

The Shareholding System in a Shandong Township: Practice and Impact*

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A minimal agreement between two theoretical perspectives—local state corporatism and privatization—lies in the recognition that incipient formal privatization is taking hold in rural China during the 1990s. While the corporatists insist that this privatization is stringently contained within local governmental jurisdiction, the other camp finds in the shareholding system a seed, protected by the Chinese Communists, that can grow into a full-bloomed privatization of rural enterprises.

This paper intends to respond to these controversies with a case study of the shareholding system in a township in Shandong. From the fieldwork materials, the author suggests, first, that the shareholding system differs from the shareholding cooperative system primarily in the local government's attitude to support privatization in the former but not in the latter. Second, the shareholding system is further connected to privatization by means of turning an enterprise's public assets into a portfolio of cash shares and free shares for individuals, especially for the managerial stratum. Finally, this privatization does not seem to be able to be contained within the jurisdiction of the local government, as the local state corporatism perspective suggests. Rather, this privatization is an expanding force that calls for the establishment of the capital market and thus it penetrates into the deep roots of socialist China.

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Addressing the Chinese Communist Party's Fifteenth National Congress on September 12, 1997, General Secretary Jiang Zemin mentioned, in a somewhat ambiguous manner, two organizational forms for Chinese enterprises. He said,

The shareholding system is a form for modern enterprises to organize capital, a form that is conducive both to the separation of ownership from other economic rights and to increasing the efficiency of both enterprise and capital. It is useful for capitalism and socialism alike. . . . There are various kinds of shareholding cooperative economies emerging in both urban and rural areas. They are new things in reform. We must support and guide them.¹

Jiang seemed to endorse the shareholding cooperative system while recognizing the existence of the shareholding system in post-1978 China. What exactly differentiates one system from the other, however? In what ways is either system connected to the notion of privatization that Jiang failed to mention yet scholars argue passionately about? Moreover, judging from the practices of these systems, how can we project the future of privatization in China?

This paper tries to answer these questions based on materials collected in Township B, Shandong in the summer of 1998.² From these materials, and the theoretical insights drawn from the perspectives of local state corporatism and privatization, the author suggests, first, that the two systems differ primarily in the local government's attitude to support privatization in the shareholding system but not in the other system. Second,

¹Jiang Zemin, *Gaoju Deng Xiaoping lilun weida qizhi ba jianshe you Zhongguo tese de she-huizhuyi shiye quanmian tuixiang ershiyi shiji* (Hold high the great banner of Deng Xiaoping theory for an all-around advancement of the cause of building socialism with Chinese characteristics into the twenty-first century) (Beijing: Renmin chubanshe, September 1997), 24.

²By no means can Township B serve as a showcase of the practices of the shareholding (co-operative) system in mainland China. The author presents its materials because he happened to be able to work intensively there for two weeks and because the gathered materials do relate to Jean C. Oi, Andrew G. Walder, and Nan Lin's research in the northern coastal provincial region.

in addition to governmental support, the shareholding system is connected to privatization by means of turning an enterprise's public assets into a portfolio of cash shares and free shares for individuals, especially for the managerial stratum. Finally, this privatization does not seem to be able to be contained within the jurisdiction of the local government, as the local state corporatism perspective suggests. Rather, this privatization is an expanding force that calls for the establishment of the capital market and thus it penetrates into the deep roots of socialist China. In short, we shall look into the *impact* of the novel economic practices on a local government and suggest that privatization is what best explains the nature of this impact.

Local State Corporatism and Privatization

To assess the significance of the shareholding system as currently implemented, we must situate this system in two rival theoretical perspectives: local state corporatism and privatization. While the corporatist view takes the shareholding system as a means to enhance local government's efficiency in controlling its rural enterprises, the privatizational account takes the system as a signal of the transference of "asset rights" from government to corporate leaders in the enterprises. The two perspectives do agree on one thing, however: incipient, *formal* privatization is firmly incorporated in Chinese local political economy in the 1990s.

As a key proponent of local state corporatism, or LSC, Oi first defines this system as "the workings of a *local* government that coordinates economic enterprises in its territory as if it were a diversified business corporation."³ She then uses the concept to characterize the relationship between local government in China and its rural enterprises in the 1980s. According to her, this working pattern came into being because of the two institutional innovations caused by the central government.⁴ One was the financial re-

³Jean C. Oi, "Fiscal Reform and the Economic Foundations of Local State Corporatism," *World Politics* 45 (October 1992): 100-101.

⁴Jean C. Oi, "The Role of the Local State in China's Transitional Economy," *The China Quarterly*, no. 144 (December 1995): 1137; Wu Guoguang and Zheng Yongnian, *Lun zhongyang-*

form that provided the leeway for local government to seek financial independence. The other was the localization of the property rights with which the local authority was granted power to run state enterprises, to create its own collective ones, and to invest in private business. These innovations resulted in a local entrepreneur-government that devoted itself to rural industrialization by practicing "the corporate management of public enterprises and the pooling of community resources."⁵

In the initial LSC, "privatization and the formation of new private firms" played a secondary role, yet became prominent in the 1990s because of "the increasing scale of the local industrial economy and increasing market competition."⁶ Under pressure from the competition, LSC has responded in two ways: (1) by encouraging the establishment of new private enterprises, which are now viewed as a lucrative source of revenues, and (2) by consolidating its enterprises through selective privatization.⁷ The policies of privatization that Oi found in Zouping County, Shandong included leasing, shareholding, formation of conglomerates, bankruptcy declarations, and auction sales.⁸ These drastic measures were adopted for the purpose of "increasing efficiency of the remaining enterprises and to reconsider [the county's] attitude toward the private sector. . . ."⁹ Hence the evolution of LSC in the 1990s has been moving toward tolerance of privatization in accord with local governmental concerns over revenues, efficiency, and the readjustment of its own attitude.

A supporter of Oi's perspective, Andrew Walder, even if reluctantly, also recognizes this loosening of LSC's grip over its rural enterprises. Walder first considers whether partial or "hidden" privatization is better

difang guanxi: Zhongguo zhidu zhuanxingzhong de yige zhouxin wenti (On the central-local relationship: The key problem in China's transitional institutions) (Hong Kong: Oxford University Press, 1995), 56.

⁵Jean C. Oi, "The Evolution of Local State Corporatism," in *Zouping in Transition: The Process of Reform in Rural North China*, ed. Andrew G. Walder (Cambridge, Mass.: Harvard University Press, 1998), 35.

⁶*Ibid.*

⁷*Ibid.*, 55-60.

⁸*Ibid.*, 57.

⁹*Ibid.*

than his own organizational analysis to explain official-qua-entrepreneur's behavior at the bottom of the government hierarchy. He takes hidden privatization to mean that:

the *private* incentives for government officials are larger as one moves down the hierarchy of government, to the point where in many rural townships and villages officials have something functionally equivalent to an "equity share" in public firms that ties their personal and family income directly to the growth and prosperity of local industry.¹⁰

He opposes this view for two reasons. First, in rapidly industrializing rural areas, private incentives for local officials are aligned with "the increased flows of budgetary revenue generated by local industry." Then the incentives are "the equivalent of executive bonuses and fringe benefits in market economies" and have nothing to do with the corruption of officials, a phenomenon stressed in the hidden privatization literature. Second, since the officials "do not have invested equity at risk," they do not have something equivalent to an equity share. But Walder does concede to the following situation of privatization: "It has sometimes been documented . . . that significant numbers of village-run and perhaps even township-run enterprises are in effect operated as family businesses, in which there is not clear distinction between officials' income and village revenue."¹¹ He mentions, however, that "there are no reliable estimates of how widespread such 'hidden privatization' is. . . ." As we shall see, the current shareholding system provides the equity shares to local officials, the shares which tie their income to an enterprise's performance. No other villages practice partial, or even *formal*, privatization by means of the shareholding system more successfully than Daqiuzhuang, as documented by sociologist Nan Lin.¹²

In his observation of the evolution of LSC in Zouping, Walder again ponders the situation of informal privatization. He now says, "Even in Zouping, where county officials have played such an important role in industrial organization, we still find nascent processes that others have de-

¹⁰Andrew G. Walder, "Local Government as Industrial Firms: An Organizational Analysis of China's Transitional Economy," *American Journal of Sociology* 101, no. 2 (September 1995): 292.

¹¹*Ibid.*, 293.

¹²Nan Lin's case of Daqiuzhuang is described in note 35 below.

scribed as 'informal privatization.' . . . [But] it is easy to exaggerate the pace of this trend."¹³ Here, as elsewhere in Oi's paper, supporters of the LSC view have to come to terms with the phenomenon of hidden, or informal, privatization in rural China in the 1990s. Where Oi situates privatization firmly in the control of the Zouping government to pursue its goals of tax revenues, enterprise efficiency, and change of its own attitude toward the private sector, Walder specifies whether or not local officials own equity shares as the key indication of privatization. But as their critics have long pointed out, the reason privatization was not serious until recently is because the corporatists have built an image of incorruptible local officials into their assumptions.

When Oi assumes that "cadres are noncorrupt,"¹⁴ she ignores the fact that "reform has brought to local bureaucrats enormous opportunities to become rich illegally."¹⁵ To explore these opportunities which have led to the so-called informal privatization, Wu Jiemin takes the contract responsibility system initiated in the beginning of the economic reforms in the late 1970s as his point of departure. The system, on the one hand, created a mass of peasant-entrepreneurs by commercializing and commodifying their agrarian produces. On the other hand, the system also granted substantive economic powers, such as land transference and tax deduction, to local officials and cadres. In the process of enlarging their investments, the peasant-entrepreneurs stumbled in face of the constraints of ambiguously defined land property rights, which resulted in high transaction costs in terms of management, finance, and taxes. To overcome the barriers caused by these costs, peasant-entrepreneurs colluded with local officials. This collusion thus created an economic situation which Wu has called "informal privatization" and which has led to major problems in the distribution of profits generated from land development.

¹³Andrew G. Walder, "The County Government as an Industrial Corporation," in Walder, *Zouping in Transition*, 84.

¹⁴Oi, "Fiscal Reform and the Economic Foundations of Local State Corporatism," 113.

¹⁵Jiemin Wu, "An Explanation of the Institutional Dynamics of China's Rapid Rural Industrialization: Local Property Rights Regime and Informal Privatization" (Paper presented at the Fourth Annual Conference of the Taiwan Political Science Association, Soochow University, Taipei, December 13-14, 1997), 14.

In Wu's account, what Walder calls the equity shares of the local officials were created in the collusion between those officials and peasant-entrepreneurs. These "shares" were of course illegal. But as our case in Township B, Shandong, along with Nan Lin's case of Daqiu Zhuang will show, these shares are now legalized in the shareholding system, with the new name "matching shares" (*xiangshou gu*).¹⁶ To be sure, Wu does not directly tackle the issues of the equity shares and shareholding system. In order to find a theoretical treatment of these issues from the perspective of privatization, we must turn to Nan Lin's work.

Lin distinguishes the shareholding from the shareholding cooperative system, treating the former as a genuine indicator of the second phase of the three-stage privatization in post-1978 China.¹⁷ The three stages of the transformation are as follows:

(1) [The first strategy is] when the local cadres gain control of the local economy and create enterprises which combine the features of collectives (with clear village ownership) and a market orientation (self-management and distribution of surplus values), with themselves or family members installed in the management.

(2) [The second strategy is] when the local enterprises are being turned by the local cadre-turned-entrepreneurs and their family members into shareholding companies, where they themselves obtain the majority of shares by both representing the collective shares and claiming a large portion of the shares given to the managers, without cash, for their "contributions" to the enterprise.

(3) A third stage, still evolving, is a plan to accumulate sufficient noncollective capital to "buy back" the collective shares by the shareholders in the enterprise. When and if this third stage is completed, . . . then the ownership of the enterprise will have been transferred from the public sector to the private sector.¹⁸

That is, privatization in rural China involves cadre-entrepreneurs moving

¹⁶We will analyze the notion in the next section.

¹⁷Nan Lin and Chih-Jou Chen, "Localization of Chinese Rural Enterprises: Transformation of Property Rights" (Paper presented at the Conference on Social Structure and Social Change: International Perspectives on Business Firms and Economic Life, Institute of European and American Studies, Academia Sinica, Taipei, May 9-10, 1997), 6-7. The author shall explore the differences between the shareholding and shareholding cooperative systems in the next section. But local cadres themselves sometimes use both terms as synonyms.

¹⁸Ibid., 8. Lin subsequently expands these three stages into a sophisticated table. See Nan Lin and Xiaolan Ye, "Chinese Rural Enterprise in Transformation: The End of the Beginning," *Issues & Studies* 34, no. 11/12 (November/December 1998): 5.

from control of enterprise assets to appropriation of returns and ultimately to personal ownership of the assets.¹⁹ Except for the last stage, which is only projected by Lin,²⁰ the other two stages have been realized in Daqiu-zhuang, as Lin's meticulous documentation shows. In these three stages of transformation, the shareholding system serves as a formal means to shift the public ownership by rural enterprises to private ownership by cadre-entrepreneurs. The system is able to fulfill the function because relevant rules regarding how a village- or township-owned enterprise can be turned into a shareholding firm are ambiguous and because the Fifteenth Party Congress of 1997 has endorsed the establishment of the shareholding type of companies.²¹ Due to these two reasons, local officials are encouraged to experiment with the kind of shareholding system that they interpret from these ambiguous rules. The results of this experiment in Township B vis-à-vis that in Daqiu-zhuang appear later on in the paper.

The minimal agreement between local state corporatism and privatization, as we have discussed, lies in the recognition that incipient formal privatization is taking hold in rural China during the 1990s. While the corporatists insist that this privatization is stringently contained within local governmental jurisdiction, the other camp, especially Nan Lin, finds in the shareholding system a seed, protected by the Chinese Communists, that can grow into a full-bloomed privatization of rural enterprises. In regard to this controversy, our case of Township B as revealed below will confirm the privatization view, because with the expanding market forces, the attitude of the local government seems to have turned to support the road of privatization.

The Shareholding (Cooperative) System in Township B

Township B is located in a northern suburb of Jinan, the capital of Shandong Province. Its jurisdiction covers 57.88 square kilometers of

¹⁹Lin and Chen, "Localization of Chinese Rural Enterprises," 2.

²⁰*Ibid.*, 25.

²¹Lin and Ye, "Chinese Rural Enterprise in Transformation," 8.

Table 1
Economic Structure and Number of Enterprises of Township B, 1988 and 1996

Unit: Million yuan					
Year	Total Income	Agricultural Income	Industrial Income	Service Income	Number of Enterprises
1988	605 (100%)	87 (14.4%)	257 (42.5%)	261 (43.1%)	274
1996	12,500 (100%)	294 (2.4%)	2,006 (16.0%)	10,200 (81.6%)	1,600

Source: Neng Liu, "Administration of Township: A Case Study of Township B" (in Chinese) (Ph.D. dissertation, Department of Sociology, Beijing University, 1998), 23-24.

land, with a population of more than 180,000 (in 1995), 55 percent of which is immigrants. Because of urbanization, Township B has been incorporated into Jinan, changing its economy from agriculture to the service industry. Table 1 indicates that from 1988 to 1996, township-wide income from tertiary products became the number one pillar of the local economy. With such an income base, the financial situation of the township government can be shown as table 2.

Whether a township such as Township B is allowed to have these three categories of revenues—budgetary taxes, extrabudgetary taxes, and self-raised funds—in its treasury depends on a number of factors. In terms of the first category and a portion of the second, Township B will turn all the revenues to its superior governments who then decide the percentage of the taxes that will be returned. Moreover, in terms of most of the second category and all of the third, Township B is entitled to collect for its own use, provided that the township does not squeeze citizens and enterprises too hard. Under these circumstances, we see that, in table 2, Township B collects most of its revenues from the category of self-raised funds, twice as much as the first and second categories combined. This fact indicates that township-owned enterprises are a lucrative source of income for the Township B government. Why, then, should the township experiment with the shareholding (cooperative) system? Is it for the purpose of increasing the Township B government's efficiency in controlling its enterprises, as local state corporatism predicts, or for transferring the public assets of the

Table 2
Financial Indicators of Township B in 1995

Indicators	Township-Wide Total
Labor force	37,016 persons
Arable land	8.72 square kilometers
Total income	10,735,850,000 <i>yuan</i>
Total fixed assets	2,165,940,000 <i>yuan</i>
Budgetary taxes	75,810,000 <i>yuan</i>
Extrabudgetary taxes	65,680,000 <i>yuan</i>
Self-raised funds	288,410,000 <i>yuan</i>

Sources: Liu, "Administration of Township: A Case Study of Township B," 47. The author has not been able to find relevant figures that would constitute the 76 percent of the total income, in addition to the 24 percent of the government's taxes. The three financial indicators in this table—budgetary taxes, extrabudgetary taxes, and self-raised funds—require explanation. The PRC's current financial system for townships is stipulated in "The Trial Financial Management Measures for Towns and Townships," promulgated by the Ministry of Finance in 1985. The Measures divide financial revenues into three categories: (1) funds within the state budget (including village and township enterprise income tax, livestock slaughter tax, urban maintenance construction tax, rural market transaction tax, livestock transaction tax, tax on licenses for vehicles and ships, and deed tax); (2) extrabudgetary funds (including agricultural surtax, rural educational surtax, utility surtax, extrabudgetary incomes managed by institutions of the administrative system, and "profits of village and township enterprises" added to the list since 1994); and (3) funds raised by villages and townships themselves (including water rates, the so-called "five kinds of unified funds"—educational surtax, militia training fee, civil affairs stipends, civilian-run transportation fee, and family planning fee—and types of non-tax levies on village- and township-owned enterprises). See Shiao-Chian Fong, "Three Hebei Townships under State-Endorsed Rural Reform Pilot Projects: Conflicts of National and Local Interests," *Issues & Studies* 34, no. 7 (July 1998): 12-13; Jean C. Oi, "Fiscal Reform and the Economic Foundations of Local State Corporatism," *World Politics* 45 (October 1992): 106, 112.

enterprises into the hands of local officials-qua-entrepreneurs, as the informal privatization foresees?

From our fieldwork in mid-July of 1998, we understand that Township B underwent "the 100-Day Reformation of the Enterprises" movement from July 1 to October 1, 1997. The goals of this movement were caught in the slogan "privatizing the enterprise and corporatizing the enterprise group" (*qiye gaisi jituan gaigu*). According to a local official's explanation,²² "privatizing the enterprise" was meant to increase rural enterprise

²²The interview with Director Li of the Office of Enterprise Reform took place on July 17, 1998.

efficiency. That is, the government encouraged entrepreneurs, especially the incumbent managers of rural enterprises, to buy out the factory machinery and to turn the enterprises into their own private companies. The new enterprises subsequently maintained only taxational and land rental relationships with the government. "Corporatizing the enterprise group" meant that the government would turn its previous economy-related offices and branches into a limited liability company to handle its taxational and rental relationships with the privatized enterprises. This company was to be staffed with former cadres, officials, and enterprise managers who individually own a piece of the firm according to the shares each accumulates. The shares here are divided into two categories: the "risk" shares that each employee buys with cash, and the matching shares which are allotted to each in proportion to the risk shares he buys, taking into considerations his seniority, position, and contributions he has made to the firm. This slogan, which suggests a two-level (enterprises and enterprise groups) operation, will become clear below with the analysis of the details of the operation.

Under these two goals, 547 out of the 614 township and village enterprises (TVEs) were reformed into nine organizational forms:²³ shareholding cooperative system (138), shareholding system (52), sold (48), "pulp-sold-peel-kept" (68),²⁴ "pulp-let-peel-kept" (27),²⁵ assets for rent (32), merge (18), bankrupt (6), and "the-red-cap-removed" (158).²⁶ In ad-

²³Of the 614 TVEs, 52 are owned by the Township B government and 562 by village councils. The numbers are taken from *B zhen qiye gaizhi zongjie, jiuqinian shiyue* (Conclusions of the reformation of the enterprises in Township B, October 1997).

²⁴"Pulp-sold-peel-kept" means that village and township governments keep the land and housing (the "peel") of the TVEs and sell the machinery and equipment (the "pulp") either to outside individuals or to employees of the enterprises. "Whoever buys it will assume its financial rights or obligations."

²⁵"Pulp-let-peel-kept" is applied to those TVEs that are badly run. In this form, the governments simply give away the assets of the enterprises (except the real estate) and maintain a simple rental relationship with the new owner, who will pay for the use of land and factories. This organizational form, along with pulp-sold-peel-kept, approximates what Oi describes as the local governments' intention to increase the efficiency of the TVEs as a whole by getting ride of the poor performers.

²⁶The "red capper" is a private enterprise that disguises itself as a TVE in order to enjoy TVE privileges such as tax exemptions. In the township reform movement, special attention was paid to identifying these "red cappers" (158 out of 547, or 29 percent) and making them accountable for their taxational responsibilities.

dition, the establishment of enterprise groups at the village level (23), the only means to realize "corporatization of the enterprise group," was also included in the movement of reform. Our analysis will focus on the operation of the other three organizational forms: shareholding cooperative, shareholding system (both at the level of the village and township enterprise), and the establishment of enterprise groups (at the level of the enterprise group).

"Privatizing the Enterprise"

To understand how Township B experimented with both the shareholding cooperative and shareholding systems, we must first understand the relevant laws and regulations (see table 3). Legally speaking, the shareholding cooperative system is a transitional form between the cooperative and shareholding systems. It is characterized by the collective, or governmental, ownership of part or even the majority of the shares. When the profit-seeking behavior of the enterprise conflicts with official policies, governments will inevitably intervene through the board of directors. But does what the law says correspond to what Township B has practiced?

Of the 547 reformed enterprises in Township B, 25 percent adopted the shareholding cooperative system. Throughout our interviews, we were told how ownership, membership, and distribution of profits were decided, but no one ever mentioned decision-making or government interference. In terms of the ownership under the system, the crux was how to distribute the equity, or net assets, of an enterprise to its employees, government, and "related persons" in the two forms of risk shares²⁷ and matching shares.

In the distribution of equity, local governments may control up to 60 percent of the net assets. The remaining assets are allotted to "related persons" that may extend from formal employees of the business only, to all employees (including informal ones and technicians recruited from outside the village), and to all local residents. Before the allotment, managers and workers must decide on the proportion of the risk and matching shares

²⁷"Risk shares" (*fengxian gu*) refer to the portion of the stock that an individual has to buy in cash, hence carrying with it the risks that the investment may fail.

Table 3

A Comparison of the Cooperative, Shareholding Cooperative, and Shareholding Systems

	Cooperative	Shareholding Cooperative	Shareholding
Goal	Mutual help, mutual benefits	Profits and equitable distribution	Profits
Membership qualification	Voluntary participation and withdrawal	Employees and local residents	Open
Ownership	Per capita	Per share	Per share
Decision-making power	Per capita	Per share	Per share
Distribution of profits	Patronage of members	Shares owned and the value of labor	Shares owned
Government interference	No interference	Direct interference	No interference

Sources: Jenny Clegg, "Multi-Stakeholder Cooperation in China: Changing Ownership and Management of Rural Enterprises," in *Village Inc.: Chinese Rural Society in the 1990s*, ed. Flemming Christiansen and Zhang Junzuo (Honolulu: University of Hawaii Press, 1998), 66-82; Nan Lin and Chih-Jou Chen, "Localization of Chinese Rural Enterprises: Transformation of Property Rights" (Paper presented at the Conference on Social Structure and Social Change: International Perspectives on Business Firms and Economic Life, Institute of European and American Studies, Academia Sinica, Taipei, May 9-10, 1997), 3-6; Jingdong Luan, "An Analysis of the Characteristics and Nature of the Shareholding Cooperative System in Rural Enterprises," *Xiangzhen jingji yanjiu* (Studies of Rural Economy) (Hefei), February 1996, 12.

according to the value of the net assets and the number of potential shareholders. The popular formula is that for buying one risk share, the shareholder received another share free. But in addition to the two forms of shares, an enterprise may opt for issuing special shares, which pay fixed interests to the buyers and which automatically deprive them of the right to attend the shareholder meeting.

The current shareholding cooperative system, as has been pointed out by Nan Lin,²⁸ has nothing to do with privatization. For, in our case,

²⁸Lin and Chen, "Localization of Chinese Rural Enterprises," 6.

the township government may control a maximum 60 percent of the net assets—in addition to its control of the real estate. The true benefit for an enterprise to undergo this type of reform is to increase its capital flow by means of issuing risk and special shares.

We now turn to the shareholding system. According to the PRC Company Law, enacted on July 1, 1994, there are two types of shareholding firms: the limited liability company and the joint stock limited company. The differences are that, compared to the limited liability company, the joint stock limited company enjoys larger scale of production, has more shareholders, and raises its capital from the stock market.²⁹ In Township B, only a few enterprise groups were transformed to the joint stock limited company type. Most enterprises adopted the limited liability type under the shareholding system. Two such common cases follow:

JH Development Company is a township-owned enterprise that has become a model of the successful shareholding entity. The process of its reform started with public accountant certification of its net assets at 2,300,000 *yuan*. The township government's economic agent—Enterprise Group B—owned 35 percent, or 800,000 *yuan*, of these assets, which the enterprise group lent to the new company as a two-year loan. In other words, JH has committed to buy back this portion in two years. The remaining assets were "quantified" into shares and distributed to all employees (97 current workers plus 140 retirees).

Many considerations went into the quantification of the assets in terms of the risk and matching forms. First, the shareholder meeting decided to deposit 450,000 *yuan* worth of shares as the retiree pension fund, a sum which hardly meets the 50,000 *yuan* needed to pay them monthly. Second, 10 percent of the remaining 1,050,000 *yuan* was decided to be sent to "legal representatives of the enterprise."³⁰ Finally, all current workers

²⁹Ibid., 4-5.

³⁰These representatives were JH's general manager, vice-general managers, factory section directors, and the director of logistics. The four positions were given 105,000 *yuan* worth of the matching shares at a proportion of 1:0.8:0.64:0.51. A sole condition was attached to the free shares: one's matching shares must be divided by 2.5 to determine the amount of the shares that one had to pay in cash. All these shares did not include the shares they would receive as employees of JH (see the following text).

must either become shareholders or resign; only retired and close-to-retirement workers may choose not to join the program.

Under these considerations, we may take JH's accountant, Ms. Wang, as an example. She has owned 294.4 shares altogether through the process of quantification. The matching part of the total shares (210.3) can be broken down to shares of seniority compensation (46), shares of position compensation (97), shares of expertise compensation (34.8), and shares of other compensation (32.5). The 210.3 shares are then divided by 2.5 and the resultant shares are sold to her with the face value of 100 *yuan* per share. Therefore she invests 8,412 *yuan* in JH by buying 84.1 risk shares. After reform, the township no longer owns JH. In addition to taxes, the government-enterprise relationship is ostensibly reduced to a loan relation between JH and Enterprise Group B.

Our second case has to do with an initially township-owned FY Paper Manufacturing Company. FY adopted the limited liability form at the end of 1996, well before the "100-Day Reformation of the Enterprises" was held. It was then not required to have an accountant certify net assets. Instead, the company simply registered 3,500,000 *yuan* as capital in order to obtain the business license. To become a limited liability company, FY divided the 3,500,000 *yuan* worth of shares into "original shareholder shares" (2,500,000 *yuan*) and "employee individual shares" (1,000,000 *yuan*). During the interview, FY's general manager Mr. Song revealed to us that 40 percent of its net assets, whose value he did not disclose, had been turned over to Enterprise Group B, and the remaining 60 percent had been distributed to employees who were also local residents.³¹ He did not explain the relationship between his original shareholder shares and the 60 percent employee shares.

Mr. Song talked as a private owner does. He criticized the reform movement from the cost-benefit viewpoint. First, he thought that if the government really wanted to help private business, it should not raise the rent of the land annually. His company paid 160,000 *yuan* for rent in 1997, but 200,000 *yuan* in 1998. Second, he argued that Enterprise Group B

³¹The interview took place on July 25, 1998.

should not take the 40 percent of FY's net assets away. The money should remain in the company for reinvestment purposes.

If we compare the two enterprises that have turned into limited liability firms, we see that the really new institutional incentives for the managers to excel in their performance are JH's free shares for legal representatives and FY's original shareholder shares. Their performance, and hence income, is directly tied to the bonus, interest, and market value of their shares. However, the shareholding system also imposes upon them a new constraint: previously the managers were only responsible for the government; now they are also responsible for the employees-qua-shareholders as a whole. However, there are noticeable differences between the two general managers. FY's manager, Song, appears to have adapted well to the new system, to the extent that he evaluated the reform in terms of a cost-and-benefit analysis. The attitude and behavior of JH's general manager Liu are ambiguous. On the one hand, Liu took his legal representative's free share, worth 20,000 *yuan*, but forewent his matching shares, which, according to his seniority, position, and contributions, would have been equal to 130,000 *yuan*. Liu said he had to give up his matching shares so that his employees would feel right. On the other hand, Liu mentioned that in May 1994, JH had relocated to the current site, turning the old site with a high market value into a housing development. The relocation had brought to the company profits of 7,907,700 *yuan* and he had used the money to reinvest in the company. Apparently, the relocation fee somehow was not counted into the net assets and only the general manager could gain access to it. Liu declined to specify how exactly he had put the money into reinvestment. But his behavior here seems to approximate what Wu Jiemin calls "informal privatization"—the economic situation where rural enterprises overcome their transaction costs by means of creating false relationships of property rights.

We can further contrast the shareholding cooperative with the shareholding system as has been implemented in Township B. On the one hand, the Township B government and its enterprise group show differences in degree, not in kind, of interference with enterprises under the two systems. That is, the government collects the land rent from either of the two types of enterprises and its enterprise group controls a given amount of the net

assets of either. The only difference here is that the enterprise group may control up to 60 percent of a shareholding cooperative but only 30 to 40 percent of a pure shareholding firm.³² On the other hand, the way the enterprise group expresses its ownership of the net assets matters much in terms of the privatization of an enterprise. We are under the impression that the group tends to hold common, "risk" shares in a shareholding cooperative but that it either holds special shares in a shareholding firm or asks the firm to buy back its portion of the net assets. It does seem that Enterprise Group B encourages the genuine privatization of enterprises that have adopted the shareholding system.

"Corporatizing the Enterprise Group"

The official goal of the reform at this level is to bring efficiency into the part of the government that deals with local economic development. But as our case of JS Enterprise Group, a limited liability company, and Nan Lin's Group M of Daqiu Zhuang will show, such reform tends to bring the control of the company assets into the hands of the managerial stratum and enhances the tendency toward informal privatization.

In Township B's "100-Day Reformation of the Enterprises," twenty-three enterprise groups at the village level were founded. JS Group was founded immediately after the reform period and was still under formation when we interviewed its general manager and party secretary, Mr. Hu.³³ JS Group was initially a limited liability company founded in 1995, with fifty employees and producing electric appliances. In May 1996, Mr. Hu visited Zhucheng County, Shandong, to learn from its experience of implementing the shareholding cooperative system. Later in November, JS itself adopted this system.

At that time, the net assets of the group were certified at 4,400,000 yuan. At the insistence of the employees—who were all local residents—the assets were quantified into equal amounts of risk and matching shares

³²This practice deviates from what we say in table 3, where, by law, a government should not interfere with the operation of a shareholding company.

³³So was Enterprise Group B when we visited there.

(1:1). All but 3 of 156 employees became shareholders, buying a total of 187,000 *yuan* worth of risk shares.

In November 1997, JS registered as having 10,278,000 *yuan* in capital and turned itself into a limited liability enterprise group. The village council now owned the capital but would, starting in 1998, turn the ownership over to the villagers by means of the shareholding system in three to five years. According to the village's "reform program," JS should collect 400,000 *yuan* from the villagers by selling them risk shares. There would be another three periods of fund-raising, with the ultimate target of collecting 4,000,000 *yuan*. In addition to this fund, the village council would contribute 40 *mu* of land, stipulated as being worth 400,000 *yuan*, so that the village could develop 8,000 square meters for commercial housing.

The four rounds of fund-raising are intended to "let villagers voluntarily purchase the shares according to their financial situations. . . . However, they should buy no less than ten and no more than one hundred shares."³⁴ The minimal purchase simply contradicts the voluntary principle. According to the same document, JS will not provide any bonuses for three years after the funds are raised but will pay shareholders interest at the rate of 3 percent higher than the bank rate.

The first round of fund-raising had just been completed when we interviewed Secretary Hu. He admitted that the result was far from desirable, being 276,000 *yuan* short of the targeted 400,000 *yuan*. He explained that the villagers were not satisfied with the ratios of the free matching shares that were distributed to the managerial stratum of JS. If we rank the "official positions" and the proportions of the free shares of these managers and their employees, they form the order of party secretary (i.e., Mr. Hu who is also the board director and general manager, with a multiplier of six), deputy secretary (five), deputy director of the village council (four), cadres of the party branch at the village (three), directors of factories (two), and employees (one). Thus, for example, when Mr. Hu buys one risk share, he will be rewarded six matching shares. This arrangement is different

³⁴ JS [jituan] youxian gongsi 1998 nian xiang jituan neibu yuangong cunmin muji gerengu ji peigu shuomingshu (Explanation of how JS Limited Liability Enterprise Group will sell individual shares and distribute compensation shares to its employees and villagers in 1998).

from the previous one that matches a share with one risk share, adopted when JS manufactured electric appliances. Mr. Hu said to us that he would give up his proportion of matching shares in exchange for the villagers buying more shares. This is because only villager cash could spur the economic development of their village.

From the above, we may compare the different strategies of economic development between JS and Enterprise Group B. JS is located in a village rich in land but poor in rural enterprises. Therefore, to enrich its villagers, JS first is trying to pool cash and land to develop commercial housing. In the meantime, the group arranges the portfolio of the risk and matching shares in order to turn its net assets back to the villagers. But this arrangement favors the managerial and administrative stratum of the village because, based on their status and financial situation, they can receive much more out of the portfolio than can an ordinary villager. On the contrary, Enterprise Group B is rich in terms of rural enterprises. It therefore manipulates its portion of the net assets in these enterprises in order to spur their performances. The group holds its ownership in a shareholding cooperative in the form of risk shares so that the group and the enterprise's employees all reinvest cash in this cooperative enterprise. Moreover, the enterprise group turns its ownership either into special shares or loans in a pure shareholding type of enterprise in order to help the firm privatize. Enterprise Group B's general goal is to stimulate township-wide economic development, but, by expressing its control of the net assets in different forms, the group helps the privatization of the enterprises that have adopted the shareholding system. Nevertheless, the managerial stratum in Group B as well as in the two types of enterprises, just as its counterpart in JS Group, benefits the most in the portfolio of the risk and matching shares.

The cases of groups JS and B support the claim that, under the current shareholding system, the managerial stratum will benefit most by pocketing the enterprise's net assets in the forms of risk and matching shares. This is also supported by Nan Lin's observation of Group M in Daqiuizhuang.³⁵

³⁵Lin and Ye, "Chinese Rural Enterprise in Transformation," 19-21. Group M was initially a town and village enterprise belonging to Daqiuizhuang. By the end of 1997, it had become a conglomerate with 9 companies, 67 enterprises, assets totaling 2.19 billion yuan, and

Comparing Group M to groups B and JS in Township B, we suggest that our two enterprise groups show the same trend of transferring "asset rights from the collectives to local corporate leaders." Although the scheme of the types of shares is not as sophisticated as that in Group M, manipulation of the ratio of risk to matching shares is enough to allow the managerial stratum in the two groups to enrich themselves in the form of personal shares. Furthermore, at the enterprise level, our cases of JH and FY limited liability companies show the same, if not more obvious, move toward privatization. The matching shares for General Manager Liu in JH and the original shareholder shares for Mr. Song in FY all confirm the tendency of transforming the initial public assets into manager private ownership.

Conclusion

The enterprise reform in Township B has been carried out at the two levels of enterprise and enterprise group. To enterprises that have been

6,500 employees. Since the end of 1995, Group M has adopted its own version of the shareholding system. Group M first divided its shares into four kinds: community shares, team shares, social-entity shares, and natural individual shares. The community shares represented the initial capital invested by the Daquiuzhuang government in founding Group M; and the team shares represented the profits that Group M had accumulated since its operation. In adopting the shareholding system, Group M had net assets at 350 million *yuan* of which 55 percent, or 187 Million, was given to the community, and 45 percent, or 163 million, to the team M itself. The next step involved distributing the team shares to Group M's employees and then changing these shares into natural individual shares. Each unit in Group M retained 10 percent of the team shares that it received for the managers who received their free shares according to their seniority, position, and contributions. The remaining 90 percent were distributed to managers and employees at a proportion of one risk share to one to three matching shares. One must bear in mind that a manager might assume different positions within Group M, drastically increasing the amount of his or her personal shares. In the meantime, each unit can issue its social-entity shares to outsiders in order to raise capital. At present, for all units that have adopted the shareholding system, the proportion of their own capital to the capital invested by outsiders is 1:0.8. In the operation of these four kinds of shares, an interesting shift has emerged. From 1996 to 1997, Nan Lin documents that the ratio of the community shares to the total decreased from 30.16 percent to 26.08 percent, while that of the team shares decreased from 26.29 percent to 2 percent. That is, those who held the shares, which represented the public ownership, turned out to be big losers. The real winners were those who owned the natural individual shares, which increased from 7.6 percent to 17 percent. This shift in ratios, according to Nan Lin, points to the growing trend that is characterized by "the transfer of asset rights from the collectives to local corporate leaders."

subject to reform, nine organizational forms were applied. However, only one form—the shareholding system—was related to the privatization that is our theoretical concern. The same shareholding system was also applied to the two enterprise groups in our case study. At either level, the shareholding system was conducive to the transformation of the lion's share of the collective assets into the pocket of the managerial stratum, by means of arranging the proportion of risk (cash) shares to matching (free) shares. The shareholding system was, along with the shareholding cooperative system, endorsed by Jiang Zemin at the Fifteenth Party Congress, and later applied by the local governments. This system signals the beginning of formal privatization of rural enterprises. In short, our case supports the trend of privatization that Nan Lin found in Daqiuzhuang, although he does not use the term "formal privatization."

As our review of the literature has shown, the two rival theoretical perspectives regarding local state corporatism and privatization do share the agreement that incipient privatization is firmly incorporated in Chinese local political economy in the 1990s. The two perspectives differ, however, in their projection of the future of the incipient trend. While Nan Lin manifestly emphasizes its *growing* potential, Oi and Walder see the privatizational trend as stringently controlled by the local governments. In their view, privatization is but a means to increase both the efficiency of rural enterprises and the revenues of the government treasury.

To some extent, our case in Township B does support the view shared by Oi and Walder. We have mentioned that 65 percent of reformed enterprises had adopted "pulp-sold-peel-kept," "pulp-let-peel-kept," "the-red-cap-removed," and other organizational forms. The purpose of these enterprise reforms was either for the township government to rid itself of the inefficient rural enterprises or to increase its taxes from the original "red cappers." Even enterprises that had adopted the shareholding cooperative system, which made up another 25 percent of the total, benefitted most from the cash flow that they had milked from their current employees. For the remaining less than 10 percent of the genuine shareholding enterprises, however, we have demonstrated that the township government endorsed privatization by turning the collective assets into loans so that the enterprises could buy back their assets. Of course, Oi admits that, in the 1990s,

local government has reconsidered its attitude toward the private sector. This author thinks "reconsideration" is an understatement for the township government, however, with "active endorsement" being a much better description of its attitude. Furthermore, Walder has specified that whether or not local officials own equity shares is the key indication of privatization. This condition has finally been met in the shareholding system where the means of matching cash shares with free shares turns an enterprise's equity into the hands of the investors. Therefore, it does seem that our case has dissolved the two reservations that students of local state corporatism have in regard to the privatization of rural enterprises.³⁶

Given the various speeds of economic reform in different parts of China, we still have to wait for more cases at the local level to support our judgment of the growing trend of formal privatization. We cannot help, however, speculating what comes next. In a recent public talk, Zhou Qiren, an economist from Beijing University, said that the expansion and perfection of the capital market in China would be the last step in clarifying property rights problems, a suggestion that echoed what Steven Cheung, another economist and a colleague of R. H. Coase, had said almost twenty years ago.³⁷ Is trading shares in the stock market with minimum government interference the next step for the shareholding enterprises in Township B? Continued research can help find out.

³⁶One anonymous reviewer wondered whether it is necessarily contradictory that a local government wants both to raise efficiency and to increase revenue. This author does not think it is necessarily so. For a handful of enterprises under its direct control, the government can undertake careful monitoring in order to achieve the two goals. However, the cost of monitoring will skyrocket if the government again attempts to put most enterprises under its control. For the government to resort to this practice is quite inefficient. Alternatively, the government can resort to market forces—i.e., competition—to weed out inefficient firms and concentrate on extracting taxes from those who have survived. Privatization will make the government's pursuit of its two goals easier.

³⁷Steven N.S. Cheung, *Will China Go 'Capitalist'? An Economic Analysis of Property Rights and Institutional Change*, second edition (London: Institute of Economic Affairs, 1986).