Asian Academy of Management Journal. 6(1): 81-97 (2001)

HISTORICAL EVOLUTION, FINANCING AND THE CHANGING NATURE OF CORPORATE GOVERNANCE IN CHINA'S COLLECTIVE TOWNSHIP AND VILLAGE ENTERPRISES

Russell Smyth
Monash University, Victoria, Australia

ABSTRACT

Collective township and village enterprises (CTVEs) have been the driving force behind China's high rate of economic growth over a sustained period. The objective of this article is to offer one possible explanation for the emergence of new governance structures in China's CTVE sector. The article begins by examining three specific aspects of the development of CTVEs; namely, their history, financing arrangements and changing corporate governance arrangements. After this review, it is then argued that local governments have adopted indirect forms of governance over CTVEs in response to increasing monitoring costs as firms have grown in size, while retaining direct control over the most profitable firms. However, as local governments still control most of the more successful CTVEs, as well as the resources on which private firms depend, it would be wrong to conclude that China's small and medium non-state sector is "going private".

INTRODUCTION

Collective township and village enterprises (CTVEs) have been the driving force behind China's high rate of economic growth over a sustained period. An unusual feature of China's industrial development is that local governments have assumed the primary responsibility for fostering small and medium enterprise development. Various authors have described the close relationship between local governments – or township-village governments (TVGs) – and CTVEs as a form of "corporatism" or have likened TVGs to economic corporations (see eg Oi 1988, 1992, Che and Qian 1998, Walder 1998). However, in recent times the economic relationship between TVGs and CTVEs has undergone significant change. An important feature of the changing relationship concerns the role of TVGs in arranging financing for CTVEs under their control.

This article reviews three related aspects of CTVEs development. The first is their historical evolution and traditional ownership arrangements. The second is the role of TVGs in procuring finance for CTVEs under their control and the benefits and costs associated with these arrangements. The third is the emergence of alternative corporate governance arrangements including privatization and shareholding cooperative reform. Following the review of what has occurred, a possible explanation for the emergence of indirect forms of financing is offered. It is argued that local governments have adopted indirect forms of governance over CTVEs in response to increasing monitoring costs as firms have grown in size, while retaining direct control over the most profitable firms.

The emergence of alternative forms of financing is an example of what Lin (1989) terms induced institutional change. The process of restructuring has been implemented by managers in CTVEs and local government officials responding to profitable opportunities in a macroeconomic environment, which has changed from shortage to surplus. On the one hand TVGs have been under increasing pressure from the central government to maintain high growth rates and, on the other hand, they are being faced with significant financial pressures on CTVEs. Under these circumstances, the cost to TVGs of exercising control rights in all CTVEs under their jurisdiction has become prohibitive.

The article is set out as follows. The next section provides a brief overview of the historical evolution of CTVEs in China and outlines their distinguishing characteristics. Section three describes the traditional role of TVGs in financing CTVEs under their control as well as the pros and cons of this approach. Section four examines alternative governance structures that are designed to address the negative aspects of the traditional role of TVGs. Section five discusses the costs associated with separation of ownership and control in traditional CTVEs and puts forward the argument that indirect forms of governance are a response to increased monitoring costs as firms have got bigger.

HISTORICAL EVOLUTION AND DISTINGUISHING FEATURES OF CTVEs

CTVEs first emerged in the late 1950s in Jiangsu Province in eastern China as commune and brigade-run enterprises. Their main role was to mobilise surplus labour and other local resources in rural areas in order to achieve local self-reliance and rural industrialisation. These enterprises were under the jurisdiction of the Ministry of Agriculture, and there were strict regulations governing the industrial activities that they could carry out. However, since economic reforms were introduced in the late 1970s, these regulations have been relaxed and now CTVEs are involved in most light industries. The fastest growing industries have been building materials, food processing, garments and textiles as well as providing inputs for state-owned enterprises (SOEs).

In 1984, the Central Committee of the Chinese Communist Party and the State Council approved a 'Report on Creating a New Situation in Commune- and

Brigade-Run Enterprises'. In this report, rural enterprises were officially renamed township (*xiang*) and village (*cun*) enterprises - CTVEs. The objective of the policy was to abolish regulations detrimental to the development of CTVEs so as to provide equal footing for CTVEs and SOEs. Responding to the new policy, the Agricultural Bank reformed its organisational structure, and provided a larger number of loans to CTVEs. As a result, the CTVEs sector expanded rapidly, in terms of both size and number. CTVEs actively entered into new areas. With the introduction of new government policies to promote rural areas, CTVEs cooperated with urban enterprises and research institutes under central government initiatives such as the 'Spark Plan' and, in doing so, developed new production methods, technologies, management know-how and marketing channels.

Traditional CTVEs, which originated in Jiangsu Province, have distinctive ownership arrangements (known as the 'Sunan model'). The residents of the township or village which established the CTVEs own the firm, but do not have the usual privileges of ownership, such as the right to appropriate, use or transfer the assets. The TVG exercises the control rights as the communal representative of the residents, giving it de facto ownership. The TVG exercises both direct and indirect control. In the initial stages of development, the local government has a direct managerial role – it chooses or approves projects, raises funds and mobilises manpower and other resources within its jurisdiction. Once the CTVEs is established, in most cases the local government delegates some decision-making power to professional managers and does not exercise control over the day-to-day operations of the CTVEs. However, the TVG still retains the power to appoint and dismiss managers. According to Oi (1992): "Those who run the enterprises are dependent on the local government officials who appoint them. There is competitive bidding to win contracts, but local officials ultimately decide who will be given the contract". Hence, it is in the best interests of CTVE managers to make all major investment decisions in close consultation with the local government. [1]

TRADITIONAL FINANCING ARRANGEMENTS

The Traditional Role of Local Governments in Procuring Finance

In the past CTVEs had a clear preferred hierarchy of financing options. In order these were (i) government credit, (ii) bank credit, (iii) inter-enterprise credit and (iv) personal credit.[2] Amongst these, bank loans and village funds were the most reliable source of funds. TVGs had a pivotal role in securing loans from either the Agricultural Bank of China (ABC) or Rural Credit Cooperatives (RCCs) – which were two of the main sources of external funds for CTVEs. TVGs performed three specific functions. First, in most cases while the manager put in the formal application and signed the loan papers, TVGs prearranged or negotiated loans on behalf of CTVEs under their control. In some instances, the TVG secured funds from the ABC as a block and distributed the funds among CTVEs, as the TVG considered appropriate. In other cases TVGs negotiated loans with local branch managers on behalf of a specific enterprise. This is confirmed in several field studies in the 1980s. For example Oi (1998) reports that in the late 1980s the township government in Zouping, in Shandong Province secured agreement from the ABC to provide one million RMB in low interest loans for one of its enterprises.

Second, the TVG provided an informal or formal guarantee to the ABC and RCCs that the loan would be repaid. Lin *et al* (1992) conducted field research in Yuanping, Shanxi Province in 1984 and 1985. Their conclusion (at p. 265) was that "a government guarantee is required in most cases" and that the banks consider this more important than the enterprise's individual creditworthiness. Writing about the practice in Zouping, Oi (1998 p. 43) states: "Regardless of whether the factory manager or the collective signs for the loan, the owner of the firm – the TVG – bears the financial responsibility for the debts of its enterprises". The most common guarantor was either the township economic commission (*jinglianwei*) or the village economic cooperative (*jingji hezuoshe*).

The TVG, itself, was often not well placed to absorb the risk. This is because its funds were limited under fiscal sharing arrangements with the central government. However it spread the risk across all the CTVEs under its control. Whiting (1996) conducted interviews with local branch managers and government officials in Wuxi (Jiangsu Province), Wenzhou (Zhejiang Province) and Shanghai in 1991 and 1992. She points out that the TVG was often an "empty guarantor" (*kong danbao)*, meaning that when a CTVE defaulted on its loans, the debt was paid off by the other enterprises irrespective of the specifics of the contract. Whiting (at p. 92) states the TVG "frequently places levies on the retained profits of the successful enterprises under its jurisdiction in order to repay the delinquent loans of enterprises that are performing poorly (*tongshou huandai)*".

Third, TVGs exercised pressure on local branches of the ABC and RCCs to direct credit to certain enterprises. Throughout the 1980s, and in some locations into the 1990s, the ABC used a series of credit ratings when allocating loans. The criteria used to devise the weightings included economic results (*jingji xiaoyi),* development trends (*fazhan qushi*), and potential sales performance (*chanpin xiaolu*) (Shen 1990). However, political interference from TVGs in the credit allocation process was still common. Ho (1994 p. 125) states that in Jiangsu: "Before making major lending decisions, credit cooperatives generally consult with township governments to seek their views and priorities". Shen (1990) puts the role of the TVG in influencing lending decisions in stronger terms. He suggests that when rating enterprises, banks "are unable to avoid local administrative interference. Some local governments and bureaus, in order to ensure that the enterprises under their jurisdiction receive a high rating, have no qualms about personal intervention". Whiting's (1996) interviews suggested that local government interference in credit allocation was facilitated through institutionalised relationships. The ABC appointed local managers of their branches, but local township and village officials had to approve their appointments. In some cases officials performed the dual role of manager of the township economic commission and manager of the local RCC.

Positive Aspects of the Role of Local Governments in Procuring Finance

A number of econometric studies have found that CTVEs with strong levels of TVG involvement are as efficient as private firms with well-defined ownership rights. For example, Svejnar (1990) runs a series of regressions using pooled panel data from 400 CTVEs and private enterprises in Wuxi in Jiangsu, Jieshou in Anhui, Shangrao in Jiangxi and Nanhai in Guangdong over a sixteen-year period. He used dummies to distinguish between different ownership forms. All of the coefficients on the ownership dummies were statistically insignificant, which suggests that "private ownership and community ownership appear to have similar effects on productivity" (Svejnar 1990 p.253). Pitt & Putterman (1996) reached similar conclusions to Svejnar (1990) using pooled data on 200 enterprises distributed across 10 provinces between 1984 and 1989. Dong & Putterman (1997) use a subset of Pitt & Putterman's data. However, unlike Svejnar and Pitt & Putterman who estimated deterministic functions, Dong & Putterman (1997) 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. Their finding was also that there was no evidence that private enterprises had a productivity advantage over traditional CTVEs.

One explanation for these perhaps surprising results is that there could be significant benefits flowing from informal institutions in the initial stages of market development. A substantial literature exists that examines how credit markets respond to asymmetric information.[3] A common conclusion is that because of asymmetric information flows borrowing is reduced below the socially optimal level. In Chinese capital markets the legal rights of creditors are not well protected and collaterals are uncertain because of well-known problems related to adverse selection and moral hazard. Zhang (1993 p. 53) states that under these circumstances, "local governments have proved indispensable to the local banking institutions for operations at the local level". Several studies have pointed to the positive role TVGs have played in the initial provision of capital to CTVEs (see eg Lin *et al* 1992, Naughton 1994, Oi 1998). The sponsorship of TVGs made it easier for CTVEs to get access to capital, which was an important reason for their growth in the 1980s and first half of the 1990s. Without the support of the TVG most CTVEs would not have the resources to provide formal guarantees. This contrasts with the experience of several post-socialist economies in Central Eastern Europe, which has been that new start-up businesses proliferate, but have trouble getting access to capital and as a result remain small, undercapitalised and largely dependent on formal capital markets.

Negative Aspects of the Role of Local Governments in Procuring Finance

Soft Budget Constraint

The budget constraint refers to the relationship between expenditure and earnings. An enterprise is said to have a soft budget constraint if it expects to be bailed out in times of financial trouble (Kornai 1980). One view is that CTVEs face hard budget constraints because local governments face hard budget constraints. Unlike the central government, local governments cannot run budget deficits and have limited funds because of fiscal sharing arrangements with the central government. However, this view overlooks the fact that TVGs cross-subsidise poor performing firms. Several commentators have argued that local budget constraints on CTVEs are soft because local governments make transfers between CTVEs to meet loan obligations to lending institutions (see eg Qian and Roland 1998, Jiang 2000). Others have suggested that the influence of local governments over lending institutions softens budget constraints. Naughton (1995 p. 153) states that in the 1980s and first part of the 1990s to the extent that they were guaranteed formal and informal credit "CTVEs did not have completely hard budget constraints".

Encourages Lending to Marginal Enterprises

A related problem is that the TVG often contributes to the availability of 'easy credit' for marginal enterprises, rather than putting pressure on these enterprises to perform (Whiting 1996). This issue is exacerbated because of asymmetrical information between the banks and the TVG. The local branches of the ABC and RCCs do not have well-trained staff, hence they usually rely on the opinion of the TVG when making lending decisions. This contributes to the soft budget constraint. Dewatripont and Maskin (1995) argue that soft budget constraints occur because creditors lack information and commitment not to refinance bad projects – ie. creditors have less information than enterprise managers and thus are prone to approve projects that are unprofitable. There is some empirical evidence to support this suggestion in field studies of CTVEs. For instance, one bank manager Whiting (1996 p. 96) interviewed in Shanghai complained that "it was impossible for his staff to conduct a feasibility study to assess the market potential of a proposed project. Instead, the staff relied on the opinions of the town's political leaders and enterprise managers. As a result the bank has repeatedly granted loans for products that ultimately were unsalable. In many of these cases firms in the same geographical area producing the same products had saturated markets".

As a result CTVEs have high levels of debt. In 1997 total losses of CTVEs were 80.6 billion RMB, which was 70 per cent higher than 1995 (Ge 1998). News reports suggest that in some locations as many as 90 per cent of CTVEs are making losses and that the debt to asset ratio is 85 percent (Cheng and Sheng 1998). In Hunan Province alone, at the end of 1998 the accumulated deficit of TVGs was 3.8 billion RMB, with 85 per cent of all CTVEs making losses.[4] One of the biggest problems is that most of this debt is shorterm. In village enterprises, the ratio of circulating debt to total debt has been in excess of 80 per cent since the beginning of the 1990s; between 1994 and 1998 the ratio was 80.8 per cent, 82.3 per cent, 83.2 per cent and 84.6 per cent respectively (SSB various). Accounts payable and shorterm loans constitute the main components of circulating debt. In 1994 the ratio of accounts payable and shorterm loans to circulating debt was 82.3 per cent and by 1998 this had increased to 84.7 per cent (Jiang 2000 p. 37).

In 1997, the proportion of circulating debt in CTVEs was higher than SOEs (84.3 per cent compared to 64.4 per cent), while the proportion of long term in CTVEs was lower than SOEs (15.2 per cent compared to 35.6 per cent) (Jiang 2000 p. 37). This suggests, the debt financing structure in CTVEs is even weaker than the state-owned sector. From the perspective of the ABC and RCCs, it is difficult for them to collect loans backed with collateral from TVGs once they are in default because the formal legal framework in China is underdeveloped. For example, Whiting (1996 p.93) reports that in Wenzhou, as of mid-1992, the ABC had attempted and failed to collect several outstanding loans guaranteed by collateral (usually building or equipment). The property had not been auctioned because the courts were unwilling to enforce the judgment.

Capital Shortages

One implication of mounting bad debts is that in the mid-to-late 1990s TVGs do not have the same influence in procuring loans. Zhang (1999) conducted interviews with local bank officers and enterprise managers in Hangzhou, Zhejiang Province. In contrast to Whiting's (1996) and Oi's (1998) studies for earlier periods he found that the power of local governments to influence the allocation of bank loans was limited. As a result total loans to CTVEs fell by around two-thirds in 1998, in spite of an increase in M2 (cash and deposits) (Dong 1998). Several studies suggest CTVEs were facing capital constraints from the beginning of the 1990s, when informal methods of raising capital started to prove restrictive (see eg Hong 1995, Liu, Chew and Li 1998). The fact that banks are less willing to lend to CTVEs has worsened this constraint, to the extent that there is now a severe capital shortage. One solution is to raise funds through the Rural Credit Institute or Rural Cooperative Fund, but neither lend to CTVEs under normal circumstances and both charge a higher interest rate than the state-owned commercial banks.

Capital shortages are exacerbated because of ad hoc local government intervention. One problem with having significant levels of TVG involvement is that it is often hard to know who is the true owner. This has made banks reluctant to lend because they are uncertain about who will be responsible if the firm makes a loss. There is a lot of anecdotal evidence of government abuse based on field research. For example, Cai (1990) states that in southern Jiangsu, managers often complain that local governments take funds from CTVEs as they please and treat enterprises under their control like 'money trees'. Ho (1995) makes a similar observation based on extensive interviews 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 township-village enterprises to their friends and supporters (or appointing them to senior positions) as rewards" (Ho 1995 p. 388).

ALTERNATIVE FINANCING AND GOVERNANCE ARRANGEMENTS

In order to offload poor performing CTVEs, TVGs have experimented with alternative governance structures. One report suggests that at the end of 1996, 66,300 or 70 per cent of CTVEs in Jiangsu had been transformed into joint stock companies, leasing or options.[5] On a visit to China in April 1998, I was told that about 70 per cent of CTVEs in the Sunan region had been converted into new organisational forms, but in less commercialized northern Jiangsu, the figure was around 50 per cent. More recent reports indicate that the percentage of CTVEs that have been restructured is as high as 80 per cent in cities such as Changzhou, Suzhou and Wuxi in Jiangsu and restructuring has not just been restricted to small CTVEs. A recent investigation in six cities in Jiangsu (Zhangjiang, Xishan, Wujin, Danyang, Xinghua and Tongzhou) found that the average restructuring rate in large and medium-sized CTVEs is 53.1 per cent (Zhou *et al* 1999).

Shareholding Co-operative Reform

One of the main approaches to ownership reform is to convert CTVEs into shareholding cooperatives. At the end of 1997 over 20 per cent of CTVEs had been transformed into shareholding cooperatives (Oi 1999 p. 624). In some localities the figure is much higher. For instance, of the 14,000 CTVEs in Changzhou almost 60 per cent have been transformed into shareholding cooperatives (Wan and Ding 1999). A major objective of shareholding cooperative reform has been to provide a mechanism for CTVEs to raise funds for modernisation and technical renovation. Issuing shares to management and workers provides an alternative source of capital to bank lending. When shareholding cooperatives need funds for a new investment, the common practice is to issue new shares.

However, in practice, shareholding cooperative reform has not worked as a method of raising capital in the manner in which it was intended. One of the main disadvantages of worker-ownership is that it promotes poor risk sharing. Hansmann (1990 p. 1772) states: "If the workers supply the required capital themselves - for example by investing their pension plan assets or other forms of personal wealth in the firm - they will be badly underdiversified. If the firm goes bankrupt they will not only lose their jobs but savings as well". In profitable enterprises this has not been a factor for workers in China. In firms that are performing well workers receive large dividends and are content to invest their savings. In fact, in field research conducted in Liaoning and Shandong, Helman (1996) found that in some better performing firms workers would have invested more of their savings if their had been opportunities to do so. In small loss-making firms, though, which are often selected for experimentation with shareholding cooperatives, risk diversification is an important consideration that workers have to take into account. In these cases workers often do not have sufficient information to make informed decisions about risk and return considerations. This issue has been magnified because of the practice of forced shareholding in rural parts of China. In some cases where workers have decided not to invest savings there is evidence that firms have withheld their wages. In other cases workers who have been unable or unwilling to purchase shares have been forced to resign or retire.

Outright Privatisation

In recent times, limited outright privatisation has become more popular as an alternative to shareholding cooperative reform. Overall, the number of private firms in China increased from 90,000 in 1988 to over a million in 1998, which represents an average annual increase of 34 per cent (Liu 1999). Some of these are CTVEs, which have been privatized. In Jiangsu, before the ownership reform, of the 300 billion RMB capital accumulated by CTVEs, 85 per cent was collective owned with the share owned by foreign investors and individuals less than 10 per cent. However, 30,000 small CTVEs have been sold, transferring 10 billion RMB in capital to the private sector. As a result the private non-state share in Jiangsu is almost 35 per cent (Wan and Ding 1999a).

The ABC is a strong advocate of privatising CTVEs, on the basis that TVGs made a number of improper guarantees in the 1980s. Private ownership was incorporated into the Chinese Constitution in March 1999. An amendment to Article 11 of the Constitution places private business on the same level as the public sector. It changes the original clause "the private sector is a supplement to public ownership" to "the non-state sector, including individual and private businesses, is an important part of the socialist market economy" (Liu 1999). In response to these changes, local governments have implemented various incentives and policies to promote private firms, including altering one's household status, for individuals who start businesses over a certain size (Oi 1998). At the provincial level, private firms are now treated on the same footing as collective and state-owned firms. For example, the Jiangsu Provincial Government has adopted a new set of policies to give private enterprises the same treatment as collective and state-owned firms in the areas of granting business scopes and accessing credit.[6]

One reason for this development is that compared with traditional CTVEs and shareholding cooperatives, private firms have more simple governance structures. Privatization has presented a more straightforward solution to issues associated with separation of ownership and control than shareholding cooperatives given the empirical evidence that shareholder meetings in the latter are acting as poor or non-existent monitors on management behavior. As Oi (1999 p. 625) puts it, "for some villages it is easier to sell some of the enterprises and get income without the headaches". However, this does not mean that China's small and medium enterprise non-state sector is "going private". Oi (1999) makes the point that local governments still control most of the more successful CTVEs as well as numerous resources, on which private firms depend. Others such as Wank (1999) stress that the close relationship between local governments and the private sector lessens the threat to the local state from an emerging business class.

Other Ownership Arrangements

Where outright privatisation of small loss-making firms is not viable, TVGs have experimented with alternative governance structures. One method is to combine leasing and selling. In these cases, the current assets of the CTVE are sold and the fixed assets, such as the building and the land, are leased. For example, the Dachijia Sofa Factory in Penglai sold its current assets for 1.76 billion RMB and leased its building and land for 181,300 RMB per annum (Cheng and Sheng 1998). A second method suitable for restructuring loss-making CTVEs that cannot be sold is a "peeled lease". With the permission of the bank, the assets are leased to an individual who can re-register as a different enterprise, while the original legal body still exists and is responsible for the debt. A third option is to use rent to offset debt. Under this approach, the bank takes over the debts of the enterprise and leases its assets to an enterprise or individual.

EXPLAINING THE EMERGENCE OF INDIRECT FORMS OF GOVERNANCE SUCH AS SHAREHOLDING CO-OPERATIVES

One of the benefits of the governance structure of traditional CTVEs is that it helped to facilitate financial contracting because the TVG was well placed to monitor managers. One explanation why TVGs prefer indirect forms of governance in a sizeable share of CTVEs under their control is that the traditional benefits of TVGs in terms of being well placed to monitor managers have been subsumed under the growing costs of monitoring activities as markets have matured and CTVEs have started to get bigger. Alchian and Demsetz (1972) represent an early attempt to define the firm within a contracting framework. In their analysis, the existence of the firm is associated with an organisational structure that consists of a monitor and a group of workers. In Alchian and Demsetz's (1972) model, the monitor has an incentive to enforce the provision of costly labour inputs because it holds a residual claim to profits from production.

Che and Qian (1998) build on this idea to view the collection of CTVEs in the community as a multidivisional firm. They argue that the community residents are the major beneficiaries of the firm, the TVG is the board of directors and CTVEs are branches, divisions or subsidiaries in the firm. Given the traditional absence of formal capital markets in rural China it makes sense to make the TVG the residual claimant for two reasons. First, the TVG has better endowed physical capital, which can be used for equity investment and to provide guarantees to access debt financing. Second, it has better endowed human capital, which can be used to monitor CTVE managers.

This is a good example of Weber's (1910, 1978) view that particular organisational forms arise at specific points in time, embedded in the extant context of social economic and technological constraints. However, Weber (1910, 1978]) also recognised that organisational arrangements are not static, but instead change as economic, social and technological conditions shift. There are significant monitoring costs associated with the separation of beneficiaries and control in traditional CTVEs. First, the rights of local residents, as major beneficiaries, are restricted. Within the framework used by Che and Qian (1998), the local residents do not have the normal privileges of share ownership such as the right to sell their shares, vote at shareholder meetings or elect the Board of Directors (local government officials). Second, because the local residents as implicit shareholders do not have a sanctioning device, this creates perverse incentives, and opportunities, for the TVG to divert funds from investment to serve its own goals.

Alchian and Demsetz (1972), among others, point out that the level of monitoring costs determines the optimal organisation of the firm. One response to competitive pressures associated with maturing markets is that CTVEs have become bigger and formed enterprise groups to benefit from economies of scale and to facilitate investment in technological upgrading. Several commentators have documented the emergence of large CTVEs and enterprise groups in the CTVE sector (see eg Chen 1998, Hsu 1999). This trend is confirmed by statistics. In 1998 there were more than 6,400 CTVEs in China that were classified as either large or medium-sized enterprises (LMEs); [7] of these 4000 have opened overseas branches and 40 have listed on the stock exchange.[8]

Some notable examples of the increasing number of large CTVEs are Chunlun Shareholdings, Huaxi Shareholdings and Kelong Electronics. In 1998 Kelong Electronics was the largest CTVE in Guangdong with revenue of 6.59 billion RMB.[9] In addition in 1998 there were 46,919 CTVEs with annual sales in excess of 10 million RMB.[10] A number of large enterprise groups that are national and international in focus are also emerging. In 1996 there were 736 CTVE enterprise groups in China. [11] In 1998 Guangdong, alone, had 350 large-scale technological-intensive CTVE enterprise groups.[12] A number of these have become major producers in a range of industries including chemicals, electronics and textiles. For instance, the Nanjing Panda Electronic Group consists of a number of major electronics enterprises in Jiangsu and is one of the biggest electronics companies in China. CTVE groups have also moved offshore.

Monitoring costs have become more pronounced as CTVEs have grown for two reasons. First, the value of CTVE assets are now often well in excess of that borrowed with the assistance of the TVG, which raises issues about who should own and control the assets. Second, CTVEs increasingly enter into contracts outside their original geographical region, where the TVG has no comparative advantage. This is not just restricted to other parts of China, but also involves investment in other parts of Asia and elsewhere. At the start of the 1990s CTVE groups had subsidiaries in developing countries such as Thailand, the Philippines, and Indonesia, as well as developed countries such as Australia, the U.S., Canada, and Japan. While at this stage the extent of their overseas operations is relatively small this highlights the breadth of their contracting activities.[13]

CONCLUSIONS

In the past TVGs have played an important role in procuring finance for CTVEs under their control. Throughout the 1980s the ABC, RCCs and TVGs worked together as an ingenious surrogate for well-defined formal capital markets in rural areas. Over this period, and into the 1990s, traditional CTVEs with significant levels of TVG involvement were the engine room driving China's high rate of economic growth. However, from the mid-1990s TVGs have started to regard CTVEs, with high levels of debt, as a burden rather than an asset. In response to competitive pressures as TVEs have grown bigger and markets have matured TVGs have adopted alternative financing and governance structures. These alternative governance structures include shareholding cooperative reform, leasing and outright privatization. Some of these, such as shareholding cooperative reform, have experienced teething problems. Nevertheless, it is likely that we will continue to see more shareholding cooperatives, private firms and other organisational forms as TVGs and CTVEs adjust to changing market circumstances.

REFERENCES

Alchian, A and Demsetz, H. (1972). Production, Information Costs and Economic Organization. American Economic Review, 62(5), p. 777-795.

Cai. X. (1990). Why the Township and Village Enterprise 'Debt Chain' is Hard to Break. Shanghai Finance, 12, p. 35-37 (in Chinese).

Che J. and Qian Y. (1998). Institutional Environment, Community Government, and Corporate Governance: Understanding China's Township-Village Enterprises. Journal of Law, Economics and Organisation, 14(1), p. 1-23.

Chen, W (1998). The Political Economy of Rural Industrialization in China – Village Conglomerates in Shandong Province. Modern China, 24, p. 73-96.

Chen, J. (2000). Institutional Change and Rural Informal Institutions: The Formation and Control of Property Rights in China's Township Enterprises. Economic Research Journal No.2, p. 48-55 (in Chinese).

Cheng, P. and Sheng, Z. (1998). Report on TVE Property Rights System Reform in Penglai. People's Daily (December 4), p. 4 (in Chinese).

Clegg, J. (1998). Multi-Stakeholder Cooperation in China – Changing Ownership and Management of Rural Enterprises. In F. Christiansen and J. Zhang (eds) Village Inc. Chinese Rural Society in the 1990s (London: Curzon), p. 66-82.

Dewatripont, M. and Maskin, E. (1995). Credit and Efficiency in Centralized and Decentralized Economies. Review of Economics Studies, 62, p. 541-555

Dong, X. Y and Putterman, L. (1997). Productivity and Organisation in China's Rural Industries: A Stochastic Frontier Analysis. Journal of Comparative Economics, 24, p. 181-201.

Dong, H. (1998). The Relationship Between Banks and TVEs Needs to be Improved Urgently. People's Daily (internet edition), (December 7) (in Chinese).

Ge, X. (1998). Where do TVE's Losses Come From? Economic Daily,(June 26), p. 7 (in Chinese).

Hansmann, H. (1990). When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination and Democracy. Yale Law Journal, 99(8), p. 1749-1816.

He, B. *et al* (eds) (1991) Research on the Non-Agricultural Development of Rural Jiangsu (Shanghai: Shanghai University Press) (in Chinese).

Helman, A. (1996). The Shareholding Cooperative System in China. Paper Presented at the 8th Chinese Economic Association (UK) Conference, LSE, December 17-18.

Hillier, B and Ibrahimo, M. V. (1993). Asymmetric Information and Models of Credit Rationing. Bulletin of Economic Research, 45, p. 271-304.

Ho, S. (1994). Rural China in Transition – Non-Agricultural Development in Rural Jiangsu, 1978-1990 (Oxford: Clarendon Press).

Hong, Z. (1995). The Shareholding Cooperative System and Property Rights Reform of China's Collective Township-Village Enterprises. Asian Profile, 23(5), p. 359-369.

Hsu, S. C. (1999). Two Local Regime Types in China's Rural Industrialization: A Comparative Study of Four Townships in Fujian and Jiangsu. Issues and Studies 35, p. 80-130.

Jiang, C. (1996). Township and Village Enterprises. In National Conditions of China Series - Social and Economic Investigation on 100 counties and cities, (Beijing: China Encyclopaedia Press) (in Chinese)

Jiang, C. (2000). Fund Resources of Township Enterprises and Dynamic Changes in their Financing Structure: Analysis and Considerations. Economic Research Journal, No. 2, p. 34-39 (in Chinese).

Kornai, J. (1980). The Economics of Shortage (Amsterdam: North-Holland)

Li, J. (1995). Township and Village Enterprises in China's Growth. China Report, 31(3), p. 367-384.

Lin, J. (1989). An Economic Theory of Institutional Change: Induced and Imposed Change. Cato Journal, 9(1), p. 1-31.

Lin, Q, He, J, and Du, H. (1992). Rural Industrial Enterprises and the Role of Local Governments: A Chinese Case Study. In D. Jones and J. Svejnar (eds) Advances in the Economic Analysis of Participatory and Labor-managed Firms: A Research Annual Vol. 4 (Greenwich CT: JAI Press), p. 243-271.

Liu, J. (1999). Private Enterprise and Economic Growth. Hong Kong Economic Journal, May 25, p. 29 (in Chinese).

Liu, Y, Chew, S and Li, W. (1998). Education, Experience and Productivity of Labor in China's Township and Village Enterprises: The Case of Jiangsu Province. China Economic Review, 9(1), p. 47-58.

Lo, D. (1997). Market and Institutional Regulation in Chinese Industrialisation, 1978-1994 , (London: MacMillan).

Lo, D. (1999). Re-appraising the Performance of China's State-owned Industrial Enterprises 1980-96. Cambridge Journal of Economics, 23(6), p. 693-718.

Naughton, B. (1994). China's Institutional Innovation and Privatization From Below. American Economic Review, Papers and Proceedings, 84(2), p. 266-270.

Naughton, B. (1995). Growing Out of the Plan: Chinese Economic Reform 1978-1993. (Cambridge: Cambridge University Press).

Oi, J. (1988). The Chinese Village Inc. In B. Reynolds (ed), China in a New Era: Continuity and Change, (New York: Paragon), p. 55-75.

Oi, J. (1992). Fiscal Reform and the Economic Foundations of Local State Corporatism in China. World Politics, 45, p. 99-126

Oi, J. (1998). The Evolution of Local State Corporatism. In A. Walder (ed), Zouping in Transition – The Process of Reform in Rural North China (Cambridge, Mass: Harvard University Press), p. 35-61.

Oi, J. (1999). Two Decades of Rural Reform in China: An Overview and Assessment. China Quarterly, No. 159, p. 616-628.

Pitt, M. and Putterman, L. (1996). Employment and Wages in Township, Village and other Rural Enterprises. In G. Jefferson and I Singh (eds) Reform, Ownership and Performance in Chinese Industry, (Washington DC: The World Bank).

Qian, Y. (1999) The Process of China's Market Transition (1978-1998): The Evolutionary, Historical and Comparative Perspectives. Journal of Institutional and Theoretical Economics (forthcoming).

Qian, Y. and Roland, G. (1998). Federalism and the Soft Budget Constraint. American Economic Review, 88, p. 1143-1162.

Shen, S. (1990). Several Thoughts on Credit Rating Work. Shanghai Finance No. 2, p. 40 (in Chinese).

Shao, X. *et al* (1991). The Experience with Jiading County's Township and Village Enterprise Contracting System. In Jiading Yearbook 1988-1990 (Shanghai: Shanghai University Publishing House) (in Chinese).

Sjoberg, O and Zhang, G. (1998). Soft Budget Constraints in Chinese Rural Industries. In F. Christiansen and J. Zhang (eds) Village Inc. Chinese Rural Society in the 1990s, (London: Curzon), p. 103-122.

Smyth, R. (1999a). Rural Enterprises in Jiangsu Province, China: Recent Institutional Changes and Future Prospects. Development Policy Review, 17(2), p. 191-213.

Smyth, R. (1999b). Shareholding Cooperative Reform and Ownership of China's Collective Township-Village and Small-Scale State-Owned Enterprises. New Zealand Journal of Asian Studies, 1(1), p. 60-76.

State Statistical Bureau (SSB) (various) Yearbook of China's Collective Township and Village Enterprises, (Beijing: China Statistical Publishing House) (in Chinese).

Svejnar, J. (1990). Productivity, Efficiency and Employment. In W. Byrd and Q. Lin (eds) China's Rural Industry: Structure, Development and Reform, (New York: Oxford University Press).

Vermeer, E. (1996). Experiments with Rural Industrial Shareholding Cooperatives: The Case of Zhoucun District, Shandong Province. China Information, 10, p. 75-107.

Walder, A. (1998). The County Government as an Industrial Corporation. In A. Walder (ed), Zouping in Transition – The Process of Reform in Rural North China, (Cambridge, Mass: Harvard University Press), p. 62-85.

Wan, S. and Ding, S. (1999). Operation on Property Rights. Shenzhen Economic Daily, (March 14), p. 2 (in Chinese).

Wan, S and Ding, S. (1999a). Overstepping the Sunan Model. Shenzhen Economic Daily,(March 12), p. 11 (in Chinese).

Wang, T. (1989). Issue of Regional Imbalance. In Q. Lin, (eds) China Rural Industry: Structure, Development and Reform, (Beijing: Economic Science Press) (in Chinese).

Wank, D. (1999) Commodifying Communism: Business, Trust and Politics in a Chinese City, (Cambridge: Cambridge University Press).

Weber, M. (1910, 1978) Economy and Society Translated by G. Roth and G. Wittich, (Berkeley, University of California Press).

Weitzman, M and Xu, C. (1994). Chinese Township-Village Enterprises as Vaguely Defined Cooperatives. Journal of Comparative Economics, 18, p. 121-145.

Whiting, S. (1996). Contract Incentives and Market Discipline in China's Rural Industrial Sector. In J. McMillan and B. Naughton (eds) Reforming Asian Socialism (Ann Arbor: University of Michigan Press).

Xu, B. (1999). What is Wrong with Rural Enterprises? Economic Daily, (January 7), p. 1 (in Chinese).

Zhang, G. (1993). Government Intervention Versus Marketisation in China's Rural Industries: The Role of Local Governments. China Information, 8, p. 45-73.

Zhang, J. (1999) Managerial Incentives and Agency Problems in Rural Collective Enterprises in China. Paper Presented at the 11th Conference of the Chinese Economic Studies Association (Australia), Melbourne, July 15-16.

Zhou, Q. and Hu. Z. (1987). Asset Formation and Operational Features of Industrial Enterprises in Chinese Townships and Their Macro-effects, China Social Sciences, No. 6

Zhou, Q. et al (1997). The Macro-effect of TVEs' Debt Operation. In Q. Lin and Y. Du (eds) Reform and Efficiency of China's Industry - A Comparison of State Owned and Non-State Owned Enterprises (Beijing: Yunan People's Press) (in Chinese).

Zhou, Y, Dai, L, and Sun, J. (1999). Reflections on the Restructuring of Southern Jiangsu Township and Village Enterprises. Economic Research Journal No. 3, p. 59-65 (in Chinese).

ENDNOTES

[1] For a more detailed discussion of the distinguishing ownership features of traditional CTVEs see Ho (1994).

[2] There is an extensive Chinese language literature on traditional financing in CTVEs. Some of the main references are Jiang (1996, 2000), Wang (1989), Zhou and Hu (1987), Zhou *et al* (1997).

[3] Hillier and Ibrahimo (1993) provide a review of the relevant literature.

[4] China Economic Times Internet Edition June 30 1999 (in Chinese).

[5] China Industry and Commerce Times, March 19, 1997, p. 4 (in Chinese)

[6] Peoples' Daily April 9 1999, cited in Qian (1999 p. 18).

[7] LMEs are classified according to either the value of their fixed assets or technical criteria. In practice, most LMEs have in excess of 500 workers. For a detailed explanation see Lo (1999 p.696).

[8] Xinhua, Beijing, in English, 1326 gmt May 13 1998. Text reproduced in *SWB-AP* May 20 1998.

[9] China Economic Times, July 27, 1999 internet edition (in Chinese); People's Daily, Southern China News April 28, 1999, p. 4 (in Chinese).

[10] Ministry of Agriculture, Fifty Years of Development of China's Rural Economy (in Chinese).

[11] Economic Daily, January 17 1997 p. 10 (in Chinese).

[12] People's Daily, Southern China News April 28, 1999, p. 4 (in Chinese).

[13] According to Li (1995 p. 379), in 1991 their overseas investments were worth US$ 5 million .