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The purpose of the Centre is to provide a framework for investigations and research on problems concerning rural cooperative communities and publication of the results, to coordinate the exchange of information on current research projects and published works, and to encourage the organization of symposia on the problems of cooperative rural communities, as well as the exchange of experts between different countries.

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# China's Rural Shareholding Cooperatives as a Form of Multi-Stakeholder Cooperation<sup>1</sup>

*by*

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## Abstract

Township and village enterprises (TVEs) are the fastest growing sector of China's economy. Their development has been shaped by their close ties with local governments and communities. However, as marketization processes dissolve these links, the increasing competitive pressures of the 1990s make the search for new forms of enterprise organization a priority. The Shareholding Cooperative System (SCS) has been proposed as a method of strengthening enterprise autonomy whilst preserving the predominance of public ownership, and of improving enterprise efficiency by tying performance to profitability whilst maintaining some principles of equity. In practice, the new opportunities opened up by reform are often monopolized by those already in positions of wealth and power: local governments and individual entrepreneurs. But workers and local farmers may also become more directly involved in enterprise ownership, gaining a greater say in decision-making. In these cases, the SCS resembles a multi-stakeholder cooperative in which workers, managers, local governments and local farmers negotiate around their stakes in the future of the enterprise.

## Introduction

Throughout the past fifteen years of economic reforms in China, rural township and village enterprises (TVEs) have proved to be the fastest growing and most dynamic sector of the economy. The private sector is growing quickly, but collective ownership remains the predominant form (Bowles and Dong, 1994:56). This process of rural industrialization has displayed distinctive characteristics as rural enterprises face two conflicting ways, on the one hand oriented towards the market and the demands of profit maximization, and on the other hand oriented towards the community and the demands of employment creation and local development.

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<sup>1</sup>This is a version of a paper presented at the 4th European Conference on Agricultural and Rural Development in China, 10–12 November, 1995, Manchester, England. Research for the paper was supported by the British Academy, the Universities' China Committee in London, and Edge Hill University College.

As the 1990s progress, new opportunities and competitive pressures intensify the conflicts and demand new patterns of enterprise organization. TVEs need to upgrade technology and skills levels, to improve internal mechanisms of accumulation, to access new sources of external finance, and to promote enterprise independence to allow even greater flexibility in meeting market demands. The aim has been to accomplish these changes within the overall context of the “socialist market economy” preserving the predominance of forms of public ownership and returns to labor, and providing for common prosperity.

In 1990, the Shareholding Cooperative System was officially proposed by the Ministry of Agriculture as a method for the reform of property rights and management systems in the TVEs applicable both to private and collectively owned enterprises. The system is claimed to achieve “an alliance of capital and labor” by integrating the shareholding system with the cooperative system. As a hybrid form of ownership, it aims to offer a new approach to investment and management mobilizing cooperation within the enterprise by maintaining the priority of return to labor whilst also taking advantage of the pooling of capital (see *e.g.* Gao, 1991:47). In this way, the SCS may be described as a microcosm of China’s “socialist market economy”.

It has been suggested that hybrid forms of enterprise have a particular role to play in China’s transition from a planned to a market economy under conditions of partial reform (Nee, 1992). White (1987) sees the situation of a diversity of ownership forms as one in which the state may develop new mechanisms for restricting and reshaping a dynamic private sector. Oi (1995) posits the concept of “local state corporatism” to highlight a symbiotic relationship between the collective and private sectors. Smith (1993) however considers the blurring of collective and private ownership in the rural industrial sector simply as a form of “creeping capitalism” that will soon overwhelm the collective sector.

Does the SCS really represent a distinct “socialist market” type enterprise providing for equitable as well as efficient development? Or are shareholding cooperatives merely a tool in the hands of the state to control or – for ideological reasons – to relabel the burgeoning private sector? Does the system signify a new corporatist accommodation of bureaucratic power and rural capitalism with those “in the know” using political capital to monopolize the new opportunities? Does it represent a step towards privatization with changes being pushed from below by private entrepreneurs?

Through fieldwork based in Laiyang City, Shandong Province, in September 1994 and 1995, I set out to examine the sorts of changes the SCS introduces into the internal organization of rural enterprises in terms of mechanisms of profit-sharing, “democratic management” and voluntary and independent organization and to discover who would be the likely beneficiaries of the new opportunities being

opened up.

Drawing on these investigations, my argument here is that the SCS is neither a straightforward privatization nor a simple corporate re-arrangement of private and public interests. Rather, in some circumstances at least, it displays features of a different kind of enterprise model which includes elements of employee and community participation. Such a model may be characterized as a system of multi-shareholder cooperation (Ackoff, 1981; Jordan, 1990) since the workers, the managers, outside investors from the local community, and the local government are all investing members.

## **The shareholding cooperative system and multi-stakeholder cooperation**

### *The shareholding system*

Experiments in converting collective enterprises and in reorganizing individual and private enterprises into shareholding cooperatives were started in a number of areas from 1987. After the Ministry of Agriculture issued Provisional Regulations on Peasant Shareholding Cooperative Enterprises in 1990, the system was more actively promoted. By 1991 it was estimated that shareholding cooperative enterprises accounted for more than 10 percent of township enterprises (Du, 1991:39).

The SCS differs from a shareholding system. Alongside general principles of voluntary participation, democratic management, distribution according to work, and reliance on self-accumulation, the Regulations make specific recommendations to preserve the collective interests of the enterprise as a whole whilst providing for individual shareholder interests. A part of the profits should be retained as indivisible public accumulation (it is recommended that no less than 60 percent of the after-tax profits should be used for reproduction of which 50 percent is to go to an indivisible public accumulation fund); return to capital is to be limited to no more than 20 percent, with the remainder of profits to be used for bonus payments (not exceeding 20 percent) and collective welfare funds and shares should be non-refundable (although they may be inherited, transferred or presented as a gift with the approval of the shareholders). Furthermore on liquidation, the public accumulation fund is not to be divided but to be used to develop new enterprises, to support agriculture or to set up a staff insurance fund.

Such provisions offer a framework for the transformation of privately owned enterprises into the system of public ownership. The Regulations stipulate that a peasant shareholding cooperative of at least three households may be deemed a "socialist collective economic entity". Significantly there are provisions for peasant shareownership with the inclusion of labor as a basis for dividend-bearing shares.

Other elements of cooperative organization provided in the Regulations include recommended limits on managers' salaries (no more than five times the average wage), managerial responsibilities for strengthening democratic management and

political education in the enterprise, and the provision for a staff assembly to evaluate the manager's work, safeguard the rights and benefits of employees and decide on the use of the public accumulation fund in the event of liquidation.

Proponents of the SCS emphasize the benefits of worker shareownership – “making workers the masters” – in raising enterprise accumulation through mobilizing labor enthusiasm. Distinctively adapted to China's conditions, the SCS allows shares in the form of materials, land and technology which permits a lot of flexibility in combining different types of owners – individual and collective entities; farmers, workers and technicians. But the SCS is not a cooperative system. Membership is not exclusive to employees but may extend to the community. Distribution is based mainly on work, but dividends are also paid; and, whilst no voting system is mentioned in the Regulations, in practice, not only “one member-one vote” but also voting according to share-ownership is accepted (see *e.g.* Gao, 1991:182). According to the Regulations, powers of independent decision-making in the SCS are vested in the Annual General Meeting (AGM) of shareholders, or shareholder representatives, which elects a Board of Directors. In practice, enterprise autonomy is compromised by the presence of local governments on Boards as holders of collective shares.

The SCS as a hybrid and flexible form is seen by its proponents to play a special role in China's dual transition from a planned to a market economy and from an economy based on individual production to one based on socialized production. It represents an alternative both to the “capitalist road” and to “the long wait for the true cooperative road” (Du and Zhang, 1994:27). Critics on the other hand have argued that the shareholding system and the cooperative system are in fact two different kinds of system which cannot be mixed and that the concept of “shareholding cooperative” is a false one. The reality of the situation from this point of view is that the SCS simply offers a “red hat” for private entrepreneurs seeking favorable treatment from local governments (see *e.g. ibid.*, 1994:27).

So how is the SCS to be conceptualized?

### ***Multi-stakeholder cooperation***

Ackoff (1981) proposed the stakeholder view of the firm as a new way of conceptualizing a corporation. The point is to recognize that the results of a corporation are co-produced by its stakeholders. Thus Ackoff, rejecting the notion of an autonomous “corporate goal” standing above particularist interests, argues that the purposes of a corporation should not be to serve any one stakeholder group to the exclusion of any others, but to serve all of them to increase their ability to pursue their objectives more efficiently and effectively (*ibid.*, 1981:33).

The problem, as Jordan (1990) has pointed out, is that in a conventional corporate setting the interests of stakeholder groups – of customers, labor and capital – really are opposed (*ibid.*:158). He argues instead for multi-stakeholder

cooperation based on a mutual recognition that the support of each stakeholder group is necessary for the enterprise to succeed. In his view it should be a part of each stakeholder's commitment to an enterprise to help other stakeholders achieve their goals (*ibid.*:159). What is needed to allow the shared commitment of the stakeholders to the future of the enterprise to outweigh their particular interests is a structure in which positive interaction is made possible, in which no one group has an absolute majority (although different groups might have different weightings) and in which each group elects its own representatives as delegates or directors (*ibid.*:159-160).

### ***The SCS as a form of multi-stakeholder cooperation***

A stakeholder approach helps to situate the hybrid character of the SCS within the changing nexus of relations between local government, enterprise and community. In China's particular conditions of rural industrialization, not only employees and managers, individual investors and customers, but also local governments and farmers have contributed to the results of the enterprises.

In the past, rural collective enterprises have drawn on various sources for funds and support – village labor, land and resources, seed capital from local governments, preferential tax policies as well as internal capital accumulation. Most recently, enterprises have also begun to diversify their funding drawing on the savings of individual employees, managers and members of the local community. Therefore, township and village governments, township and village communities as collectivities, individual members of the community, workers and managers all have a stakeholding in rural enterprise development.

As market relations now penetrate more deeply into rural communities, the interests of local cadres, enterprise managers, workers and farmers are taking on new articulations. The increasing competition between them over their claims to enterprise profits has created pressures for enterprise reform from below. To the extent that the SCS sets out to draw together the diverse interests of capital (collective and private), labor and community, it may offer a form of multi-stakeholder cooperation in which new mechanisms of participation help to reduce antagonisms and allow for the emergence of new solidarities. In this way the SCS may be seen as an innovative response to the increasing tensions brought about by rapid rural industrialization.

### **Reforming rural industries in China: dilemmas and debates**

The concept of a hybrid of “shareholding cooperative” form has arisen in the Chinese context against a background of controversy over property rights and management systems in rural enterprises as tensions in the countryside brought about by rapid industrialization have increased.

Many studies have sought to explain the phenomenal success of China's rural



enterprises in terms of the predominance of collective ownership and the important developmental role played by local governments. These have promoted rural industries not simply as a source of their own revenue but as carriers of community objectives, funding welfare, providing jobs and increasing rural incomes rather than maximizing profits. This rural developmental experience has been variously characterized as a successful form of “municipal socialism” (Nolan and Liu, 1992); as an example of a successful decentralized market-socialist system (Bowles and Dong, 1994);<sup>2</sup> and as a corporatist alternative, linking collective and private sectors, with local governments using their allocative powers to alleviate “the pains of privatization” (Oi, 1992 and 1995).

Other studies have considered the ways in which the distinctive characteristics of a peasant economy might shape the pattern of transition from a largely agricultural to a modern industrial society. Pei (1995) appeals to notions of a village cooperative or collectivist spirit to explain the success of community-based enterprises in terms of lower transaction costs and high motivation. Lin Chun (1994) identifies the community-orientation of the TVEs as representative of a special Chinese path of industrialization, neither socialist nor capitalist, driven not by profit but just improvement of life. For Chang (1993) the collective principles of the peasant family-based economy for maximum employment and welfare extend into the rural industrial sector harmonizing with the political and economic goals of the socialist regime. Luo (1990:140) suggests that property rights in Chinese TVEs are shaped by a distinctive culture in which incentives linked to motives of community benefit are at least as effective as those linked to the rewards accruing to individual property owners from profit maximization.

Within China, rural industries found favor at a national level in providing employment for rural labor, as an important source of government revenue and as a major market and supplier for state-owned industries. However by the late 1980s there was mounting concern over the rapid development of private businesses and with inflation soaring, rural industry came under criticism for its haphazard and over-rapid growth. TVEs were thought to compete with the state sector for resources, diverting funds from agriculture, producing goods of poor quality, wasting raw materials and energy and causing pollution (Ody, 1991:30).

The new economic realities of the 1990s – pressures of rapid economic growth, market competition and rural surplus labor – demand new organizational patterns for the further development of rural industrialization. The TVEs had been successful in the 1980s in finding an economic niche in the internal market, as consumer demands outstripped the supply capabilities of the state enterprises (Naughton, 1994). But by

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<sup>2</sup>With regard to property rights, Bowles and Dong note that whilst local cadres possess all of the key components of enterprise ownership they must take account of local community interests, for example, when decisions are discussed in village meetings (*ibid.*:59).

the 1990s this market niche was becoming squeezed not only by foreign products but also as reforms in the state industries begin to take effect. With profitability falling, the TVEs were becoming seriously constrained as capital requirements began to outgrow their self-financing capacity. The expanding markets of the Asian-Pacific region provide a source not only of competitive threats but also of new opportunities so long as the sector can improve its export-orientation. Here transport is also a serious constraint since the TVEs, initially set up to utilize local resources and supply local markets, are scattered in nature (Pan, 1993:23). To respond to the new challenges requires that TVEs rationalize, enlarge enterprise scale, upgrade the technology and skills base and develop flexible product lines. Infrastructural improvements are necessary to support this.

Clearly from a critical perspective, the allocative role of local governments in using enterprise profits for purposes other than reinvestment may be regarded as detrimental to economic efficiency, even appearing as “predatory” (Wong, 1988; Zweig, 1993:428). Others have rather focused on the need to end bureaucratic discrimination against private enterprises (Nee, 1992). Within China, the particular concern has been that once restrictions on private enterprises were removed, collectively-owned enterprises would be unequal to the new competition so long as their profits were siphoned off by local governments for welfare purposes. There was also concern that the arrangements for leasing collective enterprises to contractors had underestimated profit levels and failed to take account of inflation and that funds accumulating in hands of the contractors were being used to raise wages and salaries rather than for investment purposes (Gao, 1991:181; Shen, 1993:23). Collective enterprises were likened to semi-state enterprises: “cadres are promoted but not downgraded; workers are hired but not fired; their salaries go higher but not lower” (Liu, 1993:24). In contrast, individual household and private enterprises were held to be responsive to market conditions since decision-making is flexible and quick, and profits are directly linked to effort (Sun *et al.*, 1993:26).

The problems of enterprise efficiency – of bureaucratic interference on the one hand and of short-termism within the enterprise on the other – are both attributed to indistinct property rights: the lack of clarity in the distribution of decision-making powers between enterprise managers and local government which creates confusion over the question of who had the rights to claim the surplus and take responsibility for losses (Sun *et al.*, 1993:28; Shi, 1995:35).

Localistic ties and the community orientation of rural enterprises have also come under criticism as tending to immobilize productive factors within local boundaries, creating barriers for enterprise restructuring through relocation, merger or asset transfer. Kinship and community ties are seen as a particular impediment to the employment of skilled personnel in the TVEs with preference given to local people regardless of their abilities (Shi, 1995:36-37; Pan, 1993:23; see also Ody, 199:xi).

With increasingly competitive markets, falling profits, demands for greater capital intensity and improvements in product quality, reforms to improve efficiency in the rural enterprise sector were becoming a priority. To tackle the problems of high wages, short-termism, excessive social burdens and falling profitability, there were calls to increase the separation of government and enterprise, to reduce overstaffing, to improve internal mechanisms of accumulation, and to create incentives for managers to assume responsibility for growth of capital assets and to resist pressures from the workforce to pass on profits through increased wages (Nee, 1992:24). The central question was, however, how to accomplish such changes within the socialist integument.

Reforms to broaden funding channels and adopt more flexible modes of financing rural enterprises are also called for. With the accumulation of wealth in the countryside, shareholding began to appear as a viable solution to the problems of enterprise undercapitalization. During the credit squeeze of 1989/90, many collective as well as private enterprises survived by turning to unauthorized as well as authorized borrowing from private lenders and employees. This appeared to confirm the view that “in many localities peasants not only have money in the banks but they also have idle money under their mattresses and in their suitcases” (Joint Investigation Group, 1993:19).

The resilience of rural enterprises during the austerity period demonstrated that the goals of rural industrial expansion and continued support for state industry were not necessarily incompatible if alternative methods of financing the TVEs were to be encouraged. From the perspective of the “socialist market economy” and its goals of common prosperity, employee shareownership began to appear as an acceptable option. Du Rensheng (1988) pointed out the advantages: if workers bring their own funds to enable rural industries to develop this would not deprive state-owned enterprises of finance. Appealing to what he sees as the particular characteristics of a worker-peasant enterprise culture fused with the culture of community, he suggests that profit-sharing can provide both a mechanism for fair competition and for employment for if there is a conflict between employment goals and profits, worker-peasants who choose to combine a high income from industry with a stable income from agriculture, would be prepared to accept reduced wages (*ibid.*:378-379).

Nevertheless, an increasing separation of collective enterprises from the rural community raises the issue of peasant alienation from the rural industrialization process. Many rural enterprises have their origins in the people’s communes and in theory belong to the local communities. Others have been built using village labor, occupying land cleared by local farmers, using bricks made by local farmers. Therefore the property rights of the peasants are also a matter at stake.

The return to a household-based farming system in the early 1980s was a

first step in undermining the accountability of the local cadres responsible for the enterprises to the local people. The practice of contracting out enterprises to individual managers has created more distance between enterprise, community and local government. With reports of complaints from the peasants that whilst “the TVEs belong to the people in name, in practice they are the property of the government”, there is concern that the collective sector is deteriorating into “a private economy for a few powerholders” (Joint Investigation Group, 1993:20; Shi, 1995:36).

The identity between enterprise workers and community is breaking down further as labor markets open up village employment to outsiders making community orientation and community accountability even more problematic. Minchuan Yang's study of one community demonstrates clearly how, as the village enterprise raised the incomes of its shareholders and employees, those households which remained in farming on a low income had become angry and jealous. Even though the local enterprise contributed funds for a village school, they were particularly resentful of the recruitment of labor from outside the village and felt that it was unfair to have so many outsiders working in the factory built on their village land (Yang, 1994:169-70).

Village collectivism continues to exert its influence as peasants as well as cadres have demanded the renegotiation of leases as enterprise profits have soared (Zweig, 1993:429). But for new investors, drawn in as the enterprises have diversified their sources of finance, community claims and local government levies impinge on their property rights and they too have demanded reductions in fees and a more precise definition of the role of local government.

Pressures for reform have then arisen from below as, with the marketization of the rural economy, a plurality of interest groups has begun to emerge within the communities. Increasing income differentials, the growing mobility of labor and the changing orientation for TVEs, as these reach beyond the community for markets and inputs, have all tended to dissolve the close links between enterprise, community and local government, so that workers, managers, local government and local community increasingly compete over their claims to enterprise profits.

The problem of indistinct property rights is not just about enterprise efficiency. At the heart of the matter, as conflicts over enterprise goals intensify, is the question: to whom do the enterprises really belong? Enterprise reform may be essential to permit greater flexibility in the management of assets, enterprise expansion and reorganization but if an enterprise belongs to a village, how are such decisions regarding asset transfers, mergers or relocation to be made without infringing on the peasants' property rights? If enterprises become autonomous, how is public accountability to be maintained?

Local protection has been criticized as violating the economic rights of

government, banks and tax payers (Chen, 1989:58-59). On the other hand, such behavior can also be seen as a defense on the part of the rural community against the privileges of the cities (Luo, 1989:89). If the farmers are not to become further alienated in the rural industrialization process and more resistant to modernization and commercialization, but indeed are to be encouraged to commit their savings to such developments, then their interests must be protected and they must see the benefits of rural enterprise reform. In order for the peasants to be integrated into the process of rural transformation, the pace and pattern of rural enterprise reform and restructuring needs to be modified to take into account their collectivist claims and community goals.

Against this background, the SCS appears as a response to the conflicting demands of the different stakeholding groups. The question is: to what extent does it succeed in providing a framework in which they can tackle each others' problems of short-termism, excessive social burdens and local protectionism and resolve their competing claims through mutual regulation and self-restraint?

### **The shareholding cooperative experience: some case studies**

This discussion of the SCS in practice draws mainly on fieldwork conducted in Laiyang City, Shandong Province, in September 1994 and September 1995.<sup>3</sup> In 1991, the city (population 900,000) had been designated an experimental center for the SCS under the Ministry of Agriculture. By 1993 approximately 600 of the 974 township and village industries were shareholding cooperatives; of the 220,000 households, 105,000 owned shares; and of a total 0.54 billion yuan assets, 0.14 billion yuan was newly-raised capital with 30 percent from the collective sector; 10 percent from the state and foreign enterprises; 20 percent from employees, and 40 percent from other individuals.

It was clear from the investigation that the changes were the result of local improvisation rather than the simple imposition of regulations from above. Share schemes, profit-sharing arrangements and management systems varied tremendously from enterprise to enterprise, depending on the differing types of investors involved. Shares might cost as little as 10 yuan or as much as 10,000 yuan depending on capital intensity, type of industry, numbers of shareholders involved and local incomes. Both ordinary and preference shares may be sold outside as well as inside an enterprise, though usually on a restricted basis, for example within the locality. Share ownership may be wide spread among a workforce or community or limited to a few; relatively equalized or with wide differences between maximum and minimum shareholdings.

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<sup>3</sup>Visits to some SCS in Shanghai, in April 1994, and in Xiangfan City, Hubei Province, in August 1994, also provide some background here.

### ***Reforming township collective enterprises***

The conversion of an enterprise into an SCS involves an assessment of existing assets to be converted into shares and then divided according to the different contributors. However, property rights are difficult to sort out given the complex methods by which rural collective enterprises have been funded in the past. This gives rise to a complexity of shares including collective shares; state shares; enterprise shares and individual shares allocated to workers, and in some cases, peasants.

Local governments are often reluctant to lose control of their enterprises, preferring to use the SCS simply as a fund-raising mechanism involving a minimum of change within the enterprise. Where restructuring does occur and a part of the assets are individualized, these generally take the form of basic shares allocated to employees to be held in name only. These shares are non-redeemable and non-transferable but draw dividends and carry voting rights. They are assigned to individuals according to length of service and contribution, that is, with managers and technicians assigned more shares. Basic shares are often issued alongside workers' risk or investment shares, on the basis of "buy one and get one free". This may mean that not all employees become owners. Risk shares are usually repayable and transferable: generally the number that any one individual may hold is unrestricted and each share carries a vote.

A common formula is to allocate 30 percent of assets as individualized basic shares whilst retaining 70 percent as collective shares (Tung, 1994:14). This means that local governments are able to maintain their control and may manipulate the use of profits. For example, as Zhang Xiaoshan discovered at the Wangcun Construction Company, Zhoucun, Shandong (assets: 2.7 million yuan; workforce: 1,100), whilst the constitution stipulated that cash dividends were restricted to 15 percent of the share principal with the excess to be used to expand the risk shares of the employees, this method was not being implemented. Instead, dividends were paid to increase the size of the basic shares (30 percent individual; 70 percent collective) clearly to the advantage of the local government and against the principle of limiting returns to capital (Zhang, 1994: 17-18).

At the Laiyang Steam Turbine Fittings Factory (assets: 5 million yuan; workforce: 150), only a small number of low-priced shares had been sold both inside and outside the enterprise to increase cash available for technical development. Although the townships' share of profits basically remained the same, the introduction of the SCS involved other internal changes aimed to stimulate labor enthusiasm and gain local support. The townships' claims were more clearly identified with a specified amount earmarked for re-investment in the enterprise and a somewhat lesser amount for investment in other new enterprises. Despite the overwhelming predominance of collective shares, there was only one township

representative on the Board of Directors. Of the four other directors, one was a representative from the workforce and one, a local village Party Secretary, who was held to be a good manager with a high income level (who incidentally had bought over half the 240 ordinary shares sold to the public). Preference shares sold to the surrounding villages carried voting rights so that villagers as well as worker-shareholders were able to elect representatives to attend the General Assembly. Profit-sharing operated not only through dividend payments but through the allocation of 40 percent of profits to a bonus fund to reward cost savings and technical initiatives. One suggestion which came forward as a result led to a considerable saving on the use of oil; another led to the opening of a new marketing channel through one employee's family contacts.

In more developed townships, where local authorities oversee a number of enterprises, more radical changes in enterprise structures may be sought. An experiment in a partial employee buy-out had been put into operation in the busy township of Zaowangzhuang, where local officials had 53 TVEs to supervise. They welcomed reforms as an opportunity to draw in new directors thereby relieving their own workloads, releasing their time as well as funds liquidated from the sale of assets for the development of new projects. At the Hongda Food Company (assets: 4 million yuan; workforce: 73) 25 percent of the collective assets had been sold to the employees who also invested in additional shares. With a minimum payment of 10,000 yuan, the financial commitment of the ordinary workers was substantial. Managers were required to commit up to 100,000 yuan each, whilst the Chief Executive had bought an additional 50,000 yuan of shares. The employees together held the controlling interest, but votes were according to share. The Board of Directors comprised two managers, one workshop leader and one ordinary worker, with a fifth director chosen by the local government.

Selling collective assets to individuals has been criticized by some as a form of privatization (Lu, 1994). As a way of limiting the monopoly of collective shares without allowing an expansion of private ownership, the Jianhua Construction Company (assets: 1 million yuan; employees: 1,600) had distributed 70 percent of the existing assets as individualized shares in surrounding villages alongside the sale of risk shares – “because the enterprise belongs to the people”. With a further 5 percent transferred in the form of basic shares to employees (excluding the 1,000 or so temporary workers) only 25 percent of the shares remained in collective ownership. Shares were only 10 yuan each and a maximum shareholding of 100 had been set but the dispersal of ownership was considered by both the manager and the township official to be problematic.

### ***Pooling resources at village level***

Within villages, SCS are formed from the joined contributions of individual farmers and the village collective: some are set up by village or township

governments with the collective as the predominant partner; others are based on the initiatives of a few households. Generally speaking, enterprises at village level rely more than township enterprises on equity raised from individuals. Again patterns vary with shares held exclusively within the enterprise or within the village or in some cases sold outside the village.

Shareholding Cooperatives created through the transformation of household-based partnerships are likely to be dominated internally by a few wealthy villagers with large shareholdings. Employee share ownership, if it operates at all, may be a form of "buying a job". For example, the Honghu Vegetable Processing Plant (assets: 2.7 million yuan; workforce: 50) based in a relatively prosperous village engaging in intensive vegetable-growing, was a project set up by ten of the most successful local farmers using their pooled savings and funds raised from other well-to-do vegetable growers for whom the enterprise provided a service. Only the large shareholders could be Board members. The employees, mostly daughters of the local farmers, were required to purchase preference shares without voting rights and labor was barely recognized in the distribution of profits claiming only 10 percent in a bonus fund, whilst 60 percent went to dividends on shares. On percent the basis of land shares, the village Party Secretary qualified as a Board member, an arrangement which modified what would otherwise have simply been a private partnership. The public accumulation rate was 30 percent, and 80 percent of the share dividends were reinvested.

In enterprises initiated by the local government, individual share ownership tends to be more equalized and widely spread. An example here was the Huasheng Chicken Farmers' Shareholder Cooperative (membership: 350 households) which was set up by local leaders to provide a technical service and a chicken feed processing plant in a village in which over half the households raised chickens. The Board of Directors comprised three village cadres and four chicken farmers. The maximum shareholding was restricted to 1,050 yuan (3.5 shares) and about half of all those raising chickens had bought shares entitling them to purchase feed at cheap rates with free delivery. The easy availability of feed within the village was of benefit to all chicken farmers and there were plans to encourage more to join in the future.

At village level, an SCS may represent an effort to harness the skills and sometimes substantial savings of private entrepreneurs into the organized framework of the village economy. Such was the case at Jinpin Economic Development Group (assets: 7.68 million yuan; workforce: 1,680), a large enterprise for a village, resulting from the merger a village collective enterprise and three local private owners of mines producing marble. Together with the village Party Secretary these three formed the management and were all company directors. Collective shares in the form of land and buildings made up 23 percent of total assets; the three key members held 25 percent of the shares, (one with the maximum



individual shareholding of 875,000 yuan) and eight other large investors held a further 35 percent. The remainder of shares at 200 yuan were spread fairly evenly amongst employees and other villagers, the majority of whom, though not all, were shareholders.

With dividends on shares at 25 percent of profits, the large shareholders clearly had a lot to gain but some benefits were also shared with the village and the employees: the jobs created had solved the problem of surplus labor within the village; dividends paid on collective shares provide funds for irrigation and a primary school; and the “worker-peasant-shareholders” could use their dividends in agriculture. The large shareholder-managers had also apparently accepted certain restrictions: the constitution enjoins managers not to engage in competition and “to be loyal” to the company, and the economic security of the enterprise group is protected to the extent that shareholders are not allowed to withdraw their shares for five years. A proportion of the share representatives were elected by the workforce independently of the managers (and not directly according to share), and there is a worker representative on the Board.

### *Organizing agricultural producers*

In the Laiyang area, a rapid shift to commercialized farming is being driven by the promotion of exports of fruit and vegetables especially to Japan and South Korea. Whilst this creates opportunities for the more well-to-do, local authority-led initiatives often involve a wider community of peasants to set up projects on a scale large enough to support essential technical and marketing services. These initiatives represent an effort to share the benefits of commercialized farming more equally.

The Houliugezhuang Orchard Cooperative Production Society (assets: 0.54 million yuan; membership: 320 households) involved virtually the whole village with individual shares contributing roughly two-thirds of the investment, the village collective making up the rest. Individual shares included some labor shares, but most were in the form of trees, fertilizer and other inputs. Interest-free loans were available to those households unable to afford these. For their work in setting up the orchard, village and township technicians received shares calculated per labor day. The Tuanwang Vegetable Growers Cooperative (assets: 1.02 million yuan; membership: 105 households) involved farmers from two villages. Collective shares held by the township and the two villages at 70 percent of the total outweighed the contribution of individual farmers. The cooperative had 102 greenhouse tents covering 3 mu each. With each tent costing 10,000 yuan, not to mention the inputs, the costs were far beyond the means of an average peasant household. Only by combining funds from the township together with land and facilities from the two villages was such a venture possible. The low price of shares of 100 yuan sold for cash or labor made it possible for less well-off households to take part. The scale of the project allowed for the payment of the wages for a full-time technician.

Although the initiatives had come from the top down, these associations of producers more closely correspond to the cooperative form involving a fairly wide village membership. Share ownership is fairly equal with community boundaries helping to reinforce co-operation as shares were transferable only within the village. All the producers participated directly in the General Assembly with voting on a household rather than a share basis and the Boards of Directors were balanced towards the individual shareholders, with four farmers and three cadres from the villages and township. Both projects were managed by a technical association largely comprising the village Party leadership, but members and managers met regularly to discuss matters of production.

### **Towards an assessment of the SCS**

The SCS has been presented by its proponents as an innovative mechanism which can “avoid the exploiting nature of employer-employee relations”, “prevent polarization and let everybody share the wealth” and gradually eliminate the rural-urban divide. It provides incentives to improve enterprise performance since “when the workers are not only the laborers but also the owners, their sense of responsibility and solidarity as masters of the enterprise is enhanced and their enthusiasm is mobilized”. It is also claimed to offer a smooth transition for the private economy into the cooperative system without infringing on property rights of the peasants (Du, 1991:41; Gao, 1991:182; Wang, 1991:47; Du and Zhang, 1994:28-29).

In practice, the performance of enterprises under the SCS is still dogged by persistent problems of local government predation and short-termism. Decision-making processes are poor and the various share systems are not well understood with practices often diverging from government regulations.

In reformed township enterprises, the SCS may be little more than a fund-raising mechanism. Local governments often remain heavily involved in major decisions regarding merger, liquidation, the transfer of assets, profit distribution and the appointment of managers and still lay claim to a large share of enterprise profits. At village level, the roles of directors, managers and village leaders are often hard to distinguish with power remaining concentrated in the hands of the village Party Secretariat.

In more developed townships, where local authorities oversee a number of enterprises, more radical changes in enterprise structures may be sought. But in these cases again it is the economic aspects of benefits to shareholders that tend to receive most emphasis. In Laiyang, public accumulation funds averaged between 30 percent to 40 percent of profits, well below the recommended levels (in one case as low as 20 percent), with dividend payments ranging between 60 percent and 70 percent to the benefit of both individual shareholders and local governments. None of the enterprises appeared to follow the recommended procedures with regard to liquidation. Instead, enterprise regulations permitted the division of public

accumulation funds to shareholders and in some cases large individual shareholders could have gained substantially from an enterprise closure.

All this clearly raise a question mark against claims that the SCS makes “workers and peasants the masters”. Especially where the new developments are monopolized by those already in positions of power and economic advantage – by local governments and entrepreneurs – the reforms would appear to pave the way towards greater inequalities of income and wealth.<sup>4</sup>

In employee-share ownership schemes, especially where there are no ceilings on shares, a reduction in the role of local government tends to mean that power in the enterprise shifts into the hands of the managers. In the absence of schemes to purchase shares out of future wages, most employees rely on borrowing from relatives to raise funds to buy shares. Managers, with advance notice of a share issue, may have more time to get funds together to buy up shares and can therefore establish their positions as large individual shareholders with a key role on the Board of Directors. This is so the more capital intensive the plant as share prices are higher and dividends greater.

Reservations have been expressed that a wide spread of equalized shareholdings involves “too many bosses” which would lead to confusion in management (see *e.g.* Joint Investigation Group, 1993:20). Local governments may prefer to use the SCS to promote the role of large shareholding managers. In some enterprises large shareholders have more rights than small shareholders, for example, to serve as shareholder representatives, to make proposals or to automatically sit on the Board of Directors (see also Sun *et al.*, 1993:29). The “one share, one vote” system provides a particular example of a symbiotic relationship between local governments and large individual shareholders, since it allows them both to maintain influential positions, whilst also being more attractive to outside investors.

The sale of equity outside an enterprise creates opportunities for wealthy locals to gain a share in enterprise profits and play a part in the decision-making process. On the whole, though, their role is marginal since external individual investment tends to play only a very small part in total equity. Those who buy shares may not be the wealthiest in the community but Party members “in the know” since the Party is often the main channel of information about shares in the villages.

Workers and peasants often appear to be reluctant investors opting for preference shares which guarantee a rate of return above the bank rate rather than profit-sharing. They may lack understanding of the system or the opportunity to hear of it; their savings are smaller. Their limited participation may also in part express the “traditional conservatism” of risk-avoidance or survival strategies.

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<sup>4</sup> See also Islam’s criticisms (1991) of employee share systems in China as a form of ‘buying a job’ and a route to greater income inequality, since the high price of shares tends to exclude anyone other than wealthy or well-connected households. (*ibid.*:711-716).

Given these sorts of difficulties, local governments may prefer to retain a substantial holding of collective shares to protect the collective economy, to prevent a few individual large shareholders gaining a controlling interest in the enterprise, and to limit private gain and short-termism, reductions in public accumulation and the dispersal of assets on liquidation. However, where they are hamstrung for circulating capital to operate an enterprise, local governments may find it necessary to compromise with wealthier individuals willing to share risks. The only alternative is to resort to the introduction of employee share schemes through coercive measures (Shen, 1993:23).

Where the SCS is used simply as a fund-raising mechanism rather than as a method of restructuring ownership and management, where rates of public accumulation are high and collective holdings large, and where emphasis is placed on the roles of managers and key investors, labor enthusiasm will be dampened. The system is left open to abuse. Large shareholders may effect internal takeovers, change the rules as they wish, reduce the share of profits to labor, control share issues and transfers, and hive off collective assets (Shi, 1995:38).

Tung has suggested that SCS may be no more than a way of "implementing the private ownership system under guise of public ownership" (*ibid.*:30). But the tendencies to emphasize shares and dividends and the role of key investors are clearly rooted in the desperate shortage of capital in the rural areas and the high price it commands.

In fact the system opens the door to an innovative approach to the problems of capital shortage. It provides a framework for linking private funds into the collective economic structure, and for the reorganization of public assets. This creates opportunities at township level and below for local governments to form partnerships, initiate new projects, coordinate land use, undertake inter-village projects, for example, in irrigation, forestry and large-scale commercial farming, and to rationalize and merge enterprises. As the agency with shares in nearly all but the household enterprises, a local government, in cooperation with other stakeholder groups, may be able to plan the direction of local development to an even greater extent, harnessing individual entrepreneurship whilst influencing private enterprises towards a greater sensitivity to employment and other local needs. The SCS may then be seen as giving rein to the developmental role of local government, extending its risk diffusing, resource mobilizing, redistributionist and technical support and consultancy roles.

The SCS may therefore represent a pragmatic response by local governments seeking greater flexibility in enterprise organization. But in some cases the system is more than this. Through experimentation in a variety of property forms, the SCS introduces the notion of enterprise accountability to the workers and the community. Worker enterprise shares, village collective shares, shares individualized

to employees and to community members are all ways of defining different types of property rights in recognition of the interests of workers and peasants, both as individuals and as collectivities, and their rights to have a say in the future development of rural enterprises and to be involved in the processes of rural industrialization and rural transformation.

In some cases, local officials demonstrate a clear commitment to democratic management. Conscious efforts are made to spread share ownership within communities, stimulating the involvement of the less advantaged through low priced shares, low-risk preference shares with voting rights, making loans available to poorer households to buy shares and limiting maximum share ownership. In the case of one village in Bao'an County, Guangdong Province, the leader decided to use funds from the enterprise to buy shares for the poorer farmers in order to reduce income inequalities between shareholders and non-shareholders (Tung, 1994:18).

With the establishment of Boards of Directors involving a wider range of people, often through contested elections at shareholders meetings, the SCS gives workers' and peasants' a greater voice both collectively and as individuals. On the basis of land and collective labor shares as well as shares distributed to the community, village governments are able to represent community interests in the major decision-making processes in township enterprises as well as private partnerships and claim for the community a share in enterprise profits to be used to support agriculture or other economic and social development.

Through participation in shareholders meetings as well as inclusion on Boards of Directors, workers and farmers may, as individuals, become more directly involved in enterprise ownership. Where workers' capital contributions are a significant stake and make up a large proportion of the equity, it is to be expected that they will have greater interest in management affairs. Worker-representatives on the boards of directors may be large shareholders in their own right but this is not always the case. Voting according to share is a common pattern, but this may be adapted where workers are elected independently of management. Employees are also well-represented on enterprise supervisory committees with powers to seek external legal and financial advice.

To the extent that the SCS involves the diverse interests of capital, labor and community, it may be characterized as a form of multi-stakeholding cooperative where solidarity is based on risk-sharing. Whilst each group within the SCS has its own stake and may follow its own priorities and seek its own advantage, mechanisms of mutual supervision and self-restraint may limit behaviors damaging to the organization.

Restraints on capital returns may be exercised through maintaining public accumulation and indivisible reserves. The allocation of a proportion of profits to bonus payments provides incentives for the workforce, maintaining returns to labor.

Short-termism may also be restrained through joint agreements by shareholders to re-invest dividends and to limit share withdrawals. This inhibits speculative behavior given the restrictions on share trading. Under these conditions, individual savings accumulated by wealthy farmers, local small businessmen as well as enterprise managers from their large bonuses, may be used productively helping to create jobs in the local community. The powers of large shareholding managers may be limited by constitutional agreement, for example, not to change resolutions made by the General Assembly and “to be loyal”.

As local governments begin to change from “mother-in-law” of the enterprise to one of a number of shareholders (Shen, 1993:23), they become more accountable within the enterprise and decisions are made more transparent. Enterprises are becoming more assertive and able to resist the pressures of local government predation. In one case in Wangzai township, Xiangfan City, Hubei, the shareholders refused to accept a particular individual as the township’s nominee to the Board of Directors. In another example from Laiyang, the manager of a village enterprise had refused to allow the village leaders free access to the enterprise car claiming “we now have to answer to the Board of Directors above and the shareholders” (Joint Investigation Group, 1993:20). At the Hongda Food Company, it was the worker-shareholders in particular who criticized the “excessive consumption” of both the managers and the local officials at the General Assembly.

Through flexible forms of shareholding – land, labor shares and technical information shares – the SCS helps to bring workers, farmers and experts together. Frequently, share options are offered as incentives to attract skilled personnel from the urban areas where rural enterprises cannot afford high salaries. Profit- and risk-sharing may help to mitigate conflicts within enterprises and clearly close cooperation between skilled engineers and the shopfloor contributes to enterprise performance. Share-ownership may help to secure the commitment of outsiders to a village enterprise, minimizing fears of opportunism and helping to break down community barriers. In this way the SCS offers a framework which may allow scientific, technical and managerial methods and skills to be more easily absorbed into the village economy.

An interesting example here is Qiaoying village (population 1,300) near Xiangfan City, Hubei, which had formed itself into a community-type SCS. This involved pooling all of its industrial, commercial and agricultural assets (10 million yuan) and redefining community membership to accommodate the increasing mobility of labor in and out of the village. Special provisions were made for those who left the village to remain shareholders and receive dividends whilst forfeiting their claims to welfare benefits; on the other hand “outsiders” employed because of their special skills or contributions to the village economy were accepted as shareholding community members.

Clearly though, the mechanisms of mutual supervision and self-restraint are often inadequate. Patriarchal influence within households, production teams and villages tend to inhibit democratic participation at community level with, for example, voting based on households rather than individuals. Workplace hierarchies tend to limit employee participation: where in larger enterprises, worker-shareholder participation is indirect, representatives are usually workshop or section leaders.

Nevertheless, conditions of rural industrialization in China may provide a setting in which positive interaction between stakeholder groups is made possible. Encouraging employee participation makes particular sense in the rural enterprises where workers can play a key role in renovating old machinery, in helping to identify and solve production problems, and can contribute to product design as well as finding new outlets through their own kinship networks.

Whilst it is the case that local government involvement in enterprise management infringes rights of autonomy and is generally regarded as undermining democratic management and labor enthusiasm and inhibiting enterprise performance, in China, village governments play a vital community role in maintaining social stability and their continued involvement may help to maintain the reciprocity between the local enterprises and the community. Without the support of funds from village enterprises, the management of land, water resources and population which are essential to maintaining the community, would collapse (Zhang, 1995). At the same time, community-based cohesiveness has contributed to the competitive advantage of rural enterprises. Given the greater willingness to share risks within a community, village enterprises are able to operate with fewer managers than in state enterprises, workers work harder and labor relations are smoother (Pei, 1995:24). Indeed it has been argued that a disciplined but creative workforce capable of tightly operating new work methods and adapting quickly to new product lines has been fundamental to the success of industrialization elsewhere in East Asia (Amsden, 1989). A community base also helps to provide stability where a business diversifies over a range of product lines in order to diffuse risk.

In providing for the continued involvement of village governments, the SCS may help to sustain the advantages of community cohesion otherwise threatened by increasing commercialization. As SCS takes into account peasant goals of stability and risk minimization, egalitarian habits and traditional concepts of community membership it is a distinctive response to the demands of China's transition to a modern industrial market-based economy, shaped by the influence of a peasant economy with its own subsistence-based concepts of property rights derived from the community management of land, resources and population.

## **Conclusion**

The development of the SCS is shaped by a number of factors: the political goals of a "socialist market economy" to maintain the predominance of public ownership;

the pragmatism of local governments and rural enterprises in the face of competitive pressures and constraints of capital shortage; and newly arising tensions between workers, managers, peasants and local leaders over how far to share or restrict the benefits of rural industrialization. The problems and potentialities here are part of the complex dynamic of inter-relations between local governments, large individual shareholders, workers and local community members.

The SCS is not a shareholding system: shares cannot be traded; dividends on shares are limited and voting is not based entirely according to shares. Nor is the SCS a cooperative system: the enterprises are not entirely autonomous from local government and democratic management is compromised; the voting system is rarely one person – one vote; not all owners are workers – equity is raised outside the enterprise; not all workers are members; returns to capital are sometimes quite high.

As a multi-staking cooperative system, the SCS also has limitations since its mechanisms of mutual supervision and self-restraint are often inadequate and since stakeholder groups are not sufficiently balanced within enterprises, the interests of capital may predominate. However, at its best the SCS does offer a form of enterprise particularly adapted to China's characteristics of development. In a rural economy in transition, as processes of commercialization and industrialization tend to dissolve local ties and disrupt communities, the SCS is an attempt to alleviate the conflicts that arise and to sustain the competitive advantages of community-oriented cohesiveness by creating new forms of solidarity based on bonds of profit and risk-sharing among stakeholder groups.

Rather than operating to subordinate particular interests in an enterprise to a "corporate good", the directors' boards and the shareholders' general assembly in the SCS may offer a forum in which the newly emerging interest groups are able to come to an accommodation with regard to their various economic, social and political objectives – for capital returns, job security, rising incomes, local development – to a greater or lesser extent, and to realize a new balance between their stakes in the development of rural enterprises. The SCS endeavor to spread the benefits of development more widely may provide greater stability for the growth of rural enterprises and for local economies.

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