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Boudewijn R.A. Bouckaert

**BUREAUPRENEURS IN CHINA: WE DID IT OUR WAY
A COMPARATIVE STUDY OF THE EXPLANATION OF THE ECONOMIC SUCCESSES
OF TOWN-VILLAGE-ENTERPRISES IN CHINA**

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Bureaupreneurs in China: we did it our way

A comparative study of the explanation of the economic successes of town-village-enterprises in China

Boudewijn R.A. Bouckaert ⁺

University of Ghent

Centre for Advanced Studies in

Law and Economics (CASLE)

‘The greatest achievement (in China) that was totally out of our expectation is that TVE’s have developed.’

Deng Xiao Ping (Economic Daily, June 13, 1993)

ABSTRACT

This article explores the different and sometimes conflicting explanations of the success of the collective enterprises (town-village-enterprise) in China during the first phase of transition (1979-1995). It is argued that explanations, relying on cultural variables are not sustainable and this for two reasons. First, the importance of the collective enterprise is shrinking while the private sector is clearly on the rise. Second, other factors, referring to characteristics of the local and central political, administrative and economic environment, in which the Chinese enterprise has to (had to?) operate, provide for a sufficient explanation of the peculiar structure of the Chinese collective enterprises. These enterprises are seen as the result of ‘bureau-preneurship’ because local bureaucrats were integrated in their management in order to pre-empt predatory behaviour and to facilitate the relationships with the central institutions. The article contributes to the property rights’ theory of the firm as it analyses an empirically very important case in which firms with unclear property rights and structures, apparently not conducive for incentives, might still be the most efficient option.

⁺ The paper has been presented in a preliminary draft at the EALE-conference in Ljubljana in september 2005. I thank the referee and the discussants for their helpful comments. Thanks also to the students of the EMLE-class of 2005-2006 for their comments and suggestion during the Work Session of CASLE.

Introduction

Claiming that law and economics and institutional economics emerged as one of the most successful research agendas of the last third of the twentieth century is certainly no lack of modesty. The repeatedly announced obituaries of these approaches¹ express probably more the wishes of their authors than a reality within the scientific community. Both approaches remain well and alive and are spreading throughout a globalizing academic world. Success evokes of course envy, closer scrutiny and ensuing criticism. One of the most known strands of criticism regards the pretended lack of transcultural explanatory capacity. The argument is well known: law and economics and institutional economics rely on concepts, developed within and tainted by western intellectual history and depart from behavioural assumptions, typical for western utilitarian, materialist and non-cooperative beings. Although this type of criticism created some mental comfort for devoted enemies of the economic approach, it did not endanger too much the approach in its scope. Who cares that law and economics and institutional economics are biased by western culture, when this culture conquers the whole world and when anthropological and cultural rivals are reduced to small pockets, not yet contaminated by western-driven globalisation? The nearly completely westernized world as the explanatory playground for law and economics and institutional economics and the woods of New-Guinea as the playground for alternative anthropological research: not a bad deal, we would say.

The collective enterprises of China, also called town-village enterprises (TVE) seem to disturb the intellectual comfort of the always widening cultural scope of law and economics and institutional economics. A TVE (town-village-enterprise) is an enterprise nominally owned by all the inhabitants of a township (about 3500 households) or of a village (about 200 households) and governed by the local government of the town or the village (TVG: town-village government).

TVE's are (or were) certainly not a fringe phenomenon, but a booming reality within one of the fastest growing and mightiest economies in the world of today. Their reality seemed to be in conflict with the basic tenets of the property theory of law and economics. No surprise that

¹ For a well written overview of these criticisms, see Anita Bernstein, 'Whatever Happened to Law and Economics?', 2005

quite soon some authors hailed TVE's as a contemporary and dynamic phenomenon that escaped the culturally biased explanatory capacity of law and economics. Should the TVE-phenomenon be seen as the empirical torpedo, causing the transcultural pretences of law and economics to sink? This is the intellectual challenge of this article. We will try to argue that, although the success of TVE's is undeniable, it does not make a deep intellectual wound into the law and economics body. At most some scars as the TVE-success shows that the typical business environment of China pushes the transition process into the path dependent reform-phase of TVE's, based on 'bureau-preneurship'.

We do not claim to have written the most seminal story on collective enterprises in China. We relied at length on the studies, made by numerous, mostly Chinese scholars, often still unknown, but yet very promising. Most of these studies focus quite specifically on one explanatory element of the phenomenon. Some studies emphasize the role of the tax power of the local bureaucracy, others the lack of the rule of law or the biases of state banks, etc. In this article we attempt to aggregate most current studies on TVE-performance into one structured pattern. We try to show that, if one envisages the whole of these explanatory elements, all intellectually compatible with mainstream economic analysis, the cultural factor is redundant as an exogenous variable. In other words, the TVE-phenomenon does not endanger the intellectual soundness of law and economics and institutional economics, even when these approaches have to deal with complex and path dependent transition processes.

In a first section we devote attention to the general economic and sociological features of the Chinese transition process. Although not focussed on TVE's, this section is crucial to understand the specific role of the local bureaucracy in the evolution of Chinese enterprises. In a second section we tell the legal and economic story of the town-village enterprises in China, from the Maoist period on until the current period, which shows a shift towards private enterprise.

The third section provides figures and facts on the success and performance of TVE in the Chinese economy. The aim of this section is to show that TVE's were all but a fringe phenomenon.

The following sections constitute the core of our explanatory thesis on TVE's.

In section four we show that TVE-structures are such that according to the canons of the property theory of law and economics one should expect a total failure.

Section five deals with the most exotic explanation of TVE's: the one relying on an exogenous cultural variable of East-Asian cooperative culture. As this explanation raises the most serious doubts on the viability to explain the TVE's with classical economic intellectual tools, the explanations, developed in the next sections should be read as an antidote of this cultural 'special'.

In section six we discuss the TVE's as a Coasian option for a firm, in which local bureaucrats are integrated in order to tame their predatory behaviour and to align their interests with the performance of the enterprise.

In section seven we highlight the role of local bureaucrats within the firm as bureaucratic human capital, able to deal optimally with a rather hostile business environment of banks, courts and administrative agencies.

In section eight we discuss a couple of more partial explanations of TVE, such as the theory of urban proximity and the township or village itself as enterprise.

In our conclusion we discuss the impact of the TVE-phenomenon for the property rights' theory of the firm in order to assess how far this theory has kept its explanatory power also in non- or less capitalistic environments. Finally we develop some thoughts about the lessons, which can be drawn from the TVE-experience for transition strategy.

Section 1: From bureaucrats to 'bureau-preneurs' to entrepreneurs

Among all countries facing a transition from plan to market, from collective property to private property, from totalitarian one party rule to liberal and pluralistic democracy, China offers us probably one of the most fascinating stories. China seems to defy all conventional wisdom on the agenda of social reform. In order to have well-functioning markets, we need market-proper institutions such as private property, contracts and liability, a rule – based legal order, a politically independent judiciary, applying and enforcing these rules, and finally, legislative assemblies, elected by the people in order to enact the rules of conduct for society and to control the government when providing collective goods. Simple logic would require us to set up first such institutions in the hope that the market-fruits of this institutional loom will arrive as soon as possible. This logic has been followed, within a wide margin of

variations of course, in the Central- and East-European countries and many countries of the former Soviet Union. An ocean of literature has been devoted to explain the varying degrees of success of this approach.

In China this simple logic – institutions first, and then markets will develop- has not been followed at all and yet this country is the theatre of market-driven, double-digit annual GDP-growth, an explosion of entrepreneurial energy and a booming export-industry.

As is conventionally held, a society, relying on markets for its wealth generation, is based on general, abstract rules and not on particular commands, enacted by a central planning authority. These rules provide for protected domains of free action (property rights), voluntary cooperation between agents (contract law) and internalisation of external costs (tort law). The generality of such rules precludes the government from awarding privileges to particular agents, which would distort markets and allow governments to build up networks of dependent clients. It is essential that such a framework of rules (the common law in Anglo-Saxon countries, the civil law in continental Europe) be relentlessly enforced by a politically independent judiciary.

Such an institutional framework, considered crucial for viable markets, is hardly operational in China. According to Clarke, Murrell and Whiting (Clarke and alii, 2006) legislation of the general kind has been developed quite considerably in China, but the social impact of it is still doubtful. As still important defects of the rule in China they mention:

- 1) The absence of a systematic statement of the law of property. This is especially problematic for the rural population, enjoying only of weak property rights on land, i.e. leases which can be revoked by local bureaucrats or party bosses or can be overruled by a taking without or with only partial compensation (Xiaobo Zhang, 2006, p. 12-21)²

² See also the issue of *The Economist*, 25 March 2006, *How to make China even richer*, arguing for reforms awarding farmers stronger property rights in order to allow them to capitalize their property and enjoying longer term certainty.

- 2) The lack of a system of authoritatively solving conflicts between the numerous layers of government. Citizens and companies are faced with a bewildering array of levels of public decision-making without rules providing unity in the legal system.
- 3) Courts have no power to invalidate legislation by which citizens and companies are not able to enforce respect for the hierarchies of rules. This process of internal rearrangement remains totally within the discretion of party instances and administrative bodies.
- 4) The low status of courts and lawyers. Courts are not perceived as politically independent instances, driven by the conflict resolving needs of citizens and companies. Courts are rather perceived as another government-driven instance, supervising the enforcement of administrative rules and orders.
- 5) Corruption, although less bad than in other LDC's, remains however rampant. When faced with government-corruption, courts are reluctant to counteract.

Although the mentioned authors observe a steady improvement of the 'rule of law' in China, the perceived defects are still considered crucial. 'Thus, they conclude, the courts in China do not play the role, nor do they have the power, that would be consonant with a legal regime that provided secure property rights, and there are no other governmental bodies that seem capable of playing this role. In sum, the experience of the reform era in China seems to refute the proposition that a necessary condition for growth is that the legal system provide secure property and contract rights.' (Clarke et alii, 2006, p. 26)

Given these defects in what is conventionally regarded as the absolute precondition of viable markets, the question arises of course what made markets work anyway during the reform era in China.

The two realms, in which alternative social mechanisms, conducive for markets, operate, are (1) the coordination among market agents, (2) the protection of property rights. As the second realm concerns more our topic, only a quick glance at the first is necessary.

Enforceable contracts are usually considered the institutional cornerstone around which wealth-enhancing cooperation of market agents would evolve. In China this social function is largely performed by informal coordination mechanisms, allowing for ‘tit for tat’-strategies and repeat playing. Several authors point to the immense network building-efforts by the business-elites, mostly originating from homogeneous social layers (see further). ‘Chinese relational rules personalize transactions, making them part of the interpersonal social matrix of daily life’ (Chung and Hamilton, 2001). The social networks, spanning not only relations between businessmen but also between businessmen and government officials, are often more or less formalized by the numerous trade-associations, offering a platform for out of court resolving of conflicts (Clarke et alii, 2006, p. 35-38). As we will mention further (see section 5), traditional elements of Chinese culture (emphasis on trust and loyalty: ‘*gemen*’, ‘*guanxi*’)) strengthen these informal enforcement mechanisms.

The protection of property, especially the property of financial and physical capital of firms³, is the result of a complex process in which the potential enemies of business, i.e. local bureaucrats and party bosses, became partners or at least interested parties in the development of it. To sum up: ‘If you cannot beat them (the bureaucrats), make them join you (business).’ The bureaucrats became or were asked to become ‘bureaupreneurs’⁴, i.e. agents still holding public functions, but at the same time involved in firms, operating within competitive markets. ‘Bureaupreneurs’ are the embodiment of the gradual privatisation of political power, ending up in the constitution of a realm of genuine private enterprises and the full separation of business and administration.

Bureaucrats became ‘bureaupreneurs’ as a result of a gigantic shift of power from the centre to the local periphery.

As in all collectivist regimes the Chinese state controlled all resources critical for the development of business. Such as for instance: energy, especially electricity, access to roads, land, finances, natural resources, licenses to start up business, etc.). In a centrally planned economy the allocation of these resources devolves from a central plan in which the local bureaucrats act as the final executive agents. At the end of the seventies and the beginning of

³ As far as property of farmland is concerned, the situation is much less rosy. See Xiaobo Zhang, 2006.

⁴ The notion was first used in a rather negative sense by Xiaobo Lü, ‘*Booty Socialism, Bureaupreneurs and State in Transition: Organisational Corruption in China*’, *Comparative Politics*, April 2000, p. 273-294. In the analysis of Xiaobo Hu (2005) the term has a more positive connotation. We should also distinguish ‘bureaupreneurs’ from ‘institutional entrepreneurs’. The latter affect by their economic activities and the administrative impact of it (p.ex. obtaining a licence ‘at the margin’) changes in the legal-political environment. ‘Bureaupreneurs’ act often as institutional entrepreneurs but not necessarily so (Daokui Li, Junxin Feng, Hongping Jiang, 2005).

the eighties of the former century, the political centre abandoned this philosophy and allowed the local authorities to decide by themselves on the allocation of these resources. To use the notion of 'property rights' in a very broad sense, the Chinese revolution began by a massive turnover of property rights from the political centre to the periphery⁵. This decentralisation also occurred on the fiscal level. Local entities were asked to generate their own fiscal revenues, but were given at the same time also autonomy in spending these revenues. As a result of the thorough form of decentralisation and fiscal federalism, the interests of local bureaucrats became aligned with the development of business at the local level. The more business, the more profits, the more fiscal revenues, the higher the income of the local bureaucrat. This alignment was also strengthened by the cadre evaluation system setting criteria of performance of party managers and government officials, monitoring their performance, determining their remuneration, influencing their tenure in office and shaping their opportunities of advancement. Besides other criteria such as maintaining public order, the most heavily weighted performance criteria focus on promoting economic growth and targets for the collection of tax revenues (*fensuizhi*) (Clarke et alii, 2006, p. 26-28) Together with this political and fiscal decentralisation state firms were also allowed to operate on a dual track system. After fulfilling the state quota of the central plan, firms were allowed to produce surpluses and sell them on the market for higher prices. As the state was selling basic resources to firms for artificially low prices, the firms were able to make good profits. In such a way, local bureaucrats and managers in the state firms became gradually acquainted with the entrepreneurial logic, typical for a capitalistic economy.

Most of these 'bureau-preneurs' were, as Xiaobu Hu calls them, 'princelings' of the ruling groups of the old communist regime. As in all communist regimes in transition, these groups are potential resisters of market development, as they fear to lose their privileges in favour of a new social class of private businessmen. In China the resistance of this group was bought off by an informal inheritance rule, allowing the children of bureaucrats and party veterans to take positions in the firm or bureaucracy of their father. Being assured that their children

⁵ Blanchard and Shleifer (2000) however remark that administrative decentralisation in China remained combined with political centralisation. Local administration was given wide powers concerning taxation and expenditure, but this under the strict supervision and on the conditions, set by the central political force, the Communist Party. The authors agree that decentralisation was crucial for economic growth but point to the Russian example to show that under certain conditions, decentralisation can kill growth. They point to two important differences: 1) In China local administrations were allowed to keep a larger share of local tax income which aligns their interests with enterprises; this is much less the case in Russia; 2) in China the monopolistic power of the CCP allowed control on the incentives of local bureaucrats, while in Russia political competition through elections made local politicians vulnerable for bribes and protecting the incumbent enterprises.

would be given the first chance to profit from the gradual decentralisation and liberalisation, the resistance of the old bureaucrats eroded and the process of transformation from bureaucrats to ‘bureau-preneurs’ could go its way. TVE’s are, as we will show, by far the most remarkable phenomenon of Chinese ‘bureau-preneurship’. It was, to put it in Hayekian terms, the result of evolution and not of design.

During the nineties ideological resistance against private property and private enterprises had eroded further. The bureaucrat-manager-class had acquired experience in risk-taking, had explored market-mechanisms and accumulated private capital. Also the limitations of firms, managed by ‘bureau-preneurs’ became gradually visible. The ‘bureau-preneurs’ asked for a formal recognition of their property rights while the political class opted for a clear separation of administration and business. In the report for the CCP National Congress of 1997 secretary-general Jiang Zemin promoted ‘standard corporations according to the requirements of clearly established ownership, well-defined power and responsibility, separation of enterprises from administration...’ (Xiaobo Hu, 2005, p. 23). More recently private property rights were given constitutional protection by amendments of article 11 and 13 of the Constitution. In this way private property, de facto protected by several political, sociological and economic mechanisms, were given a formal protection. The ‘bureau-preneurs’ could now shake off the last remains of their bureaucratic capacity. The metamorphosis from bureaucrat over ‘bureau-preneurship’ to entrepreneur was brought to completion.

Section 2: The town-village-enterprise in China. A short political and economic history

The advent of communism in 1949 perturbed dramatically the traditional structure of Chinese agriculture. The first land reforms annihilated the class of big landlords and in a second wave the smaller farms were concentrated into agricultural cooperatives first and in 1958 into even bigger ‘peoples’ communes. The farmers’ communes were forced to sell their output at artificially low prices, causing a so called ‘scissors effect’ by which the agricultural sector was permanently squeezed from billions and billions of yuan in favour of industrial sectors (Harry X. Wu, 1997). The notorious Great Leap Forward, a crank idea of chairman Mao, not

only caused starvation and stagnation. It is also the remote origin of the town-village-enterprises, studied here. The workers on the countryside were stimulated to work harder and to consume less. To promote this, numerous smaller commune-brigade-enterprises (CBE's) were set up. At large, CBE's were a big failure. They suffered from insufficient capital, poor management and lack of any market skills. Many CBE's were forced to shut down. By 1965 their gross output had fallen from 3.2 billion renmimbi in 1961 to 0.562 renmimbi (Chen, 1997). During the first period of the notorious Cultural Revolution (1966-1975), the highlight of ideological purity, the CBE's were regarded as the 'tail of capitalism' and strictly constrained in their operation. The maximum number of workers was set at only 8 (Byrd and Lin, 1990). This attitude changed during the last years of the Cultural Revolution (1975-1979). As the political leadership now emphasized the need for modernization over ideological class struggle', CBE's were given a major task in the campaign for the mechanisation of agriculture. The so called 'Resolution on several questions about speeding up agricultural development' voted at the Third Plenum of the 11th Central Committee of the CCP in 1977, called for policies to promote the growth of CBE's and abolished the 8 workers' limit. In 1984 communes and brigades were abolished and the CBE's were renamed as town-village-enterprises. The period of 1979-1989 shows a tremendous multiplication of the number of TVE's and their output.

After the Tien-an-Min-square riots a period of retrenchment began. Many TVE's were forced to shut down, while many private enterprises took the form of TVE in order to survive political attacks. This retrenchment soon gave way to a formal and stable recognition of the merits of TVE and their role in Chinese economic development. In 1990 the 'Regulation on Township and Village Collective Enterprise of the PRC' outlined the legal framework of the TVE. Collective ownership of the TVE was assigned to all inhabitants of the town or village⁶. The community government however was given the power to effectively control the TVE by its power to appoint and fire TVE-managers or by delegating this power to an agency ('The Economic Commission', 'General Corporation for Development'). The regulation also decided on the allocation of the profits of TVE. 60 % of them had to be reinvested within the firm in order to modernize and to increase production and also swell the welfare and bonus-funds of the TVE. A part of the profits had to be remitted to the owner, i.e. the community, in order to be used for the construction of agricultural infrastructure, agricultural technology

⁶ Only in 1996 a law was passed by the National People's Congress, providing a legal base to the TVE's (Clarke et alii, 2006,14).

services, rural public welfare, renewal and transformation of enterprises, development of new enterprises. In 1985 46 % of after-tax profits were reinvested and 49 % were assigned for local expenditure. In 1992 these figures were 59 % and 40 % respectively (Statistical Survey of China, 1992, p.67, 1993, p. 67).

During the second half of the nineties CCP-policy took a sharp turn in favour of private enterprises. At its fifteenth Congress in 1997 the policy of privatising small and median state-owned enterprises (SOE) and TVE's, already started at local experimental base before, was definitely adopted (Clarke et alii, 2006,14). In contrast to former processes of privatisation in East-Europe, privatisation processes were developed at the level of cities and counties (Yangsheng Cao and Weingast, 1997). At the end of 2000 most small and median SOE's were privatised and had adopted the legal form of either corporatisation into a joint stock company with limited liability (about 8 %) or stock cooperatives where shares are mostly sold to managers and employees (about 35 %) ⁷. Other enterprises were simply sold to foreign investors (about 11%).

Also within existing TVE's a push for privatisation was felt. Many TVE's converted into joint-stock cooperatives in which shares were sold or distributed to employees and managers either on a one-person-one-vote base or on a one share-one vote base. In other TVE's managers, employees or foreign companies get control rights while the governments of towns and villages retain minority rights.

Section 3: TVE. Size and performance within the Chinese economy

TVE-development took off in the seventies and eighties, a period during which registration of economic data is poor. Also the definition of what is called a purely private or a collective firm is often unclear. Sometimes TVE's are considered a part of the private, 'non-state', sector, sometimes not. As TVE's are an important phenomenon within the Chinese economy an inconsistent use of definitions may have a dramatic impact on figures. However, in order to give an idea of the evolution of the importance of TVE's within the Chinese economy, we

⁷ In 1993 the Company Law was passed providing the normative structure of joint stock companies and limited liability companies. These structures were designed to be adopted for privatized SOE's but were also used for new private business. After some regulations on stock issuance and trading a Securities Law was passed in 1997, in 1997 a Partnership Law was passed providing a legal framework for small business and in 1999 a Law on Individual Wholly Owned Enterprises (Clarke et al., 2006, 14).

brought together the data, provided by different authors studying the phenomenon. Often we did not aggregate the figures as they originated from different sources, using possibly different definitions.

1. The rise of TVE in the Chinese economy (1978-1993)

| | 1978 | 1993 |
|---------|------|------|
| SOE | 78 % | 57 % |
| TVE-CBE | 9 % | 43 % |

Figure 1 :TVE and SOE – Share of National Industrial Output (Che)⁸

| | 1978 | 1993 | Changes between 1978 and 1993 |
|--|---------|---------|-------------------------------|
| State-owned enterprises (SOE's) | 77.63 % | 43.13 % | -34.50 % |
| Non-State-owned enterprises | 22.73 % | 56.87 % | 34.50 % |
| Urban non-state enterprises | 13.28 % | 10.42 % | -2.86 % |
| a. Urban Collectives | 13.28 % | 9.72 % | -3.56 % |
| b. Urban Individuals | 0.00 % | 0.70 % | 0.70 % |
| Rural Enterprises | 9.09 % | 36.29 % | 27.20 % |
| a. Township Enterprises | 5.05 % | 14.23 % | 9.18 % |
| b. Village Enterprises | 4.04 % | 12.25 % | 8.21 % |
| c. Household groups | 0.00 % | 2.21 % | 2.21 % |
| d. Individual households | 0.00 % | 7.60 % | 7.60 % |
| Others (large, private, foreign, joint) | 0;00 % | 10.16 % | 10.16 % |

⁸ According to Chang however TVE's produced in 1992 only 36,8 % of total industrial output and 25 % of all exports. Between 1980 and 1995 the annual growth of TVE-output was more than 30 % (Chang, 1994). According to Hehui Yin the share of TVE in the total national output grew only from 9% to 27 % (Hehui Yin, 1997)

| | | | |
|----------------------------|-------|-------|-----|
| ventures, stock companies) | | | |
| | | | |
| Total | 100 % | 100 % | 0 % |

Figure 2: Different types of firms. Evolution of shares in the Chinese economy. Source Statistical Yearbook of China, p. 373-374, 1994. In the strict sense TVE's encompass only the rural enterprises. In a broader sense also urban collectives are sometimes counted as TVE's.

| | Number | Average Population | Average Number of TVE's | Average Employees |
|------------------|---------|--------------------|-------------------------|-------------------|
| Townships | 48 200 | 18 000 | 8.2 | 66 |
| Villages | 806 000 | 1000 | 1.4 | 23 |

Figure 3: Number of townships and villages, TVE's and employees in 1992 (Chen, 1997)⁹

2. The Rise of the Private Sector (non-TVE)

| | |
|-------------|--------|
| 1985 | 2 % |
| 1993 | 12.2 % |
| 1997 | 34.3 % |

Figure 4: Evolution of share of industrial output of the private sector 1985-1997 (Yang Yao, 1999)

⁹ According to Hehui Yin there were 1,5 million TVE's, employing 52 million workers in the non-farm rural industry (Hehui Yin, 1997). According to Chen however there were 24.95 million TVE's operational in agriculture, industry and food services, employing a staggering number of 120.18 million workers (Chen, 1997). The enormous difference has to be explained by the fact that the figures of Hehui Yin do not encompass urban non-state enterprises while they do in the figures of Chen.

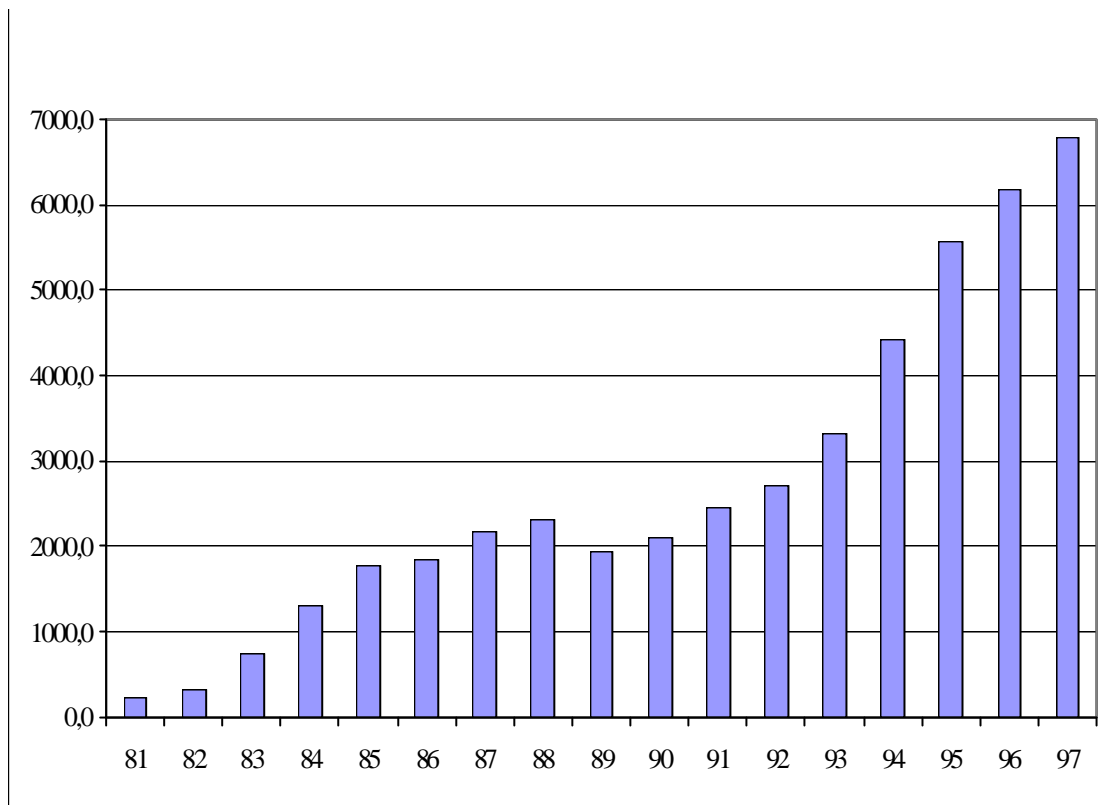


Figure 5: Evolution of workers in private sector (in ten thousands). Before 1991, only *getihu* (small enterprise, mostly family based, employing not more than 7 people) are included. Starting in 1991, both *getihu* and private firms are included. **Sources:** *Yearbook of China Industrial and Commerce Administrative Management*, 1992 - 1998, and *China Statistical Yearbook*, 1982 - 1998.

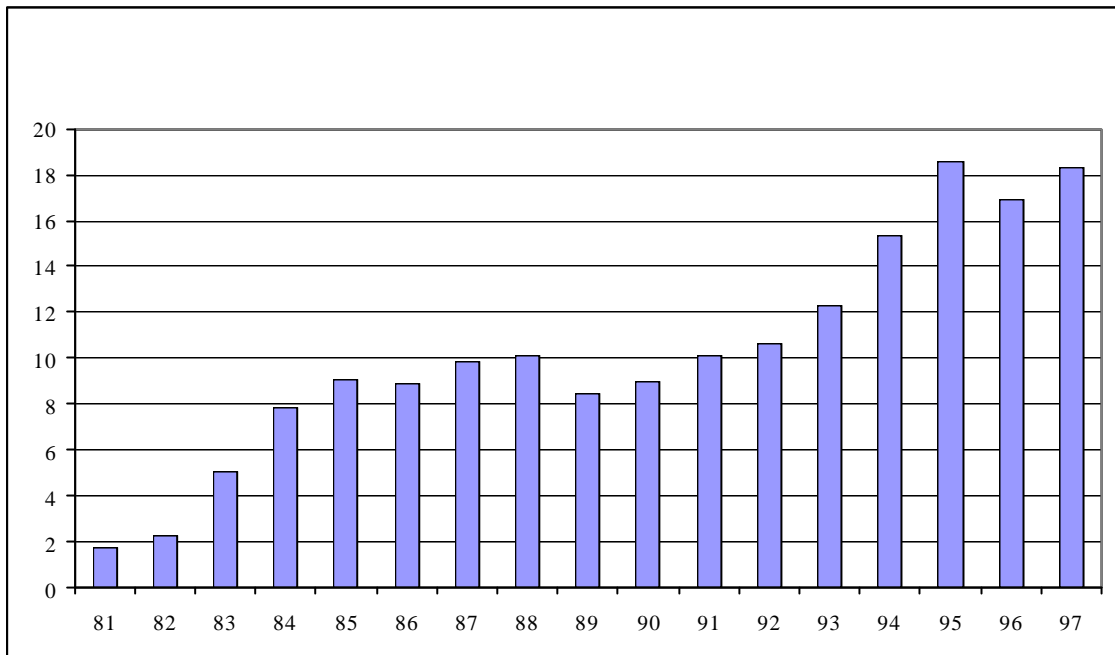


Figure 6: Evolution of the share of privately employed workers in the national non-farm labour sector. Before 1991, only *getihu* are included; starting in 1991, both *getihu* and private firms are included.

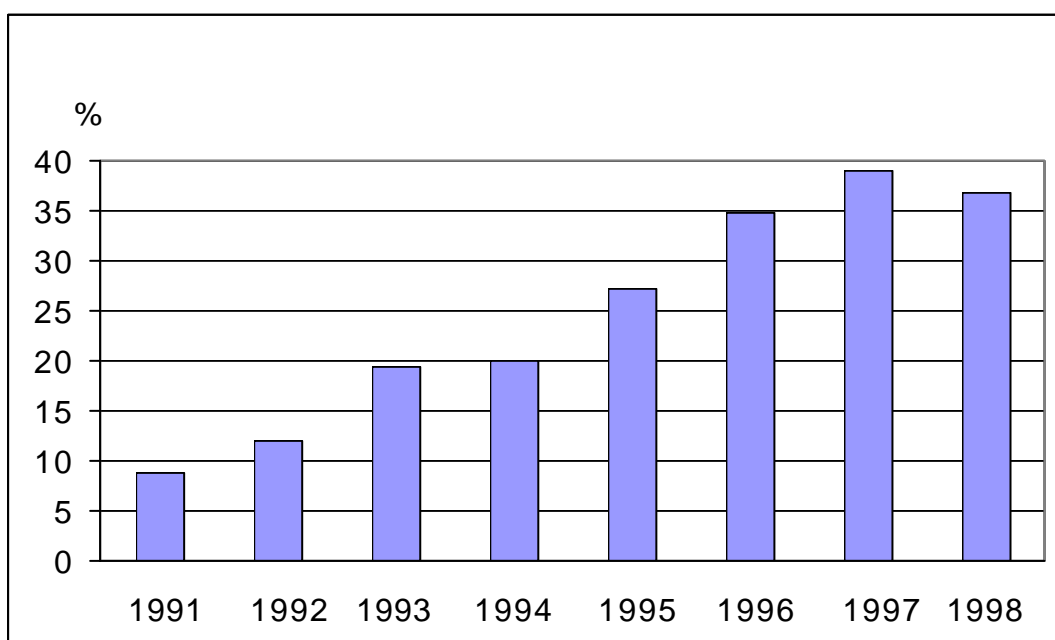


Figure 7: Evolution of the share of the private sector in Chinese GDP (Yang Yao, 1999)

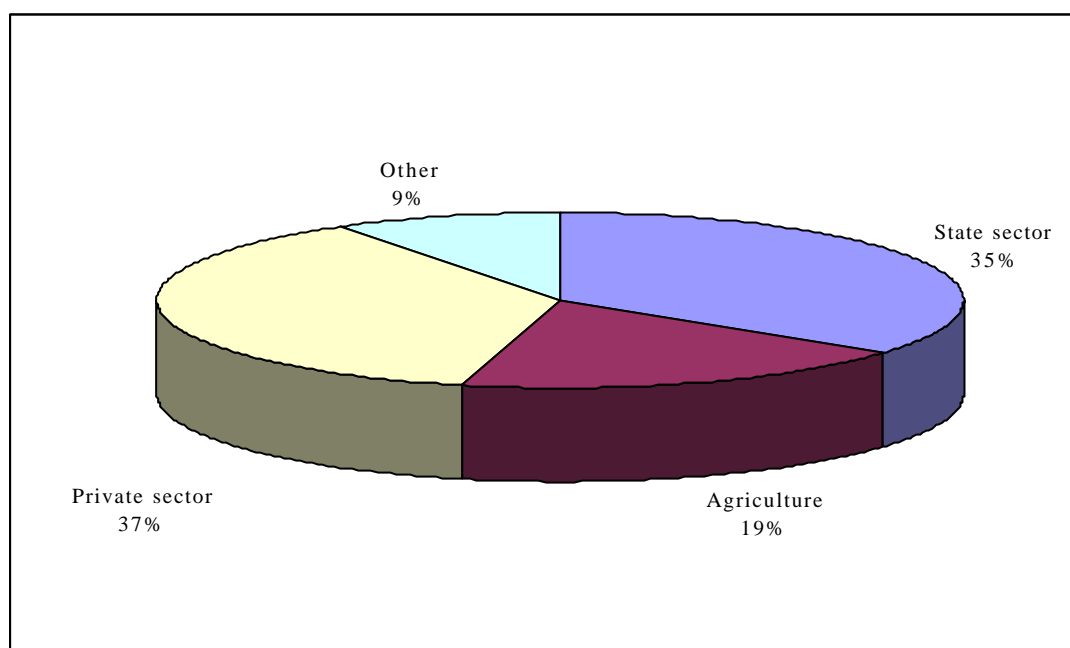


Figure 8: Evolution of shares in GDP. Source : Yang Yao,1999

| Year | Coast | | Central | | West | |
|------|-------|---------|---------|---------|-------|---------|
| | Firms | Workers | Firms | Workers | Firms | Workers |
| 1992 | 95.4 | 1754.5 | 24.5 | 453.4 | 19.7 | 380.5 |
| 1993 | 159.3 | 2351.3 | 44.6 | 768.9 | 34.1 | 600.6 |
| 1996 | 529.2 | 7232.8 | 178.6 | 2741.2 | 111.4 | 1737.4 |
| 1997 | 610.1 | 8235.5 | 211.1 | 3189.7 | 139.5 | 2067.4 |

Figure 9: Regional Distribution of private firms (in thousands).Source: Yang Yao, 1999

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | Change |
|--------------------------|------|------|------|------|------|------|--------|
| Non-farm-business-sector | | | | | | | |
| Private sector | 43 | 45,3 | 47,7 | 51.8 | 54.6 | 57.3 | 14.1 |
| Public sector | 57 | 54.7 | 52.3 | 48.2 | 45.4 | 42.9 | -14.1 |
| State controlled | 40.5 | 40.1 | 39.6 | 37.1 | 35.2 | 34.1 | -6.4 |
| Collectively controlled | 16.5 | 14.7 | 12.7 | 11.2 | 10.1 | 8.8 | -7.7 |
| Total 100 % of GDP | 100 | 100 | 100 | 100 | 100 | 100 | |
| Economy wide | | | | | | | |
| Private sector | 50.4 | 51.5 | 52.8 | 55.5 | 57.4 | 59.2 | 8.8 |
| Public sector | 49.6 | 48.5 | 47.2 | 44.5 | 42.6 | 40.8 | -8.8 |
| State controlled | 39.6 | 37.1 | 37.3 | 35.7 | 34.6 | 33.7 | -3.2 |
| Collectively controlled | 12.7 | 11.3 | 10 | 8.8 | 8 | 7.1 | -5.6 |
| Total % of GDP | 100 | 100 | 100 | 100 | 100 | 100 | |

Figure 10: Evolution 1998- 2003 of private sector (Source OECD-National Bureau of Statistics and OECD Estimates)

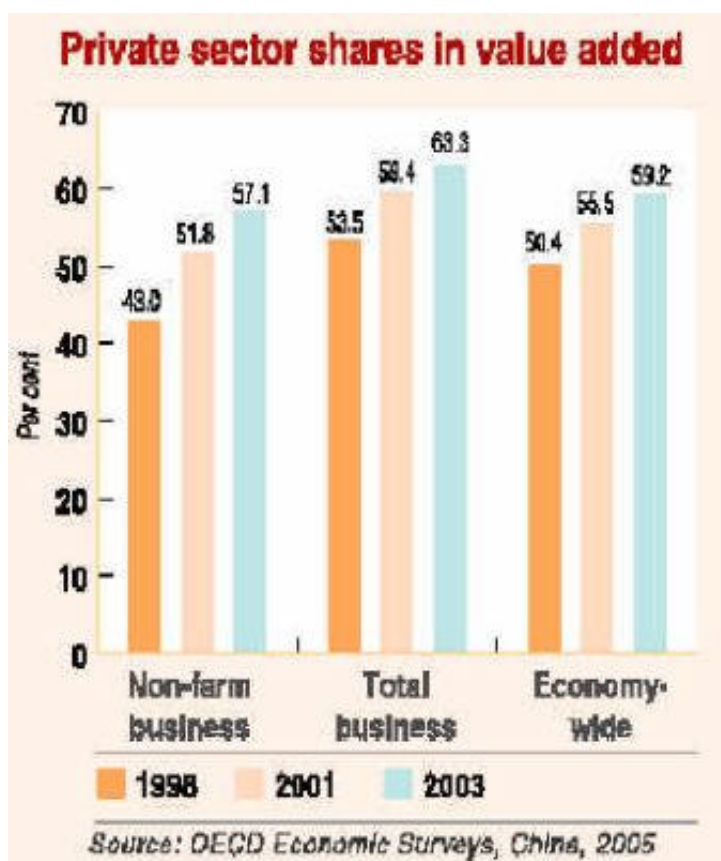


Figure 11: Evolution of Private sector 1998-2003 (Source: OECD Economic Surveys China 2005)

| | 1991 | | 1994 | | 1997 | |
|-------------------|---------|-----------|---------|-----------|---------|-----------|
| | Firms | Share (%) | Firms | Share (%) | Firms | Share (%) |
| Total | 107,843 | 100.0 | 211,388 | 100.0 | 960,726 | 100.0 |
| Sole ownership | 60,613 | 56.2 | 100,621 | 41.7 | 387,534 | 40.3 |
| Partnership | 40,552 | 37.6 | 37,532 | 15.5 | 130,668 | 13.6 |
| Limited liability | 6,678 | 6.2 | 103,235 | 42.8 | 442,554 | 46.1 |

Figure 12: Ownership Structure of private firms Source: Yearbook of China Industrial and Commerce Administrative Management, 1992 - 1998.

However incomplete, these data allow observing the general trends in the ownership structure of the Chinese firm.

First it is clear that in the industrial sector, especially in the rural one, TVE's soared throughout China at a breathtaking pace during the period 1979-1996. This is the case as concerns the output, the employment as the number of firms.

Secondly, it is clear that since the mid-nineties the growth of the TVE's was halted by the rise of the private sector. The private sector was able to encroach upon the share of the two other categories. Many small and midsize SOE's became purely private enterprises, while, on the other hand, many TVE's used the opportunity of privatization programmes to adapt their structures and shift to the private sector. As one will expect, the privatization wave is the strongest in the East of China and occurs later and in a weaker way in the West.

Section 4: The TVE-challenge to the economic theory of property rights

The law-and-economics-theory of the firm involves different aspects each generating impressive streams of literature. The theory of the firm deals among other topics with the problem of the borderline between firm and market, incentive-problems within the firm, the relationship between ownership and control, the problems of strategic behavior within the firm, etc (Foss,Lando,Thomsen, 2000). The specificity of the property rights' theory on the firm lies in its emphasis on the importance of the property rights' structure on the assets of the firm. According to the pioneers of this theory, such as Furubotn, Demsetz, Alchian, Jensen and Meckling, the property rights' structure is crucial in explaining the firms' performance. The capitalist firm for instance, relying on a split between the ownership of capital and labor, puts owners in a position of a residual claimant, linking profit maximization with the overall interests of the firm. In order to maximize profits the owners will introduce an effective and efficient discipline among the firms' workforce and develop market strategies in order to maximize the firms' output. The property approach of the mentioned pio neers of the seventies has been refined and nuanced, for instance by the seminal research of Hansmann (Hansmann, 1988) putting emphasis on the 'costs of ownership' and the rationality of possible alternatives

to the capitalist firm such as workers' and consumers' cooperatives. Such nuances and evolution within the property rights' theory of the firm does not preclude the perception of some hard core canons, common to all property rights' approaches to the firm. The canonical list can be brought back to the following positions:

- (1) A firm needs identifiable owners of its capital (physical capital, financial capital, human capital, trademarks, IP's, good will, etc.) with well defined, enforceable and transferable exclusion rights;
- (2) The owners are the residual claimants of the firm, appropriating the residual (i.e. the profits) after having paid their contractual partners such as the employees, bond holders, deliverers, etc.;
- (3) The owners have a right of control on the management of the firm and can eventually fire the management;
- (4) Without well defined property rights firms will tend to perform badly. Without residual claimants, nobody will take care of the collective interest of the firm itself. Managers will take short-term decisions, maximizing their interests. Workers will be weakly monitored and suboptimal market strategies will be developed.
- (5) Such underperformance will often lead to the 'soft budget'-syndrome: costs are shifted to the state, to taxpayers. This is often the scenario within transition economies, lacking growth capacity to offset unemployment, resulting from the underperformance of firms with inefficient ownership structures.

As Weitzman and Xu (Weitzman and Xu, 1993) pointed out correctly, TVE's do not match at all these canons.

- (1) **TVE's lack clear property rights:** the inhabitants of the town or village are the nominal owners. Yet they have no real power of exclusion or control. They cannot fire the managers, they cannot hire and monitor workers, they have no real say in market strategies, they do not decide on investment policies of the firm, etc. The real power of

control goes to local government. The nominal owners of the TVE have no 'exit'-option by selling their shares, but only by moving from the town or the village, which may be very costly. Their voice-option is weak although somewhat strengthened by recent reforms on local democracy (the Organic Law of 1987, introducing semi-competitive elections) (Schubert, 2002).

- (2) **TVE's lack residual claimants** as the inhabitants have no real shares and no claims to after tax-profits. As stated above, profits have to be spent, according to the law, to reinvestment, to bonuses for the personnel, to investment in public services within the community. The profits accrue to them partially through local social investments. This latter circumstance will however not generate strong incentives to control the firm as these social investments have often a public good character, stimulating 'free riders' behavior.
- (3) **The TVE-assets are not transferable or sellable** as they are fixed within the community. Neither the nominal owners nor the effective owners (TVG) are in a position to realize a surplus on their share, which impairs incentives for efficient management. Moreover local managers may adopt short time horizons as their power of control ends with their political term.

As shown above in the preceding section, the spectacular growth of TVE's in the period 1979-1994 (the year of the start of genuine privatization) seems to conflict with any basic intuition, resulting from confronting the canons of the property rights' theory. It is true that the spectacular growth of the TVE as such does not prove its 'efficiency' or 'optimality'. TVE's were clearly efficient in comparison with the bureaucratic SOE's and perceived as a better avenue towards rapid modernisation and growth. It is however theoretically possible that pure private companies would have been an even better alternative to the SOE's and possible vehicles to an even more rapid modernization and growth. As TVE's succeeded SOE's and private firms are succeeding SOE's and TVE's, there is a lack of large-scale synchronic comparisons. Econometric studies of Svejnar have pointed out however that a comparison of 400 TVE's and 400 purely private firms in 4 Chinese counties during the eighties showed no adverse effects of the TVE-structure on the productivity of the studied firms. Moreover, even without overall comparative studies, the growth and the performance of the TVE as such prove that they were at least not that inefficient as the

confronting with the canons of the property rights' theory would tend us to make believe. According to this theory, TVE's should be the locus of hopeless stagnation and low productivity. The figures show that they were not (Svejnar, 1990).

Section 5: Under the shadow of Confucius: a cultural explanation of TVE-performance

In their pioneering study on TVE's Weitzman and Xu (1993) rely on a cultural explanation of TVE-performance. They qualify TVE's as 'vaguely defined cooperatives', as structures in which the 'patrons' in the Hansmann sense (Hansmann, 1988), occupy very unclear positions. According to the authors, the gross deviations from the canons of the property rights theory of the firm would normally predict suboptimal outcomes due to non-cooperative behavior. The lack of operational residual claimants allows for shirking, free ridership and short term decision-making. In other words, we can expect TVE's being the theatre of prisoners' dilemmas, keeping the players into suboptimal Nash equilibriums. Of course, repeated games' environments such as the Chinese townships and villages may lead to better outcomes. According to the folk theorem (Fudenberg and Maskin, 1986), the authors state, this is not guaranteed and players could be caught into very uncooperative equilibriums as long as each player could do even worse. Whether repeat playing leads either to satisfactory results, close to the cooperative one, or remains far away from this, depends on '...an intangible expectational factor, that might legitimately be identified with the history or culture of the group of players.' (Weitzman and Xu, 1993, 19)

According to Weitzman and Xu this factor is the age old Chinese cooperative culture. Critical elements in this culture are (1) the reliance on 'trust' and 'loyalty' ('*gemen*', '*guanxi*') and (2) the Confucian inspired community sense.

The reliance on trust and buddy-ship commitment ('*gemen*') relieves the cooperative ventures from costly negotiation and contracting. Lock-in problems related to relation specific investments are avoided by this trust attitude. The community spirit, ranking high in the Confucian list of virtues, links the executive owners and managers, even without being residual claimants driven by profit expectation, to the collective and long term interests of the firm. Both cultural elements are strengthened by institutional and political factors. The lack of a reliable judiciary upholding the rule of law and enforcing property rights and contracts

stimulates the reliance on something like ‘*gemen*’.¹⁰ The household registration system¹¹ (‘*hukou zhidu*’), which prevented migration of households for many decades created the ideal social setting for the development of repeated game-processes.

Weitzman and Xu represent this cultural factor as a cultural parameter λ , expressing the level of cooperative propensities among the players. As λ is much higher in East-Asian cultures than in the West, East-Asian societies are able to foster economic development without relying too much on formal property and contractual structures. Companies will reach efficient levels by relying on spontaneous community spirit and mutual trust relationships. From the Chinese case, Weitzman and Xu deduct that the property rights’ theory on the firm is not absolute but culturally related. According to the level of λ formal property and contractual structures are more or less necessary to reach economic results. In other words, the property rights’ theory on the firm is a particular case, the Western case, of a wider cultural theory on economic performance.

As the article of Weitzman and Xu was written in 1993, the authors could not envisage the spectacular rise of a genuine private sector in China during the following years. The emergence of the private sector, indeed relying on Western-like formal property and contractual structures, puts the advocates of the cultural relativistic theory before a cruel dilemma. Either their theory is wrong and formal property and contractual structures are indeed superior, as the switch to private company structures in China shows, or the Chinese faced a dramatic drop in λ and were compelled to adapt their institutions. The latter is unlikely as cultural changes require mostly longer elapses of time (Deepak Lal, 1998). Consequently the rise of the Chinese private sector is a difficult challenge for the cultural theory.

Section 6: From the grabbing hand to the helping hand: TVE as the ‘bureaupreneurial’ firm¹²

¹⁰ On the position of the judiciary in China, see Clarke et al., 19-20, 37-44

¹¹ The household registration system was imposed in the 1950-ties by the communist authorities on order to exert a strict control on migration, especially from rural to urban areas. Under this system families got a qualification as ‘rural’ or as ‘urban’. This qualification was passed on children and grandchildren. As a consequence, rural inhabitants could be arrested even for just entering the city. The system is now gradually relaxed.

¹² The expression from the grabbing hand to the helping hand is taken from Jihua Che (2000).

The literature on TVE's of the last ten years has, however, developed explanations, which fit more within classical economic insights, more specifically the Coasian theory of the firm. Many explanatory models perceive TVE's as a Coasian choice for a firm in which local bureaucrats are integrated as owners. Such a firm is persistently preferred on a market-relationship between local bureaucrats and entrepreneurs. A Coasian analysis supposes first the identification of the costs of the 'bureau-preneurial' firm on one hand, and the bureaucracy-private enterprise-market-relationship on the other hand. Second, a plausible explanation why firm-costs were lower than market-costs in the TVE-prevailing-period, and why the opposite became true when private enterprise became to prevail.

For a local enterprise local bureaucrats are interesting 'patrons', to use a 'Hansmann' term, in two respects. First, they control local critical inputs for firms and hold local taxation and expenditure power. Second, they have wide network-advantages with bureaucrats and party-bosses of the 'outside'-world, i.e. the higher ranked tiers of the administration, the banks and the courts. In this section we explain why an option for the 'bureau-preneurial' firm is explainable from the first angle. In the following section we argue that a choice for the 'bureau-preneurial' firm is also preferable from the second angle.

Before departing upon this analysis, we have to remark that this analysis should not be interpreted as a sociological one. When we are analyzing the relationship between the entrepreneur on one side and the local bureaucrat on the other side, we are not suggesting per se two distinct social classes preexisting to the firm-market-choice. As we argued before, the TVE's and later the private enterprises, were mostly the result of the initiative of members of a large class of bureaucrat-managers, often the sons of party-veterans and the bureaucrats of the former orthodox generation. The firm-market-choice, these bureaucrat-managers faced, materializes as follows: either combine the two functions of entrepreneur and bureaucrat within the context of one firm, or split up in one group, becoming pure bureaucrats, and another group, becoming pure entrepreneurs. This pattern however cannot be generalized. Che mentions many cases in which genuinely private enterprises were started up, but were later on converted into TVE's, due to a changing business environment (see further section 7)(Che, 2002, p.20). In these cases the split between private entrepreneurs and local bureaucrats did preexist, but was followed by a merger into a 'bureau-preneurial' TVE.

Notwithstanding these different sociological itineraries, the Coasian choice between market and firm is omni-present in all these cases.

To understand the bargaining positions of bureaucrats and entrepreneurs it should be emphasized that both parties detain assets that are fully complementary, or in other words, their value as a separate item is zero. The entrepreneur on one side mobilizes resources such as finances, entrepreneurial ideas and labor. The local bureaucrat on the other side controls critical inputs such as licenses, access to roads, energy, land, etc. With Banerjee (Banerjee, 1997) we will call these critical inputs 'slots'. Thanks to the thorough fiscal and administrative decentralization, introduced in China during the eighties, the local bureaucrats can be considered as near owners of these slots (Garelo, 2006). Following the administrative logic the local bureaucrats have to award these slots to enterprises either at zero price or at a fee, fixed in an official regulation. Most analyses assume, realistically, a near free setting of the fees, or, in other words, a widespread practice of bribery. As a result, local bureaucrats, able to set fees nearly freely, are able to develop a predatory behavior towards the enterprises. Finally, it should be remarked that the local bureaucrats had a near monopolistic position in the fee-slot-exchange because the option for entrepreneurs to vote with the feet was bleak, due to the close-knitted character of the township or village, especially still during the beginning years of the reforms.

These terms of the fee-slot-exchange predict clearly a choice in favor of a 'bureau-preneurial' firm.

A market relationship puts the local bureaucrat in a full hold-up position towards the entrepreneur. Once the entrepreneur has made his investment, the local bureaucrat is able to extract all profits from it by maximizing his fees for the slots, necessary to exploit the investment. As contracts on these fees are not enforceable, full uncertainty remains on the further fees.

On the other hand, because the local bureaucrat remains an outsider of the firm in case of the market-option, information asymmetry characterizes their relationship. The local bureaucrat, suspecting the entrepreneur of hiding revenue, will overcharge the entrepreneur with fees. The prediction is that the market option under these circumstances will lead to a zero-level of investments. Entrepreneurs will anticipate the predatory behavior of local bureaucrats by refusing to invest anything.

When opting for the bureau-preneurial firm the local bureaucrat invests his slots within the firm and becomes an owner.

Instead of a predator the local bureaucrat becomes a risk-sharer within the firm, whose interests are aligned with the longer-term-profitability of the firm.

On the other hand, by becoming an insider the information asymmetry between bureaucrat and entrepreneur disappears, while the fees, now wrapped as manager-bonuses, will be fixed on a level, sustainable for the firm.

As is suggested by this analysis, the choice for the 'bureau-preneurial' firms depends on some conditions of the political-economic environment. Che emphasizes three conditions:

- 1) The 'pro-business' or 'pro-politics'-attitude of the local bureaucrats. In the first case local bureaucrats are relatively immune for the pressure to use the TVE as a means for higher employment and care more about the longer-term-profitability of the firm. In this case private entrepreneurs will continue to cooperate within a 'bureau-preneurial' firm. When local bureaucrats however yield to the call for increasing local employment at the expense of profitability, entrepreneurs may either prefer to have their own private enterprise or not invest at all.
- 2) The development of local product markets. As emphasized by Hansmann (Hansmann, 1998), monopolistic control on critical inputs for the firm constitutes a strong reason to integrate this 'patron' as an owner within the firm. In the opposite sense, it is to be expected that the liberalisation of the supply of these inputs will dissolve this integration or make it redundant. In a regression analysis of the determinants of TVE-prominence in 28 Chinese provinces, Hehui Hin and Yingyi Qian found a positive correlation between the lack or underdevelopment of local product markets and TVE-prominence, while better-developed product markets are correlated with more private enterprises (Hehui Jin and Yingqi Qian, 1997, p. 9 and p. 12).
- 3) Fiscal decentralization. Fiscal decentralization nurtures the development of TVE's in two ways. First, when the local government has some autonomy

to determine tax levels, managers of firms have an incentive to integrate local bureaucrats within the firm. In this way the local bureaucrats will be responsabilized economically, which will limit possible predatory behavior. Second, when the local government has some autonomy in public expenditures, local bureaucrats obtain a direct stake in the profitability of the firm. The more profitable the firm is, the more they will be able to make public expenses and to strengthen their hold on local political power. As mentioned before (see section 1), this direct link between pro-business behavior and fiscal revenue has constituted during the first period of the reform an effective proxy for a formal protection of property rights on the firms' assets. This mechanism does not work however for the firm, directly owned by the state (SOE's-see section 3). As state owned enterprises have to hand over a large share of their revenue to central authorities, local bureaucrats, who have often to decide on the provision of critical inputs to these enterprises too, will align themselves much less with the profitability of the firm (Jiahua Che, 200, p. 2)

Section 7: Doing business in a non-capitalistic world: explaining TVE-performance by the external business-environment

Also some characteristics of the external business environment may provide to TVE's some crucial advantage in comparison to private enterprises. Guoqiang Tian distinguishes in this respect two types of management within the Chinese firm: the internal management, coping with the internal organisation of the firm; the external management coping with the relationship of the firm with the outside world (Guoqiang Tian, 1997) (see figure 13). In a capitalistic business environment both types of management are more homogeneous as the outside world is for a large part business oriented. This is for instance the case with the financial part of the business environment (banking institutions), the world of real estate business, the delivery sector providing raw materials to the firm, etc. In the cases where this is not the case, enterprises rely on contracted specialists, such as lawyers to deal with the world of courts, (often former) politicians to deal with the political world, lobbyists to deal with

bureaucrats. The business world of the Chinese firm at the end of the seventies until the middle of the nineties remains at large non-capitalistic, even hostile to capitalism. This necessitated the enterprises to integrated local bureaucrats as external managers for their specific bureaucratic expertise. The authors relying on this business-environment-explanation point to two crucial components of the external business environment: the banking system and the legal system.

External business environment: banks, courts and central bureaucracy

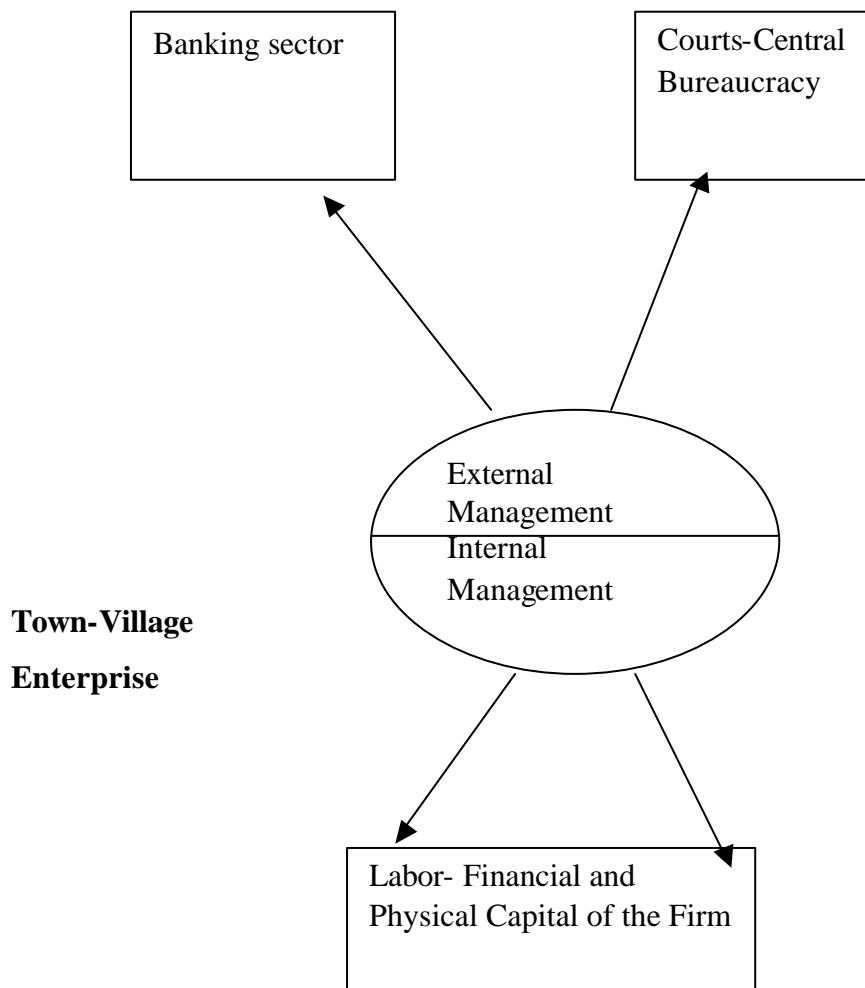


Figure 13: Internal and external management of TVE's

During the period of TVE-booming the banks in China were exclusively government owned. According to Che and Qiang (Che and Qiang, 1997; see also Hehui Jin and Yingyi Qian, 1997, p.4) public banks were clearly biased against private business. Therefore private entrepreneurs adopted the TVE structure in order to attract investment loans from banks. Empirical research seems to confirm this explanation, as TVE's received larger loans than private firms, were involved in larger scale projects and were more capital intensive (Zhang and Ronnes, 1993). By integrating local bureaucrats within the firm, TVE's were able to tap the old boys-networks from public officers in order to attract the necessary loans.

Beside this networking aspect, the banking sector had other reasons to be biased against genuinely private firms.

By involving the local authorities the TVE's disposed of larger assets than the timidly emerging private firms. Local authorities particularly disposed of much land, which could be used as collateral in case of insolvency of the TVE. With private firms at the contrary banks faced huge problems of adverse selection as the phenomenon was rather new and collateral was often entirely lacking. On the other hand, TVE's created higher risks of financial diversion. Within TVE's this could occur on two levels: the level of the local government (external management) and the level of TVE-managers particularly (internal management). This caused comparatively higher external agency costs than with genuinely private firms. As long as adverse selection problems, caused by lack of collateral, were higher than the external agency costs caused by the two-tiered structure of TVE's, banks have systematically privileged TVE's in their financial policy.

The importance of the public character of the financial sector for explaining the TVE-boom seems to be confirmed by the synchronic development of a private banking sector and the private firms in the industrial and service sector. In 1994 a sweeping reform of the Chinese banking sector was introduced (Brandt, Roberts, Li Hongbin, 2003). This reform involved the establishment of a genuine central bank (People's Republic Bank), the conversion of the urban credit cooperatives into city commercial banks, the possibility of licenses for foreign banks, licenses to non-state commercial banks, the reduction of government intervention in credit allocation. As a consequence the China Construction Bank, one of the four large banks, put an initial public offering of stock, on which the Bank of America bid for a stake of 9 % (Xinhua, June 23, 2005). Also HSBC, Citigroup and the Commonwealth Bank of Australia acquired stock in Chinese banks. As these private banks are less biased against the private sector and as the private companies become a more usual phenomenon in the Chinese picture

and can show more and more collateral, the necessity to shield the firm with local bureaucrats disappeared and genuinely private firms could develop.

Beside the banking sector, also the legal system and the tax system was part of an environment, hostile to the private sector (Che and Qian, 1997). Neither the judiciary nor the executive administrative services, nor the legislative bodies are really independent as the party controls them. In such an environment private entrepreneurs are particularly vulnerable to tax predation and extraction by bribable officers.

In all political crackdown campaigns private companies were at the heart of the target. The 'anti-spiritual pollution campaign' against Western thought and lifestyle, launched by the party leaders in 1983, led also to attacks to private entrepreneurs. The same scenario was repeated in the 'anti-bourgeois'- campaign of 1987. The worst reactions of the eighties were however the fallouts of the Tien-an-Min-events of 1989. Authorities started to harass private enterprises and blame them for 'taking huge profits by illegal methods' (Che and Qian, 1997, 13). This led to a substantial reduction of investment in private enterprises and to the conversion of many private companies into TVE's.

In such environment, with latent and acute periods of hostility succeeding each other, TVE's are less vulnerable to legal and administrative harassment. TVE's are not merely private businesses, they also provide finances for local social services, such as collective agricultural investments, kindergartens, hospitals, etc. This provision is also rewarding for the higher ranks of government. As a result they will squeeze TVE's less than private business.

Empirical research seems to confirm the causal impact of the tax and legal component of the business environment. In 1985 the share of private business was at 10 % in the county of Nanhai and only at 3 % in the county of Wuxi. The first county is situated in the province of Guangdong where reforms were introduced the first and where direct government intervention was reduced. Wuxi is in the southern Jiangsu province where reforms were only later introduced (Bird and Lin, 1990; Chang and Wang, 1994, 449).

A field study by Zhou and Fang describes the difficulties faced by private enterprises in Wenzhou. Beside moral and psychological resistance, private entrepreneurs were discriminated against TVE's with regard to their taxation (250 % higher than TVE), higher electricity prices and difficulties to obtain bank loans (Chang and Wang, 1994, 445).

David Li, relying on the property rights' theory of the firm of Grossman-Hart-Moore (Grossman and Moore, 1986), conceptualizes TVE's as firms with ambiguous property rights. Neither the TVE-managers, nor the town-village-government, nor the inhabitants, nor central political authorities can claim to be 'the owners' of the TVE. Effective ownership rights are unclear in a TVE. According to the standard theory, ambiguous ownership rights should be a source of gross inefficiencies. Ownership rights on the firm and its physical assets are given to the most critical investors because contracting with them would create numerous problems, as contracts with long-term investors have to be necessarily incomplete. By giving ownership rights to the most critical investors these investors will have the final say in whatever dispute within the firm. According to Hansmann (Hansmann, 1988) investors, lending assets to the firm would face huge problems concerning the monitoring of the firm and the handling of the funds they provided. Moreover, as investments are brought in the firm on a long-term base, investors would face problems of lock-in.

The specific business environment of the Chinese firm in the seventies, eighties and the beginning of the nineties, invites however to maintain ambiguity about the property rights of the firm, in order to cope with uncertainty.

David Li provides us with the remarkable example of the Lian-xang (Legend) Computer Company. This company, currently the largest domestic computer producer in China with a market share of 26.2 %, was founded by eleven computer scientists working at the Chinese Academy of Science, the most prestigious scientific establishment in China. These eleven scientists borrowed 200 000 yuan in 1984 and started the company. The ownership of the company was in the beginning years more or less shared between the scientists and the Academy in a very unclear way. This ambiguity was however not a liability for the firm, rather an advantage, seen the uncertainty of the business environment. The firm faced technical problems as political-administrative problems as well. If the firm had been entirely owned by the Academy, the costs to monitor the scientists would have been considerable due to huge information asymmetries (Hansmann, 1988). If the firm had been entirely in the hands of the scientists, the firm would have faced huge problems with the bureaucracy. Contracting with bureaucrats was not an option because such contracts would have been grossly incomplete and also difficult to enforce. As such, it was better to bring in the 'bureaucratic human capital', in this case the Academy, and settle the internal quarrels between the two categories of owners from issue to issue. Against the canons of the theory of the firm, remaining in ambiguity about the ownership rights was efficient, at least as long as the uncertainty in the business environment prevailed.

This 'ambiguity'-equilibrium comes however under pressure from the top as from the bottom. As mentioned in section 2, since 1993 the political center, especially the ministry of Agriculture, calls for a separation of government agencies and (private) business. This would mean that the once magic TVE-formula of combining private business with public service provision is no longer necessary. The pressure comes also from the bottom as once the business environment becomes less uncertain, entrepreneurs will prefer to work in more clear conditions and assign clearly defined property rights.

Section 8: Other explanations of TVE: geographic location and the community as the firm

For sake of completeness we mention two other theories about the explanation of TVE-success.

Naughton (Naughton, 1994, 1996) observed that TVE-successes occurred first in geographic areas in proximity to booming urban centers. This led him to develop a theory on TVE-success in which the control on land plays a key role.

At the beginning of the economic boom rural communities disposed of two factors in abundance: land and labor. For rural communities close to booming urban centers it would have been rational to open up land for industrial plants, capture the rents and financing their public infrastructure and services with these rents. The problem with this obvious choice was however the huge imperfection of rental markets. Imperfection not only due to the lack of transparency on these markets, but also, as seemed on other occasions, to the uncertainty of contract enforcement. As a consequence, the second best option was to run the business by themselves and by this generate an income to finance the public services. To state it otherwise, the landowner was co-opted into the firm in order to avoid costly contracting between the local government-landowner and the private company. Because the rents from land were the highest in the areas in urban proximity, this option was first tried out there.

This theory may provide a partial explanation for the TVE-boom but is not quite convincing as an overall theory for it.

First, it seems rather contra-intuitive that ill-working rental markets would force the landowners, in this case the local bureaucrats, massively into the role of entrepreneurs. Rental markets on land are relatively simple markets, so it seems likely that problems on these markets would be solved quite easily and quite soon.

Second, one could argue that private enterprises face fewer disadvantages in urban proximity due to more accessible outlets for output, increased support for specialized inputs, labor market pooling and technological spillovers. Private enterprises would consequently overcome quite easily the problem of land tenure in urban proximity. If not, it should be blamed to much more overriding problems, such as the one analyzed in the preceding section.

Finally, other research has pointed out that other determinants are crucial to explain interregional differences for TVE-growth. Chen Chien-Hsun mentions determinants such as the availability of surplus agricultural labor, local expenditures and potential for market extension (Chen Chien-Hsun, 1997). This undermines the point that early TVE- appearance in areas in urban proximity evidences the theory of geographic location.

The last theory on TVE's is peculiar, not for its explanatory focus, but for the setting of the boundaries of the firms. According to Che and Qian (Che and Qian, 1997) and to Taube (Taube, 2002) not the TVE-enterprises themselves, but rather the community (township or village) should be considered as 'the firm'. The boundary of the firm is neither determined by the legal definition of a TVE in Chinese law, nor by the technical production diversity between the TVE's. The firm boundary is the community itself. All TVE's, depending of one and the same township or village - government should be considered as separate branches or subsidiaries of one firm. The mentioned authors emphasize that the role of TVE-management is restricted to daily operations while the community government decides on investment and finance, especially on securing loans, on the selection of managers, on the use of after tax profits.

The different TVE's are merged into one community-firm because the town-village government (TVG) acts as a middleman between the central government and banking

institutions one hand, and local business on the other hand. The TVG's can protect the business against excessive taxation, while it can protect the interests of central government against excessive revenue hiding. The TVG's are in business because of the huge information asymmetries, existing between business and central government. Once these asymmetries diminish the community will disappear as a merger of different business and the latter will develop an immediate fiscal and regulatory relationship with the government, as it is the case in other developed industrial nations.

The basic tenet of this theory does not deviate too much from the other theories, emphasizing the importance of the external business environment. Also this theory looks for an explanation of the non-conventional TVE-firm structure to the hostile framework of central government and the unpredictable and arbitrary tax and legal system.

The peculiarity resides in the definition of the collective firm. For our purposes, this question is of secondary importance. Whether the TVE should be considered as the operational unit on the market or the TVG depends on quite complicate empirical data, such as the competition rate between TVE's of one community, the independence of TVE-managers towards the community government, the financial independence rate of TVE's etc. Whether the one is truer than the other does not matter much for our central question: whether TVE-performance defies the classical property rights' theory of the firm.

Section 9: Conclusions

The experience of the town-village-enterprises in, mainly rural, China urges indeed for a contextualisation of the property rights' theory of the firm. The contextualisation, which follows from our research and comparison of the different explanatory theories, is, however, of another kind than the cultural contextualisation, proposed by Weitzman and Xu. These latter authors are right that clearly defined, transferable property rights on the firm, allowing owners to act as residual claimants, are not as such a prerequisite for efficiency. This is only the case under certain conditions. Our comparative study shows however that, as far as TVE's are concerned, these conditions are not of a cultural kind, but rather of a politico-legal kind.

The Chinese, mainly rural, enterprises adopted structures seeming, at first sight, to impede inside-cooperation, rather than to stimulate inside-cooperation, not because Chinese individuals, culturally impregnated with an age-old cooperative morality, would not need structures, conducive for cooperation. The Chinese, mainly rural, enterprises needed such structures, however a burden for insiders' cooperation, in order to cope with the business-environment, populated by local and central bureaucrats. In order to be efficient on the level of outsiders' cooperation, the Chinese, mainly rural, enterprises, had to make heavy concessions on the level of insiders' cooperation. Since the middle of the nineties of the former century however, the requirements of outsiders' cooperation have been changed considerably. The rule of law involving a better protection of property rights has been improved, fiscal duties have become more stable, banks have been privatized and the power of local bureaucrats has been diminished by the extension of input-markets. In response to the changes on the level of outsiders' cooperation, the Chinese enterprises are changing also the structures of their insiders' cooperation, by which their structures reflect more and more the prerequisites for efficiency, advanced by the property rights' theory of the firm.

On the theoretical level, the TVE-case makes it necessary to push the boundaries of the property rights' theory of the firm towards more abstractness. As shown already by Hansmann, efficiency does not require always that the investors of capital should be the owners or the only owners of the firm. It may be very plausible that certain conditions, such as information asymmetry and the monopolistic or monopsonistic position of some 'patrons' of the firm, necessitate other ownership structures such as consumer- or producer-cooperatives. From a Hansmann angle the Chinese 'bureau-preneurial' firm can be seen as a cooperative in which important 'patrons' such as the local bureaucrats are integrated as owners, because of the monopolistic position with regard to critical inputs and their position into wider bureaucratic networks. In so far, the Chinese 'bureau-preneurial' firm constitutes only a new, albeit tremendously important, empirical case of the property rights' theory of the firm, as adapted by Hansmann. The TVE's push the intellectual boundaries however somewhat further than the already widened up limits of the Hansmann version of the property rights' theory. The 'bureau-preneurial' firm is not only special because it integrates the local bureaucrats, but even more because the property rights' structure remains unclear and ambiguous. As a result, not only the question which 'patrons' should be the owners of the firm depends on the wider context in which firms have to operate, but also the question whether the firm should have clearly defined ownerships' structures at all. As long as the

business environment remains fluid because the power positions in it are changing, it is preferable to keep the property rights' structures in it also fluid and to settle problems from case to case.

The Chinese 'bureau-preneurial' firm is finally also extremely interesting for transition theory and strategy. The impressive growth-records of the Chinese economy, compared to the poor showings of other transition countries, especially those of that other former giant Russia, makes the Chinese way very attractive. The analysis of the success of TVE's however invites for some caution. As has been pointed out, the Chinese 'bureau-preneurial' firm is a path dependent response to a given business environment characterized by the immense weight of local and central bureaucracies. It is evident that countries, lacking such gigantic bureaucratic structures, used to work under the cover of an all-encompassing collectivistic ideology, do not have to make the deviation of the collective enterprise but should move more directly toward private enterprises, operating within a context of law, enforced by courts, as less corrupt as possible.

In case of an omni-present and an omni-potent bureaucracy, the Chinese way seems to be recommendable.

According to Guoqiang Tian it is possible to divide up the Chinese transition process into three steps: liberalization, marketisation and privatisation (Guoqiang Tian, 2001)

Liberalisation means that the enterprises are kept intact with regard to their collective structure, but are gradually submitted to conditions of hard budget constraints and competition.

Marketisation means that the development of markets, as the result of step one, foster the emergence of market institutions such as bond and stock market, a commercial banking sector, an advertisement market, mortgage banks, a court and arbitration system, based on the rule of law. The government should promote these institutions but not create them.

The privatisation finally occurs under perfected conditions of liberalisation and marketisation. Firms will gradually opt for more efficient settings of property rights. In such a context opportunities for outright privatisation should be created. The Chinese took this latter step during the last ten years. If we add to this that these steps were carried out on a local,

decentralized base, albeit under the eye of a strong central authority, we summarized quite well the ingredients of the Chinese transition meal.

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