is still strongly evident.<sup>2</sup> Zombie companies are discordant with official policy to revise China's image as a leader in modern, technology-driven production, moving away from an image of excessive rust belt production and sunset industries, as

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<sup>1</sup> Rebecca Parry & Yingxiang Long, *China's Enterprise Bankruptcy Law, Building an Infrastructure Towards a Market-Based Approach*, 20 J. CORP. L. STUD. 157, 158 (2020).

<sup>2</sup> See HUIMIAO ZHAO, GOVERNMENT INTERVENTION IN THE REORGANISATION OF LISTED COMPANIES IN CHINA 17–18 (2019).

well as its image of the world's supplier of cheap goods.<sup>3</sup> There are parallels with Schumpeter's theory of creative destruction<sup>4</sup> in the combined elimination of zombie companies and the efforts to upgrade China's status through the pursuit of advanced and green technologies in place of large-scale manufacture.<sup>5</sup> This article will consider these parallels as well as difficulties that have arisen in their implementation.

This article will consider policies towards zombie companies in China in the light of broader, macro, and state policies in two dimensions. Firstly, as to how earlier state policies contributed to the development of zombie companies, and secondly, as to how zombie companies are being handled now through policies that can broadly be regarded as examples of creative destruction. This analytical approach has been chosen since the concept of creative destruction highlights how new ways of doing things replace old ways,<sup>6</sup> and this parallels narratives that have been used in relation to the elimination of zombie companies. The article will consider how these macro state policies of creative destruction have been implemented by local governments at the meso-level. The local governments in the Chinese provinces have in recent years been

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<sup>3</sup> Guillaume Gaulier et al., *Chine: atelier du monde, marché pour l'Europe [China: Workshop of the World, Market for Europe]*, LA LETTRE DU CEPII, May 2005, at 1, 2, <http://ideas.repec.org/a/cii/cepill/2005-245.html>. For image repair efforts in the manufacturing sector, see Cai Peijuan et al., *Managing a Nation's Image During Crisis: A Study of the Chinese Government's Image Repair Efforts in the "Made in China" Controversy*, 35 PUB. REL. REV. 213 (2009).

<sup>4</sup> JOSEPH A. SCHUMPETER, *THE THEORY OF ECONOMIC DEVELOPMENT: AN INQUIRY INTO PROFITS, CAPITAL, CREDIT, INTEREST, AND THE BUSINESS CYCLE*, (Redvers Opie trans., Harv. Econ. Stud. 1934); JOSEPH A. SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* (Harper & Brothers 1943).

<sup>5</sup> For an example of zombie withdrawal policies see Jun Ding (定军) & Mengyi Shi (史梦怡), *Guowuyuan Qingli "Jiangshi Qiye" Kuisun Sannian Yishang Yangqi "Chuqing"* (国务院清理“僵尸企业” 亏损三年以上央企“出清”) [*The State Council Cleans up "Zombie Enterprises" that Have Suffered Losses for More Than Three Years*], 21 SHIJI JINGJI BAODAO (21 世纪经济报道) [21ST CENTURY ECONOMIC NEWS] (Dec. 10, 2015), [http://www.gov.cn/zhengce/2015-12/10/content\\_5022115.htm](http://www.gov.cn/zhengce/2015-12/10/content_5022115.htm). For an example of the green technological trajectory see *Made in China 2025*, <http://www.gov.cn/zhuanti/2016/MadeinChina2025-plan/index.htm>. On comparisons to China's trajectory and Schumpeter's creative destruction see John A. Matthews, *Schumpeter in the Twenty-First Century: Creative Destruction and the Global Green Shift*, in *SCHUMPETER'S CAPITALISM, SOCIALISM AND DEMOCRACY: A TWENTY FIRST CENTURY AGENDA* 233, 233–50 (Leonardo Burlamaqui & Rainer Kattel eds., 2019).

<sup>6</sup> For an example of this characterization of Schumpeter's concept see Alan Gibb, *In Pursuit of a New 'Enterprise' and 'Entrepreneurship' Paradigm for Learning: Creative Destruction, New Values, New Ways of Doing Things and New Combinations of Knowledge*, 4 INT'L. J. MGMT. REV. 1, 10-11 (2003).

given the role of agents of creative destruction of zombie companies<sup>7</sup> with targets for zombie company elimination.<sup>8</sup> The adoption of this role has required some adjustment of local government incentives, since they hitherto resisted the elimination of zombie companies, for reasons which will be considered.<sup>9</sup> Subsequently, considerable progress has been made in the resolution of zombie companies against targets and there have been many headlines that have reported local successes in eliminating high numbers of zombie companies.<sup>10</sup> There is evidence of creative destruction in some examples as some local economies have developed higher technology industries as well as using technology to upgrade existing industries.<sup>11</sup> Nonetheless, the market-based implementation of state policies at the meso-level has been hampered by the developmental state of the bankruptcy framework and administrative approaches to zombie companies are still evident. In addition, zombie company withdrawals present complex issues at the micro-level of workers and communities.

This article draws upon a range of interdisciplinary literature and contributes new insights into Chinese state policies and their implementation through original qualitative analysis of Chinese language news reports regarding zombie companies. Part II of this article considers the concept of zombie companies, highlighting differences between definitions used in non-Chinese literature and those used by Chinese state agencies. In Part III, the reasons for the emergence of zombie companies in China will be considered, and in Part IV, there is a framing of the concept of creative destruction and how China's trajectory with respect to state policies towards zombie companies at the macro-level broadly parallels this. In Part V, there is an outline of the provincial, meso-level, approach to zombie company reorganizations and exits and the factors that have inhibited market-based approaches in this regard. Part VI then utilizes an original qualitative thematic review of media reports of zombie company withdrawals. It considers reporting of zombie companies in a

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<sup>7</sup> Under official policies, it is for local governments to draw up a list of zombie companies and make arrangements for their disposal. Guanyu Jinyibu Zuohao Jiangshi Qiye Ji Quchanneng Qiye Zhaiwu Chuzhi Gongzuo de Tongzhi (关于进一步做好“僵尸企业”及去产能企业债务处置工作的通知) [Notice on Steps to Deal with Zombie Companies and Eliminate Over-Capacity] (promulgated by the National Development and Reform Commission, Nov. 23, 2018) [hereinafter Notice on Steps to Deal with Zombie Companies].

<sup>8</sup> *Id.* Local governments set a target for all work to be completed by the end of 2020.

<sup>9</sup> See ZHAO, *supra* note 2, at 113; Yuyan Tan et al., *Zombie Firms and the Crowding-Out of Private Investment in China*, 15 ASIAN ECON. PAPERS 32, 33–34 (2016).

<sup>10</sup> See *infra* Part VI.

<sup>11</sup> Yi Zhou et al., *Does Creative Destruction Work for Chinese Regions? An Empirical Study on the Articulation Between Firm Exit and Entry*, 48 GROWTH & CHANGE, J. URBAN & REG'L POL'Y 274, 291–92 (2017).

variety of news sources and how these parallel creative destruction concepts in reports of meso-level implementation of zombie withdrawal policies. It also considers how zombie company withdrawals may potentially impact communities at the micro-level and highlights potential for further research in this regard.<sup>12</sup> Part VII offers some conclusions.

## II. CONCEPTIONS OF ZOMBIE COMPANIES

There is no clear consensus on the concept of zombie companies. The term “zombie company” has been widely used in many countries, having originated in the United States<sup>13</sup> and first popularly used<sup>14</sup> in around 2002 in relation to Japanese companies kept alive only through support from banks.<sup>15</sup> More recently, the term has widely appeared in literature as it has been identified that many companies were zombie companies even prior to the Covid-19 pandemic and were predicted to have difficulties.<sup>16</sup> There are many

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<sup>12</sup> This paper is part of a wider Global Challenges Research Fund project that will more closely consider zombie withdrawal policies in Zhejiang province.

<sup>13</sup> The term is credited to Edward Kane by Frank H. Easterbrook. Frank H. Easterbrook, *Regulation and Responsibility: A Note on Banking*, 77 CORNELL L. REV. 1079, 1083 (1992). See, e.g., Edward J. Kane, *Dangers of Capital Forbearance: The Case of the FSLIC and “Zombie” S&Ls*, 5 CONTEMP. ECON. POL’Y 77, 77 (1987); Edward J. Kane, *Reflexive Adaptation of Business to Regulation and Regulation to Business*, 15 LAW & POL’Y 179, 186 (1993). The phenomenon is discussed but the term not used in Edward J. Kane, *What Lessons Should Japan Learn from the U.S. Deposit-Insurance Mess?*, 7 J. JAPANESE INT’L. ECON. 329, 329 (1993).

<sup>14</sup> Early usage of the term in the press includes examples in Hamish McRae, *Korean Crisis? We’ve Been Here Before*, THE INDEPENDENT (Oct. 23, 2011), <https://www.independent.co.uk/news/business/korean-crisis-we-ve-been-here-before-1288677.html>; James Brooke, *They’re Alive! They’re Alive! Not!; Japan Hesitates to Put an End to Its ‘Zombie’ Businesses*, N.Y. TIMES (Oct. 29, 2002), <https://www.nytimes.com/2002/10/29/business/they-re-alive-they-re-alive-not-japan-hesitates-put-end-its-zombie-businesses.html>. See also Chris Taylor, *Why ‘Zombie’ Companies Are on the Rise—and Could Pose a Threat to the U.S. Economy*, FORTUNE (Sept. 2, 2019), <https://fortune.com/2019/09/02/why-zombie-companies-are-on-the-rise-and-could-pose-a-threat-to-the-u-s-economy/>.

<sup>15</sup> See, e.g., Charlotte Denny, *Japan’s Zombie Economy—Not Buying but Browsing*, THE GUARDIAN (Nov. 19, 2002), <https://www.theguardian.com/business/2002/nov/20/japan-internationalnews>. For an academic treatment, see Alan G. Ahearne & Naoki Shinada, *Zombie Firms and Economic Stagnation in Japan*, 2 INT’L. ECON. & ECON. POL’Y. 363 (2005).

<sup>16</sup> See, e.g., Claire Jones, *European Zombification Becomes Even Scarier*, FIN. TIMES (Dec. 3, 2020), <https://www.ft.com/content/dal175a86-17ad-44bf-9237-db8d4708fb21>; Dustin Voss et al., *The Covid Horror Picture Show: Why We Have Little to Fear from ‘Zombie Firms’*, LONDON SCH. OF ECON. BLOG (Dec. 10, 2020), <https://blogs.lse.ac.uk/europpblog/2020/12/10/the-covid-horror-picture-show-why-we-have-little-to-fear-from-zombie-firms/>; Brian Scheid, *Debt-Laden ‘Zombie Firms’ Threaten to Disrupt Coronavirus Recovery—Group of 30*, S&P GLOBAL (Dec. 14, 2020), <https://www.spglobal.com/marketintelligence/>

factors that can cause enterprises to become zombie companies but in recent years, many are produced by economic policies adopted in the wake of the 2007-08 financial crisis that have led to years of low-interest rates.<sup>17</sup> These low-interest rates have shielded companies from financial pressures that might otherwise have caused them to restructure or exit.<sup>18</sup>

It is important to briefly look at how zombie companies are described in non-Chinese literature as it will be shown that the Chinese concept of zombie companies, *Jiangshi qiye* (僵尸企业), is notably different, in particular as used in state policies.<sup>19</sup> Literature has provided complex definitions of zombie companies, such as those whose interest payments do not reflect their risk,<sup>20</sup> or those whose liquidation value is greater than its going concern value, taking into account potential restructuring,<sup>21</sup> and those who are insolvent and require financing for continued trading.<sup>22</sup> Common definitions have focused on the ability of an established company over a prolonged period of time to meet its interest payments.<sup>23</sup> The zombie companies always involve persistent losses, lower returns, and inefficient operations, yet many of them still manage to endure. Lam *et al* showed that zombie companies in China have strong linkages with state-owned entities (SOEs) which are involved in debt vulnerabilities and

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en/news-insights/latest-news-headlines/debt-laden-zombie-firms-threaten-to-disrupt-coronavirus-recovery-8211-group-of-30-61713009; Anna Khoo & Paul Bradshaw, *Coronavirus: Business Rescue Package has 'Delayed the Inevitable'*, BBC NEWS (July 29, 2020), <https://www.bbc.co.uk/news/uk-53417948>. Chinese state aid policy is that no bond redemption risk mitigation assistance should be given to zombie companies. Zhou Lei (周雷), *Yangqi Xinyong Baozhang Jijin Luodi Mei Jiangshi Qiye de Fen* (央企信用保障基金落地没“僵尸企业”的份) [*The State-Owned Enterprise Credit Protection Fund Has Landed Without a "Zombie Company"*], ECON. DAILY (July 25, 2020), [http://www.gov.cn/xinwen/2020-07/25/content\\_5529904.htm](http://www.gov.cn/xinwen/2020-07/25/content_5529904.htm).

<sup>17</sup> Ryan Niladri Banerjee & Boris Hofmann, *The Rise of Zombie Firms: Causes and Consequences*, BIS Q. REV. 67 68 (Sep. 2018); Robert Rich, *The Great Recession*, FED. RSRV. HIST. (Nov. 22, 2013), <https://www.federalreservehistory.org/essays/great-recession-of-200709>.

<sup>18</sup> Niladri & Hofmann, *supra* note 17.

<sup>19</sup> Technically, *Jiangshi qiye* are named after a hopping vampire from Chinese legend, rather than the will-less and speechless humans that give their name to zombie companies elsewhere.

<sup>20</sup> See, e.g., Ricardo J. Caballero et al., *Zombie Lending and Depressed Restructuring in Japan*, 98 AM. ECON. REV. 1943, 1947 (2008).

<sup>21</sup> W. Raphael Lam et al., *Resolving China's Zombies: Tackling Debt and Raising Productivity* n.2 (IMF Working Paper No. 17/266, 2016), <https://www.imf.org/en/Publications/WP/Issues/2017/11/27/Resolving-China-Zombies-Tackling-Debt-and-Raising-Productivity-45432>.

<sup>22</sup> Tan et al., *supra* note 9, at 33.

<sup>23</sup> Banerjee & Hofmann, *supra* note 17, at 68; Dan Andrews et al., *Confronting the Zombies: Policies for Productivity Revival*, ORGANISATION FOR ECONOMIC CO-OPERATION & DEVELOPMENT [OECD] ECON. POL'Y PAPER No. 21, at 5 (2017), <https://doi.org/10.1787/f14fd801-en>.

low productivity.<sup>24</sup> As businesses with poor performances, they further complicate China's rising corporate debt problem.<sup>25</sup> It is a common belief in China that one of the most important formal ways to eliminate zombie companies is through corporate insolvency.<sup>26</sup>

It has previously been noted that these non-Chinese definitions are not well suited to the Chinese context since they do not take account of the significant role of state subsidies in China.<sup>27</sup> However, in recent years, the term "zombie company" has gained its place among Chinese academics, government officials, policymakers, and practitioners. The term in the Chinese context typically refers to corporations whose existences have been maintained through government subsidies and the willingness of creditors, mainly banks, including state-owned banks, to preserve these companies by releasing additional or new loans, in particular in view of the social importance of SOEs in the areas where they are located.

One commonly used approach of distinguishing zombie companies from healthy counterparts is Wang's method of "actual profit," regarded as a more appropriate one for China,<sup>28</sup> taking into consideration the unique corporate governance mechanism and shareholding structure within many SOEs which could potentially be classified as zombie companies. This method detects zombie companies by stressing that companies' book profits do not reflect true profitability with additional positive profit from channels such as subsidies, tax rebates, and other non-recurring gains. The definition given in an OECD policy paper on zombie companies in China clarifies the essence of zombie companies as low productivity companies that would typically exit in a competitive market.<sup>29</sup> Wang's definition seems similar to that of the OECD. To be more precise, zombie companies refer to those which have lost their self-repairing ability and must rely on non-market resources, namely, government subsidies,

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<sup>24</sup> Lam et al., *supra* note 21.

<sup>25</sup> Wojciech Maliszewski et al., *Resolving China's Corporate Debt Problem* 13 (IMF Working Paper No. 16/203, 2016), <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Resolving-Chinas-Corporate-Debt-Problem-44337>.

<sup>26</sup> See, e.g., Stacey Steele, *The Future of Chinese Insolvency Law*, 28 AUSTL. RESTRUCTURING INSOLVENCY & TURNAROUND ASS'N J. 26 (2016).

<sup>27</sup> Zhou Jin et al., *The Recognition and Warning of Zombie Enterprises: Evidence from Chinese Listed Companies* 44 J. FIN. & ECON 130, 141 (2018).

<sup>28</sup> Xinxin Wang (王欣新), *Jiangshi Qiye Zhili yu Pochanfa de Shishi* (僵尸企业治理与破产法的实施) [*Corporate Governance of Zombie Companies and Enforcement of Chinese Enterprise Bankruptcy Law*], 13 RENMIN SIFA (人民司法) [PEOPLE'S JUSTICE] 5 (2016).

<sup>29</sup> Andrews et al., *supra* note 23, at 6.

state-bank renewal loans, etc.<sup>30</sup>

The Chinese state characterization of zombie companies can be taken from a State Council definition which highlights not only solvency issues and economic performance issues that are brought out in the non-Chinese definitions but also other characteristics that are not in keeping with current state policies. The definition used by the State Council can be translated as: “companies that are not in line with the national energy consumption, environmental protection, quality or safety standards, that have sustained loss for more than three consecutive years and do not conform to the restructuring direction.”<sup>31</sup> The last part of this definition, in evaluating economic performance over the last three years, bears some similarity to the definitions previously noted.<sup>32</sup> There are, however, also places that require further clarification. For example, if the “continuous loss for three years” is the criterion for zombie companies, it is impossible for listed companies to be zombie companies since companies of this type that suffer from sustained losses for three consecutive years must withdraw from the market.<sup>33</sup> This definition can otherwise be read as reflecting wider development policies for the improvement of the economy and as including companies in sunset or backward industrial sectors with excess capacity and increasing domestic and international market pressure.<sup>34</sup> Some are in deteriorating industry environments in general and present challenges regarding employee resettlement and land repurposing.<sup>35</sup>

Macro-level state policies target companies that are not sufficiently competitive to survive in market conditions and are near to or already insolvent with no substantial business activities. Many will have been substantially supported by local governments through subsidies, and by loans with favorable terms.<sup>36</sup> More recently, zombie companies have been seen as inconsistent with efforts to eliminate excess capacity and allow stronger enterprises to thrive,

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<sup>30</sup> Yanan Lu (陆娅楠) & Ya Zuo (左娅), *Chuzhi Jiangshi Qiye Buneng Deng (处置僵尸企业不能等)* [Urgency of Eliminating Zombie Companies], RENMIN RIBAO (人民日报) [CHINA DAILY] (Jan. 11, 2016), <http://finance.people.com.cn/n1/2016/0111/c1004-28034912.html>.

<sup>31</sup> Ding & Shi, *supra* note 5.

<sup>32</sup> E.g., Banerjee & Hofmann, *supra* note 17; Andrews et al., *supra* note 23.

<sup>33</sup> See RULES GOVERNING LISTING OF STOCKS ON SHENZHEN STOCK EXCHANGE (Oct. 2014); RULES GOVERNING LISTING OF STOCKS ON SHANGHAI STOCK EXCHANGE (Oct. 2014).

<sup>34</sup> The same document highlights losses in the steel, coal and non-ferrous sectors, as well as declining profits in petrochemical, petroleum and building materials industries. Ding & Shi, *supra* note 5.

<sup>35</sup> For statistics based on firm-level data see Lam et al., *supra* note 21, at 3–6.

<sup>36</sup> Qiuying Qu, *Zombie Firms and Political Influence on Bank Lending in China*, (Jan. 2019) (Ph.D. paper, University of Columbia) (available at <https://econ.columbia.edu/wp-content/uploads/sites/41/2018/10/Job-Market-Paper-Qiuying-Qu-190110.pdf>).



with an emphasis on modern technologies and green impact.<sup>37</sup> It has also been identified that subsidies to zombie companies inhibit the performance of non-zombie firms, in particular private companies, harming productivity more generally.<sup>38</sup>

### III. EMERGENCE OF ZOMBIE COMPANIES IN CHINA

The planned economy, which operated prior to the adoption of reform and opening-up policies in the years following the death of Chairman Mao,<sup>39</sup> left a legacy of underperforming state-owned enterprises which has gradually been tackled, initially through corporatization,<sup>40</sup> bailouts,<sup>41</sup> writing-off bad debts and mergers,<sup>42</sup> with an emphasis on growing larger companies.<sup>43</sup> Bankruptcy proceedings were rarely used for failing firms and more generally the approach to the adoption of market mechanisms has been gradual.<sup>44</sup> Certainly market-driven processes in the nature of creative destruction, as a feature of capitalist market economies, were restrained.

Policies in the early stages of the People's Republic of China (PRC) socialist market economy initially focused on growth through exports and there was investment in the sectors that contributed in this regard.<sup>45</sup> Growth in this area contributed significantly to the Chinese economy and was harmed by the global economic crisis. A fiscal stimulus package was launched in late 2008 with a variety of aims, including to increase infrastructure and create jobs through projects such as new and refurbished airports, and construction of roads

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<sup>37</sup> The elimination of zombie companies builds on broader policies of supply-side structural reform and reduction of excess capacity. Notice on Steps to Deal with Zombie Companies, *supra* note 7.

<sup>38</sup> Tan et al., *supra* note 9, at 33–34.

<sup>39</sup> The transition to China's version of a market economy was first announced at the Third Plenum of the Eleventh Central Committee of the Chinese Communist Party held in December 1978.

<sup>40</sup> See generally Liufang Fang, *China's Corporatization Experiment*, 5 DUKE J. COMP. & INT'L L. 149 (1995).

<sup>41</sup> See Chuyi Wei, *Bailouts and Bankruptcy Law in China: A Confusion of Law and Policy*, 12 CAMBRIDGE J. CHINA STUD. 50, 52–53 (2017) [hereinafter *Bailouts and Bankruptcy*].

<sup>42</sup> See Rebecca Parry & Haizheng Zhang, *China's New Corporate Rescue Laws: Perspectives and Principles*, 8 J. CORP. L. STUD. 113, 118 (2008).

<sup>43</sup> See *Bailouts and Bankruptcy*, *supra* note 41, at 51–52.

<sup>44</sup> LI TAN, *China's Transition to a Market Economy, in THE PARADOX OF CATCHING UP: RE-THINKING STATE LED ECONOMIC DEVELOPMENT* 116 (2005).

<sup>45</sup> On state policies and the role of foreign investment see Penelope B. Prime & Jong H. Park, *China's Foreign Trade and Investment Strategies: Implications for the Business Environment*, 32 BUS. ECON. 29, 32–34 (1997).

and railways.<sup>46</sup> Funds were invested by local governments in infrastructure<sup>47</sup> accompanied by an increase in borrowing.<sup>48</sup> These infrastructure investments, together with policies to promote the housing market, led to demand for materials, causing prices of materials such as steel to rise which encouraged further production and the boosting of capacity. Later state policies towards boosting production led to excess capacity and these factors contributed to the growth of zombie companies.<sup>49</sup> It was estimated that in 2005, a time of heavy state support, 16.7% of SOEs were zombie companies, although the number declined in subsequent years.<sup>50</sup> These zombie companies were artificially kept alive through “evergreening” of loans, with lending being rolled over to new terms rather than written off, through long-term loans and preferential interest rates.<sup>51</sup> There was also favor shown in the awarding of large contracts.<sup>52</sup>

More recently, efforts to tackle zombie companies are part of long-standing state policies to eliminate surplus industrial capacity, although the term zombie company, *jiangshi qiye* (僵尸企业), was not initially used.<sup>53</sup> Concerns were expressed at the time of the 11<sup>th</sup> Five-Year Plan in 2006 that policies of expansion had led to excess production capacity in sectors such as iron and steel, aluminum and automobiles, as well as for the potential for surplus capacity to develop in areas such as cement, coal, power, and textiles.<sup>54</sup> It was noted that this redundancy could lead to lower prices, excess stock, and decreased profitability, and strategies were identified to address these problems including “supporting the superior and eliminating the inferior.”<sup>55</sup> In a similar

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<sup>46</sup> See Margot Schüller & Yun Schüller-Zhou, *China's Economic Policy in the Time of the Global Financial Crisis: Which Way Out?*, 38 J. CURRENT CHINESE AFF. 165, 169–70 (2009).

<sup>47</sup> See generally Kelsey Wilkins & Andrew Zurawski, *Infrastructure Investment in China*, RESERVE BANK OF AUSTRALIA, at 27–36 (June 2014).

<sup>48</sup> See Kai Yuen Tsui, *China's Infrastructure Investment Boom and Local Debt Crisis*, 52 EURASIAN GEOGRAPHY & ECON. 686, 695 (2011).

<sup>49</sup> See generally NICHOLAS R. LARDY, SUSTAINING CHINA'S ECONOMIC GROWTH AFTER THE GLOBAL FINANCIAL CRISIS 5–41 (2011).

<sup>50</sup> Tan et al., *supra* note 9, at 38.

<sup>51</sup> See *id.* at 38–40.

<sup>52</sup> *Id.* at 40.

<sup>53</sup> GoogleTrends reports that the term 僵尸企业 was first searched for in October 2013, but it does not capture PRC data. See Guowuyuan Guanyu Jiakuai Channeng Guosheng Hangye Jiegou Tiaozheng de Tongzhi (国务院关于加快推进产能过剩行业结构调整的通知) [Circular of the State Council on Accelerating the Structure Adjustment of the Industries with Production Capacity Redundancy] (promulgated by the State Council, Mar. 12, 2006) [hereinafter Circular of the State] (discussing more generally the over-capacity problem in certain industries, as well as a policy of support for the superior and elimination of the inferior).

<sup>54</sup> See *id.* at 1.

<sup>55</sup> See *id.*; CHING KWAN LEE, AGAINST THE LAW: LABOR PROTESTS IN CHINA'S RUSTBELT AND SUNBELT 49 (2007).

vein, the program of supply-side structural reforms announced by President Xi in late 2015 was also directed at rebalancing supply with demand.<sup>56</sup> This program included efforts to eliminate excess productive capacity, and zombie companies were a particular focus within this objective.<sup>57</sup>

On November 4, 2015, in a State Council meeting regarding the Chinese industrial development trajectory in this critical transformative period, it was emphasized that the government focus should be placed upon stable industrial growth and enhanced entrepreneurial efficiency. At this meeting, it was stressed by Premier Li Keqiang that the government needed to “accelerate reorganization of the zombie companies and assist these companies to withdraw from the market whereas more support should be offered to SOEs to resolve the historical baggage.”<sup>58</sup> The Central Economic Work Conference, held in Beijing in mid-December 2016, also raised the policy of tackling zombie companies as a central task to reduce leverage levels and lower corporate costs.<sup>59</sup> On July 16, 2019, thirteen departments in China, including the National Development and Reform Commission, China Securities Regulatory Commission, Ministry of Human Resources and Social Security, and Supreme Court issued the “Reform Plan for Accelerating the Improvement of the Market Player Withdrawal System” (Reform plan).<sup>60</sup> The plan sets out provisions regulating the processes of market player withdrawal, provides further clarity as to these processes, and establishes several supporting systems. The plan in its basic

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<sup>56</sup> See generally John Boulter, *China’s Supply-side Structural Reform*, RESERVE BANK OF AUSTRALIA (Dec. 2018), <https://www.rba.gov.au/publications/bulletin/2018/dec/chinas-supply-side-structural-reform.html>.

<sup>57</sup> See Barry Naughton, *Supply-side Structural Reform: Policy-Makers Look for a Way Out*, CHINA LEADERSHIP MONITOR (Mar. 1, 2016) at 8, <https://www.hoover.org/sites/default/files/research/docs/clm49bn.pdf>.

<sup>58</sup> Fang Yuanzhen, *Li Keqiang Presided Over the Executive Meeting of the State Council on November 4, 2015*, CHINESE GOVERNMENT WEBSITE (Nov. 4, 2015, 6:50 PM), [http://www.gov.cn/guowuyuan/2015-11/05/content\\_5004881.htm](http://www.gov.cn/guowuyuan/2015-11/05/content_5004881.htm). At the State Council of the People’s Republic of China, Li Keqiang presided over the convening of the State Council executive meeting to deploy and implement the spirit of the Fifth Plenary Session of the Eighteenth Central Committee of the Party to guide the preparation of the 13th Five-Year Plan, promote the stable growth of the industrial structure, promote the expansion of the market, improve the efficiency and the control mechanism decided to streamline and optimize enterprise investment and highway approval to promote the expansion of domestic demand and benefit people’s livelihood.

<sup>59</sup> Hongcai Xu, *Setting the Tone for 2017—The Central Economic Work Conference*, CHINA US FOCUS (Dec. 29, 2016), <https://www.chinausfocus.com/finance-economy/setting-the-tone-for-2017---the-central-economic-work-conference>.

<sup>60</sup> Guanyu Yinfa Jiakuai Wanshan Shichang Zhuti Tuichu Zhidu Gaige Fang’an de Tongzhi (关于印发《加快完善市场主体退出制度改革方案》的通知) [Notice on Issuing the “Accelerating the Reform Plan for Improving the Exit System of Market Entities”] (promulgated by National Development and Reform Commission et al., June 22, 2019), [http://www.gov.cn/guowuyuan/2019-07/16/content\\_5410058.htm](http://www.gov.cn/guowuyuan/2019-07/16/content_5410058.htm).

principles includes the objective of achieving market-based allocation of resources and the building of efficient market enterprises.<sup>61</sup> It acknowledges, however, a need for improvement of the bankruptcy framework.<sup>62</sup>

This paper will discuss how state policies have been implemented and the aspects of their potential impact. Figure 1 illustrates the hierarchy adopted in this paper of state level policies at the macro-level, implemented by local governments at the meso-level, and impacting communities and workers at the micro-level.

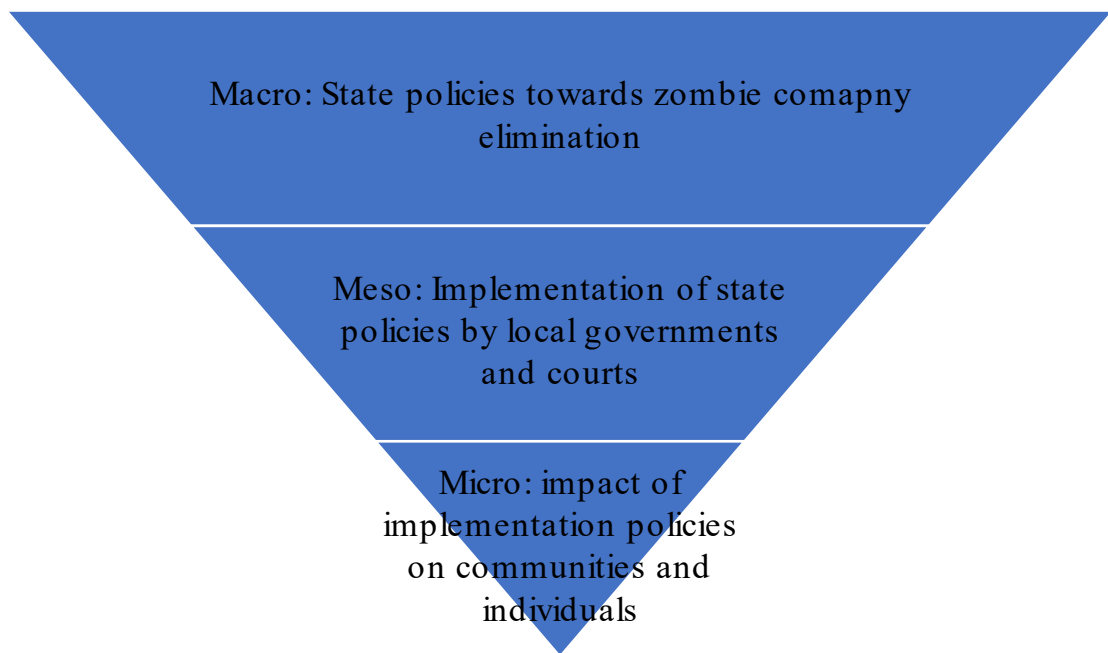


Fig. 1: Implementation and impact of state policies

Progress in the macro state-level progressive strategies was initially hampered, largely due to resistance at the meso implementation stage by local governments, who were often more focused on short-term achievements for political advantage.<sup>63</sup> For example, local governments would persuade banks

<sup>61</sup> Jiakuai Wanshan Shichang Zhuti Tuichu Zhidu Gaige Fang'an (加快完善市场主体退出制度改革方案) [Accelerating the Reform Plan for Improving the Exit System of Market Entities] (promulgated by National Development and Reform Commission et al., June 22, 2019), para. 1(2), <http://www.gov.cn/guowuyuan/2019-07/16/5410058/files/bbaef6612fed4832b70a122b39f1d5bd.pdf>.

<sup>62</sup> *Id.*, para. 2(2).

<sup>63</sup> See ZHAO, *supra* note 2, at 113. For a study of the local government influence on the coal industry see Yanfang Zhang et al., *Enterprise Investment, Local Government Intervention and Coal Overcapacity: The Case of China*, 101 ENERGY POL'Y 162 (2017).

to provide finance in an effort to keep zombie enterprises going to improve political prospects.<sup>64</sup> In later years, as detailed below, local governments have been differently incentivized, and subsidies have led them to implement strategies towards zombie company restructurings and exits.<sup>65</sup> In press releases, these local governments used the elimination of zombie companies as an example of their achievements.<sup>66</sup> As a result, as part of growing efforts, at least ostensibly, to establish a market-based economy with Chinese characteristics, there has been a stepping up of efforts to eliminate zombie companies. The state-level approach which has been devised, outlined in Part V, features a three-batch approach to zombie withdrawal with an emphasis on saving and restructuring zombie companies that have some element of viability.<sup>67</sup> One of the aims is to achieve a rebalancing of some industrial sectors through the elimination of excess capacity so that remaining market players can benefit and an excess of demand over supply can be eliminated.<sup>68</sup>

State policies emphasize a market-driven approach to the resolution of zombie companies<sup>69</sup> and it might be expected from this that liquidation procedures would play a major role. Certainly, liquidation is included as one of the possible outcomes in the three-layered approach to zombie restructuring and exits,<sup>70</sup> although as will be seen later, at the meso implementation level, this outcome has tended to be reserved for companies which are effectively

<sup>64</sup> Qu, *supra* note 36, at 1 (noting the impact of electoral cycles on local government incentives).

<sup>65</sup> Naughton, *supra* note 57, at 8.

<sup>66</sup> Examples are discussed in Part VI.

<sup>67</sup> Wang Shidan, “*Jiāngshī Qǐyè*” *De Chǔzhì Zhǔyào Shi Cǎiqǔ “Sān Gè Yī Pī” De Fāngshì* (“僵尸企业”的处置主要是采取“三个一批”的方式) [The Disposal of "Zombie Companies" Mainly Adopts the "Three Batches" Approach] (Apr. 13, 2017) (discussed in Part V).

<sup>68</sup> *Guówùyuàn qīnglǐ “jiāngshī qǐyè” kuīsǔn sān nián yǐshàng yāngqì “chū qīng”* (国务院清理“僵尸企业” 亏损三年以上央企“出清”) [The State Council Cleans up "Zombie Enterprises" that have Suffered Losses for More than Three Years] (China) [http://www.gov.cn/zhengce/2015-12/10/content\\_5022115.htm](http://www.gov.cn/zhengce/2015-12/10/content_5022115.htm), quoting Xu Zhongbo, a professor at the School of Metallurgy of the University of Science and Technology Beijing.

<sup>69</sup> For example, the preamble to *Guānyú yìn fā “jiākuài wánshàn shìchǎng zhǔtǐ tuìchū zhìdù gǎigé fāng'àn” de tōngzhī* (关于印发《加快完善市场主体退出制度改革方案》的通知; 发改财金) [Notice regarding the issuance of the “Accelerating the Reform Plan for Improving the Exit System of Market Entities”] [2019] 1104 号, available via [http://www.gov.cn/guowuyuan/2019-07/16/content\\_5410058.htm](http://www.gov.cn/guowuyuan/2019-07/16/content_5410058.htm), emphasizes improvement of the ‘market mechanism of survival of the fittest, to promote high-quality economic development’.

<sup>70</sup> Wang Shidan, “*Jiāngshī Qǐyè*” *De Chǔzhì Zhǔyào Shi Cǎiqǔ “Sān Gè Yī Pī” De Fāngshì* (“僵尸企业”的处置主要是采取“三个一批”的方式) [The Disposal of "Zombie Companies" Mainly Adopts the "Three Batches" Approach] (Apr. 13, 2017).

empty shells.<sup>71</sup>

More generally, broad state policies towards zombie withdrawal at the macro-level have encountered significant potential problems at the provincial meso-level, owing to their likely impacts on firms, workers, and communities at the micro-level. Decisions at the meso-level regarding zombie companies that have been identified, therefore, depend on many factors, such as consideration of social stability, employee resettlement, and government strategies in response to the “political tasks” of eliminating zombie companies.

#### IV. CREATIVE DESTRUCTION IN CHINA’S ENTREPRENEURIAL STATE TRAJECTORY

The process of eliminating zombie companies, alongside the greater focus on innovation, under state-level policies, widely reflects Joseph Schumpeter’s approach of “creative destruction.” Schumpeter describes how a “new commodity, the new technology, the new source of supply, the new type of organization ... competition which ... strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives,” and leads to a “gale of creative destruction.”<sup>72</sup> This approach broadly reflects China’s current and intended trajectory, with new technologies being embraced and a rescaling and modernization of industrial activities which have been important in the past.<sup>73</sup> In literature, the concept of creative destruction is often discussed as occurring within particular industries,<sup>74</sup> and is discussed as being a feature of capitalism’s restless economic order.<sup>75</sup> It is

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<sup>71</sup> Jingchen Zhao, Shuangge Wen, Rebecca Parry & Chuyi Wei, *Eliminating Zombie Companies through Insolvency Law in China: Striking a Balance between Market-oriented Policies and Government Intervention* 29 ASIA PACIFIC L. REV. (forthcoming 2021).

<sup>72</sup> JOSEPH SCHUMPETER, *THE THEORY OF ECONOMIC DEVELOPMENT: AN INQUIRY INTO PROFITS, CAPITAL, CREDIT, INTEREST, AND THE BUSINESS CYCLE* Harvard Economic Studies, Cambridge (English edition 1934, German original 1911); JOSEPH SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* (1942).

<sup>73</sup> In the context of wider economic approaches these policies arguably align also with Douglass North’s seminal analysis of the role of institutions in determining economic performance including firm entries and exits, DOUGLASS C. NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE* (1990), although not applied in this context by North during his lifetime. Yi Zhou, Canfei He, Shengjun Zhu, *Does Creative Destruction Work for Chinese Regions?* 48 GROWTH & CHANGE, J. URBAN & REGIONAL POLICY 274, 277; Andrew Sheng, *What can Douglass North’s Work Tell us about China’s Future?* WORLD ECONOMIC FORUM 21 (Dec. 2015).

<sup>74</sup> See e.g. Elena Cefis, Franco Malerba, Orietta Marsili, Luigo Orsenigo, *Time to Exit: “Revolving Door Effect” or “Schumpeterian Gale of Creative Eestruction”?* J. EVOL. ECON (2020), <https://doi.org/10.1007/s00191-020-00701-8>. Undoubtedly there is creative destruction in some industries in China in, for example the steel industry.

<sup>75</sup> Yi Zhou, Canfei He, Shengjun Zhu, *Does Creative Destruction Work for Chinese Regions?*, 48 GROWTH & CHANGE, J. URBAN & REGIONAL POLICY 274, 277.

commonly discussed as being driven by entrepreneurial inventors,<sup>76</sup> rather than state actors. The Chinese pattern of creative destruction discussed in this paper is therefore different. This creative destruction is driven by state improvements in industrial sectors, including steel and coal, through the cutting of excess capacity, but within this, there has been diversification and new business sectors have developed, including sectors built on new technologies. It therefore partly consists of “creative destruction in moving one technoeconomic system to another – or removing the vestiges of one system to create space for the new.”<sup>77</sup> Change is engineered by China acting as an “entrepreneurial state”<sup>78</sup> in deciding policies at the macro-level. It has implemented transformative policies with a more limited role for the market in bringing the gale of creative destruction.<sup>79</sup> As discussed in this paper, implementation by provinces at the meso-level has presented difficulties, partly due to path-dependent, embedded ways of doing things and the immaturity of the legal infrastructure, and concerns that the impacts at the micro-level on individual firms and workers are potentially significant.

### *Innovation Strategy*

Before examining the approaches taken to zombie companies, it is necessary to briefly discuss the important emphasis on innovation as one component of creative destruction. This trajectory emerged in the 13<sup>th</sup> 5-year plan (2016-2020), which promoted investments in innovative companies in an effort to move away from reliance on old growth models.<sup>80</sup> For the upcoming

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<sup>76</sup> See e.g., Kurt Dopfer, *The Origins of Meso Economics* 22 J EVOL ECON 133, 140-142 (2012), <https://doi.org/10.1007/s00191-011-0218-4>. See for a critique of Schumpeter’s conception of entrepreneurs Samuel Bostaph, DRIVING THE MARKET PROCESS, “ALERTNESS” VERSUS INNOVATION AND CREATIVE DESTRUCTION 16 Q. J. AUSTRIAN ECON. 421. State entrepreneurial involvement is identified in the work of Schumpeter by Leonardo Burlamaqui, *Schumpeter, the Entrepreneurial State and China*. UCL INSTITUTE FOR INNOVATION AND PUBLIC PURPOSE, WORKING PAPER SERIES (IIPP WP 2020-15), available at: <https://www.ucl.ac.uk/bartlett/public-purpose/wp2020-15>.

<sup>77</sup> John A Matthews, *Schumpeter in the Twenty-First Century: Creative Destruction and the Global Green Shift* in SCHUMPETER’S CAPITALISM, SOCIALISM AND DEMOCRACY: A TWENTY FIRST CENTURY AGENDA (Leonardo Burlamaqui and Rainer Kattel eds, 2019), 235.

<sup>78</sup> Leonardo Burlamaqui, *Finance, Development and the Chinese Entrepreneurial State: A Schumpeter-Keynes - Minsky Approach*, 35 BRAZILIAN J. OF POLITICAL ECON. 728, 728 (2015); Leonardo Burlamaqui, *Schumpeter, the Entrepreneurial State and China* (UCL INSTITUTE FOR INNOVATION AND PUBLIC PURPOSE, Working Paper No. IIPP WP 2020-15), <https://www.ucl.ac.uk/bartlett/public-purpose/wp2020-15>.

<sup>79</sup> Yi Zhou, Canfei He, & Shengjun Zhu, *Does Creative Destruction Work for Chinese Regions?*, 48 GROWTH & CHANGE 274, 277 (2016).

<sup>80</sup> SCOTT KENNEDY & CHRISTOPHER K. JOHNSON, PERFECTING CHINA, INC.: THE 13TH FIVE-YEAR PLAN (Center for Strategic and International Studies, 2016) (discussing the

14<sup>th</sup> 5-year plan (2021-2025), nascent and familiar themes have also been introduced, such as “replacing high-speed growth with high-quality growth and driving modernization through innovation and technological advancements.”<sup>81</sup>

The China Manufacturing 2025 (中国制造 2025) initiative, commonly referred to as “Made in China 2025,” aims to enhance China’s external image through strategic goals for economic development in the period from 2016-2025.<sup>82</sup> This initiative has similar aims to Germany’s Industry 4.0,<sup>83</sup> which outlined Germany’s technological ambitions based on the inclusion of advanced technologies in manufacturing processes. The China Manufacturing initiative similarly aims to place China at the “forefront of world industrial technology development”<sup>84</sup> through the “intelligent upgrading of manufacturing”<sup>85</sup> and emphasizes focus on ten technological industries.<sup>86</sup> This initiative’s importance in rhetoric has been noted as having reduced in recent years but its aims have continued<sup>87</sup> and form merely a part of the current industrial strategy of development through innovation.<sup>88</sup> Alongside these new ways of doing things, there is, as outlined above, a reduction in surplus capacity in old industrial and

limitations of the technological ambitions while maintaining administrative approaches to governance).

<sup>81</sup> Dorcas Wong, *What to Expect in China’s 14th Five Year Plan? Decoding the Fifth Plenum Communique*, CHINA BRIEFING (Nov. 12, 2020), <https://www.china-briefing.com/news/what-to-expect-in-chinas-14th-five-year-plan-decoding-the-fifth-plenum-communique/>.

<sup>82</sup> *Building a World Manufacturing Power-premier and ‘Made in China 2025’ Strategy*, STATE COUNCIL OF PEOPLE REPUBLIC OF CHINA (Jan. 31, 2017), [http://english.gov.cn/premier/news/2017/01/29/content\\_281475554068056.htm](http://english.gov.cn/premier/news/2017/01/29/content_281475554068056.htm).

<sup>83</sup> Ling Li, *China’s manufacturing locus in 2025: With a comparison of “Made-in-China 2025” and “Industry 4.0”*, 135 *TECH. FORECASTING AND SOC. CHANGE* 66, 73 (2018).

<sup>84</sup> *Made in China 2025*, GOV.CN, <http://www.gov.cn/zhuanti/2016/MadeinChina2025-plan/index.htm>.

<sup>85</sup> *Id.*

<sup>86</sup> *Made in China 2025’ Plan Issued*, STATE COUNCIL OF PEOPLE REPUBLIC OF CHINA (May 19, 2015), <http://www.gov.cn/zhuanti/2016/MadeinChina2025-plan/index.htm> (“Information technology, including artificial intelligence; robotics; green energy and green vehicles; aerospace equipment; marine engineering and advanced ships; railway equipment; power equipment; medicine and mechanical devices; agricultural machinery”).

<sup>87</sup> See Max Zenglein & Anna Holzmann, *Evolving Made in China 2025: China’s Industrial Policy in the Quest for Global Tech Leadership*, MERICS PAPERS ON CHINA NO.8, (July 2019), at 8.

<sup>88</sup> Xinhua, *Full text of Xi Jinping’s report at 19th CPC National Congress*, CHINA DAILY (Nov. 04, 2017), [https://www.chinadaily.com.cn/china/19thcpcnationalcongress/2017-11/04/content\\_34115212.htm](https://www.chinadaily.com.cn/china/19thcpcnationalcongress/2017-11/04/content_34115212.htm) (There was a focus on innovation and supply-side structural reforms in Xi Jinping’s speech at the 19<sup>th</sup> National Congress of the Communist Party of China); see also *Guānyú Yīnfā “Jiākuài Wánshàn Shìchǎng Zhūtǐ Tuìchū Zhìdù Gǎigé Fāng’àn” De Tōngzhī* (关于印发《加快完善市场主体退出制度改革方案》的通知; 发改财金) [Notice regarding the issuance of the “Accelerating the Reform Plan for Improving the Exit System of Market Entities ”] (July 16, 2019), [http://www.gov.cn/guowuyuan/2019-07/16/content\\_5410058.htm](http://www.gov.cn/guowuyuan/2019-07/16/content_5410058.htm).



manufacturing sectors under the supply-side reform policy. The elimination of zombie companies has formed an important part of the rhetoric regarding that policy, emphasizing renewal. As discussed below, zombie withdrawal has frequently been accompanied by new technology developments, as well as technological improvements to existing industries, and these examples arguably parallel Schumpeter's concept of creative destruction.

## V. CREATIVE DESTRUCTION IN RESTRUCTURING AND EXITS OF ZOMBIE COMPANIES

Alongside the increased focus on technological enterprises in the creative destruction trajectory there has, as noted, been an effort to address surplus productive capacity, including through restructuring and exits of zombie companies. In late 2018, the National Development and Reform Commission and other government agencies issued a notice to direct these efforts.<sup>89</sup> There was an emphasis on disposal according to market principles and the rule of law through liquidations, reorganizations, and mergers, and local governments were tasked with identifying zombie companies and notifying creditors and financial institutions.<sup>90</sup> The discussion of restructuring opportunities in this notice emphasizes that there may be zombie companies which have operating value.<sup>91</sup> Those enterprises in this category would be restructured, with the market exit of others and a target to complete all disposal work by the end of 2020.<sup>92</sup> Land occupied by zombie companies or freed up by elimination of surplus capacity could be reclaimed by local governments and sold to generate funds for employee resettlement.

A March 2019 statement by Premier Li Keqiang again highlighted a need to “accelerate reorganization of the zombie companies and assist these companies to withdraw from the market.”<sup>93</sup> A multi-agency notice issued in July 2019, regarding improvements towards a market-based insolvency system,

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<sup>89</sup> *Guānyú Jìnyībù Zuò Hǎo “Jiāngshī Qǐyè” Jí Qù Chǎnnéng Qǐyè Zhàiwù Chǔzhì Gōngzuò De Tōngzhī* (关于进一步做好“僵尸企业”及去产能企业债务处置工作的通知) [Notice on Steps to Deal with Zombie Companies and Eliminate Over-Capacity] (Dec. 04, 2018), [http://www.gov.cn/xinwen/2018-12/04/content\\_5345675.htm](http://www.gov.cn/xinwen/2018-12/04/content_5345675.htm) (This notice also applies to companies with excess capacity that require downsizing).

<sup>90</sup> *Id.*

<sup>91</sup> *Id.* (Identifies that there are some viable companies that needed to reduce capacity but which have difficulties paying debts due to a high level of liabilities compared to assets).

<sup>92</sup> *Id.*

<sup>93</sup> Li Keqiang, *Report on the Work of the Government: Delivered at the Second Session of the 13<sup>th</sup> National People's Congress of the People's Republic of China on March 5, 2019*, XINHUA NEWS AGENCY, [https://www.wsj.com/public/resources/documents/2019NPCWorkReportEN.pdf?mod=article\\_inlin](https://www.wsj.com/public/resources/documents/2019NPCWorkReportEN.pdf?mod=article_inlin).

again emphasized disposal of zombie companies according to market principles and prohibited the provision of bailouts to zombie companies.<sup>94</sup> The elimination of zombie companies is an important part of what we are describing as the creative destruction narrative, alongside entrepreneurship and technological development.

### A. Approaches to Zombie Company Withdrawal

State-level policies towards zombie company elimination at the macro level have been implemented at the meso level in accordance with an official work plan, which was discussed by the chief accountant of the State-owned Assets Supervision and Administration Commission, "SASAC"<sup>95</sup> in April 2017. Under this work plan there are three batches of zombie companies.<sup>96</sup> It is clear from these batches that not all zombie companies are regarded as hopeless cases. The approach of the work plan will briefly be outlined with some illustrative cases.

The first batch is composed of zombie companies with resources and revitalization potential. Under the work plan this group would be the subject of mergers and reorganizations, an approach that would be used if the enterprise's problems were simply a case of over-capacity.<sup>97</sup> A notable example of a success in this category is the takeover of Dongbei Special Steel, which had been consistently reporting losses prior to its restructuring and, after debt for equity swap investment by private steel firms, had its restructuring plan

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<sup>94</sup> *Guānyú Yīnfā "Jiākuài Wánshàn Shìchǎng Zhǔtǐ Tuìchū Zhìdù Gǎigé Fāng'àn" De Tōngzhī* (关于印发《加快完善市场主体退出制度改革方案》的通知; 发改财金) [Notice regarding the issuance of the "Accelerating the Reform Plan for Improving the Exit System of Market Entities"] (July 16, 2019), [http://www.gov.cn/guowuyuan/2019-07/16/content\\_5410058.htm](http://www.gov.cn/guowuyuan/2019-07/16/content_5410058.htm).

<sup>95</sup> Zhong Nan & Ren Xiaojin, *SOEE Reforms Prove Profitable*, CHINA DAILY (Apr. 14, 2017), [http://english.www.gov.cn/state\\_council/ministries/2017/04/14/content\\_281475626457171.htm](http://english.www.gov.cn/state_council/ministries/2017/04/14/content_281475626457171.htm) (SASAC is responsible for non-financial SOEs).

<sup>96</sup> Wang Shidan, *"Jiāngshī Qǐyè" De Chǔzhì Zhǔyào Shi Cǎiqǔ "Sān Gè Yī Pī" De Fāngshì* ("僵尸企业"的处置主要是采取"三个一批"的方式) [The Disposal of "Zombie Companies" Mainly Adopts the "Three Batches" Approach] STATE COUNCIL INFORMATION OFFICE (Apr. 13, 2017), <http://www.scio.gov.cn/xwfbh/xwfbh/wqfbh/35861/36467/zy36471/Document/1547838/1547838.htm>.

<sup>97</sup> This approach was evident in a report on Pingxiang Economic and Technological Development Zone 萍乡经开区部署 2021 年招商引资工作 (图)[Pingxiang Economic and Technological Development Zone Deploys Investment Promotion Work in 2021 (Picture)] JXNEWS (Feb. 22, 2021). <https://px.jxnews.com.cn/system/2021/02/20/019194923.shtml>.

approved.<sup>98</sup> It has since been profitable.<sup>99</sup> Another example is ST Jianfeng, which had operated a chemical business but sold this business as part of a restructuring and acquired a pharmaceutical business. This enabled the company's fortunes to be turned around.<sup>100</sup> The Enterprise Bankruptcy Law 2006 offers market-based revitalization prospects through reorganization and reconciliation procedures, but for reasons to be outlined there have not been many examples of these formal procedures being used.<sup>101</sup>

The second batch under the SASAC work plan was composed of zombie companies which had potential to be improved by strengthened management. This approach was considered appropriate where there had been mistakes, too much debt, too many staff workers, or inadequate management. An example from this category is Chongqing Iron and Steel Corp., which was restored to profitability after private equity investment, including a party with experience in distressed steel companies in the United States.<sup>102</sup> Managerial changes were also credited as having revitalized Shandong Yankuang International Coking Co., Ltd.<sup>103</sup>

The third batch would be companies regarded as hopeless, with no prospects for redevelopment and this batch would be addressed under bankruptcy law. The limited nature of this third batch is confirmed by a previous study carried out during the project from which this article stems. This study considered the use of the term "zombie companies" in judgments carried out in 2020 using the China Judgments Online database.<sup>104</sup> Using this search term, it was found that the term "zombie company" was mostly defined in liquidation judgments as companies with no assets, books, personnel, litigation and

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<sup>98</sup> See e.g., Chuin-Wei Yap, *China's Zombie Companies Stay Alive Despite Defaults*, WALL ST. J. (July 12, 2016), <https://www.wsj.com/articles/chinas-zombie-companies-stay-alive-despite-defaults-1468303515>.

<sup>99</sup> *China's Northeast Shows Positive Growth, Strong Resilience* CCTV.COM, (Mar. 2, 2021), <https://english.cctv.com/2021/03/02/ARTI4OA9ie0zeAei97b0PUh2210302.shtml>.

<sup>100</sup> Zhao Yihui, 股市场国资“僵尸企业”如何化茧成蝶 [How Do State-Owned "Zombie Companies" in the A-Share Market Turn Cocoons into Butterflies], SHANGHAI SECURITIES NEWS (Aug. 10, 2018), [http://www.xinhuanet.com/2018-08/10/c\\_1123249430.htm](http://www.xinhuanet.com/2018-08/10/c_1123249430.htm).

<sup>101</sup> Chung Hua, “僵尸企业”市场化处置：清算与重组双管齐下 [Market-Oriented Disposal of "Zombie Companies": Two-Pronged Approach to Liquidation and Reorganization], (Aug. 3, 2017), <https://www.yicai.com/news/5325955.html>.

<sup>102</sup> David Stanway, *Weight of history: Chongqing Steel and China's state sector dilemma*, REUTERS (Aug. 16, 2019), <https://www.reuters.com/article/uk-china-steel-chongqing-idUKKCN1V60EI>.

<sup>103</sup> Cong Min “国有体制、民营机制”联合激活“僵尸企业” [“State-owned system and private mechanism" jointly activate "zombie enterprises"], WORKERS' DAILY (Oct. 20, 2020), [http://www.xinhuanet.com/politics/2020-10/20/c\\_1126631774.htm](http://www.xinhuanet.com/politics/2020-10/20/c_1126631774.htm).

<sup>104</sup> See *supra* note 71.

business (无资产、无账册、无人员、无诉讼、无经营等).<sup>105</sup> Liquidation therefore seems to be rarely used and is the outcome in cases where the affairs of the company have been wound down and only, effectively, an empty shell is left.<sup>106</sup> This limited usage of the term in case law may therefore suggest processes of salvage and renewal in the other two categories.<sup>107</sup>

Before the approaches to zombie company resolution are discussed in more detail, it is necessary to consider why there have been so few examples of zombie company withdrawals using the formal insolvency procedures when the state policies are stated to be market-driven.

### B. *Immaturity of the Insolvency System*

One problem is that the insolvency system is relatively immature. Having formerly operated a highly-controlled system of handling company insolvencies, the Enterprise Bankruptcy Law 2006 (hereinafter “EBL 2006”) was enacted, partly in response to internal need for reformed insolvency procedures but also in response to the demands of external relations, notably with the EU and United States.<sup>108</sup> This law follows the modern international focus<sup>109</sup> on reorganization as a possibility for viable but struggling enterprises,<sup>110</sup> as well as the possibility of liquidation. However, revised laws

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<sup>105</sup> *Id.*

<sup>106</sup> Other zombie companies in this category may have been dealt with through cancellation of their registrations, for example this was the approach in relation to Tianjin Yangliuqing Painting Club, which had not operated for many years: *Dātōng “Sān Shàn Dàmén” Zhīchí Shìchǎng Zhūtǐ Fāzhǎn* (打通“三扇大门”支持市场主体发展) [Open up the “three doors” to support the development of market entities], (Feb. 23, 2021), <http://www.cicn.com.cn/zggsb/2021-02/23/cms135651article.shtml>.

<sup>107</sup> For example Shandong identified 48 examples where the quality and efficiency of zombie companies was improved, as well as 130 cleared through bankruptcy: *Shāndōng Fǎyuàn 2020 Nián Shěnjié 1875 Jiàn Pòchǎn ànjàn “Jiāngshī Qǐyè” Chū Qīngzhù “Téng Lóng Huàn Niǎo”* 山东法院 2020 年审结 1875 件破产案件 “僵尸企业” 出清助 “腾笼换鸟” [Shandong courts concluded 1,875 bankruptcy cases in 2020, “zombie companies” cleared out to help “vacate cages for birds”], (Feb. 3, 2021), <https://www.chinanews.com/gn/2021/02-03/9403518.shtml>.

<sup>108</sup> See also Rebecca Parry & Haizheng Zhang, *China’s New Corporate Rescue Laws: Perspectives and Principles*, 8 J. CORP. L. STUD. 113 (2008), <https://www.tandfonline.com/doi/abs/10.1080/14735970.2008.11421524?journalCode=rcls20> (for a discussion of the internal and external pressures which finally led to the enactment of the 2006 Law and the reasons for the resistance prior to that time).

<sup>109</sup> See e.g. REINHARD BORK, *CORPORATE INSOLVENCY LAW, A COMPARATIVE TEXTBOOK* (2020), 165-166.

<sup>110</sup> For an analysis of reorganization cases under the EBL 2006, see ZINIAN ZHANG, *CORPORATE REORGANIZATIONS IN CHINA*, UNIV. OF LEEDS, (Nov. 2018).

are insufficient in themselves to create a modern insolvency system<sup>111</sup> and, as discussed below, there is a process in progress of development of judicial capacity and a suitable court structure to handle insolvencies.<sup>112</sup>

China's underdeveloped corporate insolvency mechanisms have been regarded as a hindrance when dealing with the zombie companies. The weak enforcement of the law and inexperienced judges (discussed below) and insolvency practitioners will be "likely to expose companies to a 'creditors' race' that forces the piecemeal sale of assets."<sup>113</sup> The judicial system and government interference can also make eliminating zombie companies uncertain and unfair. The decisions to recognize zombie companies are largely to be decided by the local or central government in legal practice. An improved market-oriented insolvency law regime would boost Chinese economic development and some potential improvements can be suggested.

As previously noted, it might be thought that under a market-based approach to zombie companies there would be a strong role for liquidation, consistent with international practice and the Doing Business Environment. Given the complexity of some cases and ambitious restructuring and relocation efforts noted later in this paper, it is important to establish communication channels for the courts, insolvency practitioners, and banks to settle social problems brought on by zombie companies.<sup>114</sup> For example, an employee resettlement plan is to be included in the filing documents and this will require

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<sup>111</sup> Jingxia Shi, *Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy*, 16 NORTON J. BANKR. L. & PRAC. 645, 649 (Apr. 11, 2007), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3370604](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3370604).

<sup>112</sup> Rebecca Parry & Yingxiang Long, *China's Enterprise Bankruptcy Law, Building an Infrastructure Towards a Market-Based Approach*, 20 J. CORP. L. STUD. 157 (Aug., 2019).

<sup>113</sup> David Stanway & Engen Tham, *China Bankruptcies Rise Steadily in 2017 Amid 'Zombie Firm' Crackdown' Reuters Report*, REUTERS (Aug. 3, 2017), <https://www.reuters.com/article/china-insolvency/china-bankruptcies-rise-steadily-in-2017-amid-zombie-firm-crackdown-idUSL4N1KP2YP>.

<sup>114</sup> The makings of such an approach have been developed in Shanghai's courts: 可凭法院文书注销上海出台政策破解"僵尸企业"注销难题 [Can be cancelled by court documents, Shanghai issued a policy to solve the problem of "zombie enterprises" cancellation], CHINA INDUSTRY INFORMATION DATABASE, (July 24, 2019) (Companies which have not filed taxes or filed annual reports can be dealt with under an expedited procedure); see also, 山西太原清退近 1 万户"僵尸企业" [Shanxi Taiyuan Qing withdraws nearly 10,000 "zombie enterprises"], CHINA INDUSTRY INFORMATION DATABASE (Sept. 4, 2020); 海西全面清理"僵尸企业" [Haixi cleans up "zombie enterprises"], CHINA INDUSTRY INFORMATION DATABASE (June 8, 2020). Good practice in this regard has also been noted in the autonomous agricultural area of Ningxia: see 宁夏: 建立企业破产协调联动机制方便"僵尸企业"退出 [Ningxia: Establish a coordination and linkage mechanism for corporate bankruptcy to facilitate the exit of "zombie companies"], CHINA INDUSTRY INFORMATION DATABASE, (Aug. 10, 2020).

careful collaborative planning.<sup>115</sup> The complexities of some of the restructurings which have taken place in areas with high numbers of zombie companies will be considered later in this paper.

An investigation of general insolvency law enforcement may give some insights on how to use this legal regime more effectively for the case of zombie companies. Focusing on insolvency statistics, the official figures in China illuminate the sharp rise of the Chinese insolvency cases in 2017 with 9,542 cases, a huge climb compared with 5,665 cases in 2016 and 3,685 in 2015.<sup>116</sup> This upward trajectory is likely to continue, as predicted by Andrew Fennell, the director of sovereign rating agency Fitch Rating.<sup>117</sup> The increase is closely associated with government policies toward a more relaxed and market-driven insolvency procedure and with the attitude of Chinese authorities being more accepting of corporate insolvency. Additionally, the improved insolvency law may also contribute to this trajectory. He Xiaorong, senior director at China's Supreme People's Court confirmed that "the difficulties of launching a bankruptcy case have been effectively eased."<sup>118</sup> The enhanced system should make it easier and more effective to eliminate zombie companies through the insolvency procedure by establishing mechanisms to ascertain, reconstruct or liquidate the zombie companies; deal with layoffs; and sustain social stability.

Looking at the issue from a global perspective, it is asserted by the Tsinghua National Finance Institute and China University of Politics and Law Insolvency Law Research Centre that the number of cases filed in China is still comparatively low.<sup>119</sup> The number of insolvency cases is obviously largely dependent on the effectiveness of corporate insolvency law in China but account

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<sup>115</sup> ENTERPRISE BANKRUPTCY LAW OF THE PEOPLE'S REPUBLIC OF CHINA ORDER OF THE PRESIDENT OF THE PEOPLE'S REPUBLIC OF CHINA NO.54, 1 Art. 8 (2006), Zuigao Renmin Fayuan Gongbao.

<sup>116</sup> See Supreme People's, Court People's Court Press Conference: Overview of the Progress of Court Bankruptcy Proceedings (最高法召开发布会 介绍法院破产审判工作情况), (Mar. 6, 2018), <http://www.court.gov.cn/zixun-xiangqing-83772.html>.

<sup>117</sup> Andrew Fennell, *Bankruptcies to Keep Rising as China Tackles Overcapacity*, FITCHRATINGS (Aug. 10, 2017), <https://www.fitchratings.com/research/corporate-finance/bankruptcies-to-keep-rising-as-china-tackles-overcapacity-09-08-2017>.

<sup>118</sup> See Umaima Khobaib Vahedy, *Report: Chinese 'Zombie Firm' Campaign Sees Bankruptcy Cases Rise in 2017*, S&P GLOBAL (Aug. 4, 2017), <https://www.spglobal.com/marketintelligence/en/news-insights/trending/ihe9syemvnelprz48p9dqa2>.

<sup>119</sup> *Strengthening the Implementation of the Bankruptcy Law and Eliminating Zombie Companies through Market and Law* (加强破产法实施、依法促进市场出清), TSINGHUA NATIONAL FINANCE INSTITUTE AND CHINA UNIVERSITY OF POLITICS AND LAW INSOLVENCY LAW RESEARCH CENTRE (July 5, 2016). For example, there are around 39.3 thousand insolvency cases averagely filed in the US which is around 10 times the number in China. So is the case in other civil law countries such as Germany with 30 thousand cases and France with 55 thousand cases averagely.

must also be taken of some contextual factors, considered next.

### C. *Reluctance to Initiate Bankruptcy Proceedings*

The Enterprise Bankruptcy Law 2006 was introduced at a time when the supporting framework of courts was under-developed and the idea of bankruptcies was new. It has taken time for case numbers to become established. Proceedings can be opened voluntarily or involuntarily,<sup>120</sup> however there is limited incentive for creditors to file as employee resettlement requirements may limit the amounts that they can expect to receive.<sup>121</sup> From the standpoint of the debtors, there is a lack of awareness and understanding as to insolvency protection measures, functions, and procedures in zombie companies. Therefore, they would be unfamiliar with the procedures of seeking protection through insolvency regimes, in particular the prospects of reorganization.<sup>122</sup>

There has also been a culture of local government officials requiring pre-approval for the opening of bankruptcy proceedings.<sup>123</sup> As noted, since local government officials are employed on a short-term basis, there has been a tendency for them to favor short-term results and they have tended to resist closures that would undermine these political achievements.<sup>124</sup> Governors of the local government may be only employed on a short-term basis with the potential to be promoted to provincial or even central level. Therefore, there is a danger that they may only want to boost the short-term interest of the company for their promotion and political achievements while ignoring the long-term strategic goals.<sup>125</sup> Numbers of insolvency cases have been comparatively low

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<sup>120</sup> The Enterprise Bankruptcy Law (promulgated by Standing Comm. Nat'l People's Cong., Aug.27, 2006, effective June 1, 2007), art. 2.

<sup>121</sup> Rebecca Parry & Yingxiang Long, *China's Enterprise Bankruptcy Law, Building an Infrastructure Towards a Market-Based Approach*, 20 J. CORP. L. STUD. 157, 170, (2020).

<sup>122</sup> Chung Hua (重华), *Market-Oriented Disposal of "Zombie Companies": Two-Pronged Approach to Liquidation and Reorganization* (僵尸企业"市场化处置: 清算与重组双管齐下) YICAI (Aug. 3, 2017), <https://www.yicai.com/news/5325955.html>.

<sup>123</sup> HUIMIAO ZHAO, GOVERNMENT INTERVENTION IN THE REORGANISATION OF LISTED COMPANIES IN CHINA 243 (2019).

<sup>124</sup> Kai Yuen Tsui, *China's Infrastructure Investment Boom and Local Debt Crisis*, 52 EURASIAN GEOGRAPHY AND ECON. 686, 698 (2011); See also *supra* note 71.

<sup>125</sup> Qiuying Qu, *Zombie Firms and Political Influence on Bank Lending in China* (Jan. 2019), <https://econ.columbia.edu/wp-content/uploads/sites/41/2018/10/Job-Market-Paper-Qiuying-Qu-190110.pdf>.

in general,<sup>126</sup> and therefore high numbers of zombie company liquidations would have been surprising. It is likely that many zombie companies will simply be deregistered, without using the insolvency procedures.<sup>127</sup>

#### D. Judicial Environment for Eliminating Zombie Companies

The effective enforcement of the insolvency law at the meso level to liquidate or reorganize the zombie companies has been hampered by judicial issues such as limited judicial resources or judges' skills and knowledge.<sup>128</sup> The judges' knowledge is not only particularly important for judgement on identification and characterization of zombie companies but also for considering the filing of the insolvency cases so that some zombie companies with viable prospects can go the route of reorganization before too many creditors enforce their debts in the court. It has been suggested by Yang Linping, President of No.2 Civil Law Tribunal of the Supreme Court, that the biggest difficulty of insolvency trials is how to initiate the insolvency proceedings.<sup>129</sup> The narrow understanding of insolvency can mean that restructuring opportunities are missed and can make it challenging for judges and legal practitioners in China to open insolvency procedures.

Insolvency proceedings are still fairly new to Chinese judges in many areas, and it has been reported that many will regard such proceedings as time

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<sup>126</sup> Li Shuguang & Wang Zuofa, *China's Bankruptcy Law after Three Years: The Gaps Between Legislation Expectancy and Practice and the Future Road, Parts 1 and 27* INT'L CORP. RESCUE 303-12 and 373-81 (2010); INSOL International, REVIEW OF THE PRC BANKRUPTCY LAW IN 2009 (Mar. 2010).

<sup>127</sup> Tianlei Huang, *As China Recovers from the Pandemic, will Zombie Firms Return?* PETERSON INST. FOR INT'L ECON. (Oct. 21, 2020), <https://www.piie.com/blogs/china-economic-watch/china-recovers-pandemic-will-zombie-firms-return>; *Shanghai's Export Policy can be Cancelled with Court Documents to Solve the Problem of "Zombie Enterprises" Cancellation* (可凭法院文书注销上海出台政策破解"僵尸企业"注销难题) CHINA INDUS.INFO. DATABASE, (July 24, 2019), <https://finance.sina.com.cn/roll/2019-07-17/doc-ihytcitm2622062.shtml>; Zhang Xiujuan, *Zombie Companies will be Delisted, and Difficult Companies Can go out of Business! Implementation of Shenzhen's New Regulations on Commercial Registration* (僵尸企业将除名, 困难企业可歇业! 深圳商事登记新规施行) SOUTHERN NET (Mar. 3, 2021), [http://www.sznews.com/news/content/2021-03/02/content\\_24008999.htm](http://www.sznews.com/news/content/2021-03/02/content_24008999.htm).

<sup>128</sup> See Ting Gong, *Dependent Judiciary and Unaccountable Judges: Judicial Corruption in Contemporary China* 4 CHINA REV. 33, 48 (2004).

<sup>129</sup> Wanxiang Li, *Insolvency Trial Reorganizes "Zombie Companies" (破产重整让"僵尸企业"重整再生)* (ECON. DAILY (经济日报) (June 22, 2016), [http://www.gov.cn/xinwen/2016-06/22/content\\_5084258.htm](http://www.gov.cn/xinwen/2016-06/22/content_5084258.htm)



consuming, difficult and unpleasant.<sup>130</sup> The function of corporate insolvency includes objectives such as providing a management framework for distressed companies,<sup>131</sup> stimulating the rehabilitation of insolvent or nearly insolvent companies, and inducing effective corporate governance by imposing sanctions on directors when appropriate.<sup>132</sup> Insolvency procedures will also have impacts on the entitlements of creditors in the proof and ranking of their claims and impact on executory contracts. Transactions which are detrimental to the general body of creditors may give rise to transaction avoidance litigation.<sup>133</sup> The judicial workers could arguably also play a more active and interactive role by communicating with companies and their directors and creditors on the nature and scope of insolvency proceedings.

One positive judicial resource that is worth mentioning is the guiding cases system, which was introduced as a novel attempt to benefit from the advantages of both the common law and civil systems. It has the potential to bring some benefits by enhancing the faith of the masses in the judiciary in China.<sup>134</sup> On March 6, 2018, the Supreme People's Court issued the ten typical cases of recent corporate insolvency trials. These cases provided guidance and reference for application of insolvency law in lower courts. However, guiding cases are nothing more than administrative instructions presented in the form of cases,<sup>135</sup> and do not offer much guidance in the case of zombie companies, which vary significantly in individual cases and have a great degree of discretion for directors, insolvency practitioners and judges, as well as potentially wide social impact.

Increased capacity to handle zombie company cases has arisen after the establishment of specialized bankruptcy courts. The Beijing Bankruptcy Court accepted its first bankruptcy case on February 15<sup>th</sup>, 2019. This case involved China Aviation Airborne Equipment Corporation, a state-owned zombie

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<sup>130</sup> Zhang Chi, Feng Dapeng, An Lumeng & Li Lijing, *Can't Die, Can't Afford to Live, Zombie Companies Encounter Three Obstacles When Clearing Out* (死不了活不起, 僵尸企业出清遇三堵点) XINHUA NEWS AGENCY (Jan. 18, 2020), [https://www.sohu.com/a/367667964\\_267106](https://www.sohu.com/a/367667964_267106).

<sup>131</sup> DAVID MILMAN, GOVERNANCE OF DISTRESSED FIRMS (2013).

<sup>132</sup> VANESSA FINCH & DAVID MILMAN, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES 24-25, (3rd ed. 2017).

<sup>133</sup> See e.g. REINHARD BORK, CORPORATE INSOLVENCY LAW, A COMPARATIVE TEXTBOOK (2020). In the Chinese context, see REBECCA PARRY ET AL., *Transaction Avoidance, in CHINA'S NEW ENTERPRISE BANKRUPTCY LAW* (2010).

<sup>134</sup> Ruiyi Li, *Case-law adopted by China?*, UK CONSTITUTIONAL LAW ASSOCIATION (Jan. 26, 2012), <https://ukconstitutionallaw.org/2012/01/26/ruiyi-li-case-law-adopted-by-china/>.

<sup>135</sup> Jinting Deng, *The Guiding Case System in Mainland China*, 10 FRONTIERS L. CHINA 449, 450 (2015).

company, that had ceased operation in 2010. Lina Ma, vice-president of Beijing First Intermediate Court, serves as the presiding judge in this case. She said that a systematic trial of bankruptcy cases will have positive effects for disposal of "zombie companies," facilitating the supply-side reforms and improving the competitiveness of SOEs. She also emphasized that placement of employees would continue to be the primary consideration in the bankruptcy cases. Previously, in the cases heard before the insolvency tribunal, the rights of employees have been adequately protected and, in some cases, employee's claims have been fully realized.<sup>136</sup> According to the media report, Bankruptcy Courts will hear cases of compulsory liquidation, bankruptcies and bankruptcy-related cases as well as cross-border insolvency cases.<sup>137</sup> Specific regulations on the scope of jurisdiction of bankruptcy courts are yet to be formulated.

The establishment of the bankruptcy court was in response to a call initiated by the Supreme People's Court which issued *Minutes of the National Court Bankruptcy Trial Work Conference*<sup>138</sup> on March 6, 2018. In this document, the SPC states that it is necessary to establish insolvency tribunals at intermediate court and change the current practice of adjudicating a bankruptcy case in the basic court of the place where the debtor is registered.<sup>139</sup> The SPC also stresses that in reorganization proceedings the court must use the power to cram down with caution and communicate adequately with creditors, debtors, administrators and other parties in respect of the reorganization plan. The court shall review the feasibility of the reorganization plan in addition to its formal compliance with the law. The enlarged power and duties of court also reaffirm the necessity of establishing the specialized tribunal for insolvency cases.

Looking at the current portfolio of the Chinese judicial system, however, it is arguably not yet competent to deal to a full extent with the problem of zombie companies. Additionally, the large extent of corruption in China's judicial system makes it of even greater concern that such a regime should be applied as the instrumental variable to assess the possibility of adoption.<sup>140</sup> Political pressure from central and local government also makes the decisions

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<sup>136</sup> Wei Wang, (北京破产法庭首案涉央企“僵尸企业”) [Beijing Bankruptcy Court's First Case Involving State-Owned Zombie Company], BEIJING NEWS (Feb. 16, 2019, 2:30 AM), <http://www.bjnews.com.cn/news/2019/02/16/547467.html>.

<sup>137</sup> *Id.*

<sup>138</sup> *Minutes of the National Court Bankruptcy Trial Work Conference* [全国法院破产会议纪要 50 条], SUPREME PEOPLE'S COURT NETWORK (2018), <http://www.court.gov.cn/zixun-xiangqing-83802.html>.

<sup>139</sup> *Id.*

<sup>140</sup> See Ting Gong, *Dependent Judiciary and Unaccountable Judges: Judicial Corruption in Contemporary China*, 4 CHINA REV. 33, 34 (2004).

of judges difficult.

Therefore, although progress has been made in more recent years, through the development of supporting guidance as to insolvency cases, as well as the training of judges and opening of bankruptcy courts, there is progress still to be made.<sup>141</sup> As noted, the insolvency framework has not been widely used with respect to zombie companies, and alternative approaches have been taken towards zombie company restructurings and exits, with liquidation being confined to companies which are effectively empty shells.<sup>142</sup> The next part considers in more detail the approaches taken.

## VI. ZOMBIE COMPANY WITHDRAWAL OUTCOMES, A REVIEW OF MEDIA REPORTS

Having sketched the macro level policies of the Chinese state towards both zombie companies and the growth of innovation, the aim in this section is to consider their implementation and identify their possible impact in practice. From the zombie company angle this part considers the meso level application of the state's creative destruction policies by provincial governments, as well as an assessment of possible micro level impacts of exits of individual firms. This part draws upon an original qualitative thematic content analysis of a sample of media reports of zombie company withdrawals in Chinese press sources in the period from 2016 to 2021 in three regards. Firstly, the aim of this study was to evaluate how zombie company withdrawals have tended to be characterized in news reports. Secondly, it was used to identify aspects of creative destruction within these characterizations. Thirdly, the data was also used to consider the possible impact of withdrawal strategies on local communities and workers at the micro level.

This part of the study was carried out after a review of most of the literature used in this study and therefore there were some initial expectations as to the creative destruction themes that might appear as well as their likely impacts.<sup>143</sup> These themes were then used in a semantic thematic content analysis of 89 Chinese language news stories. Sources for this study were initially drawn from the Nexis database and were selected on the basis of the

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<sup>141</sup> Rebecca Parry & Yingxiang Long, *China's Enterprise Bankruptcy Law, Building an Infrastructure Towards a Market-Based Approach*, 20 J. CORP. L. STUD. 157 (2020).

<sup>142</sup> Jingchen Zhao et al., *Eliminating Zombie Companies through Insolvency Law in China: Striking a Balance between Market-oriented Policies and Government Intervention*, 29 ASIA PACIFIC L. REV. (forthcoming 2021).

<sup>143</sup> The research broadly followed the 6-stage approach in Virginia Braun & Victoria Clarke, *Using Thematic Analysis in Psychology*, 3 QUALITATIVE RESEARCH IN PSYCHOLOGY 77 (2006).

most-read stories that were primarily about zombie companies. Mostly these sources were found in the China Industry Information Database (33 sources). There were also several sources from the official state-run press agency, Xinhua, but those on the Nexis database (9 items) were not primarily about zombie company withdrawal, and what was included about zombie companies was still from a macro perspective. Other sources were taken from the State Council website (27 sources) but these sources were found to mostly discuss procedural aspects and macro level issues and not the themes that are the focus of the study. Nineteen further sources were obtained from a search of Chinese news websites for stories that were primarily about zombie companies and these were found to contain greater discussion of implementation and impact.

To outline the methods in more detail, there was initially familiarization with the translated newspaper article data to identify relevant discussion of zombie company withdrawals. The translated texts were coded and a deductive review of these sources identified eleven themes that appeared regularly in reports of zombie company withdrawals. These themes were reviewed.<sup>144</sup> The themes that were identified are as shown in the table, showing the number of sources that included each theme, as well as the total number of occurrences of discussion of the theme (reflecting that some sources included more than one example).

Theme	Number of sources mentioning the theme	Total number of references
Cages for Birds	3	3
Green issues	12	14
Innovation	17	19
“Kinetic energy”	5	8
Land repurposing	20	28
Market principles	18	21
Revitalization	32	41
Speed of disposal	24	31
Statistical achievements	30	36
“Survival of the fittest”	8	9
Impact on workers	30	42

<sup>144</sup> Ignoring ghoulish zombie trope references such as subsidies being blood transfusions and zombie companies being corpses.

Themes are discussed below, grouped into discussions of meso-level implementation and micro-level potential impacts.

### *A. Discussion of meso-level implementation*

Several factors that emerged from the thematic analysis relate to the implementation of state policies. The review revealed a pattern of most sources emphasizing good implementation of state policies in the large volume of zombie companies dealt with (30) and the pace with which this was done, or intended to be done (24). There was often an emphasis on revitalization (32), emphasizing that not all zombie companies are beyond salvage, and in line with the SASAQ work plan discussed above. Other factors bring out creative destruction through discussion of innovation (17), kinetic energy (5), green issues (12).

#### *i. Statistical Reporting*

Included in the reports were many discussions of local achievements in implementing the state policies of zombie company elimination, with reports of numbers sometimes running into thousands of companies. Good initial progress had been made in economically advanced provinces, and by the end of 2017 it was reported that Guangdong had closed 2,394 and Zhejiang 555 zombie companies.<sup>145</sup>

There was not always clarity in reports, however, about what is being included as a zombie company and the means of disposal of these companies was not always specified.<sup>146</sup> The most difficult tasks would have related to closures of enterprises with some level of ongoing operation rather than companies which were on the books but not trading. A city in Shanxi's total of 9,955 companies eliminated was stated to be composed of long-term inoperative

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<sup>145</sup> Qin Jiaofeng, Wu Menda, & Li Jinfeng, (处置“僵尸企业”，这个“牛鼻子”怎么抓?) [How to deal with “zombie companies”?], XINHUA NEWS AGENCY (Mar. 4, 2017, 2:36 PM), [http://www.gov.cn/xinwen/2017-03/04/content\\_5173244.htm#1](http://www.gov.cn/xinwen/2017-03/04/content_5173244.htm#1).

<sup>146</sup> Hu Wei, (我县多措并举激发消费市场活力) [Our county takes multiple measures to stimulate the vitality of the consumer market], NINGHAI NEWS NETWORK (Feb. 23, 2021, 8:53 AM), <http://nh.cmb.com.cn/system/2021/02/23/012202350.shtml>. For example, a high number of 2857 zombie companies were reported as having been cleared in one county of Zhejiang.

companies.<sup>147</sup> Similarly Ningxia's statistic of 134,000 zombie closures<sup>148</sup> and Henan's report of 48,000 closures must have bulked out by these eliminations.<sup>149</sup> Therefore high numbers did not always indicate significant transformations.

## ii. Innovation, Revitalization and Green Renewal

Besides the raw statistics of numbers of zombie companies eliminated, the news reports often emphasized technological developments, either in the repurposing land formerly occupied by zombie companies (considered further below) or in improvements to zombie companies which were revitalized. These examples, in emphasizing new ways of doing things, alongside moves away from old ways of doing things, arguably represent narratives of creative destruction.

One notable example of a creative destruction narrative appeared in a report that was in the initial literature review but not included in the qualitative study sample. This report considered a development in Linqing City, in the coastal province of Shandong, which emphasized a move from labor-intensive industries to knowledge-intensive industries:<sup>150</sup>

The abolition of old kinetic energy enables better cultivation of new kinetic energy, replacing old models with new models, new formats for old formats, new technologies for old technologies, new materials and new energies for old materials and old energies, to achieve industrial upgrading, and to achieve quantitative growth.

For Shanxi, a coalfield region, the tale was one of diversification so that the coalfields would be one pillar of the economy, but three new pillars would be added, including big data analytics and cloud computing, in a report that also

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<sup>147</sup> Qin Haifeng, (山西太原清退近 1 万户“僵尸企业”) [Shanxi Taiyuan Qing withdraws nearly 10,000 "zombie enterprises"], CHINA QUALITY NEWS (Sept. 4, 2020, 9:50 AM), [https://m.gmw.cn/2020-09/04/content\\_1301526529.htm?source=sohu](https://m.gmw.cn/2020-09/04/content_1301526529.htm?source=sohu).

<sup>148</sup> Tao Tao, (宁夏市场主体总量达 65.9 万户 清理“僵尸”企业 1.34 万户) [The total number of market entities in Ningxia reached 659,000, and 13,400 "zombie" companies were cleaned up], NINGXIA DAILY (Jan. 28, 2021, 10:00 AM), <https://news.cnstock.com/news,yw-202101-4652524.htm>.

<sup>149</sup> Bai Tiantian, (湖南：注销吊销“僵尸企业” 4.8 万户) [Hunan: 48,000 "zombie companies" were cancelled and revoked], XINHUA NEWS AGENCY (Feb. 16, 2017, 5:40 PM), [http://www.gov.cn/xinwen/2017-02/16/content\\_5168561.htm](http://www.gov.cn/xinwen/2017-02/16/content_5168561.htm).

<sup>150</sup> Pang Yuwei, (临清市 破立之间动能涌) [Dynamic energy surges between Linqing City], LIAOCHENG DAILY (Feb. 20, 2021, 9:33 AM), <http://news.lcxw.cn/liaocheng/yaowen/20210220/886462.html>.

emphasized the improvement of existing industries alongside the development of new high technologies.<sup>151</sup> Shanxi has been described as having undergone a transition from “coal boss” to a “pioneer of the energy revolution.”<sup>152</sup> There were other examples of green innovations, such as a traditional straw-making area, Linzhang County, diversifying into biogas production, following the closure of a “desolate” zombie company: a textile factory which had suffered economically due to a change of market conditions.<sup>153</sup>

### *B. Discussion of micro-level impact*

There was also discussion in the sources of the impact of zombie company withdrawals. This included frequent discussion of land repurposing (20 sources). In this latter regard the term “cages for birds” was chosen as a theme as it had appeared frequently in the initial literature review. However, it only appeared 3 times in the sample. Previously, the term had been noticed in regional news sources and it is discussed in detail below as one of the factors of significance at the micro level. Similarly, the impact on employees figured highly in the news sources (30) and relevant matters are discussed in more detail below, given this factor’s likely significance at the macro level. The transition to a market-based system was echoed in several mentions of a “survival of the fittest” approach being developed and the future of SOEs is discussed in this regard.

It is acknowledged that in the discussions below, the research relies on deductions from documentary sources and that further research is needed to assess impacts in practice.

#### *i. Land Repurposing*

The freeing up and repurposing of land was frequently discussed in the reports. Poor quality land left by industrial enterprises has, however, created

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<sup>151</sup> Cheng Yao, (打破“一煤独大” 构架“四梁八柱” 山西新型国企密集发力) [Breaking the "One Coal Domination" Framework "Four Beams and Eight Pillars" Shanxi's new state-owned enterprises are intensively making efforts], XINHUA NEWS AGENCY (Jul. 16, 2018, 7:57 AM), [http://www.xinhuanet.com/finance/2018-07/16/c\\_1123129881.htm](http://www.xinhuanet.com/finance/2018-07/16/c_1123129881.htm).

<sup>152</sup> Wang Haibin, (山西：从“煤老大” 到能源革命排头兵) [Shanxi: From "Coal Boss" to Pioneer of Energy Revolution], SCIENCE AND TECHNOLOGY DAILY (July 23, 2019, 8:30 AM), [http://www.xinhuanet.com/energy/2019-07/23/c\\_1124785910.htm](http://www.xinhuanet.com/energy/2019-07/23/c_1124785910.htm).

<sup>153</sup> Ma Shuping, (河北临漳治理“僵尸企业” 推动高质量发展) [Linzhang, Hebei Governs "Zombie Enterprises" to Promote High-Quality Development], XINHUA NEWS AGENCY (May 17, 2019, 2:13 PM), [http://www.xinhuanet.com/politics/2019-05/17/c\\_1124508008.htm](http://www.xinhuanet.com/politics/2019-05/17/c_1124508008.htm) (stating an enterprise “full of vitality like the apricot tree in front of the workshop”).

problems for redevelopments. It has been reported that land tends to be the main asset of many zombie companies but that it is also can be of low value and in remote locations.<sup>154</sup> It is possible that the elimination of zombie companies will require extensive land clearance,<sup>155</sup> and not all brownfield sites may be readily suitable for redevelopment.<sup>156</sup> One report of difficulties in the province of Hebei indicated that there had been difficulties with the land occupied by moribund enterprises in the Quang Binh Economic Development Zone, as reported by locals. The land had been “overgrown with weeds and became a paradise for pheasants and rabbits, and places for the masses to herd sheep.”<sup>157</sup> An example of dramatic redevelopment was in the transformation of coastal area, south of Beijing, from a “heavy chemical industrial zone” into a “green growth center” and tourist destination.<sup>158</sup> In another example, innovative land clearance methods were reported to have enabled the cleaning of land formerly occupied by a chemical factory.<sup>159</sup>

A further problem for land redevelopment that was discussed in some reports has related to legal difficulties. In some instances, there were ownership issues that impacted on the repurposing potential.<sup>160</sup> It also notable that property law issues have presented barriers to repurposing in some cases.<sup>161</sup>

<sup>154</sup> Zhang Chi et al., (死不了活不起，僵尸企业出清遇三堵点) [Can't Die, Can't Afford to Live, Zombie Companies Encounter Three Obstacles When Clearing Out], SOHU.COM (Jan. 18, 2020, 1:38 PM), [https://www.sohu.com/a/367667964\\_267106](https://www.sohu.com/a/367667964_267106).

<sup>155</sup> Cheng, *supra* note 151. Land redevelopment was one of the identified avenues for the future economy of Shanxi.

<sup>156</sup> (中国政协常委葛红林在两会发言时建议强力督导 多管齐下 加速出清“僵尸企业”) [Ge Honglin, member of the Standing Committee of the Chinese People's Political Consultative Conference, suggested strong supervision and multi-pronged approach to speed up the clearing of "zombie enterprises" in his speech at the two sessions], CHINA INDUSTRY INFORMATION DATABASE (Mar. 18, 2019).

<sup>157</sup> Fan Shihui, (河北广平盘活“僵尸企业”实现资源集约利用) [Hebei Guangping revitalizes "zombie enterprises" to achieve intensive use of resources], XINHUA NEWS AGENCY (Dec. 18, 2018), [http://www.gov.cn/xinwen/2018-12/18/content\\_5349991.htm](http://www.gov.cn/xinwen/2018-12/18/content_5349991.htm).

<sup>158</sup> Duan Yongliang, (渤海新区：打造沿海经济带绿色增长极) [Bohai New Area: Building a Green Growth Pole in the Coastal Economic Belt], HEBEI PROVINCIAL GOVERNMENT WEBSITE (Jan. 14, 2020), <https://news.sina.com.cn/c/2020-01-14/doc-iihnzhak3958510.shtml>.

<sup>159</sup> (从负债 16 亿元到扭亏为盈 大成农化土壤修复成效显著) [From debt of 1.6 billion yuan to turning losses into profits, Dacheng agrochemical soil restoration has achieved remarkable results], INFORMATION MORNING POST (Mar. 4, 2021), <http://finance.eastmoney.com/a/202103041830690666.html>.

<sup>160</sup> *Id.*

<sup>161</sup> Jia Qinyuan, (宁国经开区结合“四送一服”盘活“僵尸企业”) [Ningguo Economic Development Zone combined with "four get one server free" to revitalize "zombie enterprises"], CHINA INDUSTRY INFORMATION DATABASE (Aug. 18, 2020); (分割转让 司法拍卖 整体出租江苏金湖多部门多维盘活“僵尸企业”) [divided transfer, judicial auction, overall rental Jiangsu Jinhu multi-department multi-dimensional revitalization "zombie enterprises"]



ii. “Cages for Birds,” Impacts on Communities

The Shanxi transformation, discussed above, has been described as approach of freeing “cages for birds.”<sup>162</sup> This slogan has been commonly used in recent successful approaches to zombie companies and ongoing reforms, in particular in cases where there is large scale and complex repurposing of land and economic activities. It was often found in reports considered in the earlier research for this paper, although only found three times in the qualitative sample. An earlier internet search in February 2021 identified over thirty recent examples of news stories from different Chinese localities where the term was used in relation to zombie companies indicating that this complex pattern of land-use restructuring is common.

The term of “cages for birds”<sup>163</sup> is drawn from industrial restructuring and was coined in Guangdong Province to describe ambitious changes to land usage.<sup>164</sup> The land is the “cage” and industry is the “bird” and the term describes the transfer out of labor-intensive, low-end manufacturing and attraction of technology, capital-intensive, and service industries.<sup>165</sup> It is therefore a transformative and ambitious approach to restructuring of productive capacity in particular areas and it has not been without criticism.<sup>166</sup>

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overall lease of Jiangsu Jinhua, multi-sectoral and multi-division revitalization of "zombie enterprises"], CHINA INDUSTRY INFORMATION DATABASE (Mar. 4, 2020); Gao Haoliang, (江西: 2020 年底完成开发区“僵尸企业”处置) [Jiangxi: Complete the disposal of "zombie enterprises" in the development zone by the end of 2020], XINHUA NEWS AGENCY (Sep. 29, 2018), [http://www.gov.cn/xinwen/2018-09/29/content\\_5326670.htm](http://www.gov.cn/xinwen/2018-09/29/content_5326670.htm).

<sup>162</sup> See (山东法院 2020 年审结 1875 件破产案件 “僵尸企业” 出清助 “腾笼换鸟”) [Shandong courts concluded 1,875 bankruptcy cases in 2020, "zombie companies" cleared out to help "vacate cages for birds"], (Feb. 3, 2021), <https://www.chinanews.com/gn/2021/02-03/9403518.shtml>; Pang Yuwei, (临清市 破立之间动能涌) [Dynamic Energy Surges between Linqing City], LIAOCHENG DAILY (Feb. 20, 2021), <http://news.lcxw.cn/liaocheng/yaowen/20210220/886462.html>; Duan Yongliang, (渤海新区: 打造沿海经济带绿色增长极) [Bohai New Area: Building a Green Growth Pole in the Coastal Economic Belt], HEBEI PROVINCIAL GOVERNMENT WEBSITE (Jan. 14, 2020), <https://news.sina.com.cn/c/2020-01-14/doc-iihnzakh3958510.shtml>.

<sup>163</sup> “Téng lóng huàn niǎo” (腾笼换鸟)[Cage for Birds].

<sup>164</sup> In Guangdong’s case the term was coined in relation to the transfer of labor-intensive industries in the Pearl River Delta to the east and west wings and the mountainous areas of northern Guangdong. It was coined by Guangdong Provincial Party Committee Secretary Wang Yang on May 29, 2008 in the form of "Decisions of the CPC Guangdong Provincial Party Committee and Guangdong Provincial People's Government".

<sup>165</sup> “Téng lóng huàn niǎo”: Wéijī niándài de shēchǐ? (“腾笼换鸟” : 危机年代的奢侈) [“Cage for Birds”: Luxury in the Crisis Age?], BBC CHINESE (Mar. 16, 2009), [http://news.bbc.co.uk/chinese/simp/hi/newsid\\_7940000/newsid\\_7942500/7942594.stm](http://news.bbc.co.uk/chinese/simp/hi/newsid_7940000/newsid_7942500/7942594.stm).

<sup>166</sup> *Id.*

In the zombie company context, the term “cages for birds” is used to emphasize the optimal use of resources and creation of opportunities for new ventures to occupy the space created by elimination of zombie companies. An example is a story concerning the city of Yingtian, known as the Capital of Copper. This article discusses the modernization of this business sector,<sup>167</sup> as well as the development of a high-tech park specializing in the internet of things, alongside the optimization and integration of zombie companies and the freeing of a cage for birds.<sup>168</sup> These ambitious land repurposing projects illustrate an aspect of the creative destruction trajectory but existing controversies relating to “cages for birds” projects highlight the difficulties of restructuring on this scale and their potential impact on land-use and on workers. These restructurings are likely to present similar externalities to the restructuring of the Pearl River delta,<sup>169</sup> for example, where “cages for birds” reconstruction is more advanced and the negative impact on workers has been highlighted in research.<sup>170</sup>

### iii. Impact on Employees

It is notable that many zombie companies in China are in established industries and business is conducted by companies that are important local employers, so closure of the zombie company would present significant externalities at the micro level. China does not yet have a fully developed social security system<sup>171</sup> nor a personal insolvency system,<sup>172</sup> and a reflection of this

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<sup>167</sup> On more general modernization of the copper sector in this area, including elimination of zombie capacity see Frank Liu, *Copper Summit, Present Situation and Copper Application of Wire and Cable Industry in China*, SMM NEWS (Apr. 1, 2019), [https://news.metal.com/newscontent/100919710/\[copper-summit\]-present-situation-and-copper-application-of-wire-and-cable-industry-in-china](https://news.metal.com/newscontent/100919710/[copper-summit]-present-situation-and-copper-application-of-wire-and-cable-industry-in-china).

<sup>168</sup> Xu Huan, *Stimulate Vigorous Endogenous Motivation to Ensure Tangible Results*, YINGTIAN ONLINE (Aug. 30, 2019), <https://jxyt.jxnews.com.cn/system/2019/08/30/018572100.shtml>.

<sup>169</sup> See George C. S. Lin, *Metropolitan Development in a Transitional Socialist Economy: Spatial Restructuring in the Pearl River Delta, China*, 38 URBAN STUDIES 383, 387 (2001), <https://doi.org/10.1080/00420980120027429> (explaining that the Pearl River delta, in the south of China, has been one of the leading areas in economic development).

<sup>170</sup> On the impact on migrant workers see Xu Wang ET AL., *Economic Restructuring and Migrant Workers' Coping Strategies in China's Pearl River Delta*, THIRD WORLD QUARTERLY (forthcoming 2021), DOI: 10.1080/01436597.2021.1873763; on earlier impacts on workers from restructuring see John Giles ET AL., *How Has Economic Restructuring Affected China's Urban Workers?*, 185 CHINA QUARTERLY 61 (2006).

<sup>171</sup> See Ken Willis, *Seeking Balance, China Strives to Adapt Social Protection to the Needs of a Market Economy*, 55 FIN. & DEV. 20, 21 (Dec. 2018), <https://www.imf.org/external/pubs/ft/fandd/2018/12/social-protection-in-china-wills.htm>.

<sup>172</sup> Rebecca Parry ET AL., *Personal Insolvency in China: Necessities, Difficulties and Possibilities*, 46 BROOK. J. INT'L L. (forthcoming 2021).

is that employees' interests are given importance under the EBL 2006. A court in bankruptcy proceedings is required to guarantee the legitimate rights and interests of employees<sup>173</sup> and a company can only file for bankruptcy if it has an employee resettlement plan.<sup>174</sup>

The social impact of eliminating zombie companies in China, in the form of unavoidable social problems, could be damaging for the establishment of harmonious society. A social impact from the closure of many zombie companies is inevitable and could be a serious concern for China, especially for the cases with close connection with SOEs.<sup>175</sup> The considerations as to social stability and likely redundancies have tended to provide officials with the motivation to keep companies alive, their workers employed, and their pensions intact, especially for vulnerable groups. Han *et al.* suggest that the government should enhance the supervision of corporate social responsibility-oriented activities of zombie companies and take action to mitigate their economic damage.<sup>176</sup> It is believed that central and local government should engage in activities that assist zombie companies to undertake corporate social responsibilities, such as employment, social security, and environmental protection.<sup>177</sup>

Employee resettlement issues were one of the areas of greatest concern in the qualitative sample,<sup>178</sup> and they featured prominently in many of the reports considered, with some discussing detailed provision for employees. For example, the official guidance in Guangdong province regarding workers in zombie companies contains several points regarding employee resettlement including transfers, training opportunities, guaranteed loans, and subsidies to support entrepreneurship.<sup>179</sup> It is also laudable that programs to reduce capacity

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<sup>173</sup> Enterprise Bankruptcy Law of the People's Republic of China, art. 6 (2006).

<sup>174</sup> *Id.* at 8.

<sup>175</sup> Yui-Tim Wong, *Trust, Job Security and Subordinate-supervisor Guanxi: Chinese Employees in Joint Ventures and State-owned Enterprises*, 24 ASIA PACIFIC BUS. REV. 638 (2018).

<sup>176</sup> Shaozhen Han, Guoming Li, Michel Lubrano & Zhou Xun, *Lie of the Weak: Inconsistent Corporate Social Responsibility Activities of Chinese Zombie Firms*, J. CLEANER PRODUCTION (Apr. 20, 2020) at 1.

<sup>177</sup> Banerjee & Hofmann, *supra* note 17.

<sup>178</sup> On difficulties caused by earlier restructurings, *see generally* John Giles, Albert Park & Fang Cai, *How Has Economic Restructuring Affected China's Urban Workers?*, 185 THE CHINA QUARTERLY 61 (2006).

<sup>179</sup> (广东省人民政府关于全省国企出清重组“僵尸企业”促进国资结构优化的指导意见) [Guiding Opinions of the People's Government of Guangdong Province on the Reorganization of “Zombie Enterprises” by State-Owned Enterprises in the Province to

in the coal and steel industries have included a requirement for employee resettlement arrangements to be included in plans.<sup>180</sup> However the impact on individual workers may be life-changing. There may be a problem of “spatial mismatch” if other suitable opportunities for the skills that those made redundant possess are not available locally.<sup>181</sup>

An example of an area where there is potential for the zombie clearance policies to have wide impact is the Northeast region. This area is identified as having a high concentration of zombie companies, as well as having previously suffered notable increases in unemployment.<sup>182</sup> The northeast of China includes iron and steel industries and coalfield areas,<sup>183</sup> all sectors identified as having high numbers of zombie companies.<sup>184</sup> For example, in the province of Shanxi, a major coalfield area, it was reported in 2017 that 21,775 employees required resettlement.<sup>185</sup> One coal production firm in Shanxi noted a lack of

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Promote the Optimization of State-Owned Assets Structure], GUANGDONG PROVINCIAL PEOPLE’S GOVERNMENT (Apr. 14, 2016), [http://www.gd.gov.cn/gkmlpt/content/0/144/post\\_144876.html#7](http://www.gd.gov.cn/gkmlpt/content/0/144/post_144876.html#7); Shenzhen has established a corporate wage arrears protection fund: Mao Yizhu, (最高法院: 创新机制推动清理 “僵尸企业”)[Supreme Court: Innovative Mechanism Promotes the Cleanup of “Zombie Companies”], XINHUANET (Apr. 26, 2018, 8:02 PM), [http://www.xinhuanet.com/2018-04/26/c\\_1122749014.htm](http://www.xinhuanet.com/2018-04/26/c_1122749014.htm).

<sup>180</sup> Barry Naughton, *Supply-Side Structural Reform: Policy-Makers Look for a Way Out*, CHINA LEADERSHIP MONITOR, no. 49 (2016), <https://www.hoover.org/sites/default/files/research/docs/clm49bn.pdf>.

<sup>181</sup> April A. Herlevi, *Disposing of “Zombies”: Why the Reform of Non-Performing State-Owned Enterprises Has Gotten Even Harder*, THE JAMESTOWN FOUNDATION (Mar. 16, 2020, 2:19 PM), <https://jamestown.org/program/disposing-of-zombies-why-the-reform-of-non-performing-state-owned-enterprises-has-gotten-even-harder/>.

<sup>182</sup> Chuyi Wei, *Bailouts and Bankruptcy Law in China: A Confusion of Law and Policy*, 12 CAMBRIDGE J. OF CHINA STUDIES 51, 63 (2017) (discussing the example of Dongbei Special Steel located in the Northeastern province of Liaoning).

<sup>183</sup> Wang Qian, (2019 去产能发出僵尸企业 “出清令” 一揽子政策将出)[In 2019, a “Clearing Order” Package Will be Issued Regarding Zombie Companies], ECONOMIC INFORMATION DAILY (Feb. 1, 2019, 2:05 PM), [http://www.xinhuanet.com/fortune/2019-02/01/c\\_1124075339.htm](http://www.xinhuanet.com/fortune/2019-02/01/c_1124075339.htm).

<sup>184</sup> Sara Hsu, *Some of China’s Zombie Firms May Finally Die*, THE DIPLOMAT (Jun. 14, 2016), <https://thediplomat.com/2016/06/some-of-chinas-zombie-firms-may-finally-die/>; (2019 年钢铁煤炭去产能施工图敲定 确保 2020 年底前 “僵尸企业” 完成全部处置工作) [Construction Drawings for Steel and Coal Capacity Reduction in 2019 Are Finalized to Ensure that “Zombie Companies” Complete All Disposal Work Before the End of 2020], CHINA INDUSTRY INFORMATION DATABASE (May 13, 2019), <http://www.guiwangjiaoyu.com/html/chany/xny/2019/0510/524928.html>; (煤炭钢铁“僵尸企业”明年全部退出兼并重组进程加快)[Coal and Iron “Zombie Enterprises” Will Withdraw from Next Year and Accelerate the Process of Merger and Reorganization], CHINA INDUSTRY INFORMATION DATABASE (May 21, 2019), <https://xw.qq.com/cmsid/20190518A0DP1Q00>.

<sup>185</sup> Cao Jisheng, (去产能如何处置好僵尸企业? 山西职工转岗不下岗) [How to Deal with Zombie Companies? Shanxi Employees are Not Laid Off], PEOPLE’S DAILY (Jun. 5, 2017), <https://www.china5e.com/news/news-989984-1.html>. For anecdotal evidence of the

potential transfer jobs for employees, as well as a lower level of state financial support than would be required to compensate for the termination of the contracts of employees.<sup>186</sup> Another report suggested that there were limited opportunities for employee transfers and that it would be difficult to meet the needs of all.<sup>187</sup> Shanxi's range of industries has diversified in recent years,<sup>188</sup> as previously noted, and a positive picture has been presented in other reports with respect to employee opportunities.<sup>189</sup> Although some mines operated by a group in Shanxi have closed and some employees have retired, there have been employees transferred to other mines in the group; others given low-technical jobs outside the coal industry; and still others into emerging industries.<sup>190</sup> In this latter category are, for example, employees who have been reskilled and given employment in pharmaceuticals.<sup>191</sup> Others have been offered early retirement and self-employment opportunities.<sup>192</sup> A 2021 report indicated that 17,000 employees in the region had been resettled.<sup>193</sup> The statistics present a positive picture of a transition, aligned with creative destruction. This transition brings a reduction in capacity of old industries and the development of new activities and opportunities in their place. It must be added, however, that the social impact of this scale of restructuring and employee resettlement is again likely to have been significant.

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impact of closures *see* *Zombie Factories, Ghost Cities Haunt China's Shanxi Province*, NPR (Sept. 5, 2015, 8:00 AM), <https://www.npr.org/2015/09/05/437768119/zombie-factories-ghost-cities-haunt-chinas-shanxi-province?t=1614026835230>.

<sup>186</sup> Qian, *supra* note 183.

<sup>187</sup> (去产能发出僵尸企业出清令 加码处置人员安置难) [2019 Overcapacity Reduction Issued a Clearing Order for Zombie Companies], CHINA METALLURGICAL NEWS (Feb. 1, 2019), [http://www.csteelnews.com/xwzx/hgjj/201902/t20190201\\_1552.html](http://www.csteelnews.com/xwzx/hgjj/201902/t20190201_1552.html).

<sup>188</sup> Liang Xiaofei, *Shānxī: Cóng “Méi Lǎodà” Dào Néngyuán Gémìng Páitóubīng* (山西: 从“煤老大”到能源革命排头兵) [Shanxi: From “Coal Boss” to Pioneer of Energy Revolution--Shanxi Creates a New Situation of Transformation and Development], XINHUA SCIENCE AND TECHNOLOGY DAILY (Jul. 23, 2019), [http://www.xinhuanet.com/2019-09/03/c\\_1124956298.htm](http://www.xinhuanet.com/2019-09/03/c_1124956298.htm).

<sup>189</sup> Jisheng, *supra* note 185.

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

<sup>192</sup> *Id.*

<sup>193</sup> Liu Ruiqiang, *[Guóqǐ gǎigé sān nián xíngdòng] mùbiāo lùjìng gèng qīngxī chéngfēngpòlàng zhèngdàngshí* (【国企改革三年行动】目标路径更清晰 乘风破浪正当时) [[Three-Year Action for Reform of State-Owned Enterprises] The Target Path is Clearer and the Time is Right to Ride the Wind and Waves], SHANXI PROVINCIAL GOVERNMENT (Jan. 17, 2021), <https://news.sina.com.cn/c/2021-01-17/doc-ikftpnx8234934.shtml>.

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iv. Survival of the Fittest

It should not be thought, from the above analysis, that another impact of creative destruction of zombie companies is to bring about the demise of state-owned enterprises. Rather, as emphasized in eight of the media reports, the aim is to achieve a Chinese market economy that enables the “survival of the fittest.” SOEs still function as a crucial part of China’s economy, carrying great economic weight in the contemporary context. To date over 150,000 SOEs are active at the national and local level, with half of the listed companies under this control. These SOEs also seem to do relatively well in global competition: they control an astronomical \$690bn in assets abroad, with 47 centrally-owned firms ranked in last year’s Fortune Global 500.<sup>194</sup> These facts provide compelling reasons to think about the government’s involvement with SOEs’ operational policy, and its continuing roles in the socio-economic sense if they are seen as zombie companies. The unique mission and corporate responsibilities of SOEs will be discussed in further research in this project, in particular their pragmatic efforts to achieve and balance the commercial objectives and political/social agendas advocated by the governments.

## VII. CONCLUSION

This article has examined Chinese state efforts to tackle the legacy of zombie companies using a broad framing of creative destruction. This framing was selected since many of the enterprises that have been identified as zombie companies are in sunset industries, and their elimination has been accompanied by stories of renewal, technological advancement, and entrepreneurship. The article has discussed how macro state-level policies towards zombie companies have been implemented by local governments at the meso level, and the article has identified some likely impacts at the micro level on local communities and on workers. There have been complex examples of restructuring including tales of revitalization and ambitious restructurings with the slogan “cages being emptied for birds.” This trajectory parallels Schumpeter’s idea of new products, methods, and ways of organization acting as a force to bring changes in economic structures. In the case of China, these effects have been driven by entrepreneurial state policies that are part of wider supply-side reforms to the

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<sup>194</sup> Wendy Leutert, *China’s State Enterprise Reform: Bigger, Yes, But Better?*, BROOKINGS (Apr. 23, 2015), <https://www.brookings.edu/opinions/chinas-state-enterprise-reform-bigger-yes-but-better/>.

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industrial sector.<sup>195</sup> Although state policies set out market-driven criteria for zombie companies, it has been highlighted that at the meso level of implementation, the legal infrastructure of insolvency laws, Judges, and courts require further development.

This article represents a first attempt to identify how official state policies towards zombie companies are being implemented in ways that parallel creative destruction. Using original and multidisciplinary analysis, the article has demonstrated example narratives of reduction of reliance on old ways of doing things. Undoubtedly the downsizing of capacity in heavy industries, as well as the elimination of zombie companies according to an ambitious timetable, has impacted on communities and presented difficulties in employee resettlement and matching skills to new opportunities. It has also been noted that not all zombie companies leave behind sites that can readily be reused. There is a need for further research on zombie company outcomes and their impacts at the micro level on communities and employees.

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<sup>195</sup> Barry Naughton, *Supply-Side Structural Reform: Policy-Makers Look for a Way Out*, CHINA LEADERSHIP MONITOR, no. 49 (2016).