

PROPERTY RIGHTS IN COMMON, FROM COMMUNES TO TOWN AND VILLAGE ENTERPRISES IN RURAL CHINA

Malcolm Cone
University of Otago

Zhilong Tian
Huazhong University of Science and Technology

André M. Everett
University of Otago

ABSTRACT

The paper is an investigation of the emergence of town and village enterprises (TVE) in rural China. Part one investigates the antecedents of the TVE phenomenon, adopting the dual perspectives of macro economic policy (especially the household responsibility system) and the role of culture as explanatory paradigms. Part two is a case study of a successful TVE that shows the effects of economic policies and culture on a single organization in rural Hubei Province.

Key Words: Town and village enterprises, China, forms of ownership, competitiveness, spontaneous emergence of self-managing systems, extended orders of cooperation

INTRODUCTION

When one thinks of monolithic states, few countries leap to mind faster than China. The image is of an omnipresent state with a somewhat capricious temperament dictating the terms by which its citizens must abide. Few states have exercised as much control over the lives of their citizens as the Chinese government has throughout the past five decades. Society in China has been subjected to an almost continuous campaign of social reform and economic restructuring by the committed cadres of the Chinese Communist Party (CCP). The state has penetrated every aspect of Chinese society. The campaigns against capitalist middle roaders and revisionist back

sliders that marked the decades of the late fifties till the mid seventies would have served, one would imagine, to have eradicated the spirit of capitalism forever from the Chinese psyche.

Interestingly the contrary has been the case; after two decades of economic and social reform, China is poised to overtake Japan as the second largest economy in the world. Even more startling is the realization that the stimulus for this growth has not come from rejuvenated state-owned enterprises (SOEs) or foreign invested international joint ventures (IJVs), although both have contributed to recent development. It has come from rural China. The question must be: How has this happened? After all, the collectivizing of agriculture was completed by the middle of the first decade of communist rule; the last landlord had been either shot or banished by 1960. Centralized planning production targets and fixed prices for all produce became the staple realities for the farmers of China.

Yet it appears that through all of this farmers and small-town residents, while bending before the wind, have retained the values of self-help and cooperation (latent during some periods of the turmoil of the 1960s and 1970s). The hard work and intensive networking one associates with Chinese enterprises elsewhere in Asia (where they prosper almost no matter what the political climate in which they have to operate) is flourishing in rural China. Polanyi's Great Transformation (1945) has come to significant parts of rural China; a process that took many decades to achieve in the West has occurred in China in the space of a few of years.

The collectivization of labor, a feature of the Mao era, has been transformed into a private enterprise system, dependent for its success on the previously maligned family network and extended kin groups. This was accomplished through the application of the family responsibility system, believed by some commentators (e.g. Christiansen and Zhang 1998) to be the factor that gave China's farmers the opportunity to massively expand agricultural production. Property rights, in current economic thinking the foundation of the emergence of extended orders of economic cooperation, were reformed in China so that by 1983 farmers' property rights became quasi-private. In most of rural China, including Hubei province where the research that informs this paper was carried out, small strips of land were divided among rural households, who suddenly possessed the right to decide how to use that land; the rights granted did not, however, extend to the right to actually sell the land, as the state could confiscate land or oblige the farmer to grow specific crops to satisfy state-specified production targets (Zweig 1997).

An unanticipated outcome of the family responsibility system was that it provided a foundation for an innovation that has resulted in the emergence over the last 20 years of town and village enterprises (TVEs), which now account for over one third, by some accounts one half, of China's economy in terms of output value.

The reason for this change can be found in part in the necessity, if China was to

become a developing/developed country, for a substantial proportion of the one billion rural population to move from farming to non-agricultural activities. However, this change in occupation did not occur solely by migration to the urban areas; instead, the government actively promoted the policy of “leave the land but not the country side, enter the factory but not the city” (*li tu xiang, jin, chang bu jin cheng*). China’s farmers responded to the call to leave the land with great enthusiasm, and the rural non-agricultural sector emerged in the 1980’s as the most dynamic component of the Chinese economy. The gross value of industrial output rose from 10% in 1978 to 27% in 1989 to almost 50% in 1998, with little or no investment from the state (Ho 1994). By 1984 TVEs constituted only 10% of rural income; in the next 6 years (to 1990), industrial output as a percentage of GDP rose from 10 to 31% (Forster 1997). Since then the industrial output of small towns and villages has continued to increase as a percentage of GDP, standing at 40% of GDP in 1994 (Goodman 1997). Goodman’s figures are supported by Selden (1996, 20), who in his study of Zhejiang province found that in the period 1978-1984, TVEs grew by 32% per year; by 1993 this share had increased to such a level that the TVEs produced 73% of state GDP and provided 67% of the province’s fiscal revenue. There is thus little wonder that even Deng Xiaoping in 1988 expressed real surprise that the TVEs were so successful (Xu 1995, 16).

There was of course a downside to this very rapid development: Being almost entirely market oriented, the rural non-agricultural sector has been able to grow as it pleased. Whilst this has enlivened the economies of provincial China, it is not without its problems. These include reduced ability of the government to plan investment, poor spatial distribution of enterprises that are not always economically efficient, often wasteful duplication of investments, tension between rural and urban enterprises, and finally the misuse of a very valuable resource in China, good agricultural land (Ho 1994, 2).

FIELD OF STUDY

It is against this background that this study is conducted. The fieldwork was carried out in October – December 2001. The study is focused on rural Hubei province, identified by various authors as being one of the more conservative provinces where officials were reluctant to allow the kind of economic freedoms enjoyed in other provinces, notably Guangdong and Fujian provinces in the southeast and Jiangsu province in the east, adjacent to Shanghai (Zweig 1997, 15). For this reason TVEs in Hubei are in a different stage of development and so provide insight into a range of fundamental issues of development, more than is the case in the above provinces, which have moved on to be confronted with more of the problems associated with maturing commercial organizations. For example, the experience of the early

developers was relatively unhindered by structural impediments or incentives, whereas later development has been both helped and hindered by the positive view taken of TVEs by central government. Once it was realized that the spectacular success of TVEs was an unintended consequence of rural reform, the concern of central government was to limit the transformations of TVEs into fully shareholder-owned and operated businesses; this has materially altered TVE behavior, as the case study presented later will demonstrate.

THE ORGANIZATIONAL STRUCTURE OF TOWN AND VILLAGE ENTERPRISES

It can be convincingly argued that the unique features of TVEs and their relationship to small-town government exist in the symbiosis between the two. However, like the earlier outcome of the household responsibility system, this also was an unintended outcome. The replacement in 1983 of the commune regime of production brigades, which had been the mechanism for the administration of local affairs in the country side up until that point, created a structure of townships and towns, according to the new constitution representing 'popular self-organization' in the form of villager communities (Zhang 2001). Where the people's communes had governed both production and public administration, the new townships and towns were intended as organs of public, that is of state, administration only (Christiansen and Zhang 1998).

However, the separation of the functions of production seems to have been incomplete, as in many cases the town/village governments still control both administration and production (Zhang 2001). These functions were frequently taken over by the new governments (as will be noted in the case study later) because local entrepreneurs were unable to find the capital to develop past a small, relatively labor-intensive mode of production. There are those who argue for this reason that the TVEs are fake collectives (that is, not owned and operated locally); they are owned by the government, either local or provincial (Oi 1995, Parris 1993) and have been taken coercively from private enterprise owners. This argument may or may not be true; it is certainly an interpretation that can be taken from some of the details of the following case, yet it does not alter the fact that there is a certain management structure that is so constituted that it appears to stimulate a high level of productivity and efficiency without any overt coercion.

Chen (2000, 22-24) has identified the two-tier system of principal-agent proxy relations, in which the community residents are the nominal or *de jure* owners of the town and village enterprise, who serve as the *de facto* owners of the firm. The community via its elected councils assumes responsibility for the provision of public goods and services (local welfare) and the provision of funds for investment in local infrastructure.

The second tier, if we follow Chen's formulation of principle-agent proxy relations, is between the community government and the firm management where the

community government delegates the actual hands-on control of the operation of the company to a management team. This management receives compensation via a management contract. In return for the incentives to pursue efficiency and productivity, the management team is obligated to remit profit and pay rents and fees to the village government (Chen 2000).

Conventional accounts of property rights theory, seen to be the most effective analytic approach to understanding issues of management accountability and organizational efficiency, leads to the question: How do these arrangements stimulate entrepreneurial activity over a sustained period of time? Does the management contract contain some financial incentives, i.e., bonuses or stock options, that fit into conventional conceptions of property rights, in which it can be expected that management will be both accountable and performance orientated? These questions need answers, because the phenomenal growth of the sector, and the success of the Hubei Hanchuan Steel Wire Company (the subject of the case study), both raise the question of ownership, budget responsibility and operational efficiency.

MANAGEMENT RESPONSIBILITY AND PROPERTY RIGHTS

The generally accepted principle at the core of property rights theory is that without well-defined private ownership a firm will tend to operate relatively poorly (Alchian and Demsetz 1972). This is readily understood if we consider comparative accounts of the frailties of cooperatives or organizations where the ultimate benefits are either undefined or only vaguely defined. Kornai (1992) suggests that this can be called the soft budget syndrome; since there are no clearly defined owners to pay for mistakes or bad luck, someone else pays, typically the state. When property rights owners exist, it is ultimately they who have the rights and incentives, to observe and monitor output behavior, negotiate and enforce contracts, hire and lay off workers, sell or buy property, and generally make decisions that increase the profitability of the firm. It is the property owner who at the end of the day pays for mistakes and bad luck. However, when private owners can obtain compensation for losses from the state, then there is no incentive for the property owners to seriously address issues of inefficiency and free riding that typically characterize soft budget syndrome.

Following this line of reasoning we can argue that TVEs ought not to be as efficient as they are. They ought to be plagued by the soft budget syndrome, yet they seem to be just as efficient in their use of resources as private organizations in Taiwan or Hong Kong (Xu 1995).

A comparative study of property rights was carried out by Weitzman and Xu in 1994. They outline the following arguments that focus on the issues of property rights as being fundamental to the successful long term economic vitality of an organization. This formulation features a number of characteristics that are worth noting because it

provides a model against which the TVE's organizational structure can be measured.

- 1) To every property is assigned a well defined owner or owners with exclusive rights of ownership.
- 2) To the owner of the property goes the residual income accruing from the assets.
- 3) The owner has the right to control or determine use of the existing assets, to restructure the property, and to sell or lease it. (Weitzman and Xu 1994).

The key areas in which TVEs differ from the standard property rights theory can be listed as:

- 1) TVEs have no owners. In the spirit of traditional property rights theory; no shareholders in the normal sense of that word exist. Participation in a TVE is not a decision made by residents of a village; participation is defined by residency and by the requirement that residents contribute financially to the TVE as a condition of employment in it.
- 2) There is no residual claimant; the residents of a village are simply passive recipients of the benefits that accrue from the financial success of the TVE, either as bonuses or as reinvestment back into the village community. Xu (1995) reports that 60% of after tax profits are reserved for reinvestment into the TVE. The balance is invested in community assets and a small proportion, typically 7-10%, is paid out as bonuses to staff employed by the TVE.
- 3) TVE assets are non-salable, non-transferable, and non-heritable for either the executive owner (the manager) or village residents. Residents of the village will automatically lose their nominal residency (and hence benefits) if they leave the community. An outsider will become a participating resident automatically upon marrying a resident of the village.

According to property rights theory such a situation seems a prime candidate for the soft budget syndrome, yet all the surveys of economic efficiency have found TVEs to be as efficient as a fully private company where all of the principles of property rights theory are in place (Xu 1995). Why is it that soft budget syndrome does not afflict the TVEs as it does the SOEs (whose performance seems to confirm the general argument put forward as to the inadequacies of soft budget scenarios)? As noted already, the performance of TVEs has been spectacular, providing a sustained growth path that is unprecedented in economic history. Current theories seem inadequate when we seek to explain the contemporary situation in rural China.

We acknowledge that many factors have come together in a unique way in China. Christiansen and Zhang (1998) and Pei (1998) suggest two significant factors that are in addition to those already discussed earlier in this paper.

- 1) The demographic profile of China's over one billion people, who are largely subsistence farmers, and the divisions between rural and urban China.
- 2) The gross inequities of the collective farming system where personal effort

was not aligned with reward, and free riding (if not endemic) was always a problem.

Pei suggests that the household responsibility system transformed these two apparently intractable problems into a solution, and agricultural productivity increased rapidly. Per capita incomes in rural China tripled from 133.57 yuan in 1978 to 397.60 yuan in 1985 (Pei 1998, 86). The shift in responsibility and accountability was working in a spectacular fashion; productivity grew in what were industrial production brigades (now TVEs) at over 30% per year up until 1998, according to Pei (1998, 87). However we agree with Pei's comment (1998, 83) that "we need to look for deeper explanations" than demographics and poor production incentives. Our investigation here looks for those deeper explanations in Chinese culture.

We turn to the social theorist Gary Hamilton (1991), who, in looking at the history of economic activity in China, suggested that for at least the past 500 years a market economy has been in evidence in China. It has rested on two social institutions, one regional, the other based on kinship relations. Hamilton asserts that the state's interest in the lives of the people was limited to its concern with the preservation of order in society and the collection of revenue to fund the bureaucracy of government. This it did by upholding the ethical demands of social relationships embedded in kinship relations and regional methods of governance, that is guilds and village councils.

Hamilton suggests that what regional guilds, local governments, village councils, and kinship groups had in common was a strong emphasis on collegiality. He states:

"Collegiality in China plays an analogous role to law in the West, whereas kinship plays an analogous role to individualism in the West. Like law, collegiality served as the force to guarantee creditable market behavior. The state in China did not standardize weights and measures, did not back its own currency, did not enforce a priori the validity of contracts, did not support credit institutions... it was the merchant institutions that made the market predictable and continuous" (Hamilton 1991, 58).

This is reminiscent of Hayek's (1988) account of extended orders of cooperation, based on the acceptance by participants of the rules of the game. This in turn is similar in many ways to Fukuyama's description of spontaneous social order, which he describes as "the capacity to form new associations and to cooperate within the terms of reference they establish" (Fukuyama 1995, 27).

Hamilton makes a strong case for seeing the Chinese ability to develop collegial networks as being founded on the core Confucian values. In evidence of this he quotes from Needham:

"The Chinese notion of Order positively excluded the (Western) notion of law... the Chinese world view depended upon a totally different line of thought from the law based world view in the West. The harmonious cooperation of all beings arose, not from the orders of a superior authority external to themselves, but from the fact

that the Chinese were all parts of a hierarchy of wholes forming a cosmic pattern, and what they obeyed were the internal dictates of their own natures” (Needham 1956, 582).

Studies conducted by Wong (1996) in Taiwan serve to support Hamilton’s contention that collegial relationships were and still are the basis of networks of trust in Chinese societies. In a series of studies between 1987 and 1990, Wong carried out research into Taiwanese businesses in order to discover their level of dependence on kinship ties and family obligations. His findings led him to propose a new term to capture the essence of the Taiwanese model of ‘guanxi capitalism,’ not based exclusively on family networks but operating more particularly on the basis of personal trust, which by extension means a belief in the good character of the business person. This pattern of behavior is served by the same dynamic as that mentioned above in reference to Chinese collegiality as a basis for economic networking. Wong (1996, 131) offers a fascinating picture of the influence of culture on economic activity. He notes that entrepreneurship thrives in Chinese family firms outside China. Overseas Chinese firms undertake economic innovations and compete fiercely with one another. They form business networks and subcontracting systems so as to enhance flexibility and coordinate production. Such networks flourish in spite of the state. Their collective strength is derived from private initiative, not from government patronage or planning. Before 1979 such firms were non-existent in China; since the economic reforms, the situation has altered dramatically. The patterns of behavior identified by Wong in Taiwan are now proliferating in China (Wong 1996).

These insights are further validated by contemporary examples of extended orders of cooperation in rural China, that of town and village enterprises (see the following case study). The factors that are at work in China to aid such a rapid adoption of hitherto banned practices can be found in the Confucian traditions that are part of China’s history. Wong (1996) identified the values of pragmatism, familism, autonomy, and personal trust as the necessary ingredients for Chinese-style entrepreneurial activity. He noted that the revival of Confucian values is selective; it is occurring predominantly in the rural areas of China where in excess of 70% of China’s population still lives. Wong seems to be supporting the contention of Selden (1996) that the market economy never left rural China. Confucian values are re-emerging there first, and they are driving the private and collective (IVE) sectors to dominate the Chinese economy. Interestingly, Selden (1996) suggested that the urban Chinese nourished by the iron rice bowl welfare system have not been able to participate in the emergence of ‘guanxi capitalism’ in China. The urban dwellers, apart from a relatively low number of entrepreneurs and contractors, are little more than disgruntled spectators, at best stockholders in new rural-based companies.

There is also an interesting correspondence between these views and the theory proposed by the economist Weitzman (Weitzman and Xu 1994) that Chinese society

is a cooperative culture and that this cooperative spirit is born of a pragmatic assessment by Chinese entrepreneurs of the most strategic of means securing the benefits of economic growth for themselves and their families. Weitzman proposed that the folk theorem of the outcome of a repeated non-cooperative game, played among sufficiently patient players, looks as if it is the outcome of a cooperative process or some legally binding agreement to play cooperatively (Weitzman and Xu 1994). He maintains that if each member of the group expects that every other member of the group will play cooperatively, this ethical norm being sanctioned by the awareness that there will be a severe penalty for not playing cooperatively (which in Chinese business circles is exclusion from the game [Redding 1993]), then the cooperative solution may become a self-reinforcing equilibrium. The following case seems to bear out Weitzman's theory.

CASE STUDY: THE HUBEI HANCHUAN STEEL WIRE COMPANY (HSW)¹

Duanjia village is 80 kilometers north of Wuhan, not far from the banks of the Han river, some 30 kilometers from the city of Hanchuan. This village of over 3000 people is set in the middle of a wide plain surrounded by cotton fields, apricot trees, and fish ponds. The township seems not unlike many other towns of equal size, but appearances are deceiving. On entering the town all of the streets are paved, all of the houses are new, and trees are planted along both sides of the road to further enhance the already attractive image of a town on the move. Local people were much in evidence, farmers driving their tractors out to their fields, wagons piled high with hay for animal fodder or bulging with freshly picked cotton. The entrance to the Hubei Hanchuan Steel Wire Company (HSW) is via a large gateway on the main street under an archway that identifies the factory.

The front office was spacious and staffed by a number of company officials. Mr Jung, a university graduate from Hebei province to the north, acted as an escort, and Mr Zhou (whose role we were to discover later) accompanied us. We were to find that at almost every turn Mr Zhou was at our shoulder, especially when we were interviewing staff or looking at the production process. A company car took us to the township's hotel, built by the company to house visitors and overseas experts who were involved in some of the technical aspects of new production methods.

Whilst we were in Duanjia village we encountered several technicians from Italy training company staff in the use of new wire extrusion equipment imported from Italy. This was a surprise to us because the village was two and a half hours drive from Wuhan and the technicians, with no transport and no language skills, were virtually obliged to spend their six month tour of duty within the radius of the local

¹ Note: Names and titles have been changed in this case study

community. This would have been a minor concern for most of the townspeople who until recently required permission from their local headman and the brigade leader for the town to travel to Hanchuan, only 30 kilometres away. However, for the technicians from Italy it must have made the time when they were not working seem rather long and tedious. Television provided only local fare, but of course there was always the Internet.

We were introduced to a Senior Manager, Mr Jiang, a tall urbane man who quickly took charge of the tentative efforts of the hotel staff to make us comfortable. Within a short time we were enjoying a very pleasant lunch of fish, cabbage, broccoli, lotus root, chicken, and thin slices of beef, supplemented by copious quantities of green tea and Chinese beer. After lunch Mr Jiang invited us into a spacious and well-appointed lounge furnished with large leather couches and a smooth tiled floor with bay windows looking out to a recently established Chinese garden. We settled into our chairs and a two hour conversation with Mr Jiang ensued, a conversation that was closely attended to by Mr Zhou, who we were able to identify afterwards as without doubt a member of the local government team whose duty it was to ensure that the Senior Manager did not give away any secrets.

Mr Jung, the front office member of staff, presented a short history of the village that had been prepared for the company by a local historian. It is from this account that the following facts about the village are drawn. Duanjia village traces its roots back to its inception as a village of migrants when approximately 600 years ago the ancestors of the current families arrived from Jiangxi province during the reign of the Ming Dynasty. Despite the rather difficult farming conditions due to the low-lying nature of the surrounding countryside, which was subjected to regular flooding that ruined crops and resulted in frequent food shortages, the villagers survived mainly due to their skills in forging and working with iron in the manufacture of nails. In the period after the foundation of the new China, political reforms began with the consolidation of the Communist Party control. This process of consolidation was typified in Duanjia village by the example made of five prominent landlords who in 1954 were sentenced to death by the land reform working team. The period following the consolidation of power was relatively stable politically although some of the state planning objectives interfered with the diversification of economic activity that had been part of the village's history for 600 years. This was particularly noticeable during the Cultural Revolution when the iron manufacturing industry was prohibited as a non-agricultural activity and as contrary to the objectives of the planners, who - following the dogmas from Beijing - gave scant consideration at that time to local needs or skills. However, despite these impediments the first iron plant was begun in earnest in the 1950s; this was followed by a farm hardware company founded in the 1960s. It was in the 1980s with the Deng reforms that a prefabricated slab company was added to produce reinforced concrete panels for the construction of

prefabricated buildings in the surrounding towns and villages. Since the introduction of rural reform, the iron forging business developed very quickly, such that by 1986 almost every family was involved in some way in the iron forging business. The village became known throughout Hanchuan county as the iron forging village. During this time a steel molding plant and a brick making factory were also established.

Following this interesting background briefing, Mr Jiang took up the story. Parallel to these cooperative developments, several individuals set up some small businesses of their own, also in the iron processing and marketing areas. Mr Jiang noted that these individual enterprises employed up to seven or eight people, often employing family members and wider kin; this number was what the provincial government considered the maximum number of employees that a person could engage without becoming something of a capitalist. Such has been the success of these enterprises that there is an emerging class of residents in the village who would qualify as middle class; some have moved on to bigger things, including several who have moved as far away as Shanghai and Beijing.

The original steel wire company was formed in 1981 by six partners, five from Duanjia village, and one from a neighboring village. Mr Jiang, a senior manager for the past twelve years, was one of the original group. The leader of this small group was at the time of the interviews still the President although Mr Jiang said that like himself the President was no longer young and both would soon have to begin to consider their futures within the company as they would need to give way to younger managers. In 1988 the Hubei Hanchuan Steel Wire Company (HSW) was formed to further develop the existing iron working talents in the village. Part of this process was the introduction of new technologies to improve production outputs and wire quality. The change in status from a small essentially private company to a shareholding one was brought about by the need to put more capital into the company in order to purchase the necessary equipment.

The issue that was central to our visit to HSW was that of the nature of ownership of the company. Did it conform to the structure discussed earlier that is officially said to be the status of all TVEs, or was it some kind of hybrid? It was, after all, initiated by a group of six residents of the village. It would not be unreasonable to assume that they still retained private interests in the company, and it was those private interests and benefits that they were primarily interested in preserving. We approached the matter carefully, mindful of Mr Zhou who was sitting in the corner on a straight-backed chair alternately dozing or peeling and eating apples from the village's nearby orchards.

Mr Jiang was completely unconcerned by our enquiry, answering our questions easily and convincingly. He said that originally the six entrepreneurs saw the establishment of the company as a way to ensure the livelihoods of their families and this was sufficient motivation in itself. In this there was the added incentive of the

household responsibility system, which decreed (as noted earlier) that residents of towns and villages were prevented from migrating into the urban areas and were encouraged to invest in the local community. He and his partners were surprised and somewhat delighted by their early success but soon found that to secure the success in the first years they needed access to new technologies. For this they required a considerable amount of capital but they lacked the necessary collateral to approach a state bank to ask for a loan. In any case, they knew that the state bank would be reluctant to lend to them, preferring to provide development capital to enterprises that fitted the preferred criteria for investment in rural China, wherein the TVE conformed to the model of group/community ownership.

In the spirit of pragmatism that is characteristic of many Chinese people, he said they simply decided to go along with the TVE option. This decision was one he did not regret because in the ensuing years all of the community had received great benefits as already noted. When asked if the management, of whom he was a senior member, gained any added benefits for themselves, he indicated that the rewards were to the whole community, but as senior management they did receive a higher level of bonus than that of the regular workers in HSW. In the presence of our elderly interloper he could not be persuaded to be more forthcoming. We gained the impression that he was certainly aware of the issue of free riding and equal reward for unequal effort, but because of the presence of the cadre was reluctant to discuss it. Later conversations with other members of the management team (with a third party absent) brought the same response.

By 1994, the company was so successful that it had a total gross output value of 200 million yuan, and profits and tax of more than 20 million yuan. In 1996 the company attained certification to the ISO 9002 quality management systems standard; this has helped the diversification of the company away from a dependence on the domestic market, consolidating the export gains achieved in the past year when the company had exports to South America and the Middle East of US\$ 10,000,000. At the end of 2001, the company had 3,500 employees and total assets of 1.7 billion yuan. Since listing on the stock exchange in 1997, they have diversified into real estate and biotechnology research using the local peanut industry as the base of what they hope is a new direction for the company. This biotechnology initiative is a joint venture between HSW and Huazhong University in Wuhan. With the listing on the stock market, the original shareholders have kept the TVE's investment in the listed company at 50% of shares, retaining effective control of the company. The real estate and biotechnology activities are not part of the listed company; these are still owned and by the original shareholders who are part of the original TVE, that is all residents in the village of Duanjia

HSW and Local Government

The emergence of the Hubei Hanchuan Steel Wire Company has had a marked effect on the distribution of political power in the village. Up until the past decade the headman was appointed by a process of consultation with the leading families in the village and the local Communist Party secretary. The increased prestige of the original company founders enabled them to have more influence on the political direction within the village. As a result of their success, their influence was greater than that of the headman. As the position of headman or mayor is an elected one, the increased popularity of the entrepreneurial group had the net effect of encouraging the mayor to be supportive of initiatives proposed by the entrepreneurs. This has been the case in Duanjia where the entrepreneurs were not interested in gaining political office themselves but were content to control the formation of the leading group and be active in supporting candidates for the mayoralty that supported their interests. The residents meanwhile, were more than happy to comply with this state of affairs, because all benefits that are surplus from the operations of the company are put back into the local community, providing community facilities, including a new movie theater just completed in December 2001 and yearly scholarships for the children of residents.

Mr Jiang believed the key to the success of the company was the type of management structure employed, which allowed the company to use the natural abilities of the staff to their full potential. He noted that previously the company had suffered a great deal of interference from the village headman who had attempted to politicize the position of HSW to secure his own position. It was only when this type of interference ceased that real progress could be made. He noted that the success of the company had been very important in the reconstruction of the whole community. He identified the provision of better roads, improved schools, good health care available for all residents and the construction of a home for the care of the elderly who were without a family to take care of them. A retirement fund has been established, as has an insurance fund for all members of the community.

A notable factor in the cooperative approach to development being pursued in the village is the readily acknowledged use of influence to gain advantages for the enterprises in the community. Reliance on networks of influence to finesse any difficulties of supply for raw materials and electricity and coal was reported with some pride. It is interesting to note that this networking behavior is another example of the complexity-absorbing behavior of entrepreneurial organizations in Chinese societies. In the same vein, Li (2001), in his study of knowledge transfer in TVEs in China, found a very high level of cooperation between TVEs (which one could have assumed were competitors) in marketing their products and securing resources for their operations (Li 2001, 38).

The village has grown over the past 12 years as people from the surrounding

countryside were drawn to work in HSW. By the end of 2001, upwards of 970 households with a population of over 6000 people inhabited the village. A recent survey indicates all households have diversified their activities from an exclusive reliance on agriculture; 89% of the respondents are involved in some way in the iron processing industry, either as shareholders and workers or as contract suppliers of raw materials. It was noticeable that in other villages in a 5 kilometer radius of Duanjia, crews of workers were busy extracting reinforcing steel from concrete masonry from demolished buildings, delivered to the villages by dump trucks from construction sites around Hanchuan County. This recycled steel was then sold to HSW as raw material for its operations.

Local Government and TVEs: A Cautionary Tale

That evening as we were sitting down to our evening meal in the hotel dining room with Mr Jiang and two of his staff, our quiet dinner was interrupted by the arrival of two car loads of officials from the local government office in Hanchuan. Led by a person who turned out to be the local government official responsible for roads and bridges in Hanchuan County, they proceeded to invite themselves to dinner. Another seven places were hastily set and we watched our quiet evening meal turn into a kind of diplomatic encounter between Mr Jiang and the local officials. Ostensibly they had come to the village to inspect the safety of the roadways in and around the village, but they had arrived too late to carry this out properly as it was by that time 7:30 in the evening, and as it was early winter in Hubei it had been dark for almost an hour. Their real reason for coming seemed to be to shake down HWS for some fringe benefits in exchange for the county officials turning a blind eye to the supposed safety issues to do with roading in the village. The scene was a classic case of the MIL (mother in law) problem reported throughout China by businesses that had benefited from the patronage of local government officials in their start-up phase, and were now obliged to submit to various petty extortions from their erstwhile patrons.

On this occasion the only benefit seemed to be a free meal with copious quantities of potent Chinese liquor. The dynamics of the drinking games were a fascinating study in gamesmanship with Mr Jiang demonstrating his considerable talents as not only an entrepreneur and successful businessman, but also as more than a match for the officials who inhabit the halls of local government in provincial China. The leader of the local government delegation challenged all and sundry to a drinking game with shots of 40% proof liquor at each round; Mr Jiang was obliged to participate. As his competitors became increasingly befuddled, he by a carefully choreographed display succeeded in downing two shots of liquor to nine or ten for his opponents. The evening became increasingly raucous until it ended at 11pm, when unable to stand without assistance, the local officials made their way to their cars and drove slowly out of the village back to Hanchuan.

Discussion

The connections between the legislators, inspectors, and entrepreneurs seem to be evolving very rapidly. It is difficult to disagree with the Senior Manager when he says that in his opinion the start-up phase was critical and the role of local government was important at that time, but now that things are more established there needs to be a greater separation between the government and commercial enterprises. For him, it seemed that their objectives were different: The company needed to be able to focus on the development of its own future. That included the objective of increasing HSW's market share in the domestic market for high tensile wire from the present 10% to around 15%. In his view, local government had responsibilities and expectations that no longer coincided with those of the company.

The above incident highlights the continued tension between local government and commercial organizations. For forty years the local cadres feasted with impunity off their country cousins, who unable to defend themselves had in the past simply acquiesced. Now the appetite of the local government officials has increased; the wealth in rural China they see as a development for which they ought to receive primary credit. This (unjustifiable) perspective is made more problematic by the overstaffing of local government departments, who are used to having complete control of almost every aspect of daily life for many citizens. However, they are now losing their relevance; the emergence of the market as the arbiter of resource allocation means their services are no longer required. Those officials with some initiative have already moved into the private sector, leaving their more timorous comrades without a great deal to do and a steadily shrinking resource base from which to gain an income. Senior local government officials spoken to are painfully aware of the problem; they optimistically say that they believe it is a passing phenomenon, and that attrition in the local government workforce will solve the problem in the coming decade as the cadres grow old and retire.

While the Senior Manager saw a clear need for reform of the relationship between TVEs and local government, at the same time he felt strongly that the success of the company was still tied to the success of the village of Duanjia and its people, and he hoped it would stay that way for at least the next 30 years. He saw that connection as best maintained via the provision of benefits to the residents as employees of the company, rather than via the local government officials as intermediaries. The issue of property rights was obviously of paramount importance to him, even though he disclaimed any personal interest in changing the status quo. He was a realist in that he was all too aware that there would be continuing pressure in the very process of conforming to the demands of financiers and trade officials, to rationalize ownership and accountability in such a way that inevitably the present ownership structure would become more differentiated. Yet at the same time there was a realization that what had been in place since the founding of the company had

served the company and the village very well, so there was a need to retain the best and reform the rest.

In addition to the issue of the relationship between local government and TVEs, there are a number of questions that have come to light that are relevant to an understanding of what constitutes an environment conducive to innovation, competition, and motivation. An interesting example of the innovative approach to development found in the TVEs is not only their intra-organizational cooperation but also the inter-organizational cooperation noted earlier by Li (2001) between enterprises that are competing in the same marketplace. An equally fascinating issue is the innovative way in which TVEs have financed their operations. Latest figures from research by Fung (2002) indicate that the non-state sector contributes over 60% of China's GDP yet is a recipient of less than 1% of lending from state banks, indicating a very large and essentially informal network of capital flows within this sector, which is essentially unknown in its dimensions and its rules of practice.

This aside, it is the property rights issue that is central to this study, for this is where the success of TVEs appears to be unique. Economists and business commentators tend to suggest these issues are a product of the transitional stage through which the Chinese economy is passing, on its way to a market economy with a fully developed share market trading leading stocks and a bond market similar to that found in the USA and Europe. The professionalization of management and its attendant transformation of the structures of ownership accountability and performance seem almost self-evident. These conclusions seem sufficient if we accept the oft-made argument that the current arrangements are those of an economy in transition to a market economy like that in the west. But what if is not?

China is not Japan; the transition to a fully developed industrial society in Japan gives few reliable pointers to how the same process will emerge in China. Likewise, the development trajectories of Taiwan, Hong Kong, and Singapore seem to diverge too much from that of China to offer a reliable guide. All of these places have in common the shared heritage of the Confucian traditions with its stress on self-responsibility, frugality, and collegiality. The account of HSW's development pathway in its first fifteen years seems to support Weitzman's theory of cooperative behavior and Hamilton's theory of collegiality, as well as the Hayekian idea of extended orders of cooperation.

Trust is the underlying theme in all of these accounts, both institutional and personal. Trust acts as the social capital to bind individuals and communities together, allowing the development of institutional arrangements unfamiliar in the West. If there truly is another way of creating a modern industrial society, then our enquiry ought not to rest on what seems a comfortable and perhaps to some points of view 'quaint' reliance on personal interest being 'always' best realized in cooperative behavior. Perhaps the need is to look at the pragmatic/holistic nature of Chinese

cultural orientations; if we do this then perhaps we will not be taken by surprise when the kinds of cooperation discussed here are in the future no longer the preferred practice in rural China. Intimations of this are already present in the case study: As noted in the case, HSW is now a listed company with real estate and bio-tech investments, suggesting that what has been done in the past may not be a reliable way to predict the future (unless that past included an appreciation of the pragmatic orientation of Chinese culture). Looking at the rapid evolution that has taken place since the household responsibility legislation in 1983, one would be bold to predict anything about the future direction of TVEs.

CONCLUSION

Can we look at the present fate of other towns in developing economies of 19th and 20th century USA and Europe, the company towns of industrial England or the USA that are now struggling or have failed, and surmise that the same fate is in store for the town and village enterprises of today's China? Or will the pragmatism and cooperative spirit that is evident in early 21st century China offer alternative development trajectories to the earlier industrializers in other parts of the world?

Whatever the medium to long-term outlook, in the view of the authors, the issues outlined in this paper confirm the belief that if a rational explanation for the presence of TVEs as the engine room of the Chinese economy is to be found, that explanation must at least in part be a cultural one. How else could one explain the positive attitude to cooperation noted earlier, which, coupled to the vibrant market economy now present in rural China, has made the lives of hundreds of millions of rural Chinese people more prosperous than ever before in the history of this vast nation?

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