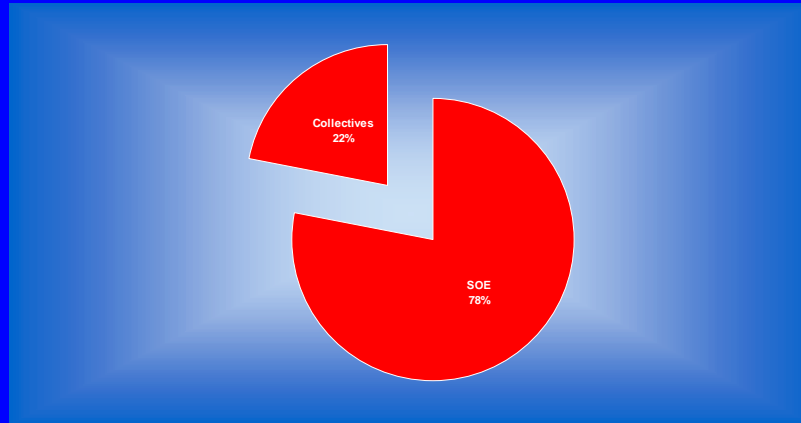
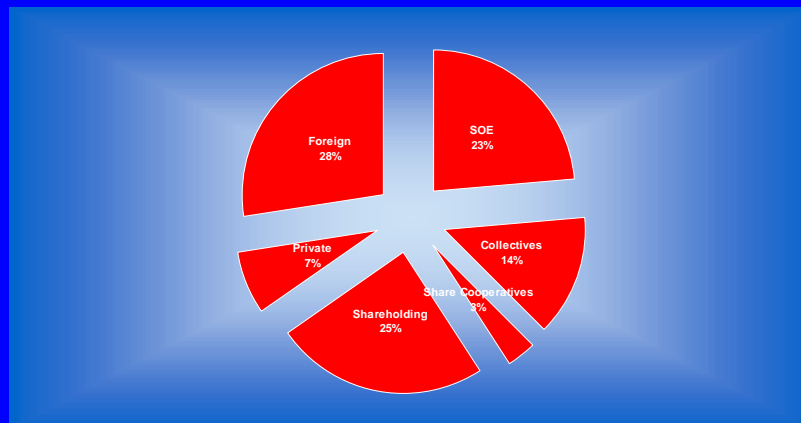


Ownership Composition of Industrial Output (1978)



Ownership Composition of Industrial Output (2000)



What Is in the Non-State Sector?

- Firms which are not
 - Traditional State-Owned Enterprises (SOEs)
 - Stock companies in which the state has controlling shares (called state controlled enterprises)
- Types of ownership forms in the non-state sector
 - Private ownership firms
 - Non-private ownership firms (collectives and cooperatives)

Varieties of Non-State Ownership Forms

- Private ownership
 - Individual family business
 - Private companies hiring more than 8 employees
 - Foreign invested
 - Share holding companies (private parties have controlling shares)
 - Listed on the exchange
 - Not listed
- Non-private (but also non-state) ownership
 - Rural Township-Village Enterprises (TVEs): rural collectives
 - Urban collectives
 - Joint ventures with TVEs or collectives controlling
 - Share holding companies (neither the state nor private parties have controlling shares)

Two Stages of Development

- First Stage: from 1978 to mid-1990s
 - Slow start of private ownership firms
 - Very rapid growth of collective firms, especially rural TVEs
 - No privatization of collectives
- Second Stage: from mid-1990s to present
 - Rapid growth of private ownership firms
 - Fast privatization of collective firms
 - Fast emergence of share holding ownership forms
 - Publicly traded stock companies
 - Closely held stock companies

From 1978 to mid-1990s

- The major growth engine: rural industry
 - Most new non-state enterprises in other planned economies under socialism were in service sector, not in industry
 - Most new industrial enterprises in developing countries are not in rural areas
- Rural enterprises = TVEs + rural private enterprises
- There are separate (may be related) reasons for rapid growth of rural industry and rapid growth of TVEs

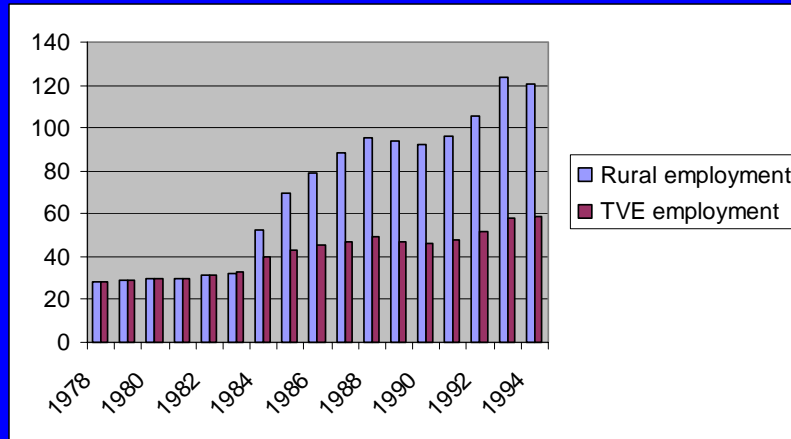
Ownership Classification

	Rural Enterprises	Urban Enterprises
State Ownership	N/A	State-Owned Enterprises (SOE)
Collective Ownership	Township-Village Enterprises (TVEs)	Urban Collective Enterprises
Private Ownership	varieties of private enterprises	varieties of private enterprises

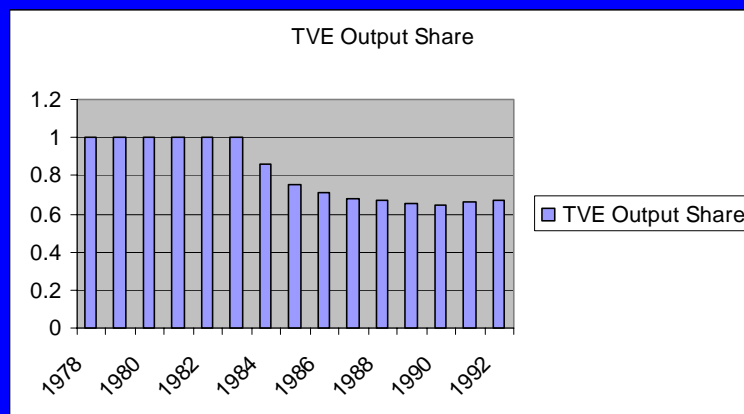
Share of Industrial Output by Ownership

	1978	1993	Changes
SOEs	78%	43%	-35%
Non-State	22%	57%	+35%
Urban	13%	10%	-3%
Rural	9%	36%	+27%
TVEs	9%	27%	+18%
Private	0%	9%	+9%
Others	0%	10%	+10%

Rural Enterprise Employment (million)



Output Shares of TVEs and Rural Private Enterprises



How the TVEs Changed China?

- During the first 15 years of reform, TVEs made the most important contribution
- TVEs changed the landscape of China's industry, as well as its reform
- The ownership form of TVEs is unique
 - Neither state-ownership
 - Nor private ownership
 - A corporate form between entrepreneurs and community (township or village) government
- TVEs are uniquely Chinese
 - Not in other transition and developing economies
 - Not in other East Asian economies

Why TVEs?

- Why is TVE a puzzle?
 - We usually think government ownership is bad
 - Reform is to transform government ownership to private ownership
 - But TVEs represent a major anomaly: government ownership is the key to reform success
- Understanding TVEs
 - Historical reasons
 - Political reasons
 - Economic reasons

Prior to 1979

- 1958: Communes set up small scale industrial enterprises such as steel mills but short lived
- 1970s: Re-emergence of “Commune-Brigade Enterprises” (CBEs), the predecessor to TVEs
- Annual growth rate: 26% between 1970 and 1976
- By 1978: 49 billion yuan output, of which 39 billion yuan from industry (9% of national total industrial output)

Prior to 1979

- Main motivation: agricultural mechanization drive
 - Typical business: machine repairing, food processing
 - Limits: only to serve agriculture
 - Grey areas: subcontracting for SOEs in nearby urban areas (Southern Jiangsu province near Shanghai)

The Golden Period: 1979-mid-1990s

- Government Policies: a gradual process from tolerance to encouragement
 - Lifted restrictions on lines of business (most industrial lines, not only agricultural supporting industries)
 - Provided some tax relief (three years tax holidays)
 - But other supports were limited (e.g., limited credit from state banks)
- The Effects of Agricultural Reform
 - Township and Village government focused on rural industry after the household responsibility system
 - The success of agriculture reform supplied labor, capital, and market for rural industry growth

The Golden Period: 1979-mid-1990s

- TVEs at the peak (1992): 52 million employees
 - Townships
 - 48,200 townships
 - On average 8.2 township enterprises in each township
 - Total of 400,000 township enterprises with 26 million employees
 - Villages
 - 806,000 villages
 - On average 1.4 village enterprises in each village
 - Total of 1.1 million village enterprises with 26 million employees

Industrial Subsectoral Composition of TVEs (1985)

Metallurgy	3.4%	Forestry	3.0%
Electric power	0.4%	Food	7.9%
Coal	3.8%	Textiles	12.5%
Petroleum	0.1%	Garments	3.7%
Chemicals	8.4%	Leather	1.6%
Machinery	25.5%	Paper	2.4%
Construction materials	18.9%	Cultural	3.0%

TVEs vs. Private Firms

- Distinct feature of TVE: Entrepreneurs and Community (Township or Village) Government's coalition
- What do entrepreneurs contribute?
 - Ideas
 - Management skills
 - Connections (people)
 - Connections (supplies and marketing)

TVEs vs. Private Firms

- What does township and village government contribute?
 - Political protection
 - Initial capital investment
 - Help obtain loans from rural credit cooperatives/banks
 - Negotiation
 - Collateral provision
 - Loan guarantee
 - Selection and rewarding managers
 - Profit sharing
 - Leasing
 - Connections

TVEs vs. Private Firms

- What does township and village government benefit?
 - Use of after tax profits
 - Retained profits earmarked for local public expenditure (40%)
 - Retained profits for reinvestment (60%)
 - Private benefits
 - Cars, banquets, cell phones, offices, hotel rooms, traveling
 - “corruption”
 - Promotion
 - Not clear

Economic Conditions for Rural Industry

- Distortions under central planning created enormous opportunities for rural industry to enter
 - Very cheap labor in rural areas
 - High prices for industrial goods due to state monopoly
 - Persistent shortages, especially in consumer goods
 - Small scale operation advantage: low overhead, flexibility
- Early entry is very profitable: average rate of profit on capital was 32%, or 40% if tax revenue also included, in 1978
 - Even without state subsidies in input prices and capital

Why Privatize TVEs

- Government ownership has costs
 - Some TVEs were collectives in name (in Wenzhou)
 - But most TVEs were real collectives
- Changing economic conditions
 - Markets became more competitive, profit rates declined rapidly
 - Private firms enter, attracting able entrepreneurs away
 - When TVEs grew larger, more costly to manage with government involvement
- Changing political conditions
 - Private property rights become more secure

Patterns of TVE Privatization

- A local government driven process, no national privatization program
 - Some started in mid-1990s, some started in late 1990s
- Various methods of TVE privatization
 - Sale (at discount) to managers and employees
 - Sale to outside domestic investors
 - Sale to foreign investors
 - Going public (IPO)
- Various corporate forms after privatization
 - “stock cooperatives”
 - Private firms
 - Joint ventures

Case 1: Shunde, Guangdong Province

- Fast growing area in Pearl River Delta, 60 miles south of Guangzhou
- In late 1980s, account for 1/2 of top 10 TVEs in the country
- Big brand names such as Rongsheng refrigerator
- Big market shares in consumer electric products (e.g., gas ranges and electric fans)
- Starting 1993, TVEs were privatized
 - Some were sold to employees
 - Some were sold to public
 - Township governments still maintain some minority shares in profitable firms

Case 2: Wuxi, Jiangsu Province

- Birth place of TVE, in Southern Jiangsu, 80 miles northwest of Shanghai
- All of rural firms are TVEs, no private firms existed
- Strong local governments
- Late starter of privatization, under pressure from Zhejiang province competition
 - 1996: modest privatization, mainly distribution shares to employees
 - 1999: second round, managers buy shares from employees
- Southern Jiangsu becoming more attractive than Pearl River Delta for Taiwan investment

Domestic De Novo Private Firms

- Varieties of private firms: Domestic privatized firms, de novo private firms, and foreign firms
- From rural to urban areas, from local to national or even international
- Takeoff of domestic de novo private firms (start from scratch) in urban areas in mid-1990s
- A class of the new rich: *siren laoban* (private bosses)

Entrepreneurs and Private Firms

- Liu Yonghao, New Hope Group of Sichuan (新希望集团), animal feed
- Ren Zhengfei, Huawei (华为通讯) of Shenzhen, telecommunication equipment
- Li Shufu, Geely of Zhejiang (吉利汽车), automobile

Entrepreneurs and Private Firms

- Li Yanhong, Baidu (百度), search engine
- Ma Yun, Alibaba (阿里巴巴), b2b e-commerce
- Deng Zhonghan, Vimicro (中星微电子), micro processor

The Case of Zhejiang Province

- Population 44 million, size of South Korea
- The first province where private industry accounts for the majority of output in late 1990s
- Small enterprises employing 82% of workers and producing 79% of industrial output
- Zhejiang is special: the state sector was small to start with for historical reasons
- Lessons from Zhejiang:
 - future trend of China
 - need SOE reform to relax the constraint on private enterprise development

Problems

- Political status
- Government regulation
 - Registration difficulties
 - Business line restrictions
- Financing
 - Hard to get bank loans
 - Hard to go raise funds from the public