
Rural Enterprises in Jiangsu Province, China: Recent Institutional Changes and Future Prospects

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Introduction

Jiangsu province has been at the forefront of rural industrialisation in China. The distinctive feature of rural enterprises in the Sunan region (southern Jiangsu) is the level of involvement of township and village governments (TVGs), in particular in the start-up phase. In the mid-1980s this ownership structure was viewed as a 'model' which was copied in other provinces; however, more recently these arrangements have come in for criticism, which has focused attention on whether the outstanding performance of rural enterprises in Jiangsu is sustainable. One view is that their unusual institutional structure worked well when the enterprises were small, but as they became bigger and more commercialised, informal methods of contracting have proved restrictive. This is reflected in calls from a number of senior officials in China for rural enterprises to adopt diverse forms of ownership. For example, in December 1997 the Vice-Minister for Agriculture, Wan Baorui, proposed that rural enterprises 'change their existing unitary form of organisation...[and that]...all organisational forms such as share-stock partnerships, stock co-operatives, enterprise groups, leasing and mergers should be used boldly'.¹ As a result of such statements a number of alternative arrangements, such as the shareholding co-operative model which first emerged in Zhucheng, Shandong and Zhengding, Hebei, are now challenging the dominant position of traditional rural enterprises with high levels of TVG involvement in southern Jiangsu.

This study has two objectives: first, to set the problems that rural enterprises are facing in Jiangsu in their historical context, and secondly, to review some of the reforms recently introduced to address these problems and to consider the extent to which these policies have been successful. The article will argue that the rapid development of rural enterprises in Jiangsu has been due to unique conditions which are now either fast disappearing or have ceased to exist, and that factors such as their location and size, which were considered advantages

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in the past, are now constraining further development. It will also be argued that if they are to continue to be competitive in domestic and international markets, government reform measures will need to take account of changes in the external institutional environment.

The article is organised as follows. The next section sketches the historical development of rural enterprises and provides some statistics which emphasise their current significance in Jiangsu. The specific distinctive characteristics of enterprises in the Sunan region are then described, followed by a review of the literature explaining the success of rural enterprises over a sustained period. The institutional factors and changed circumstances impeding the continued growth of rural enterprises in Jiangsu are then examined, followed by a consideration of the recent ownership changes introduced to address these issues and some of the problems hindering their effectiveness. The final section draws some policy implications.

Historical development and current significance

Rural enterprises first emerged in southern Jiangsu in the Great Leap Forward, but never really prospered until the beginning of the 1970s. There were several reasons for their initial lack of success in the 1950s and 1960s. First, their technologies were backward. Second, during this period their products were directed towards local markets which were limited. Third, their economic and political fortunes depended to a large extent on fluctuations in government policies. However, in the fallout from the Cultural Revolution a number of factors changed and created opportunities for rural enterprises to flourish. Before the 1970s they contributed little to the industrial output of Jiangsu, but their share increased sharply in the 1970s and 1980s, from a mere 5.31% in 1970 to 23.37% in 1980 and 45.29% in 1990 (*JTN*, various issues).

One change in the 1970s was that rural enterprises in Jiangsu obtained access to skilled labour and technology. There have been three main sources of management skills and technical expertise. First, during the Cultural Revolution there was a periodic influx of urban cadres and intellectuals who had been 'sent down' to learn from the peasants. Second, skilled workers from cities such as Changzhou, Shanghai, Suzhou and Wuxi often return to southern Jiangsu to retire. Third, rural enterprises have invited engineers, skilled workers and technicians (*pinyong renyuan*) to help train workers for different periods of time. Because they are willing to offer high wages to attract the right people, this arrangement has had considerable success in drawing in skilled personnel who have retired from state-owned enterprises (SOEs).

Another reason for their rapid development in the mid to late 1970s was their prime location. First, they were able to take advantage of their rural location to draw on surplus labour. There is considerable evidence that throughout the

1970s and for at least the first half of the 1980s there was surplus labour in most of the Sunan region. For example, Gao and Hong (1996) suggest that for most of this period the marginal product of labour in agriculture was almost zero. Consistent with models such as that of Lewis (1955), excess labour in rural areas meant that there was a continual flow of labourers from agriculture to non-agricultural activities; this kept wages low and gave rural enterprises a competitive advantage.

Secondly, rural enterprises in Jiangsu benefited from geographical proximity to Shanghai. This facilitated informal exchanges between rural enterprises in Changzhou, Suzhou and Wuxi (in southern Jiangsu) and SOEs in Shanghai. Rural enterprises in the Sunan region relied on SOEs for technological transfers and supplied raw materials in return. For example, Naughton (1995: 155) points out that in 1985 in the southern Jiangsu town of Wangshi, every one of the 93 rural enterprises had some form of sub-contracting or joint venture with an urban enterprise. The growth of rural enterprises in the Sunan region was also facilitated by various lateral relations (*hengxiang lianxi*) with other bodies such as research institutes. In 1986 there were 2,900 jointly operated rural enterprises (*xiang-cun lianying qiye*) in Jiangsu, making up about 3% of the total. Around 80% of these were in partnership with an urban enterprise (either an SOE or a large urban collective enterprise) and another 12% were in partnership with other units such as technical schools, vocational colleges or universities (Ho, 1994: 131–2).

One of the most important factors explaining the success of rural enterprises in the 1970s and 1980s is that they filled gaps in China's haphazard planning regime. Putterman (1997) argues that the success of rural enterprises over this period can be attributed to controlled agricultural prices which caused returns to farming to be low, combined with structural inefficiencies in the state-owned sector. This was true of Jiangsu where rural enterprises expanded in light industries not included in the state plan (such as bricks) and goods which SOEs produced in insufficient amounts (such as textiles) (Ho, 1994: 137). In addition, in the 1980s rural enterprises became more outward-looking and this opened up new markets. Under the traditional state plans, most of Jiangsu's non-state manufacturing firms were not able to obtain sufficient state-allocated inputs. They were therefore forced to explore alternative avenues to obtain raw materials such as coal, steel and timber. The course most of them took was to enter into informal exchanges with firms from other provinces. Between 1978 and 1988 coal imports into Jiangsu increased from 3.45 million tons to 25.88 million tons. Over the same period, imported steel increased from 0.11 million tons to 1.95 million tons (Tan et al., 1997: 21).

Increased contact with firms in other provinces also opened up new marketing channels for finished products and from the mid-1980s most rural enterprises in southern Jiangsu sold their output outside their local area. For example, in 1986–7 in Wuxi only 4% of rural enterprise sales were within the

home town or village and 82% of rural enterprises sold less than 20% of their output in their home county (Svejnar and Woo, 1990). The development of marketing networks resulted in the emergence of a number of specialised trading centres. In 1991 there were 70 trading centres in Jiangsu with a turnover of RMB 16 billion. These had regular commercial connections with more than 9,000 trading companies in 30 cities throughout China. A number of towns and cities such as Changzhou (electronics), Luoshe (furniture), Suzhou (pearls) and Wujiang (silk) developed into regional trading centres for particular products (Tan et al., 1997: 21). As a result Jiangsu became the richest province in China.

Table 1
Basic statistics on rural enterprises in Jiangsu 1978–97

Year	Total Enterprises		Total Employment		Gross Output Value (measured in 1990 prices)	
	Thousand	Growth %	Million	Growth %	Billion Yuan	Growth %
1978	75.6	—	3.3	—	na	—
1979	71.6	-5.3	3.4	3.1	na	—
1980	75.6	5.3	3.9	16.1	na	—
1981	71.9	-4.9	4.1	5.4	na	—
1982	70.1	-2.5	4.3	4.6	na	—
1983	68.5	-2.2	4.6	7.0	na	—
1984	254.7	271.8	6.1	32.5	na	—
1985	496.6	95.0	7.4	22.0	84.6	—
1986	765.8	54.2	8.4	12.8	103.8	22.7
1987	998.9	30.4	9.2	10.3	132.6	27.7
1988	1129.1	13.0	9.8	6.1	151.5	14.3
1989	1079.0	-4.4	9.2	-6.1	135.1	-10.8
1990	1058.4	-1.9	9.0	-2.5	147.1	8.9
1991	828.3	-21.7	8.7	-3.3	168.4	14.5
1992	918.9	10.9	9.1	4.7	273.1	62.5
1993	984.9	7.2	9.5	4.4	382.9	40.2
1994	1033.0	4.9	9.4	-1.0	443.0	15.7
1995	924.0	-10.6	9.3	1.4	518.4	17.0
1996	914.0	-8.2	8.8	-5.4	na	—
1997	865.2	-5.4	8.8	0	587.2	—

Note: na = figures not available to author. The price index used is the national price index.

Sources: Figures for 1978–94 are from *JXZQN*, 1995: 198–9. Figures for 1995 and 1996 are from *ZTN*, 1996: 387–9 and 1997: 399–400. Figures for 1997 are from *ZXZQN*, 1998: 108, 112. The national price index is from *ZTN*, 1998: 301.

For instance, in 1994 Jiangsu had 944 towns with more than RMB 100 million in rural output — more than any other province in China. In addition, it also

had four of the ten towns with the largest gross output value in China (Luoshe, Shengze, Qianzhou and Zhouzhuang) (*Renmin Ribao* (People's Daily) 27 January, 1994, p.2).

Overall, by the beginning of the 1990s rural enterprises had become a significant part of the local economy in Sunan. For instance, in 1990 local officials in southern Jiangsu estimated that rural enterprises were responsible for 90% of the gross product in the Sunan region (Martellaro, 1994: 348). By the mid-1990s they were dominant in a range of light industries such as clothing and textiles, where they produce 85% of Jiangsu's total output, and transport equipment as well as some heavier industries such as chemicals, where they produce 65% and 75% of Jiangsu's total output respectively. In other industries such as coal and electronics, they are not as dominant but still have sizeable market shares.

Table 1 gives some basic statistics on the significance of rural enterprises in Jiangsu. Consistent with the above discussion, it suggests that their importance has grown over time. Their number increased almost twelve-fold between 1978 and 1997. Between 1985 and 1997 the value of their real gross output grew by 23.5% per annum (measured in 1990 prices). While there has been little change in employment levels since 1988, employment in rural enterprises still increased at an average annual rate of 5.9% between 1978 and 1997. In 1997 there were 8.8 million people working in rural enterprises, which represented 32% of the rural labour force and 23% of the total provincial labour force (*ZTN*, 1998: 130-1). The contribution rural enterprises have made to improving living standards is reflected in per capita net income. In 1997 the per capita net income of rural households in Jiangsu was RMB 3,630, which was 74% higher than the national average (*ZLTN*, 1998: 90).

Ownership characteristics

Nominal ownership

The distinguishing characteristic of traditional rural enterprises in southern Jiangsu is their unusual ownership. In the Sunan region rural enterprises are best characterised as community enterprises which belong to all the residents where the firm is located — either a township (consisting of about 4,000 households) or a village (about 200 households). Typically each rural community will have several of these enterprises. It is important to be clear that rural enterprises are not state-owned enterprises or co-operatives (Che and Qian, 1998b: 2). Moreover, while some private firms have registered as collectives to overcome political discrimination against the private sector (wearing a so-called 'red hat'), most scholars accept that the majority of traditional rural enterprises in the Sunan region are not private firms with well-defined property rights (see, for

example, Weitzman and Xu, 1994; Bowles and Dong, 1999).

The main reason for this is that the residents do not have the accepted privileges of ownership — i.e. the right to use, transfer or appropriate the assets. Mi (1994) suggests that ‘in rural enterprises sponsored by local communities such as townships or villages, the property rights belong to the whole community but no individual in particular’. Weitzman and Xu (1994: 63) argue that rural enterprises in the Sunan region resemble ‘vaguely defined co-operatives’ whose ownership structure ‘appears to go almost completely against the grain of standard property rights theory’. Luo (1990) expresses a similar view, writing about rural enterprises in Wuxi; ‘[we have] not yet found an appropriate paradigm for this peculiar system of property rights. It is heavily tinged with Chinese tradition and very different from the Western system under which the individual is the ultimate owner of property.’

The fact that the rural enterprise belongs to no individual in particular makes it difficult to determine the residual claimant. Weitzman and Xu (1994: 75) even suggest: ‘There is no residual claimant in the traditional sense. The typical resident waits passively to receive or enjoy the benefits, of which the major part is not in monetary form but in the form of communal social investment which is shared by everyone.’ Chang and Wang (1994), however, dispute the claim that there is no residual claimant. They focus on the second part of Weitzman and Xu’s observation that the residual benefits are shared. In Jiangsu about 40% of profits from rural enterprises are paid to the TVG in the form of fees and taxes (ZTN, 1998: 422). Chang and Wang (1994: 439–41) point out that this benefits both the TVG, because part of it is used to support running costs including fringe benefits for local officials, and the local residents, since the rest of the fees support communal social welfare programmes and infrastructure projects. The rural enterprise retains the other 60% of the profits to finance further development, which also benefits the local residents since it means that more job opportunities are created and existing jobs are made more secure.

Control rights

It is widely accepted that, while ownership is ill-defined, the TVG exercises the control rights in the initial and intermediate stages of the enterprise’s development (see, for example, Naughton, 1994; Rawski, 1995). For this reason Weitzman and Xu (1994: 69) suggest that the TVG can be regarded as the representative of the residents and, as such, is best seen as the *de facto* executive owner of the enterprise. When setting up the firm, the functions performed by the TVG are ‘hands-on’. The TVG ‘will choose or approve projects, raise or help raise funds, mobilise manpower and other resources within its jurisdiction to support the project and supervise the construction process’ (Chang and Wang, 1994: 437). Once the enterprise is up and running, casual observation suggests that in most cases control rights at the operational level shift to the managers.

The TVG becomes less involved in running the individual enterprise, but continues to make the strategic decisions and maintains ultimate control because it holds the managerial veto as well as the power to appoint managers. Once the enterprise is established, Byrd and Zhu (1990: 87) argue that TVGs become profit-oriented economic entities similar to diversified investment corporations:

The community governments often play a critical role in strategic decision-making, on investment, new product development, breakup and merger and so on. They also take the lead in establishing new community enterprises, and they pool funds and absorb risk across subordinate enterprises. In fact community governments can be compared with diversified holding companies or, when tightly integrated as in Wuxi, with headquarters of multidivisional corporations.

Market-oriented and redistributive functions

Gang (1993: 57) builds on the above suggestion to argue that managers in rural enterprises resemble executives in market economies, while TVGs are similar to a board of directors. The relationship between the two is different, however, in some important respects. The main difference is that rural enterprises serve as vehicles for the social welfare policies of the TVG. This takes four forms. First, the enterprise is a source of revenue for the TVG through taxation and profit remittances. In addition, rural enterprises pay a management fee (*guanlifei*) to the township industrial corporation, which in essence is a tax because they receive little or no management services in return (Ho, 1994: 225). Secondly, rural enterprises are a source of employment for the nominal owners — the local residents. Thirdly, TVGs make transfers between rural enterprises often routed through township industrial corporations. Whiting (1996: 92) reports that in Jiangsu and neighbouring Shanghai TVGs frequently put levies on the retained profits of successful enterprises under their jurisdiction in order to repay the outstanding loans of other poorly performing enterprises (*tongshou huandai*). Fourthly, when funds are needed for specific projects the TVG imposes additional levies on rural enterprises. A good example of this practice is Sigang in Jiangsu; in the late 1980s Sigang raised RMB 1.2 million for a road construction project by imposing levies on rural enterprises under its control (Ho, 1994: 225).

At times misgivings have been expressed about the potential for conflict between managerial operations and the redistributive objectives of rural enterprises. For example, Koo and Yeh (1997: 388) argue that, because TVGs make transfers between rural enterprises, local budget constraints are soft. While there are no direct studies of Jiangsu, studies of other provinces provide some weak support for this argument. Lin et al. (1992) sampled 400 rural enterprises in Yuanping County, Shanxi in 1984–5. Their results suggest that

some local budget constraints are hard, while others are soft. All loss-making enterprises in their sample reported that they had paid indirect taxes, which implies that the taxation constraint is relatively hard. On the other hand, they all cut down their profit remittances to the government, which suggests that this constraint is relatively soft. This said, an important consideration is that most rural enterprises regard profit maximisation as a subset of a broader communal welfare function, in which the objective is to maximise the welfare of the local residents or nominal owners. Ultimately, whether the potential for conflict between objectives is realised depends on how well the rural enterprise manages the redistributive constraint on its profit maximisation function.

Theories explaining the success of rural enterprises

Various theories have been put forward to explain the success of these ownership arrangements over a prolonged period of time. Weitzman and Xu (1994) attribute it to the internal institutional structure which facilitates co-operation by means of implicit contracts. A number of writers, such as Chang and Wang (1994), Li (1996), Che and Qian (1998a) and Luo et al. (1998), see rural enterprises as specific strategic responses to competitive pressures in transforming economies. For instance, Chang and Wang (1994) and Li (1996) argue that it makes sense to give *de facto* ownership rights to TVGs because their political connections make it easier for rural enterprises to circumvent government regulations. Hence, ambiguous ownership rights might be desirable, given the market imperfections in socialist economies.

Others such as Che and Qian (1998b), Pei (1996) and Whiting (1996) build on the notion of risk-sharing behaviour between local governments and residents to interpret the firm's boundaries at the communal rather than the enterprise level. Che and Qian (1998b) argue that if one defines the boundaries of the firm not as the enterprise but as the community (township or village), and consider the enterprise as a division of the firm, much of the ambiguity in property rights disappears. This is similar to Pei's argument (1996) that the township or village (TVG and residents) behaves like a firm and internalises the net benefits of collective action as economic rents. He argues that rural enterprises with communal ownership have been successful because the net benefits of collective action have increased with fiscal decentralisation. Whiting (1996) stresses that, regardless of ownership rights, one needs to look in detail at the contract between the local government and the manager. Some recent field research suggests that many rural enterprises in Jiangsu (and other parts of China) have shifted from fixed wage to share and fixed rent contracts (see, for example, Dong, 1998; Cheng et al., 1998). These provide managers with a greater residual claim on the profits and make the relative roles of manager and TVG more transparent.

From an empirical point of view, a number of econometric studies have found rural enterprises with strong levels of TVG involvement to be just as efficient as private firms with well-defined ownership rights. For example, Svejnar ran a series of regressions using pooled panel data from 400 rural enterprises controlled at the township-village level and private enterprises in Wuxi in Jiangsu, Jieshou in Anhui, Shangrao in Jiangxi and Nanhai in Guangdong over a 16-year period. He used dummies to distinguish between different ownership forms. The co-efficients on the ownership dummies were statistically insignificant, which suggests that 'private ownership and community ownership appear to have similar effects on productivity' (Svejnar, 1990: 253). Pitt and Putterman (1996) reached similar conclusions, using pooled data on 200 enterprises distributed across 10 provinces (including Jiangsu) between 1984 and 1989. Dong and Putterman (1997) used a subset of their data (which also included observations from Jiangsu). However, unlike Svejnar and Pitt and Putterman who estimated deterministic functions, they used a stochastic production frontier model and checked the robustness of their results under alternative assumptions regarding the random error component and the component measuring technical inefficiency. Putterman (1997: 1648) expressed their findings as follows:

[there was] no evidence of a productivity advantage for private enterprises. Indeed their results suggest that those sample enterprises owned by township and village governments if anything displayed a productivity *advantage*, since the raw average technical efficiency of these firms is higher than that of private firms in the sample, and dummies for township and village ownership have significant positive signs in multivariate productivity regressions in which preference in access to capital and other variables are controlled for. (emphasis in original)

One explanation for these perhaps surprising results is that there might be significant benefits flowing from informal institutions in the initial stages of market development. For example, in the capital market the legal rights of creditors are not well protected and more generally collateral is uncertain because of imperfect information. Hence, in Jiangsu rural enterprises with communal ownership often borrow on the basis of an informal guarantee from the TVG. If the loan application has the support of the TVG, it is approved on the basis of an implicit understanding that the TVG will absorb the risk. Naughton (1994) points out that TVG sponsorship made it easier for rural enterprises in Jiangsu to get access to capital, and this was an important reason for their growth. Without the informal support of the TVG, most enterprises would not have the resources to provide formal guarantees. The experience of other post-socialist economies has been that new start-up businesses proliferate but have trouble in getting access to capital, and as a result remain small,

undercapitalised and dependent on formal capital markets.

Another traditional benefit is that informal institutions made rural enterprises in Jiangsu more flexible than local SOEs. For instance, communally owned enterprises in the Sunan region often operate without explicit labour contracts or follow practices that lie outside the scope of formal arrangements. If the enterprise is facing economic hardship a common practice is to close it down for a short period to cut costs. Another reason for periodic closure in the past was that, prior to the tax reform measures, rural enterprises in Jiangsu received tax concessions in the first three years of their operations. Thus, it was common for them to close down towards the end of the first three years and re-open under a different name. Related to this, most communally owned enterprises in Jiangsu, at least in the past, were relatively small and possessed little fixed capital. This made it easier for them to change their product-mix or manufacturing process to cope with changing market trends. The benefits are reflected in the popular saying in Jiangsu that ‘small boats can change direction quickly’ (*chuan xiao tiao tou kuai*).

The close relationship between agriculture and rural industries also contributed to making the rural labour market flexible. Workers were willing to accept temporary lay-offs and/or substantial wage cuts because most of them were able to return to agriculture. In a joint survey by the State Statistical Bureau and the People’s University of 200 TVG-controlled rural enterprises in 10 provinces (including Jiangsu) in 1986, 61% of workers retained their share of contracted farmland (Zhou and Hu, 1987: 131). This suggests that agriculture and rural industrialisation complemented each other in Jiangsu. For example, in the Hela Commune Agricultural Machine Plant in Wuxi ‘in the busy farming season [workers in the factories] went back to work in their fields and in the slack season they worked in the plant. Whenever labourers were needed for intensive operations in vegetable farming and fishing, they were also released by the plant. Thus there was a flexible allocation of labour time among various branches of the rural economy’ (Mohanty, 1993: 35).

Institutional problems impeding future growth

Most informal arrangements emerged because formal alternatives were not available. In this sense, informal institutions acted as a surrogate for a well-defined legal framework and market institutions. As suggested in the previous section, informal institutions worked in the start-up phase when most rural enterprises in Jiangsu needed the assistance of TVGs to develop. However, as they have become bigger, informal institutions are constraining their further development. One set of difficulties relates to informal methods of raising capital. In the past these have worked well, but as rural enterprises in Jiangsu have diversified and extended their business interests the lack of a well-

developed capital market in rural areas is now hindering the development of further opportunities.

In the 1980s rural enterprises in the Sunan region were growing at such a rate that it was difficult to get capital to fund further expansion. This situation was exacerbated by central government policies which curtailed fund raising from traditional sources. In the past rural enterprises borrowed from local farmers and workers by issuing bonds; however, in the mid to late 1980s the central government began to impose stringent regulations which restricted this practice (Hong, 1995: 361). Liu et al. (1998) provide some direct evidence of the capital constraint on rural enterprises in Jiangsu at the beginning of the 1990s. They estimated the productivity of capital using a production function and panel data on 140 rural industrial enterprises in 15 counties in Jiangsu in 1989 and 1990. One of their main findings was that the marginal product of capital (on average 29.6%) and the output elasticity of capital (64%) were both high for rural enterprises. This indicates a strong capital constraint on rural enterprise production at the start of the 1990s, i.e. an increase in capital could lead to an increase in output. These results are backed up by more casual observation. Xu (1994) examined several case studies of rural enterprises in Taixi City and Gaijiang and Jiangning counties in Jiangsu. He suggests that a number of rural enterprises were forced to forgo business opportunities at the start of the 1990s because of a shortage of funds. Zheng (1993) suggests that nationwide as many as one-third of rural enterprises stopped production or even went bankrupt in the period 1989-91 because of a shortage of capital.

A second set of problems relates to ownership issues. While TVGs played an important role in the initial stages of rural enterprise development, the downside of having significant levels of TVG involvement is that it is often hard to know who is the true owner. While it is difficult to provide direct evidence of local government abuse, there is a lot of anecdotal evidence of this based on field research. For example, Cai (1990) reports that, in southern Jiangsu, managers often complain that local governments take funds from rural enterprises as they please and treat enterprises under their control like 'money trees'. Ho (1995) makes a similar observation based on his field research in Jiangsu. He found that:

Personal abuse of power was [a] problem. At the township and village levels, because power was concentrated in the hands of the local party secretary and his/her deputies, an often-heard complaint was that those in authority acted like 'little emperors', contracting out [rural enterprises] to their friends and supporters (or appointing them to senior positions) as rewards. (Ho, 1995: 388)

The difficulties this creates have been magnified as rural enterprises have grown in size, because in most instances the value of their assets is now well in

excess of that borrowed with the assistance of the TVG. This is also limiting their ability to get funding for diversification and growth. One of the biggest problems in recent times is that banks have been reluctant to lend because they are uncertain about who will be responsible if the firm makes a loss. This has contributed to the problem of capital shortage discussed earlier. The relationship between government abuses and funding shortages was highlighted in a recent article in one of the official newspapers, the *China Daily*:

Today most rural enterprises face a severe shortage of funds. Most agricultural banks are unwilling to risk lending money to small rural firms that can easily fall prey to poor management....Although the enterprises are nominally owned by townships or villages, no one is actually responsible for the losses or profits of the enterprises. Officials...[often] take advantage of their power for personal gain such as hiring their family members and making extravagant use of public funds. (*China Daily*, 14 February 1997, quoted in Woo, 1999: 133)

In addition, a number of factors responsible for the rapid growth of rural enterprises in the 1970s and 1980s have now changed. First, as pointed out above, rural location was an advantage because of the existence of surplus labour and low wages. However, since 1988 there has been no growth, on average, in employment levels in rural enterprises (see Table 1), which is consistent with the view that surplus labour has been exhausted. Men (1990) found that as far back as 1985 surplus labour in Wuxi was less than 5% of the total rural labour force. Ho (1994) also suggests that, by the mid-1980s, in many rural communities in southern Jiangsu, nearly all those wanting jobs in rural enterprises had them. Thus, in these communities local workers became increasingly selective about the jobs they would accept. This forced rural enterprises to hire workers from northern Jiangsu or other provinces to fill the less desirable jobs, usually on a contract basis. Whiting (1996) reports that in the late 1980s up to 20% of workers in rural enterprises in southern Jiangsu were estimated to come from outside the local township or village. A number of other studies support the more general conclusion that from the mid-1980s there was a shortage of labour in core regions and near major urban centres in the eastern parts of China (see, for example, Blank and Parish, 1990; Perkins, 1990; Knight and Song, 1993).

A number of studies have also found that the marginal product of labour in rural enterprises in Jiangsu is greater than the wage rate (see Xu, 1995; Dong and Putterman, 1996; Liu, 1996; Chiew et al., 1997). As a result, there has been upward pressure on labour costs. While employment levels have been stagnant, between 1988 and 1997 the total wage bill of rural enterprises in Jiangsu increased from RMB 8.06 billion to RMB 29 billion in current prices (*ZTN*, various). This is reflected in a reduction in the urban-rural differential. In the early 1980s the average monthly wage in rural enterprises in Jiangsu was about

RMB 15, which was less than half the urban workers' wage, but in 1997 it had increased to around RMB 375, about 60% of the wage in SOEs and 85% of the wage in urban collective-owned units in Jiangsu (ZXZQN, 1998: 108–9; ZLTN, 1998: 237, 325). In some cases wages are higher in rural enterprises than in the state-owned sector. For example, World Bank research in 1985 found that, in Wuxi, average wages in rural enterprises were higher than in local SOEs (Byrd and Lin, 1990).

A second factor that has changed is that rural enterprises in Jiangsu have lost their 'first-mover' advantage. In the 1970s and first half of the 1980s they were able to take advantage of underdeveloped market institutions in the cities without facing competition from urban enterprises. However, from the middle of the 1980s market-oriented reforms were extended to urban areas and 14 open cities were established in the coastal provinces to attract foreign investment. There have been four main implications of the urban reforms and the greater economic openness. First, from the mid-1980s there has been a shift in economic power to the urban areas and the open coastal cities, such as Guangzhou, Shanghai and Wenzhou, in particular. Secondly, rural enterprises are facing increased competition from urban enterprises, foreign-owned firms and joint ventures which tend to have better resources and technologies. Thirdly, in the 1970s and first half of the 1980s prices for energy and industrial materials were fixed under the state plan. However, since the late 1980s urban enterprises have had the power to sell these at market prices which has increased the cost of industrial inputs for rural enterprises.

Fourthly, the product standards and product mix of rural enterprises are not well-suited to more sophisticated consumer markets. The main performance criterion for rural enterprises in Jiangsu has been output maximisation. This is because indirect taxes, which are based on output, form a large share of the tax receipts from rural enterprises. Hence, at least in the past, township officials have focused on output maximisation in evaluating the performance of managers (Whiting, 1996: 73). As a result managers in rural enterprises have focused on maximising output without paying attention to product standards (He et al., 1991: 121; Shao et al., 1991: 185–7). Most rural enterprises produce bulk-runs of low standard products which are copied from urban enterprises or foreign firms. While in the past they have been flexible in terms of being able to adjust their product mix and this has been a strength, the rise in per capita income means that consumers are now demanding higher standards and more product innovation. Rural enterprises are not well placed to make this adjustment since most of them depend on outdated machines and lack technical know-how (Cao and Shen, 1997: 35–7).

Recent ownership reforms

Small and medium-sized rural enterprises

The central government has initiated a range of ownership reforms to address these issues. The most common approach is to convert small and medium-sized rural enterprises into shareholding co-operatives. One news report suggests that at the end of 1996, 66,300 or 70% of rural enterprises in Jiangsu had been transformed into joint stock companies, leasing or options.² The main objective of this reform is to sort out the rights of competing owners (local governments, residents and workers). Under the shareholding co-operative system (*gufen hezuo zhi*) shares equivalent to the net assets (assets less liabilities) of the enterprise are issued more or less equally to management and workers. The co-operative nature of the enterprise is reflected in three features. First, the shareholders (management and workers) receive dividends in addition to wages. Second, both management and workers bear the risk. Third, managers and workers have equal voting rights at shareholder meetings. The relationship between the enterprise and the TVG is clarified by creating a 'government share' in the enterprise. The size of this share varies, but in most cases accounts for around 20–25% of the total shares.

An important objective of the shareholding reform is to raise capital. When shareholding co-operatives need funds for a new investment, the common practice is to issue new shares. This provides rural enterprises with a means of funding new machinery and technologies which will make them better able to meet shifts in market demand and hence to compete with urban enterprises and joint ventures. Another reason for separating the administrative and economic functions of rural enterprises and local communities is to rationalise production and open up new investment opportunities. The close relationship between local communities and rural enterprises has restricted the flow of resources and curtailed opportunities for investment outside the boundaries of the controlling township or village, because the movement of resources between localities alters the distribution of economic interests between local communities and thus affects the administrative power of township and village authorities. The central government hopes that the creation of shares will put rural enterprises in a better position to compete with urban enterprises and foreign-owned firms by freeing them to allocate resources to the most profitable areas, regardless of local boundaries.

However, a range of problems have limited the effectiveness of the reform.

2. *Zhonghua Gongshang Shibao* (China Industry and Commerce Times) 19 March 1997, p. 4. On a visit to China in April 1998 I was told that about 70% of rural enterprises in the Sunan region had been converted into joint stock companies, but that in less commercialised northern Jiangsu the figure was around 50%.

First, there is a lot of casual evidence to suggest that it has not reduced government interference in the operation of the enterprise. In some areas where the number of shareholding co-operatives has increased, the local officials do not understand what they are, and so have included firms that are not in fact joint stock co-operatives. For example, Vermeer (1996) conducted fieldwork on shareholding reform in neighbouring Shandong province. He concluded that all parties needed more time to live up to the spirit of their new roles, and that in most instances the local government, and not the shareholder meeting, still controlled the appointment of managers and took important investment decisions.

Secondly, in most cases the shares issued to managers and workers are not transferable, but are similar to a bond with a fixed interest rate. The role of 'internal shares' in facilitating ownership reform is restricted, because non-transferable shares have no function in the reorganisation of capital and resource allocation. In fact, it might be argued that non-tradeable shares hinder the free flow of resources. Workers cannot transfer their shares and so it is harder for them to change jobs. And secondly, because each individual is a shareholder as well as a worker, it is more difficult to dismiss workers or reassign them to new positions (*Guangming Ribao*, 3 December 1997, p.7). This makes enterprises less flexible, which undermines their traditional strength.

A third problem is that some workers have been forced to purchase shares. There is some evidence that where workers have been reluctant to do so, local authorities have withheld their wages. In other cases local governments have modified contracts or forced workers to purchase shares, using their employment as a threat. For example, this has occurred in Gaijiang, Jiangning and Tanxing counties in Jiangsu (Hong, 1995: 366). The problem is so serious that at the beginning of 1998 the central government issued a circular asking enterprises not to force workers to purchase shares. The circular made it illegal to withhold wages or terminate contracts if workers did not purchase shares.³

A fourth problem is 'asset stripping' or 'asset draining'; the drainage (*liushi*) occurs because the current method of evaluating assets is subjective. This provides opportunities for local officials to understate the true value of the collective assets so that purchasers of shares can benefit at reduced cost. Because of price increases in the mid-1990s the value of fixed assets tends to be about 30% higher than the book value. However, in some places local officials have valued fixed assets at below the book value to reduce prices. This amounts to granting 'insiders' (officials, management and workers) private windfalls. In other instances local officials have taken advantage of their positions to misappropriate collective assets. This has happened in Yangzhong, Jiangsu where local officials have purchased rural enterprises at below market

3. *Xinhua*, Beijing, in Chinese, 18 February, 1998. Text reproduced in *SWB-AP*, 5 March 1998.

prices and are running them as private firms (*Renmin Ribao*, 22 April 1998, p. 10).

Large enterprises and enterprise groups

Another approach to ownership reform is to encourage mergers of small and medium-sized rural enterprises to form large enterprises and enterprise groups. There are two main factors driving the evolution from small to large enterprises. First, it allows rural enterprises to upgrade their technologies, which places them in a better position to compete in more mature markets. In particular, it allows them to increase their investment and take advantage of economies of scale. Massive increases in investment have also strengthened their basis for developing new products and improving product standards. For example, in 1995 large and medium-sized rural enterprises accounted for 40% of the new products produced in rural enterprises as a whole, and 95% of large and medium-sized rural enterprises passed the state's general inspection test, 26% higher than the pass rate for all rural enterprises (Li, 1997: 52).

A second reason for the evolution to large firms is that it promotes diversification of ownership. A number of larger rural enterprises are converting into joint stock companies in which each shareholder's liability is proportionate to his/her investment. In 1997 there were 9,200 joint stock companies in China, including new companies and those transformed from existing enterprises (both rural enterprises and SOEs). There are 107 joint stock companies among China's 500 largest industrial enterprises and 62 in the 500 biggest service industries (*Wen Wei Po*, 12 May 1997, p. A4). There are a number of prominent examples in Jiangsu, one of the most famous being the Wuxi-based Little Swan Group, one of China's major producers of washing machines. Little Swan recently purchased a 51% share in the Sanjiang electronics appliance plant in Jingjiang for RMB 50 million. The new venture, which has been transformed into a limited liability company, is expected to have annual sales worth RMB 300 million.⁴

Overall in 1998 there were more than 6,400 rural enterprises in China that were classified as either large or medium-sized enterprises (LMEs);⁵ of these

4. *Xinhua*, Beijing, in English, 29 September 1997. Text reproduced in *SWB-AP*, 1 October 1997.

5. LMEs are classified according to either the value of their fixed assets or technical criteria. For example, computer manufacturers with fixed assets in excess of RMB 40m. are classified as large enterprises and firms with assets valued at between RMB 10 and 25m. are classified as medium-sized firms. In iron and steel integrated manufacturers with an annual output in excess of 600,000 tons are classified as large enterprises and manufacturers with an annual output between 100,000 and 600,000 tons are considered to be medium-sized enterprises. In practice most LMEs have in excess of 500 workers. For a more extensive discussion of the

4,000 have opened overseas branches and 40 are listed on the stock exchange.⁶ Jiangsu has been at the forefront of promoting large firms through mergers. In 1997 it had 1,209 rural enterprises which were classified as LMEs. Nationwide, large rural enterprises account for a small proportion of both total rural enterprises and total LMEs in terms of numbers; in 1995, 7.4% of LMEs were rural enterprises and in 1996 the largest 5,000 rural enterprises accounted for only .02% of total rural enterprises. But these figures understate their true importance. For instance, in 1995 the cumulative investment of large and medium-sized rural enterprises was RMB 45 billion, or 15% of total investment in all rural enterprises (Li, 1997: 52). In addition, in 1996 nationwide the largest 5,000 rural enterprises accounted for 11% of fixed assets, 6.5% of sales revenue, 8.1% of pre-tax profits and 13.2% of export revenue for all rural enterprises.⁷

A number of large enterprise groups that are national and international in focus are also emerging. In 1996 there were 390 provincial-level rural enterprise groups in Jiangsu and 736 across China (*Jingji Ribao* (Economic Daily) 17 January 1997, p. 10). In Jiangsu large enterprise groups are important in a range of industries including chemicals, electronics and textiles. A number of these have become major producers at the national level. For instance, the Nanjing Panda Electronics Group consists of a number of major electronics enterprises in Jiangsu and is one of the biggest electronics companies in China. The Chunlan Group, which is one of China's largest airconditioner manufacturers, is another example. Chunlan emerged in the mid-1980s as an amalgamation of three small factories. At that time it had fixed assets worth RMB 2.8 million. In June 1996, the total net assets of the group were worth RMB 3 billion.⁸ Moreover, at the start of the 1990s groups of rural enterprises in Jiangsu had subsidiaries in a range of developing countries such as Thailand, the Philippines, and Indonesia as well as developed countries such as Australia, the US, Canada, and Japan. While at this stage the extent of their overseas operations is small (in 1991 their overseas investments were worth US\$ 5 million), this highlights that these groups are often well organised.

On the down side, as rural enterprises have become bigger, most have become less flexible. While it is hard to provide direct documentation of this, casual observation suggests that the organisational arrangements of large rural enterprises in Jiangsu have become similar to those of large SOEs. This is

criteria used to define LMEs see Lo, 1997:3.

6. *Xinhua*, Beijing, in English, 13 May 1998. Text reproduced in *SWB-AP*, 20 May 1998.

7. Unless indicated otherwise, all statistics in this paragraph are from *Renmin Ribao*, 17 February 1997, p. 10 and 19 February 1997, p. 2.

8. *Xinhua*, Beijing, in English, 22 February 1998. Text reproduced in *SWB-AP*, 24 February 1998.

reflected in the fact that in China large rural enterprises in the coastal provinces are often referred to as 'the second state-owned sector'. A point in support of this observation is that growth rates in large rural enterprises are lower than in small and medium-sized ones. For example, using aggregate provincial-level data, Xu (1995) found that, in the developed provinces where there is the greatest concentration of large rural enterprises, total factor productivity (TFP) in rural enterprises was growing at a slower rate than in the interior provinces. However, he also found that actual TFP levels in the developed provinces was higher than in the interior provinces.

There is some evidence to suggest that the more rigid organisational structure has made large rural enterprises more vulnerable to sudden economic slowdowns. Ho (1994: 137–8) gives the example of Yixing Telecommunications Material (YTM). YTM was set up in the late 1970s as a joint venture between Dongling Village and Hufu Township to produce circuit boards for radios. In the beginning it filled gaps in the market and showed strong growth, but from the mid-1980s a number of enterprises started to produce circuit boards and it faced intense competition. As a result, when a competitor in a neighbouring village invested in a new press to produce circuit boards, YTM felt it had no option but to do the same. Hence, in late 1987 it took out an RMB 180,000 bank loan and invested RMB 616,000 in new facilities, including a 1,000 ton press. At this time, it had 238 workers and produced a gross output of RMB 4.36 million (in 1980 prices). In 1988 there was a slump in the market for circuit boards. Because the press could not be used for other purposes, it was not possible to switch production, and after a short period of substantial losses, YTM laid off its workers and closed down.

Conclusion and policy implications

This article has described the historical evolution of rural enterprises in Jiangsu and some institutional problems impeding further growth. It has been argued that the rapid development of rural enterprises in Jiangsu was due at least in part to factors such as their rural location and small size which made them more flexible than urban enterprises. However, as the market has matured and consumer tastes have become more sophisticated, these features which were once regarded as strengths are now making it difficult for rural enterprises to compete with other forms of ownership. In response, the government has initiated a range of ownership reforms designed to ensure that rural enterprises continue to be competitive in domestic and international markets. This article has suggested that these reforms have had some success in areas such as improving product development and product standards, but that there are problems which have limited their effectiveness, in particular in small and medium-sized enterprises.

If the shareholding reforms in small enterprises are to prove successful, a number of issues need to be addressed. First, workers should not be forced to purchase shares. As noted above, the central government has issued a circular condemning forced shareholding, but at the present time it is not clear what effect this will have in practice.

Secondly, in order to deal with asset drainage there needs to be a method of independent asset evaluation. There are 3,300 agencies which conduct independent evaluations. In 1996 independent agencies conducted almost 60,000 evaluations with an appraised value of more than RMB 1000 billion.⁹ However, in most instances, independent asset appraisal is limited to large state and non-state firms earmarked for stock market listing, and asset evaluation in small local rural enterprises is left to the township and village authorities.

Thirdly, there is considerable evidence that shareholding co-operatives are not 'co-operative' in nature and that local governments continue to make all the important investment decisions. In this respect, it is arguable that in the current round of reforms there has been too much focus on the internal structure of rural enterprises. While it is true that ownership issues have increased as enterprises have become bigger and that shareholding reform is trying to address the problems, from a practical perspective authors such as Putterman (1997) argue that real empowerment of those outside the cadre and management ranks will be difficult to achieve under prevailing economic and political conditions. In these circumstances, there might be mileage in giving more attention to the external institutional environment. For example, product markets could be reformed to make it easier for capital to flow between localities and for rural enterprises from Jiangsu to set up branches in the interior provinces where there is surplus rural labour. Labour markets could be reformed to make it easier for rural enterprises in Jiangsu to hire more migrant labour from the interior provinces for their local operations (see Putterman, 1997: 1650). These sorts of policies would represent a direct attempt to deal with changes in external conditions that have cost rural enterprises their first-mover advantage. As a result, they could generate significant benefits for rural enterprises, either stopping short of radical changes in ownership structure or as a complement to existing ownership reform.

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