

I. INTRODUCTION

In the past 15 years, the total output of the township-village enterprises (TVEs) in China has grown at an average rate of 30% per annum. In 1993,

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⁴ Ruttan (1991) emphasizes the need to consider the interactions between political and economic developments.

⁵ Besides its distributional effect, local ownership also makes the state less obligated to bail a TVE out when it is losing money.

ing the current political system subject to the constraint that citizens' welfare is not too low.

World is part of the dynamic process of change in the 1920s. Our theory makes some predictions about the dynamic process but does not fully address it.

in their positions since the start of the firm 10 or 15 years ago. These are cases in which the PFC has so far not proposed a change or another election. Changsha municipality consists of the city of Changsha, four rural counties, and a suburban district. In 1992 about one-third of the municipal's industrial output was produced by the TVEs, which was about the national average.

¹² The term completeness of control is used here to describe how difficult it is for the owners to take back the right after delegating control to a nonowner.

These two items counted for more than 16% of the TVEs' total posttax profits in that year. (See *A Statistical Survey of China* (Bureau of Statistics, 1990, p. 65.))

Edison, Dec. 15, 1993, p. 1), in the first 11 months of 1993, total revenue of the TVEs increased 55% over that from the same period of 1992. The TVEs' profit used for construction of agricultural projects in this period increased 50%. From 1985 to 1990, the total posttax profit of the TVEs increased 35.8%. During the same period TVEs' income spent for rural welfare programs increased 21.3%, that for rural education 145%, and that for township infrastructure 108%. (See *A Statistical Survey of China* (Bureau of Statistics, 1991, p. 65.))

the TVE's profits for rural social programs and infrastructure. Such rules are imposed by an authority that has the power to enforce them. They are also relatively simple rules to enforce.

²⁰ Only a small portion of the rural population works in the cities. Furthermore, the majority of them are only temporary workers in cities. They leave their wives, elderly parents, and children behind in their rural homes. Many of these workers also return to their rural homes for traditional holidays such as the Spring Festival and during the planting and harvest seasons to meet the peak demands for agricultural labor.

²¹ On June 5, 1993, peasants' complaints of fee burdens led to a riot in a county in China's most populous Sichuan province.

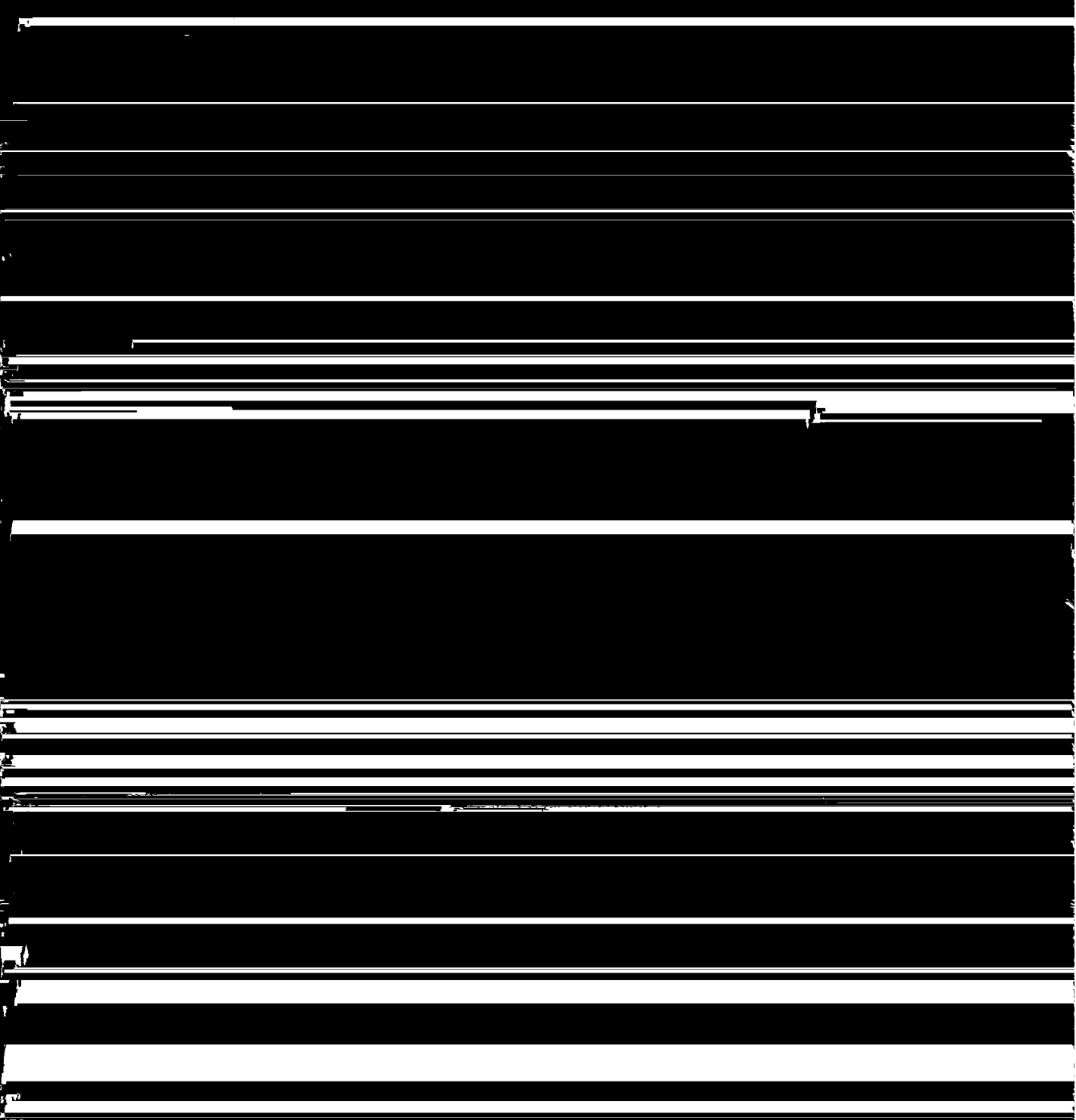
TABLE 1
OWNERSHIP STRUCTURE IN DIFFERENT TYPES OF FIRMS

	TVE	PC	SOE	J-firm	A-firm
1. Nominal owner	Local citizens	Workers	People of nation	Shareholders	Shareholders
2. Control right	TVG	Workers and managers	Center	Workers and managers	Managers
3. Main beneficiaries	Citizens and TVG	Workers	Center and citizens	Workers and shareholders	Shareholders

Table 1 summarizes the above discussion on the nominal ownership, control right, and distribution of benefits in the TVE. The features of four other types of firms along the same dimensions are also provided for comparison. Many writers have likened the TVE to the PCs. The table, however, seems to suggest that the ownership structure of the TVE bears a greater resemblance to that of the A-firms in many aspects. First, in both the TVE and the A-firms there is a separation of ownership and control, as seen in the fact that Row 1 and Row 2 in the table are occupied by different parties. Such a separation is not as obvious in PCs. Second, in both the TVE and A-firms, nominal owners are the main beneficiaries from improved performance of the firm. This is not true in SOEs and J-firms. The main difference between the TVE and A-firms is that, instead of professional management appointed by owners, the TVG as a government institution is in control of the TVE. Separation of ownership and control also exists in J-firms and SOEs. Workers in J-firms, however, have more control of the firm than their counterparts in the TVE or A-firms. Their compensation is also more directly related to the performance of the firm.²² We thus see more consistency between Line 2 and Line 3 for J-firms, but not between Row 1 and Row 3, as in the cases of the TVE and A-firms. A situation similar to that in J-firms is found in SOEs, where the government has the control right and also benefits the most from improved performance of SOEs. The comparison between the TVE and SOEs suggests that nominal ownership has more distributional significance in the TVE than in SOEs, as shown by the consistency between Rows 1 and 3 for the TVE but not for the SOEs.

²² According to Freeman and Weitzman (1987), bonuses based on the firm's profit account for one-quarter of Japanese workers' total incomes. Our casual observation suggests this figure is much lower in the TVEs.

extreme case, but it does illustrate how far a local government official can abuse power before it becomes a problem.



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higher. One cost results from the agency problem. The center, without giving the control right to the TVG, cannot ensure the support and cooperation of a TVG so that a TVE located within its jurisdiction can perform well.³⁰ An-

²⁹ More often than not *jizhi* is not voluntary. Instead, it is conducted in a manner similar to the one used by the TVG to collect fees for social programs. The TVG orders how much each household must contribute.

³⁰ A local government authority is capable of affecting the performance of any firm within its jurisdiction because of the sweeping power it has over people's lives. For example, a TVG may ask an SOE within its jurisdiction to use its resources, money, skills, or equipment to help a local project. If the executives of the SOE do not accommodate this request at least to some extent, they may find their families living in a very hostile environment.

the TVG's... county level; they have only office outlets to serve private individuals. Since major lending decisions have to be made at a county or higher bank branch, it is harder for a TVG to assert its influence on banks' lending decisions than for a county or higher government authority. The concept of a soft-budget constraint was first used by Kornai (1992) to describe socialist SOEs' lack of financial responsibilities. Dewatripont and Maskin (1990) explain the phenomenon of informational asymmetry between the center and the managers.

A good reputation is important even for an authoritarian government because many of its policies cannot be implemented without voluntary cooperation from various other parties. At present, the Chinese government is campaigning for modernization. To achieve this goal, it wants to encourage private business and foreign investment. The incentives of domestic and foreign private investors to respond positively to this policy depend on the reputation of the Chinese government as a protector of property rights. With so many other things at stake, whatever the center may gain by violating the property rights of the TVE, it would probably lose more by scaring away many potential investors. For this reason, the center's commitment to a distributional rule based on ownership seems to be a commitment with a higher stake, and thus it is also a commitment with better credibility.

3. Ownership in the TVE as a Design Problem for the Center

We have argued that the rationale of the ownership structure in the TVE can be understood by looking at the costs and benefits of alternative arrangements. For such an analysis to be valid, the premise that the center, which has the ultimate power to determine the ownership structure in the TVE, cares about production efficiency in the TVE must be true.

³² As a recent example, the contracting and responsibility system [*chengbao zheren zhi*] that implements tax-profit sharing between the government and SOEs was introduced in the mid-1980s to replace the old hand-in-everything system. There has been discussion of whether the new system has led to improved performance of the SOEs. For example, the results of Xiao (1991) and Woo et al. (1994) tend to suggest that reforms led to very limited productivity improvement in SOEs. The work of Chen et al. (1988) shows the opposite. In contrast, when there is a widespread change in ownership, its effect on productivity is often obvious from simple statistics and hardly disputable.

capital requirement. This is so because access to the state banking system,

was 10% in Nanhai County, whereas it was only 3% in Wuxi. Both Wuxi and Nanhai belong to those areas in China where TVEs have been most successful. Nanhai, however, is in Guangdong province where reforms started the earliest and have been the most profound in China, whereas Wuxi is in southern Jiangsu province where government control has remained very tight. Byrd (1990, p. 211) also reports that, starting from zero, the share of total gross income generated by rural private enterprises increased steadily in both a sample of four counties and in China as a whole from 1978 through

Unemployment levels and low growth rates of local employment in the past few years have something to do with full local employment in places where TVEs have been the most successful and with a lack of adequate growth of TVEs in

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