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Economic institutional evolution and further needs for adjustments: Township Village Enterprises in China

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Number

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**Economic Institutional
Evolution and Further Needs
for Adjustments: Township
Village Enterprises in China**

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Economic Institutional Evolution and Further Needs for Adjustments: Township Village Enterprises in China

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List of Abbreviations

TVEs: Township Village Enterprises

The CC of CPC: The Central Committee of Communist Party of China

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Abstract

Township Village Enterprises (TVEs) have essentially contributed to China's economic development and institutional transformation over the last twenty years. One of the explanations for the mechanism of TVEs' growth is the co-operative culture theory which claims that Chinese - compared with other nationalities - could better resolve "free riding problems" and work more efficiently under collective TVEs. In this paper, based on official documents, statistical data and results from important surveys, we analyze the historic development of property rights in TVEs. We have proved that the evolution of TVEs' property rights depended on the interaction between peasants and policy makers. In this interaction process peasants showed strong pursuit of private ownership and policy makers reacted with delay towards owner interests. Owing to the delay of political adjustments, peasants had to adopt various ownership forms for their enterprises - joint households, collective and shareholding cooperative - in order to struggle against a discriminating environment for private ownership. This institutional evolution is not a proof for the co-operative culture theory, but instead for the conventional theory of property rights because the long struggle of the peasants finally led to one clearly defined form of ownership - private property rights.

We have tested our hypothesis in view of the following process: In the collective economy under the commune system, policy-makers changed the size of owner units of TVEs from "big" (commune) to "small" (production brigade or production group) and back in accordance with the importance of TVEs to the national economy. In the individual economy after the reform of land use rights, the property rights of TVEs were forced to change step by step to private property rights under the pressure of farm households striving for private ownership. The peasants instrumentalized the various vaguely defined property rights in order to avoid political risks. Due to the "principal agent problem", the collective-owned TVEs went down despite political and financial support. The financial viability of private TVEs however grew in spite of their competition with collective-owned TVEs and severe political and financial discrimination.

With the evolution of property rights in TVEs, at present private enterprises dominate the non farm sector in China's rural areas. These structural changes require adjustments of China's financial policy: Formerly, formal financial institutions directed their support mainly towards collective enterprises, whereas private TVEs depended on informal capital sources. In order to meet private TVEs' financial demands, the rural financial market which officially is still dominated by formal financial institutions should be replaced with a financial market consisting of legally recognized multiform-intermediaries.

Kurzfassung

Township Village Enterprises (TVEs, ländliche Unternehmen) haben in den letzten zwanzig Jahren in erheblichem Maße zur wirtschaftlichen Entwicklung und institutionellen Transformation der Volksrepublik China beigetragen. Eine Erklärung für den spezifischen Wachstumsmechanismus von TVEs liefert die Theorie über den kooperativen Charakter der chinesischen Kultur, nach welcher Chinesen im Vergleich zu anderen Völkern das „free-riding“-Problem besser lösen und effizienter in kollektiven Unternehmen arbeiten können.

In dieser Arbeit wird anhand von offiziellen Dokumenten, Statistiken und Erhebungen vor Ort die historische Entwicklung der Eigentumsrechte in TVEs analysiert und nachgewiesen, dass die Evolution von Eigentumsrechten weniger vom kollektiven Charakter der Chinesen als vielmehr in entscheidendem Maße von der Interaktion zwischen den Bauern und den politischen Entscheidungsträgern abhängig war. In diesem Interaktionsprozess stand dem hartnäckigen Streben der Bauern nach Privateigentum jeweils eine zeitlich verzögerte, vom Eigeninteresse der politischen Entscheidungsträger geleitete Reaktion gegenüber. Aufgrund der verzögerten politischen Anpassungen waren die Bauern gezwungen, verschiedene Eigentumsformen (wie Joint-Familien-, Kollektiv- und Aktien-Genossenschaftsunternehmen) einzusetzen, um gegen ein die Privatunternehmen diskriminierendes Umfeld anzukämpfen. Diese institutionelle Evolution ist kein Beweis für die Theorie des kooperativen Charakters der Chinesen. Sie bestätigt vielmehr die Anwendbarkeit der konventionellen Theorie der Eigentumsrechte, da der lange Kampf der Bauern schließlich zur Einführung von Privateigentum führte.

Die aufgestellte Hypothese wird durch den im folgenden beschriebenen Prozess verifiziert: In der Kollektivwirtschaft unter dem Kommunensystem variierten die politischen Entscheidungsträger den Umfang von Eigentümereinheiten in Abhängigkeit von der Bedeutung der TVEs für die nationale Wirtschaft. Der Umfang schwankte zwischen großen Eigentümereinheiten (Kommunen) und kleinen Eigentümereinheiten (Produktionsbrigaden oder Produktionsgruppen).

Mit der Einführung der Individualwirtschaft nach der Reform der Landnutzungsrechte wurden die Eigentumsrechte in TVEs unter dem Druck der Bauern schrittweise in Privateigentum transformiert. Die chinesischen Bauern instrumentalisieren die nur vage definierten Eigentumsrechte zur Vermeidung politischer Risiken. Aufgrund des „Principal agent Problems“ verloren kollektive TVEs trotz der ihnen gewährten politischen und finanziellen Unterstützung an Bedeutung. Im Gegensatz dazu wuchs die finanzielle Überlebensfähigkeit privater TVEs trotz des Wettbewerbs mit den im Kollektiveigentum befindlichen TVEs und ungeachtet der gravierenden politischen und finanziellen Diskriminierungen.

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Einhergehend mit der Evolution der Eigentumsrechte in TVEs dominieren gegenwärtig private Unternehmen den nichtlandwirtschaftlichen Sektor in ländlichen Gebieten Chinas. Diese strukturelle Veränderung erfordert Anpassungen in der Finanzpolitik der Volksrepublik China: Bis heute lassen formelle Finanzinstitute ihre Unterstützung vornehmlich kollektiven Unternehmen zukommen, während private Unternehmen auf informelle Kapitalquellen angewiesen bleiben. Um zukünftig den Finanzbedarf privater TVEs zu decken, muss der ländliche Kapitalmarkt, der offiziell noch immer von herkömmlichen formellen Finanzinstitutionen beherrscht wird, durch einen Kapitalmarkt mit rechtlich anerkannten Multiform-Intermediären ersetzt werden.

1 Introduction

It is well known that in the last twenty years the growth of Township Village Enterprises (TVEs) has essentially contributed to China's economic growth, rural development and institutional transformation¹. In 1978, the number of TVEs amounted to 1.52 millions and in 1999, it had already reached 20.71 millions. In the same period, the number of workers employed in TVEs increased from 28.27 millions to 127.04 millions, and TVEs gross output value went up from 49.5 billion Yuan² to 1084.3 billion Yuan (Table 2).

In this paper we draw on the analysis of the historical development of China's TVEs and on the analysis of the relationship between the development of TVEs' property rights and political adjustment to discuss the ensuing institutional evolution and its hypothetical determinants. We argue that the development of China's TVEs and their property rights result from the strong and continuous pursuit of private ownership by peasants as well as from political adjustments where policy makers have gradually given up the principle of collective ownership under the pressure of peasants. Owing to the delay of political adjustments, peasants had to employ various legal forms of enterprises – collective or co-operative – to struggle against the unfavourable political environment for private enterprises and with this to avoid political risks.

¹ The results of statistical analyses by Lin and Liu show that four factors, namely fiscal decentralization, the agricultural responsibility system, state/private/foreign direct investments and non-state-owned enterprises played a key role for economic growth. With 14.2 %, the contribution of the non-state-owned enterprises was the greatest, whereas fiscal decentralisation contributed 3.62%, the responsibility system 3.72% and the investments 4.78% to economic growth. The entire contribution of the latter three factors was equal to the contribution of non-state-owned enterprises. Thus, the development of the non-state-owned enterprises was the most decisive factor for China's economic growth in the last 20 years (Lin and Liu, 2000, pp. 1-21). Other important contributions on this topic: Chen and He, 1996. Wing, 1999, pp. 115-137. Chen, 1998, pp. 29-55.

² In 1999: 8,3 Yuan = ca. 1 US\$.

2 Previous Research on the Developmental Mechanism of Township Village Enterprises (TVEs)

The dynamic development of TVEs has drawn wide scholarly attention to their development mechanism. Before the middle of 1990s, because collective enterprises³ were the most important kind of China's TVEs, research on developmental impetus of TVEs was basically centered around a discussion of the development of collective enterprises. In comparison with state-owned enterprises, the main reason for the growth of TVEs was thought to be the support by local governments. The reasons for local support were found to be an expected rise in tax income, the creation of jobs and a rise in personal income (Qian and Weingast, 1997). On the evaluation of participation of local governments in TVEs, early studies basically express the opinion that the support of local governments was an optimal institutional arrangement under the constraints of the given policy and in an imperfect market (Chang and Wang, 1994, Li, 1994, Zhao, 1997). Furthermore, some positivist studies tried to show differences in efficiency by comparing collective and private enterprises, albeit with differing results. Some researchers found no significant deviances in efficiency between public and private firms (Svejnar, 1990, Dong and Putterman 1997). Others concluded that non-collective firms were more efficient than collective ones (Zhang, 1997), whereas others proved that inefficiency possibly existed in public firms (Jin and Qian, 1998).

The second line of explanation for TVE's developmental impetus stems from theories of comparative advantage. These theories demonstrate that the positive development of TVEs after the reforms was caused by structural adjustments that induced a change from a system with focus on heavy industry to a focus on light industry. As TVEs in general belong to the category of labour-intensive light industry, they benefited from this shift in policy (Lin, Cai and Li, 1994). This set of theories also relates to regional differences in China. After the reform, one of the reasons for increasing regional differences was that TVEs in the industrially prospering regions developed faster than the other regions (Ito, 2002).

The third explanation for the impetus of TVE growth comes from theories on cultural factors. The first theory on cultural factors concentrated on collective enterprises. This strand of literature emphasizes TVE's inner organizational mechanisms rather than their relationship to local governments. The authors see collective enterprises as a cooperative organization between labourers. Drawing on their co-operative culture theory, Weitzman and Xu (1994) claim that Chinese could better work under unclear ownership than other nationalities because of the co-operative traits inherent to traditional Chinese culture. They substantiate their theory on the

³ There are three different ownership units for the „collective“: community / town, village and groups of individuals. In theory, Chinese collectives are in common ownership, all members of a given community have equal ownership rights.

development of rural enterprises (TVEs) with the help of game theory. As the basis of the game theory the authors assume that people have different approaches to resolve “free-riding problems” in a system of common property rights. Compared with other nations, the authors imply that Chinese people are better able to resolve “free riding problems” inside their respective groups and therefore work relatively more efficient in collective TVEs. This contravenes the conventional theory of property rights which asserts that only under clearly defined ownership one has an incentive to work and can achieve efficiency. The authors demonstrate that although the ownership of TVEs is unclear, TVEs’ economic growth and efficiency exceed those of China’s state-owned enterprises.

In the early 1990s, shareholding cooperative enterprises (*gu fen hezuozhi qiye*) evolved as an important ownership form among China’s TVEs. Since one part of the shares inseparably belonged to the whole enterprise in shareholding cooperative enterprises, this distinguished them from regular shareholding companies or cooperative enterprises. In their analysis of the differences between shareholding co-operative, conventional shareholding and conventional co-operative enterprises, Vermeer (1995) and Chen (1998) draw the conclusion that the Chinese have a co-operative nature. At about the same time, by looking at the shareholding cooperative enterprises, many authors projected the impact that this form of enterprises, as a new kind of ownership form, would have on China’s future ownership system. Putterman (1997) suggests that shareholding cooperative enterprises would become an important form for China’s future TVEs, a prognosis that is clearly based on the cooperative culture theory. Herrmann-Pillath and Kato (1996), through a discursive analysis of the structure of shareholding cooperative enterprises and their role in the transformation process, projected that shareholding cooperative enterprises would be a transitional ownership form.

In the later 1990s, especially in Southern Jiangsu, where in the past collective ownership provided the model for China’s TVEs, the property rights reform in TVEs created a variety of (private) company forms that became an important form of ownership for TVEs. In this process, shareholding cooperative enterprises lost their distinctive position as one important enterprise ownership form because in spite of their high prevalence only a small number of them had a real co-operative character (Zhang, 2001, p. 56). The historical development thus showed that shareholding cooperative enterprises indeed played only a transitional role within the organizational reforms. In view of the results of the reforms in Southern Jiangsu, both the theory on support by local governments as basis for the success of collective enterprises and the theory on cooperative culture as the main factor for the success of shareholding cooperative enterprises ultimately failed to explain the driving power behind TVE’s surprising development.

To prove our central thesis, in the study at hand we place a special emphasis on a combinatory analysis of empirical data and historical facts.

3 Evolution Process of TVEs Property Rights

3.1 The First Stage: Emergence and Development of the Collective Owned Enterprises in Rural Areas (1958-78)

China's rural collective industry emerged during the process of rural industrialisation in the late 1950s. Since 1958, with the "Resolution about the Set-up of People's Communes", which was passed by The Central Committee of Communist Party of China (The CC of CPC) people's communes were established in rural areas (The CC of CPC and the State Council, 1958). In this resolution rural industry was for the first time defined as an independent part of production tasks in the communes and no longer as secondary to agricultural production. In the course of the *Great Leap Forward* (1958-1959), industrial enterprises were set up and at that time named "five small industries".⁴ Out of political ostentation, industrial production in communes sacrificed a large amount of resources for high output. In the years after the *Great Leap Forward*, the rural industry in communes was adjusted, again redefined as sideline production, and downgraded to production groups. This strict policy clearly limited the development of the TVEs. In 1965, the policy on TVEs was changed, allowing production groups to unite in order to set up TVEs for large-scale production. Brigades were permitted to organize a small number of production groups to build up TVEs (The CC of CPC and the State Council, 1965). In the early 1970s, communes and brigades were encouraged to set up small factories manufacturing agricultural machinery and repairing tools in rural areas for speeding up agricultural mechanization (The Yearbook of Chinese Township and Village Enterprises 2000, p. 4).

During the Cultural Revolution (1966-1976), the urban state-owned big industry was not able to produce normally. This fact provided a possibility for rural enterprises to undergo an essential development, supported by the brigades who were allowed as owner and manager of enterprises. Consequently, the rural non state-owned industry became an ever more important component of the rural economy. The development of TVEs made the policy makers aware of the significance of TVEs. To support TVEs, the 'Township Enterprise Bureau in the Agricultural Ministry' was established in 1975. Since then, there has continually been a national administrative organ for rural enterprises in China⁵. In this period, TVEs grew rapidly, especially in those regions where agricultural productivity was high and per capita acreage of cultivated

⁴ "Five small industries" comprised steel production, coal-mining, artificial fertilizer production, cement production, and mechanical engineering (Li, 1985, p. 447).

⁵ In 1959, Mao delivered the speech "The industry in the commune has a great and bright future". In 1974, Mao's words "the industry of communes and brigades is full of promise" were published for the first time officially in "Henan Daily" (a province newspaper). An investigation into commune- and brigade-owned enterprises in one model commune in Henan Province was also published in the same newspaper. In 1975 it was published under the

land low. For example in Jiangsu Province, where the first model of collective TVEs was found, the industry gross output doubled between 1970 and 1975. In 1978, before the agricultural reform, rural non-state-owned enterprises made a large contribution to the gross industrial output (see Table 1). At that time, non-state-owned enterprises were still solely owned and run by collective units, namely commune, brigade and production group.

Table 1: Structural Change of the Industrial Ownership 1971-1986
(Proportion of Gross Industrial Output)

Year	1971	1975	1978	1980	1981	1982	1983	1984	1985	1986
State-Owned Enterprises	85.9	81.2	77.6	75.1	74.3	73.8	72.6	67.6	64.9	62.2
Urban Collective-owned Enterprises	10.9	13.7	13.7	14.4	14.1	14.2	14.4	15.9	15.5	15.3
Others				0.5	0.6	0.8	0.9	1.3	1.6	1.7
Rural Non-state-Owned Enterprises	3.2	5.1	8.7	10	11	11.2	12.1	15.2	18	20.8
Total= 100%										
Township enterprises (Commune and Township-owned)	50.2	51.2	55.5	53.9	53.8	53.8	52.4	50.5	45.1	42.2
Brigade Owned	49.8	48.8	44.5	46.1	46.2	46.2	47.6			
Village Enterprises								39.6	37.7	57.8
Enterprises below Village Level								9.9	17.2	

Source: Lin und Byrd, 1989, pp. 243-244.

3.2 The Second Stage: Emergence of Private Enterprises without Clear Political Support (1979-83)

Since 1978, various agricultural production responsibility systems⁶ were set up by peasants spontaneously in some of China's rural areas. Through the "Resolution on the Acceleration of Agricultural Development" (The CC of CPC, 1979), responsibility systems were introduced in more regions. This new economic policy promoted a diversified economy at the national level. In 1979, the State Council published a document titled "Regulations on Issues of Developing Commune and Brigade owned Enterprises (draft)" (The State Council, 1979, No. 170). This document did not only point out the importance of the development of TVEs for the

headline "A great and bright prospect" in "People's Daily". This increasing publicity for the subject was a proof for the strong political support for TVEs. (Chen, 1997).

⁶ Under the responsibility system for agricultural production, farm households received the land use rights from the collective via a contract, according to which they had to sell a portion of products to the state at a state-set price and pay land use fees to the collective.

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recovery of rural economy, but also initiated a series of policies promoting the development of TVEs. According to this document, banks were asked to grant TVEs a part of their available loans and 50% of state investment in poor areas should flow into poor communes and brigades to help them to set up TVEs. Despite this progress, the document still emphasised the following: “The development of commune and brigade enterprises is to reinforce the collective economy” (ibid., 427). This implies that the final goal of the policy was the transformation of the small collective (communes) into large collective ones. The commune and brigade enterprises were defined as the service sector of agricultural production.

In 1981, the State Council published “Some regulations on the realisation of the adjustment of the national economy in commune and brigade enterprises” (The State Council, 1981, No. 77). In this document the commune and brigade enterprises were defined as an important part of the rural economy. However, in order to carry out the adjustment policy, many small commune and brigade enterprises which competed for resources with the big urban industry were ordered to stop their production. Those enterprises which used local resources and were closely connected with the life of peasants or with agricultural production were allowed to continue their production. At that time, official policy on TVEs was unclear and provided only limited support. But under the relaxed national economic policy, the growth of commune and brigade enterprises gained momentum, and by 1983 TVEs contributed 12.1% to the gross industrial output (see Table 1). For the first time, the gross output value of TVEs exceeded 1000 billion yuan (Table 2). Policy was thereafter focused on emphasising the importance of TVEs in the rural economy.

Table 2: Contribution of TVEs to Rural Employment, Gross Output and Income 1978-1999

Year	Number of firms	Labor Force	Proportion of total rural labor in China	Gross Output Value	Proportion of total rural output	Per capita Income	Contribution of TVEs
	mill.	mill.	%	100 mill. yuan	%	yuan	%
1978	1.52	28.27	9.2	495.1	24.2	122.9	7.6
1979	1.48	29.09	9.4	552.3	n.a.	n.a.	n.a.
1980	1.42	30	9.4	656.9	23.5	166.4	10.1
1981	1.34	29.7	9.1	736.7	n.a.	194.5	n.a.
1982	1.36	31.13	9.2	846.3	30.4	n.a.	n.a.
1983	1.35	32.35	9.3	1007.9	24.4	272.91	
1984	6.07	52.08	14.5	1697.8	33.7	315.06	
1985	12.22	69.79	18.8	2755	43.5	350.1	24.6
1986	15.15	79.37	20.9	3583.3	47.7	374.68	n.a.
1987	17.5	88.05	22.6	4947.7	52.4	418.4	28.1
1988	18.88	95.45	23.8	7017.8	56	494	30
1989	18.69	93.67	22.9	8401.8	58	540.3	31.2
1990	18.5	92.65	22.1	9581.1	57.7	623.1	26.8
1991	19.08	96.09	22.3	11611.7	61.1	638.9	27.9
1992	20.92	106.25	24.2	17695.7	69.7	746	27.1
1993	24.53	123.45	27.9	31776.9	74.3	873	32.5
1994	24.95	120.18	26.9	45378.5	74.2	1144.8	31.8
1995	22.03	128.61	28.6	68915.2	77.2	1479.5	32.6
1996	23.36	130.58	29.8	77903.5	76.9	1813.3	34.2
1997	20.15	130.5	28.4	89900.6	78.5	1987.27	n.a.
1998	20.04	125.37	27	89534.33	60.8*		
1999	20.71	127.04	27.1	108426.1	63.8*		

Note: * means TVEs' share of rural total value-added.

Source: Data till 1997 stem from Lin and Yao, 1999, p.37. Data of the remaining years from "The Yearbook of Chinese Township and Village Enterprises", 2000.

With the beginning of the agricultural reform in 1978, the collective as production and operating unit dissolved step by step. The collective means of production were sold to or distributed among the households which also had contracts for the sideline production of the collective. The emergence of household economy provided the possibility to set up self-employed individual enterprises⁷ (ge ti hu). Thus, many joint households enterprises or other types of co-operative enterprises and individual enterprises were set up in the rural areas in this period. The share of brigade owned enterprises (on village level) in the total industrial output of TVEs rose from 44.5% in 1978 to 47.6% in 1983. At the same time, the share of commune and brigade enterprises decreased from 55.5% in 1978 to 52.4% in 1983. In 1983, there were more than 500,000 joint households enterprises (lian hu qiye) (The Yearbook of Chinese TVEs, 1978-

⁷ Contains 1 household, not more than 5 employees.

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1987, pp. 423-427). The increasing set-up of private enterprises is shown in Table 3. All enterprises where research was conducted fulfilled the required criteria of private enterprise, namely having more than eight workers and 50,000 yuan capital. Apparently, since 1978, the development of ownership forms of TVEs was ahead of policy-makers rather than following the course of official policy, because at that time, official policy only supported collective enterprises.

Table 3: Set-up Time of Private Enterprises in Several Investigated Regions

Regions	Anhui Province	Wenzhou and Shanghai	National scope, 20 villages in 11 provinces
Investigated households	5556	120	97
Year of investigation	early 1988 ^a	summer 1987 ^b	Late 1987 - early 1988 ^c
Years of existence	Percentage of Enterprises	Percentage of Enterprises	Percentage of Enterprises
over 9 years		9.35	
7-9 years		6.26	
over 5 years	6.62	19.79	25.8
3-4 years	34.82	43.76	40.2
1-2 years	58.72	20.84	34

Sources: ^a Agricultural Commission of Anhui Province, 7th June 1988; ^b Zhu, Qiuxia, 1990, p. 2;

^c Policy Research Office of the CC of the CPC, the office of the rural survey station, 1992, p. 359.

3.3 The Third Stage: Development of Private Enterprises with Political Toleration (1984-1988)

The process of transferring land use rights to individual households in rural areas was completed by the end of 1984.⁸ As a result, households became individual economic units. The emergence of individual economic units did not only stimulate the growth of agricultural production, but also provided a possibility for individual capital accumulation in the agricultural sector. Consequently, a new investment mechanism that transferred the surplus of the agricultural sector into the non agricultural sector was developed. This new investment mechanism stimulated the emergence of varied private enterprises on the basis of joint households enterprises and co-operative enterprises (hezhuo qiye) as well as on the basis of self-employed individual enterprises. The set-up of private enterprises put policymakers under pressure and made the change of property rights policy indispensable. In 1984, The CC of CPC approved the "Report on the Exploration of New Prospects for Commune and Brigade Enterprises" by the Ministry of Agriculture, Animal Husbandry and Fish Farming (The CC of CPC, 1984, No. 4). This document changed the official policy for TVEs. For the first time it defined the commune and brigade enterprises as "township and village enterprises". This change did not only respond to the demands of the ongoing rural organization reform where the

⁸ At the end of 1984, 99.15 % of the production groups vested the land use rights in the households (Zhu, 1997, p. 73).

communal units were changed into community units and brigade to village units, but also gave the definition TVEs a more territorial character which was independent from questions of ownership. *“The gradual transfer of commune and brigade enterprises to co-operative economic organizations and the emergence of enterprises with various kinds of property rights on a higher level than households and villages and the concentration of these enterprises in small towns and villages made the name change necessary”* (ibid., § 8) . In this document the definition of TVEs included:

- commune (community) and brigade (village) owned enterprises
- joint households enterprises whose owners are members of the commune
- self-employed individuals

In other words, TVEs were changed “from two wheels into four wheels”. Since then, they statistically included four types of rural enterprises of which two types were in fact private enterprises, namely joint households enterprises and self-employed individuals. Joint households enterprises contained more than one household and self-employed individual only one household. Joint households enterprises were politically treated as collective enterprises because the categories under which they were administratively registered belonged to the collectives. The most important issue here is that self-employed individuals were politically treated as a part of TVEs.

In 1984, the State Council published “Some Regulations on Self-employed Industry and Commercial Individuals in Rural Areas” (The State Council, 1984, No. 26). Although the terms “joint households enterprises” and “self-employed individuals” were used in these documents, the content implied the change of the political course towards private property rights for the first time. The relaxed policy had a positive impact on self-employed individuals. Their total number and the percentage of total TVEs increased enormously between 1984 and 1986. At the same time, their share of gross output rose equally high (see Table 4). In this period, the number of joint households enterprises decreased while their share of output increased.

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Table 4: Structural Change of TVEs Ownership 1984-1992

Year	in Numbers						
	Total	Township-owned Enterprises	Village-owned Enterprises *	Joint Households	Self-employed Individuals	Ratio of JH	Ratio of In
	(T)	(Co)	(Vi)	(Jh)	(In)	Jh/T	In/T
	in 10,000	in 10,000	in 10,000	in 10,000	in 10,000	%	%
1984	606.52	40.15	146.15	90.63	329.59	14.94	54.34
1985	1222.46	41.95	143.04	112.12	925.35	9.17	75.70
1986	1515.31	42.55	130.22	109.34	1233.20	7.22	81.38
1987	1750.1	42.01	116.27	118.75	1473.07	6.79	84.17
1988	1888.16	42.35	116.65	119.99	1609.17	6.35	85.22
1989	1868.63	40.57	113	106.94	1608.12	5.72	86.06
1990	1850.44	38.78	106.61	97.88	1607.17	5.29	86.85
1991	1907.88	38.16	106.01	84.86	1678.85	4.45	88.00
1992	2091.62	39.65	113.07	90.18	1848.72	4.31	88.39
	in Gross Output						
	Total	Township-owned Enterprises	Village-owned Enterprises *	Joint Households	Self-employed Individuals	Ratio of JH	Ratio of In
	(T)	(Co)	(Vi)	(Jh)	(In)	Jh/T	In/T
	100 million yuan	100 million yuan	100 million yuan	100 million yuan	100 million yuan	%	%
1984	1697.78	808.58	645.19	126.54	117.47	7.45	6.92
1985	2755.05	1160.59	913.05	245	436.41	8.89	15.84
1986	3583.28	1446.91	1109.39	314.14	712.84	8.77	19.89
1987	4945.58	1897.18	1460.45	446.23	1141.72	9.02	23.09
1988	7017.77	2666.96	2067.87	591.4	1691.54	8.43	24.10
1989	8401.81	3092.97	2489.29	682.03	2137.52	8.12	25.44
1990	9581.1	3431.61	2822.15	726.62	2600.72	7.58	27.14
1991	11621.69	4274.54	3445.28	755.47	3146.40	6.50	27.07
1992	17659.69	6466.39	5310.15	113.83	4769.32	6.31	27.01

* The number of village-owned enterprises includes group-owned enterprises.

Source: The Yearbook of Chinese TVEs, 1993, p. 145, 147.

The rapid growth in the number of self-employed individuals and co-operative enterprises was on the one hand due to the set-up of new enterprises and on the other hand due to the transformation of collective enterprises below village level into private running (or owning) enterprises. In the regions where research was carried out the speed of this transformation accelerated after 1984. According to Lin and Byrd (1989, p. 245), in most of the regions the enterprises owned by production groups disappeared step by step. Table 5 shows this privatization process after 1984.

Table 5: Change of the Ownership Structure in Two Counties (Proportion of the Industrial Output), 1983-1986

	1983	1984	1985	1986	1986 minus 1983
Nanhai County					
District and Town owned	32	35	43	40	8
Village (Brigade) owned	36	37	31	35	-1
Group (production team) owned	32	22	16	13	-19
Private		6	10	12	12
Shangrao County					
Commune and Town owned	43	47	43	32	-11
Village (Brigade) owned	41	30	22	18	-23
Group (production team) owned	16	1			-16
Private		22	35	50	50
hereof: jointly owned enterprises		17	23	27	27
self-employed individuals		5	12	23	23

Source: Lin and Byrd, 1989, pp. 245, 247. Year of investigation: 1987.

Between 1983 and 1986, self-employed individuals were quite important for the development of the new forms of ownership rights. According to the new law on self-employed individuals, they could become private enterprises. An investigation of 141 private enterprises in Wenzhou showed that 50% of the owners were originally self-employed individuals and small factory owners. If all traders or merchants were considered unregistered self-employed individuals (politically they were individual traders or commercial households (geti shanghu)), the above-mentioned share would be around 80% (Zhu, 1990, p.13). The political framework, however, still limited the development of private enterprises. As far as the administration was concerned, the category 'private enterprises' did not exist in the registrar's office of the department for industry and trade. There were only two categories for non-farmer economic units: firstly, collective enterprises with more than five employees, secondly self-employed industry and commercial individuals with five employees or less (The State Council, 1984, No. 26, § 7). In order to continue their businesses, these households had to conceal the real number of their employees which was difficult and illegal. The question is how these enterprises could be legalised. Obviously, an institutional need for a non-collective form of enterprises arose at that time. Policy-makers did not react promptly to solve this problem. Because of this delay of institutional arrangements, self-employed industry and commercial individuals had to find their own solutions for this problem. Nominally, they fell under the category of collective ownership by paying administration fees to collective enterprises or local governments which in turn allowed them to register as collective or co-operative enterprises. The so-called Wenzhou model, whose character is retained in the expression "carrying red hats", was typical for this practice. While the investigation of Wenzhou enterprises in 1987 showed that 71% of private enterprises were registered as collective ones and 29% as self-employed individuals (Zhu, 1990, pp. 16-17),

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an investigation in 97 enterprises in China (with sampling) revealed that 42.7% of private enterprises were “carrying red hats”. Among these 97 enterprises, 34.3% were registered as collective, 27.4% as co-operative and only 26% as private ones (Policy Research Office of The CC of CPC, The office of the rural survey station, 1992, p. 359).

There is no data available on how many enterprises with more than five employees existed at that time in other ownership forms in the national statistics. Nevertheless, enterprises on and below village level proved to be an essential part of the gross industrial output (see Table 1). In 1988, the enterprises on and below village level contributed 32% to the gross production output of the TVEs.

3.4 The Fourth Stage: Growth of Private Enterprises with Political Recognition (1989-1995)

The number and size of self-employed individuals increased the need for political and legal arrangements for private enterprises. In June 1988, State Council published a draft law on private enterprises called “Temporary Regulations on Private Enterprises” (No. 4). In this document, private enterprises were for the first time given a legal position as a part of the rural industry, but still only as a supplementary part of national economy. Half a year later, in January 1989, 39 clauses with detailed measures for carrying out the 1988 regulations were published by the Bureau for Administrative Management of Industry and Trade (The Yearbook of Chinese Economy 1990, pp. VIII, 36-39), which determined the performance of enterprises. As a consequence, since 1989 statistical data on private enterprises are available in China. In 1989, there were 90,500 private enterprises in rural and urban China. In the following years, the number of private enterprises increased continually (see Table 6). The statistical data, however, did not reflect this dramatic improvement, because many enterprises did not change their status immediately after this political change. Between 1989 and 1990, the number of employees in private enterprises went up only 3.8%, while in 1990 and 1991, it rose to 8.0%. At that time, the widely acknowledged Yearbook of Chinese Township and Village Enterprises still had not provided independent statistics on private enterprises in rural areas. Joint households enterprises were listed under “collective owned co-operative enterprises”. The statistical category of self-employed individuals actually included those with less *and* more than eight employees.

Table 6: Development of the Private Enterprises in Rural and Urban Areas 1989-1997

Year	Private Enterprises	Employees in private enterprises	Growth rate of the number of enterprises	Growth rate of employees	Taxation of private enterprises	Growth rate of Taxation
	10,000	10,000	%	%	100 million Yuan	%
1986					50	
1987					70	40.00
1988					92	31.43
1989	9.05	164			132	43.48
1990	9.81	170.2	8.4	3.8	145.7	10.38
1991	10.87	183.89	10.8	8.0	179	22.86
1992	13.96	231.84	28.4	26.1	203	13.41
1993	23.79	372.63	70.4	60.7	293	44.33
1994	43.22	559.44	81.7	50.1	350	19.45
1995	65.5	956.00	51.6	70.9	436	24.57
1996	81.9	1171.13	25.0	22.5	448	2.75
1997	96.07	1349.26	17.3	15.2	540	20.54

Source: China Individual Labors Association, 1997.

After 1992, as the Chinese economy came out of its recession and the government once again attached importance to economic growth, the growth of private enterprises was essentially accelerated. Table 7 illustrates that the growth rate of employees in rural private enterprises mostly increased between 1993 and 1995. In these three years, the number of township and village private enterprises went up by 70.4%, 81.7% and 51.6% per year. The growth rate of employees in enterprises of self-employed individuals was considerably lower than that in private enterprises, implying that many self-employed individuals immediately reregistered themselves as private enterprises after having reached a certain scale. Table 7 likewise shows the positive effect of the development of rural private enterprises on China's institutional framework. In 1990, the percentage of employees in *rural* private enterprises reached 66.47% of total employees in private enterprises, and 70.83% of the self-employed individuals worked in rural areas. These figures prove that before 1990, China's rural areas were the region with the fastest development of private economy, especially of private enterprises. Later, after policy sanctioned the development of private economy, the growth rate of urban private enterprises and self-employed individuals was faster than that of rural enterprises so that the percentage of employees in *rural* private enterprises and self-employed individuals of total employees dropped gradually. This is an evidence for the contribution of TVEs in China's institutional transformation.

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Table 7: Change of Employment in Private Enterprises 1990-1999

Year	Urban Areas				Rural Areas					
	Private enterprises		Self-employed individuals		Private enterprises		Self-employed individuals		Rural share of total private Enterprises	Rural share of total self-employed individuals
		Growth rate %		Growth rate %		Growth rate %		Growth rate %		
	10000		10000		1000		10000		%	%
1990	57		614		113		1491		66.47	70.83
1991	68	19.30	692	12.70	116	2.65	1616	8.38	63.04	70.02
1992	96	41.18	740	6.94	134	15.52	1728	6.93	58.26	70.02
1993	186	93.75	930	25.68	187	39.55	2010	16.32	50.13	68.37
1994	332	78.49	1225	31.72	316	68.98	2551	26.92	48.77	67.56
1995	485	46.08	1560	27.35	471	49.05	3054	19.72	49.27	66.19
1996	620	27.84	1709	9.55	551	16.99	3308	8.32	47.05	65.94
1997	750	20.97	1919	12.29	600	8.89	3522	6.47	44.44	64.73
1998	973	29.73	2259	17.72	737	22.83	3855	9.45	43.10	63.05
1999	1053	8.22	2414	6.86	969	31.48	3827	-0.73	47.92	61.32

Source: China Statistical Yearbook 2000, pp. 136-137, own calculation.

In this period, two positions emerged with regard to ownership diversification. On the one hand, after the announcement of the new policy private entrepreneurs still kept their observing - or even skeptical - attitude towards this policy. On the other hand, in the development process of private enterprises, the entrepreneurs faced the problem of accumulating capital. In order to solve this problem they built shareholding enterprises. The size of shareholding enterprises normally equals the size of several self-employed individual or private enterprises. Following this business strategy also meant less political risk for the entrepreneurs. At the end of 1987, 22,833 of such shareholding enterprises were counted in Wenzhou prefecture.

Under these specific circumstances, the form of “shareholding co-operative enterprises” emerged in China. This name was used for the first time by peasants. The set-up of private shareholding enterprises became a new challenge for the policy-makers. In 1990, “Temporary Regulations on Shareholding Co-operative Enterprises” were announced by the Ministry of Agriculture (The Yearbook of Chinese Agriculture, 1991, pp. 507-508). From 1992 till 1994 the Ministry for Agriculture and the Chinese Central Government published several documents on shareholding co-operative enterprises. Enterprises owned by more than three farm households or enterprises set up through a co-operation contract were defined as shareholding co-operative enterprises. According to the new regulation, these enterprises had to keep a certain part of their profits back for undivided reinvestments (a de facto capital accumulation which was like a kind of collective share), and moreover, they had to take social responsibility and pay some social contributions. Although many of the shareholding co-operative enterprises were in reality private

enterprises, they were considered as collective enterprises in the official definition because the government sought to maintain the idea of collective ownership. Peasants who wanted to extend the size of their enterprises had to accept this definition. But they never stopped demanding to regain the name of *private* enterprises.

At the same time, shareholding co-operative enterprises developed also from enterprises which were transformed from collective enterprises. The development of various forms of private rural enterprises made the institutional reform of large-scaled collectively-owned town and village enterprises necessary. The competitive pressure forced these enterprises to conduct reforms in management and ownership, with the establishment of the responsibility system as a concrete reform measure. The set-up of the agricultural production responsibility system in non-agricultural TVEs since 1984 was a spontaneous process that moved from lower levels to higher ones (from peasants to policy makers). According to a research conducted by the Institute of Rural Development of the Chinese Social Academy in 1989, a large share of collective-owned town and village enterprises was already at that time run jointly or individually by managers with a contract (see Table 8). Under these circumstances, the Ministry of Agriculture published the "Regulation on the responsibility of the town and village owned enterprises" in 1990 (ibid., 1991, pp. 508-511) and acknowledged politically the separation of ownership and management rights, making clear that individuals were allowed to run collective-owned enterprises on the basis of contracts.

Table 8: Share of the Responsibility Contracted Enterprises in Five Counties

County	Run by managers with contract	Run by individuals with contract	Shareholding	Number of investigated enterprises
	%	%	%	
Chixi	32.54	25.4	5.56	126
Linhai	20.63	22.22	53.17	126
Ouhai	12.7	9.52	26.04	126
Qionglai	11.9	31.75	1.59	126
Changshou	15.87	31.75	1.14	126

Source: Zhang, 1993. Investigated in 1989.

The responsibility system provided the possibility that managers running the enterprises on the basis of contracts could change the collective enterprises into collective *and* private owned shareholding enterprises through reinvestment of the profits gained under the responsibility system. Sometimes the employees also took part in the investment in these collective owned and managers run enterprises. Since the collective possessed shares of the legal person (*fa ren gu*) or individual shares of employees and manager of collective enterprises (*gong ren gu*), these shareholding enterprises were called shareholding co-operative enterprises. According to an investigation of the author in Wenzhou and Yuanping, shareholding co-

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operative enterprises mainly consisted of two forms. One form was jointly established by private entrepreneurs. These private joint enterprises were registered as shareholding co-operative enterprises. The other form was transformed from collective enterprises run with contracts under the responsibility system, and the managers who had run the enterprise on contract basis became the main shareholder of the enterprise (Zhu, 1998). Thus, in the period from 1991 till 1994, many regions employed the shareholding co-operative enterprise as the main form in the property rights reform of collective-owned enterprises. The political background for this was that the governments of each level considered the shareholding co-operative enterprise as a basis of rural common ownership in the beginning period of socialism (Wen, 1998; Zhang, 1998). Influenced by the encouraging policy towards shareholding co-operative enterprises, 1,328,000 of China's TVEs applied for the shareholding co-operative form till 1993 and their share amounted to 8.74% of all rural collective enterprises (Lu, 1997, p. 5). In many cases the collective share was high, so that the local governments still had control over the enterprises.

Although politically, shareholding co-operative enterprises and joint households enterprises were defined as collective enterprises under common ownership, statistically they were distinct from the town and village owned enterprises which were *mainly* owned by the collective. The "Law on Private Enterprises", the "Regulation on Shareholding Co-operative Enterprises" and the property rights reform of collective enterprises all changed the institutional conditions for private enterprises and proved favorable to the high growth rate of private enterprises. In 1995, the share of non-town-and-village-owned enterprises (these were private enterprises in practice) of gross output value reached 39.5% (s. Table. 9).

Table 9: Structural Change of TVEs Ownership (Gross Output Value) 1985-1995

Year	Total TVEs (Y)	Township- owned Enterprises	Village-owned Enterprises	Ratio of t t/Y	Ratio of v v/Y	Ratio of Others
		(t)	(v)	(tp)	(vp)	1-tp-vp
	100 million yuan	100 million yuan	100 million yuan	%	%	%
1987	4764.3	1825.9	1411.6	38.3	29.6	32.0
1988	6495.7	2438.5	1924.2	37.5	29.6	32.8
1989	7428.4	2672.9	2182.7	36.0	29.4	34.6
1990	8461.6	2987.4	2441.8	35.3	28.9	35.8
1991	11621.7	4274.5	3445.3	36.8	29.6	33.6
1992	17975.4	6649.3	5450.5	37.0	30.3	32.7
1993	31540.7	10787.8	9572.5	34.2	30.3	35.4
1994	42588.5	15040.9	13825.1	35.3	32.5	32.2
1995	68915.2	21400.9	20310.4	31.1	29.5	39.5

Source: Statistical Yearbook of China, 1996, p. 389, own calculation.

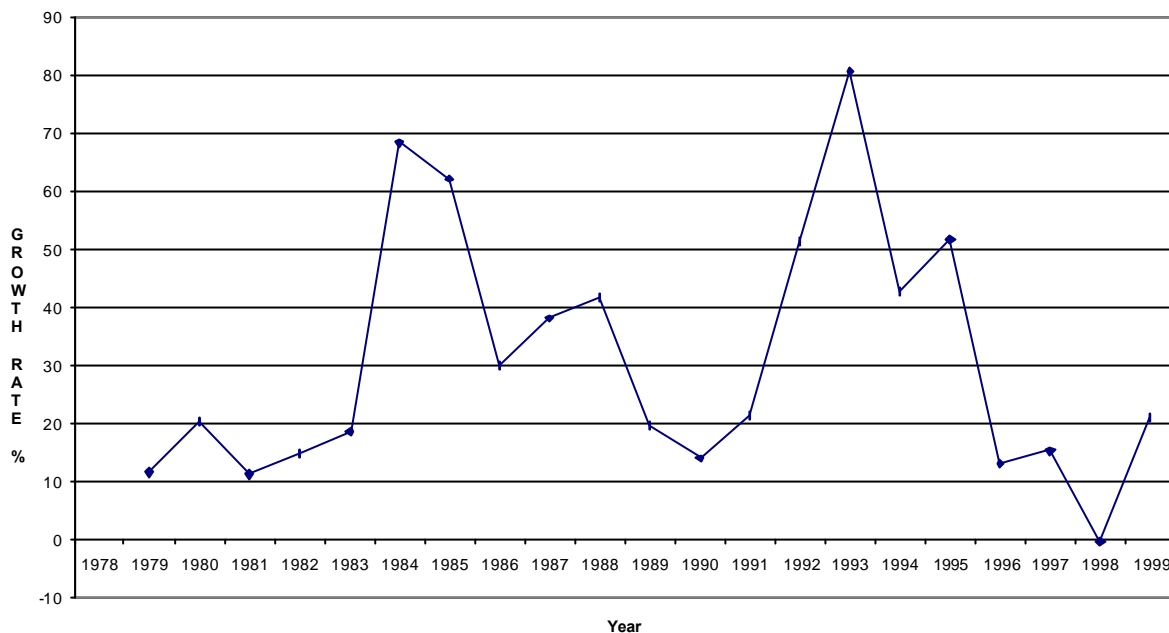
3.5 The Fifth Stage: The Last Stage of Property Rights Transformation (1996-2000)

The ownership rights reform of China's collective TVE's began in 1984 together with the agricultural reforms. Since 1984, a privatization was brought about through conversion of collective enterprises into individual or self-employed enterprises. Due to the comparatively slow pace of ownership rights reform for collectively owned enterprises on township and village levels, regional differences in grade and intensity of reforms emerged. In regions with more private enterprises pressure on the collective enterprise system was high and reforms came about earlier. In regions where collective enterprises were stronger ownership rights did not undergo complete reforms. Even though in the period between 1991 and 1994 a lot of collective enterprises were transformed into shareholding co-operative enterprises, in some regions collectively held shares still prevailed. The collective as the major shareholder still kept all management rights, and decisions on personnel remained with the local governments. Thus, problems concerning the managing mechanism for this kind of enterprises remained unsolved because of the continued political support for collective ownership in collective shareholding enterprises within this first stage of TVE property rights reform. According to Zhang (1998, p. 302), the development of Shareholding Co-operative Enterprises (SCEs) has led to a merger of local government and enterprises, especially at the township and village level where they both acted as political institutions and fully fledged economic actors. Ironically, this contradicts one of the original aims of the property rights reforms, namely separating administrative functions from enterprises management.

Under the pressure from private enterprises the collective enterprises encountered harsh difficulties. After 1996, the growth rate of TVEs shrunk drastically, from 49.3 % growth rate in 1995 to 21% in 1996, to 17% in 1997 (see Figure 1) because the growth rate of collective TVEs declined dramatically. At the same time, after 1995, losses of collectively owned TVEs rose quickly. Losses of Chinese TVEs rose from 47.4 billion yuan in 1995 to 80 billion yuan in 1997, i.e. a 70 % increase (Economic Daily, 12/4/1998), reaching 113.5 billion yuan in 1999 (The Yearbook of Chinese TVEs, 2000, p. 13). According to the results of a survey, with the losses of collective enterprises which were above those of private enterprises, unreformed enterprises had higher losses than reformed ones, while the collective ownership form was reported to be the main reason leading to losses of collective TVEs (Ge, 1998). It was precisely high losses of TVEs that forced these enterprises to push forward the property rights reform. In the summer of 1996, the author discussed problems of local TVEs with peasants in Northern Jiangsu. Peasants used the metaphor "cadres' hens" for the local TVEs - as long as "the hen still lays eggs", the local government could not sell it. Only if "the hen won't lay any more eggs", it could be sold. This vividly explains the reason why local TVE's had not been reformed until then. Especially in those regions where collective TVEs prevailed, for example in Jiangsu's Sunan region, property rights reforms had to be carried out.

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Figure 1: Growth Rate of TVEs Gross Output



Source: Data till 1997 stem from Lin and Yao, 1999, p.37. Data of the remaining years from “The Yearbook of Chinese Township and Village Enterprises”, 2000.

In the beginning of the reform, Jiangsu province was the strongest collective TVE-province in the country. The reason for losing this leading position after 1994 was the strong position of collective TVEs in comparison to private and individual enterprises in this province. In 1996, profits of TVEs in Jiangsu province, well-known for their collective character, fell back behind Zhejiang, Shandong and Guangdong, taking the fourth place. The most important reasons for this development were the unsettled management situation and property rights. Even though management forms on leasing or contract base as well as other management forms were adopted, their competitiveness sank because they still could not change phenomena such as “the manager assumes responsibility for profits, but not for losses” (Chu, 1998). Those companies who had already transformed into shareholding co-operative enterprises had to sell their collectively held shares and diminished the collective shareholding ratio further.

Between 1996 and 1997, the reform of TVE’s property rights reached a high tide.⁹ In 1996, there were 3,000,000 of all different forms of shareholding co-operative enterprises, among them 143,500 formed through collective enterprise reforms (making up 9.3 % of total TVEs). In 1996, 41.6 % of Shandong’s collective enterprises were transformed into shareholding co-operative enterprises; 32.8 % in Jiangsu and 25.9 % in Zhejiang and roughly 20% in Guangdong (The Yearbook of Chinese TVEs 1997, p. 299). Although the function of

⁹ On this transformation process see Li and Rozelle, 2000, pp. 241-252; Nan and Ye, 1998, pp. 1-28.

shareholding co-operative enterprises in the transformation process varied greatly from place to place and phase to phase, it was not the main form of enterprises. Other forms of enterprise transformation were equally implemented such as forms of leasing, selling, contracting or other forms of direct privatization. Table 10 presents survey results from Zhejiang and Jiangsu. They show that leasing and selling were the main transformation methods. The ratio of shareholding co-operative enterprises in the Suzhou district was 6.72% of all transformed enterprises, in Jiaxing and Shaoxing 13.3% and 11.7% respectively.

Table 10: Ownership Forms in a Few Regions in Jiangsu and Zhejiang Province

Forms	Jiangsu						Zhejiang			
	Suzhou			Wuxi			Jiaxing		Shaoxing	
	Number	Ratio %	Share (S) Assets (A) 100mil. yuan	Number	Ratio %	Share(S) Assets (A) 100mil. yuan	Number	Ratio %	Number	Ratio %
Shareholding co-operatives	855	6.72	S: 29.7	2834	26.55	S: 51.05 A: 16.39	815	13.3	583	11.7
Shareholding Company	7	0.05								
Limited company	520	4.09					42.4	6.9	428	8.6
Leased	6176	48.53	A: 45	2273	21.29	A: 40.38	3182	51.2	2364	47.5
Sold	729	5.73	A: 15.5	3794	35.54	A: 8.93	665	10.8	818	16.4
Merged	239	1.88					311	5.1	151	3
Leased and Sold				170	1.59					
The responsibility on the pledge	4200	33		987	9.25					
The responsibility with the additional value									443	8.9
Enterprise Group	368		A: 368	309		A: 129.77*	385		115	
Enterprise with foreign capitals	3944		FDI 100 USD	n.a.			519		n.a.	
Others							741	12.1	186	3.7

* = only the assets of core enterprises

Source: Lu, 1997, p. 5.

In 1996, the number of shareholding of co-operative enterprises dropped by 21.35% from the previous year even though in the same time, the total number of TVEs increased by 6 % (The Yearbook of Chinese TVEs, 1997). In the years after 1996, TVEs ownership rights reform underwent further developments. From 1.5 million TVEs, 80% had already accomplished a reform of their property rights. Possibly most of those companies that implemented a shareholding co-operative system in reality were based on capital shares, not worker shares (Zhang, 2001, p. 56).

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In the last phase of ownership rights reform in collective enterprises, a heterogeneous enterprise ownership system finally took shape, in which limited liability and responsibility system enterprises as well as shareholding enterprises gradually became the more important forms (Lu, 2001, pp. 15-23). This development is shown in Table 11. In a further step of shareholding co-operative enterprise reform, collectively hold shares were sold by and by to the managers. After these managers became principal shareholders, the actual property rights and control/monitoring rights were transferred from the collective to individuals.

Table 11: The Ownership Forms after Property Rights Reform in Wujiang City, Jiangsu Province

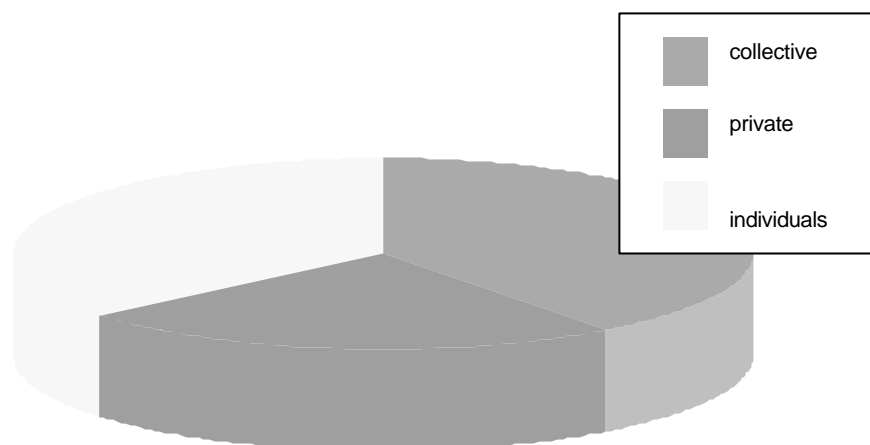
Before reform						
	Responsibility	Leased	Collective trust		Others	Total
Shengze town	11	2	6		1	20
Qidu town	4	1	5		0	10
Total	15	3	11		1	30
After reform						
	Limited Liability	Share-holding	Self-employed individuals	Shareholding co-operative	Others	Total
Shengze town	11	2	6	0	1	20
Qidu town	3	5	1	1	0	10
Total	14	7	7	1	1	30

Note: Investigated time: July 2000; the total number of enterprises in Shengze town is 700; the article does not mention the total number in Qidu.

Source: Lu, 2001, p. 23.

According to 1999 statistics, among China's TVEs non-collectively owned enterprises, i.e. individual and private enterprises both surpassed collectively owned enterprises in their number and added value quotas (Figure 2). Until the end of the 90s, the results of property rights reforms gave private enterprises the leading position instead of collective-owned TVEs.

Figure 2: Structure of TVEs Ownership 1999 (Proportion of Value-added)



Source: The Yearbook of Chinese TVEs 2000, p. 11.

3.6 The Changes of the Statistical Definition of China's Rural Enterprises

In the statistics, between 1978 and 1983, only commune and brigade enterprises were registered. In 1984, after the rural administrative system reform, when the communes had been transformed to communities or townships (xiang zhen) and the brigades to villages, the commune- and brigade-owned enterprises were newly defined as TVEs.¹⁰ Apart from the township- and village-owned collective enterprises, other co-operative, joint, shareholding or private enterprises in the rural areas were registered under the definition of TVEs. Self-employed individuals and private enterprises were clearly legally and statistically defined.¹¹ Although the statistical definition included other non-collective ownership forms for enterprises, a specific law on private enterprises was lacking so that private enterprises were not separately registered. In 1988, with the “Law of Private Enterprises” private enterprises obtained a legal position, but not before 1989 were there statistics on private TVEs in China.

In 1991, the Ministry of Agriculture published the “Regulation on Farmers’ Shareholding Co-operative Enterprises”. Driven by this regulation, many private joint enterprises registered themselves as shareholding co-operative enterprises.¹² From that time, statistical data on co-operative enterprise were published.

¹⁰ In 1984, the CC of CPC approved of the suggestion by the Ministry of Agriculture, Animal Husbandry and Fish Farming to rename the commune and brigade enterprises in township and village enterprises (see The CC of CPC and the State Council, March, 1984).

¹¹ Self-employed individuals who employ more than seven workers were private entrepreneurs (see The State Council: A few regulations about self-employed individuals, Feb. 27, 1984).

¹² A field study demonstrated that private rural enterprises were registered in two forms: private enterprises and shareholding co-operative enterprises (Zhu, 1998, p. 65).

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In 1996, the announcement of the law on TVEs contained more strict regulations on the statistical size of self-employed individuals and private enterprises. In 1997, according to the law on TVEs, the Ministry of Agriculture adjusted the statistical methods for TVEs which now included the two categories of collective and private enterprises (Chen, 1997).

The category of collective enterprises consisted of:

- collective enterprises
- enterprises with control of shares owned by the collective
- shareholding enterprises, co-operative enterprises, shareholding co-operative enterprises and joint ventures, **all with legal rights to control shares owned by the collective.**

The category of private enterprises consisted of:

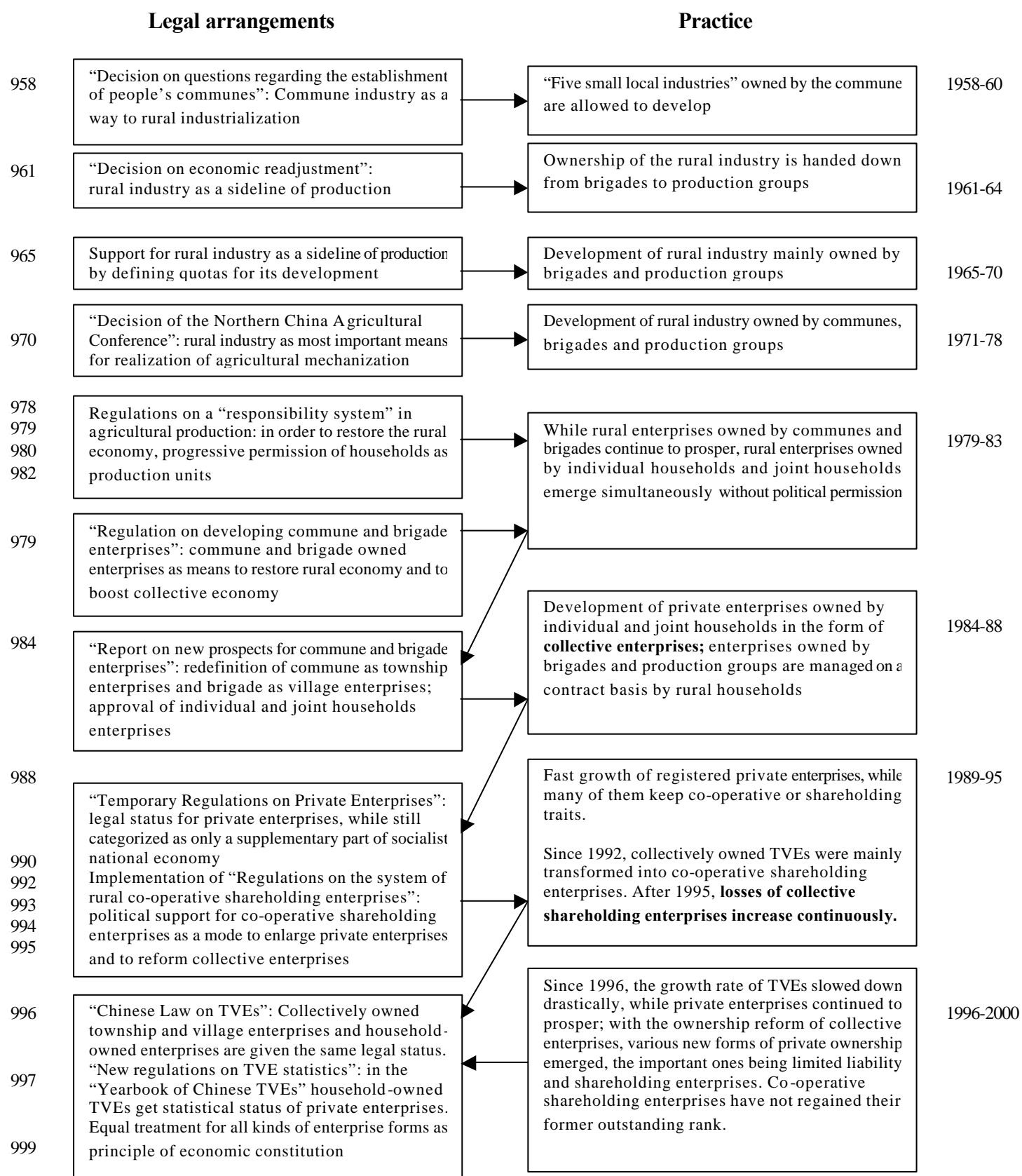
- private enterprises
- private co-operative (joint) enterprises
- private limited liability companies
- shareholding enterprises, co-operative enterprises, shareholding co-operative enterprises and joint ventures, **all with legal rights to control shares owned by private individuals.**

In 1998, TVEs were for the first time statistically reported in three categories in the Yearbook of Chinese TVEs, namely collective-owned enterprises, private enterprises and individuals.

3.7 Summary of the Evolution Process of Property Rights in TVEs

Between the end of the 1990s and the beginning of the 2000s the property rights reform of TVEs achieved a structural change where the dominating collective ownership in TVEs was replaced by private ownership. This evolution was an outflow of a long interaction between policy makers and peasants. Figure 2 illustrates the analysis of the historical development of political regulations on TVEs and its interaction with practice.

Figure 3: Interaction between Legal Arrangements and Practice



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At the outset, rural collective enterprises developed with political support under the planned economy system. Characteristic for the development of legal arrangements about TVEs' property rights was the following procedure: Policy-makers granted TVEs "big" collective ownership, e.g. commune ownership, if they considered the development of TVEs important for their political aims or for the national economy. Alternatively, they decided to grant "small" collective ownership to TVEs if they regarded TVEs as less significant, e. g. at the time of economic adjustment when TVEs' ownership was downgraded from commune to production group ownership. From 1958 to 1978, under the collective economy, the practice always followed after legal arrangements had been made.

After the reform of land use rights (introduction of the responsibility system in agricultural production), the property rights policy for TVEs was forced to change under the pressure of households striving for private ownership. The establishment of private enterprises by self-employed individuals with over 5 and up to 7 employees, the development of joint households enterprises carrying "red hats" (collective enterprises) and the reformation of collective-owned enterprises to shareholding co-operative enterprises showed the failings of policy-makers to keep up with the actual development as well as the intensity of peasants' pursuit of private ownership.

4 The Role of Rural Banks for TVEs' Economic Performance and Financial Viability of Private TVEs

As a result of the evolution of the property rights of TVEs, private enterprises have since taken the leading position in the rural non farm sector. This privatisation process has essentially changed the economic environment for TVEs and requires new policy to adjust the rural bank system to TVEs.

4.1 Development of Private TVEs under Financial Discrimination by Formal Financial Institutions

The analyses of the history of TVEs shows that private TVEs developed from two original types, namely originally private TVEs (self-employed individuals, joint households enterprises) and TVEs transformed from collective-owned enterprises. The original private TVEs were set up by farm households. Farm households had extreme difficulties to obtain capital to set up private enterprises. Firstly, owing to 40 years of collective economy, farm households did not possess any assets. In 1986, each farm household possessed a fixed productive capital of 940.5 yuan, 28.9% of that were work animals.¹³ Secondly, in the agricultural reform 1978-1984, only land use rights were transferred to farm households, whereas the collective land ownership remained unchanged. Chinese farm households could not put up their land as security on the loan from banks in the way farmers do in other developing or transforming countries.¹⁴ Thirdly, formal financial institutions dominated the financial market in China. They worked on the will of local governments and discriminated private enterprises (see Table 12). Although private enterprises and self-employed individuals only had a small share of credit, they contributed a big share to industrial gross output. A recent study shows that in the past 20 years, the loans of private TVEs from formal financial institutions amounted to only 20% of their total capitals (funds) (Zhang and Zheng, 2002).

Thus, in the early reform period, many private TVEs could only acquire capital by self-financing, savings and by lending money from relatives, friends or through informal financial intermediates in the informal financial market. In this situation, some farm households or self-employed individuals united to enlarge their own capital which they needed to set up an enterprise. Consequently, the form of joint households enterprise was preferred at the beginning of TVEs' development. Family relations and network persons played an important role in finding the adequate business partner (Zhu, 1998). Only a few TVEs had personal relations to local

¹³ From Policy Research Office of The CC of CPC and the Minister of Agriculture, the office of the rural sample survey station, 1992, p.7.

¹⁴ While Bank Law allowed the land use right as a guarantee for loans, in reality, banks did not accept this.

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cadres or other persons in whom financial institutions had placed their confidence and who could have access to formal financial institutions, acting as guarantors of loans. As private TVEs went into operation after their establishment and grew to a certain size, they gained assets as collateral for formal financial institutions and then obtained loans from them. A survey in Jiangsu and Zhejiang showed that while 6.3 % of private firm loans were secured by collateral in 1994 and 52.7% in 1997, 67% of them were secured by guarantors in 1994 and 41.8% in 1997 (Park and Shen, p. 39). The financial competition of private TVEs in obtaining loans grew gradually.

Table 12: Share of Credit Provided by Formal Financial Institutions to Private Enterprises and Self-employed Individuals

Year	Share of credit	Share of industry gross output
	%	%
1993	0.11	7.98
1994	0.15	10.09
1995	0.08	12.86
1996	0.10	15.48
1997	0.54	15.92
1998	0.54	15.92

Source: Luan and Tang, 2001, p. 44.

4.2 The Fall of Collective Owned TVEs with Formal Financial Support

Collective-owned TVEs made up a large part of China's TVEs and grew from the beginning of the reform to mid-1990s (see Table 1, 4 and 9). Since then they lost their financial competitiveness step by step. During the early period of the reform, the owner of collective TVEs (township, community and village as a whole) was financially stronger in comparison to private ones. The owners had four legal financial origins of capital:

1. Profits of the TVEs

Older collective-owned TVEs who developed in the collective time had to deliver their profits to their owner (the collective). If collective-owned TVEs were run by managers on contract basis, the managers had to pay contract fees to the collective.

2. Resource use fees

The collective as owner could take use fees for their resources, important among them were the land use fees paid by farm households, which were named "land contract fees". Between 1986 and 1990, the contract fees and other fees of households paid to the collective rose from 77.4 Yuan to 123.7 Yuan (per household), which was more than the

tax paid to the state.¹⁵ Apart from being used as administrative expenditure, these revenues could be spent on the investment of TVEs.

3. Self-Raised Funds

The collective could raise capital from households for a certain use, for example for setting up a new enterprise. Additionally, the collective could get funds from supervising agencies and other investors.

4. Land ownership as investment

The collective could use land ownership as investment to collective-owned TVEs. In many cases where the collective set up an enterprise with foreign investors or with state-owned enterprises in the cities, they only invested land and they were shareholders of the enterprise.

At the same time, the collectives have been supported by formal financial institutions. They could get credits for collective-owned TVEs: On the one hand, supporting the development of the collective TVEs was politically the main task of rural formal financial institutions. On the other hand, the collective was seen as a trustworthy creditor in the conservative way of thinking, because the local governments would always continue to exist and never be shut down. Apart from the normal situation, collective TVEs could get support under special programs, for example antipoverty programs with financial support by the Chinese government or by foreign donors.¹⁶ Thus, collective TVEs had a big share of credits of formal financial institutions. Table 13 shows that this share has grown from 17.2% in 1985 to 33.1% in 1995.

Although collective-owned TVEs received strong support from legal policy and formal financial institutions, they finally went down under the competition of private TVEs and in the new economical and political environment. In the view of the incentive, the collective ownership is better than the total state ownership, because the collective as owner is smaller and better defined than the state as owner. But in comparison with private ownership, the collective owner is not clear and larger. The collective-owned TVEs had the same principal agent problem as state-owned enterprises, since the local government is an institution that consists of individuals, namely cadres. The collective had the authority to appoint the manager of collective-owned TVEs. If the main leader of the owner (normally the secretary of the village, the township or the community) changed, it was possible that the manager of this enterprise was also changed. In the past, as mentioned above, the production responsibility system was adopted in TVEs which the managers ran on contract basis. But this system did not go well for a long time, because the principal-agent problem could not be solved. The contract would be changed at the end of the

¹⁵ Policy Research Office of The CC of CPC and the Ministry of Agriculture, the Office of the Rural Sample Survey Station, 1992, p. 20.

¹⁶ In the village Wang Jian, Shanluo Prefecture of Shanxi Province, a collective enterprise (brickkiln) was set up with loans of the antipoverty program of the Chinese government (Hu, 1996, p.130).

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contract time. If a manager made high profits in the contract time, the local leader could enhance the contract fees. If the manager made losses and was not able to pay for the losses, the enterprise would be no longer his. The mechanism in collective-owned TVEs was “the manager assumes responsibility for profits, but not for losses” (Chu, 1998), so that the trend of collective TVEs to make losses could not be stopped under the various contract systems. The final solution is privatization.

Table 13: Collective TVEs' Share of Rural Loans from Formal Financial Institutions in China

Year	Loans Outstanding of ABC* and RCC*	Collective TVEs' share of total rural lending	Growth rate
	in billion yuan	%	%
1985	118.8	17.2	
1986	169.7	21.3	4.1
1987	202.7	22.5	1.2
1988	204.0	23.4	0.9
1989	196.5	22.7	-0.7
1990	231.6	22.0	-0.7
1991	178.2	22.2	0.2
1992	348.3	23.8	1.6
1993	424.3	31.9	8.1
1994	419.2	33.2	1.3
1995	430.7	33.1	-0.1
1996	444.8	28.3	-4.8
1997	409.0	22.9	-5.4

* ABC: the Agricultural Bank of China; * RCC: Rural Credit Co-operatives

Source: Statistical Yearbook of Rural Finance and Banking of China (1986-1998) as cited by Park and Shen, 2001, p. 37.

The same problem existed in the relation between collective-owned TVEs and formal financial institutions. The collective TVEs obtained loans in many cases through their local leader as guarantor. We assume that local leader X as guarantor negotiated with a bank in favor of enterprise A and enterprise A has not repaid the loan yet. If then leader X is replaced, the new leader Y can disclaim responsibility. In addition, collective TVEs considered themselves as a collective, a form of public ownership, and the formal financial institution saw themselves as state ownership, a form of public ownership of the highest degree, so that if they were not able to repay the loans, the leader of the collective and the manager of the collective-owned TVEs considered this as harmless, as illustrated in the saying “the son owns debts of his father”. With this idea, they developed a strategy, namely “setting up and shutting down” enterprises. If one collective-owned enterprise had debts and did not want or was not able to repay it in order to get loans as working capital from banks, the manager and the local leader could shut down this enterprise. Then they set up a new enterprise and applied for loans under the new enterprise

name. Application for bankruptcy became a method to avoid repaying the loans of banks.¹⁷ If a lot of TVEs applied this strategy, many banks would go bankrupt. After 1995, profits of collective-owned TVEs entirely decreased and the losses increased, so that the debts of TVEs came to threaten the financial safety of the formal financial institutions. At the same time, since Asia was in financial crises, China had to carry out many financial safety policies. The most important ones were the obligation for bank leaders to assume responsibility for the debts of their bank and the introduction of new classifications of loans. The new policy required to enhance the collateral level of the credits in which collateral had to be valuable, so that the role of the local leaders as guarantor declined.¹⁸ In the framework of this financial policy the highest priority was given to the safety of the financial sector, whereas the priority of collective-owned TVEs went down theoretically. Furthermore, this new financial policy led to a more difficult situation for collective TVEs. Therefore, Park and Shen concluded that the main factor of the rise and fall of collective-owned TVEs was the loan policy of formal financial institutions. Collective-owned TVEs had no driving power out of themselves. They grew because of financial support and declined when this support ran out (Park and Shen, 2001).

4.3 The Development of Private TVEs Requires Multiform-intermediaries in the Rural Financial Market

In the past, formal financial institutions continuously dominated the rural financial market. Two big financial institutions, the Agricultural Bank of China (ABC) and the Rural Credit Co-operatives (RCC) are legal financial institutions in rural areas. The RCC are co-operatives, but within the Chinese institutional frame, their organizational structure and operations resemble state owned banks, and the rights of their members and the feature of “helping each other among the members” were not known publicly (Cao, 2001). Legally, they are deposit institutions. While 80% of the funds of RCC came from farm households, they mainly gave credits to collective-owned TVEs and not to households and private TVEs. 80% of the credits of collective TVEs stemmed from RCC. In contrast, 30% of the loans of households came from formal banks and 70% of that were loans from other farm households (Zhu et al., 1997, pp. 22-23, 67, 101,-102). In 1997, loans to rural collective enterprises amounted to 84.7 % of total loans to rural enterprises (Statistical Yearbook of TVEs, 1998). In the last years, with the reform of the Chinese financial sector, the dependence of financial institutions on the local governments declined, and the competition between financial institutions was enhanced, but this competition still mainly took place between big state-owned banks.

Since 1999, with the structural changes, private enterprises became the main kind of TVEs. This constitutes a challenge for the reform of the Chinese rural financial system. A multi-

¹⁷ This happened already in the 1980s, as Zhu investigated in Nantong, Jiangsu Province, in 1984.

“..... the township leaders play an active role in loan applications and in ensuring repayment of loans, but this involvement declined from 1994-1997” (Park and Shen, 2001, p. 7) .

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form financial market satisfying the demand of rural private TVEs should be established. Characteristic for rural private TVEs is their small size and great number. Far too few of them have assets as collateral, they need a small credit sum and do not have historical repay records at the banks. Considering the costs, the difficulty to obtain information and the risk, formal financial institutions do not want to give credits to them. How this problem can be solved, is the main topic of development policy. International organizations have experiences in this field in the past when they directly subsidized Small and Middle Size Enterprises (SMEs) and gave cheap loans to intermediaries carrying 100 percent government guarantees. This approach had some positive effect. But it is increasingly being criticized for distorting local markets and contributing to a “culture of non-repayment” (SME FOCUS, 2000, p. 1, 7). Another problem is that the money of donors really did not go to SMEs, but to larger enterprises instead (SME FOCUS, 2001, p. 1-2). Newly developed strategies are investment in financially viable intermediaries targeting SMEs and improving technical assistance to reduce transaction costs. How this new thinking will help China to set up private financial institutions for rural TVEs, that is a question requiring further research.

In the past, rural farm households have continually undertaken considerable efforts to set up private financial institutions. In the early 80s, “Qianzhuang” (old-style Chinese private bank), pawnshops and “Qianhui” (financial self-help group) emerged in Wenzhou in Zhejiang province, the place of origin of private TVEs in China. These traditional financial intermediaries which had already existed in China before 1949 were abolished many times because they were illegal seen from financial political framework. In reality, they continued to exist in various forms (Cao, 2001). The Chinese government has no plans to relax the restrictions for Chinese private intermediaries to enter the rural financial market. With its accession to WTO, China committed itself to open its financial market to foreign banks. In view of the costs and the difficulties in collecting information, it is however unlikely that foreign banks will operate in the rural credit market. Therefore, how multiform intermediaries can change the domination of formal financial institutions in the rural financial market, needs to be analyzed in theory and practice urgently, for the purpose of a policy which undoubtedly stimulates the development of private TVEs.

5 Conclusions

The evolution of property rights in TVEs as well as private TVEs growing financial abilities show that – rather than co-operative cultural characteristics – interactions of peasant and state tactics helped to promote the development of China's TVEs.

In the collective economy, policy-makers changed TVEs ownership in the collective framework according to their needs, while peasants had no means against it. After the reform of land use rights, farm households became independent economic units. From that time, the property rights policy for TVEs was forced to change step by step under the pressure from peasants. Chinese policy-makers did not change any policy unless and until the circumstances (i.e. peasants' appropriation of the creation of new forms of ownership) forced them to do so. The form of 'shareholding co-operative enterprises' finally turned out to be the special ownership form which was used by peasants and cadres alike. Individuals used this ownership form in order to avoid political risk if their enterprises grew with the number of households involved. The collective or local cadres used this ownership form in the reform of collective enterprises in order to maintain their political power which was connected with economic interests. However, it should be noted that 'shareholding co-operative enterprises' are only one miraculous form of ownership amongst many others produced by a political environment discriminating private ownership. Taking into account the diverse forms of ownerships, the development of TVEs in China in the past is not, as stated by several scientists, a paradox of the conventional theory of property rights.

In the process of TVEs' property rights evolution, the financial viability of private TVEs has grown gradually. Nevertheless, private TVEs still have difficulties in finding financial support from formal banks. The main evolving question is how the domination of formal financial institutions in the rural financial market can be changed in order to meet the demand for financial services by private TVEs.

There is an urgent need for research in theory and practice on the kind of policy that would further stimulate the development of private TVEs. As any further development is closely linked to the financing of TVEs, the research should include an analysis on which problems and experiences the private TVEs made in their growth process with financing by informal financial intermediaries. On this basis, researchers should concentrate on three questions:

1. What regulations are necessary for informal financial intermediaries in order to lower the costs (rent) and risks for enterprises and how can the traditional private financial intermediaries be officially recognized and improved?

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2. How will resources of formal financial institutions be further used in the multiform financial markets?
3. How will TVEs themselves as a financial institution further operate?

In its description of the historical development of political and statistical regulations on TVEs, the present work tries to give a sound basis for future research.

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