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## Property Rights and Legal Reform in Township and Village Enterprises in China

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### I. INTRODUCTION

Although ailing state enterprises and a booming private sector garner the most attention,<sup>1</sup> China's Township and Village Enterprises ("TVEs") are equally important aspects of China's economic system.<sup>2</sup> TVEs are also at the forefront of a battle over how to move China's legal system toward the Rule of Law and determining which laws will

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<sup>1</sup> See, e.g., *China's Private Surprise*, ECONOMIST, June 19, 1999, available at LEXIS, News (remarking on the growing private sector of China's economy and the "inefficient . . . loss-making" state sector without mentioning TVEs).

<sup>2</sup> TVEs accounted for 40% of China's gross industrial output in 1996, and 25% of China's total exports in the mid-1990s. WORLD BANK, ACCELERATING CHINA'S RURAL TRANSFORMATION 87 (1999).

encourage economic efficiency.<sup>3</sup> In the TVE arena, the battle over legal change is generally framed in the language of property rights.<sup>4</sup> For some scholars, TVEs demonstrate the importance of absolute property rights.<sup>5</sup> For others, TVEs are a unique phenomenon of Chinese culture, blending the cooperative nature of Chinese villages with a property regime that reduces transaction costs.<sup>6</sup> Still others see TVEs as the first example of a new, market-based socialism based on “disaggregated” property rights.<sup>7</sup> The legal issues facing China’s TVEs, however, are much less complex than these theories imply. The hardest problems facing TVEs are corruption, fraud, and contract breaches.<sup>8</sup> Thus, this paper argues that the most important legal issue facing TVEs is establishing a basic legal order in which they can carry out their entrepreneurial activities. Property rights, which are the focus of most scholarly and governmental attention, are not TVEs’ most pressing problem.

The data in Part IV provides some insight into the legal needs of TVEs, and also into a more general policy debate regarding the transition to a capitalist economy.<sup>9</sup> Briefly, on one side of this debate are scholars who argue that property rights must be the top priority in this transition, and that without clear property rights economic growth will suffer.<sup>10</sup>

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<sup>3</sup> See *infra* Part II.B.

<sup>4</sup> See *id.*

<sup>5</sup> See Janet Tai Landa, *The Co-Evolution of Markets, Entrepreneurship, Laws, and Institutions in China's Economy in Transition: A New Institutional Economics Perspective*, 32 U.B.C. L. REV. 391, 392 (stating that property rights are the single most important factor for explaining China’s economic success).

<sup>6</sup> See CHENGGANG XU, A DIFFERENT TRANSITION PATH 63-80 (1995) (discussing the “unique Chinese” characteristics of China’s TVEs); *infra* Part II.B.

<sup>7</sup> See ROBERTO MANGABEIRA UNGER, DEMOCRACY REALIZED: THE PROGRESSIVE ALTERNATIVE 105 (1998) (stating that powers that we denote by “property” today should be diffused among governments, NGOs, and individuals); *infra* Part III.D.

<sup>8</sup> See *infra* Part IV.

<sup>9</sup> For a detailed examination of this debate, see *infra* Part II.B.

<sup>10</sup> See generally ANDERS ASLUND, HOW RUSSIA BECAME A MARKET ECONOMY (1995) (arguing that private property rights are the crucial first step to economic efficiency in the transition to capitalism). For an overview of this approach, commonly referred to as the “Aslund-Sachs approach,” see LYNN D.

Other scholars advocate a broader “institutional” approach, emphasizing the creation of legal, political, economic, and social institutions as a foundation for the transition to capitalism.<sup>11</sup> No single study can hope to decide this complicated debate, but the empirical data examined in Part IV indicate that in rural China, institutionalization should take priority over property rights.

This paper is divided into five parts. Part II gives a short introduction to China’s legal system. Part III outlines the emergence of TVEs in China over the last twenty years and analyzes three property rights theories that attempt to explain the growth of TVEs. Part IV examines the body of PRC law on TVEs, demonstrating that the laws for TVEs emphasize property rights over other aspects of legal reform. Part V analyzes newspaper articles reporting the legal problems of TVEs. These articles clearly indicate that the most important issue facing TVEs today is institutionalization, not property rights. Finally, in the conclusion I argue that only after order is established should property questions become the focus of legal reform in the TVE sector.

## II. THE CHINESE LEGAL SYSTEM

There is widespread interest in China’s legal transformation, particularly in the attempt to instill a system of “Rule of Law.”<sup>12</sup> Officials in the U.S. State Department, human rights activists, and Western academics look at the Rule of Law as a logical step toward building Chinese democracy.<sup>13</sup> Economists and many legal academics see the Rule of Law as important for establishing secure, stable property rights and a positive environment for business.<sup>14</sup> I argue in Part II.B, however, that the Rule of Law has been conflated with establishing property rights, while in

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NELSON & IRINA Y. KUZES, *PROPERTY TO THE PEOPLE: THE STRUGGLE FOR RADICAL ECONOMIC REFORM IN RUSSIA* 35-41 (1994) (arguing that the Sachs-Aslund approach was harmful to Russia’s economy and motivated by ideology rather than a understanding of the Russian situation).

<sup>11</sup> See *infra* note 40 and accompanying text.

<sup>12</sup> Thomas Carothers defines the “Rule of Law” as “a system in which laws are public knowledge, are clear in meaning, and apply equally to everyone.” Thomas Carothers, *The Rule of Law Revival*, FOREIGN AFF., Mar.-Apr. 1998, at 95, 96.

<sup>13</sup> See *id.* at 96-97.

<sup>14</sup> See, e.g., JEFFREY D. SACHS, *GLOBALIZATION AND THE RULE OF LAW* 5 (Yale L. Sch., Occasional Papers 2d Series, No. 4, 1998).

Part IV, I show that institutionalization—the establishment of order—should be the focus of legal reform in rural China.

A. *Underdetermination of Law in China*

The Chinese legal environment has been, and remains, one that is characterized by a high degree of uncertainty, what this paper refers to as the underdetermination of law in China.<sup>15</sup> Law in China is underdetermined by statute, precedent, and procedure.<sup>16</sup> Part of the underdetermined nature of Chinese law stems from China's decision to create a Civil Law system; however, it is a Civil Law system without a Civil Code.<sup>17</sup> Although the Organic Law, along with numerous new laws over the past twenty years,<sup>18</sup> has partly filled this void, underdetermination is still perhaps the singular feature of China's legal system.

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<sup>15</sup> The term "underdetermination" refers to the relative autonomy of institutions from the rules that establish the institutions. *See* MARTIN CARNOY, *THE STATE AND POLITICAL THEORY* 95 (1984) (explaining the concept of "relative autonomy of the superstructure with respect to the base"). To say Chinese law is underdetermined means that the process of executing laws is independent of the formal, written rules of the Chinese legal system. The term derives from the literature on political and economic development. *See id.*; Louis Althusser, *Contradiction and Overdetermination*, in *FOR MARX* 89-126 (1990) (describing the relative autonomy of law and ideology from other political and economic factors).

<sup>16</sup> Although law in all systems is somewhat indeterminate, of course, China is an extreme example of this indeterminacy. *See generally* JOSEPH RAZ, *THE AUTHORITY OF LAW: ESSAYS ON LAW AND MORALITY* 53-77 (1979) (explaining that law in any system will have "gaps" where neither precedent nor statute can guide judges, and these gaps will be filled on the basis of judge's personal moral ideas).

<sup>17</sup> *See* Edward J. Epstein, *Codification of Civil Law in the People's Republic of China: Form and Substance in the Reception of Concepts and Elements of Western Private Law*, 32 *U.B.C. L. REV.* 153, 154 (1998) (stating that "the first successful codification of Chinese civil law was promulgated by the Nationalist government between 1929 and 1930," but the newly established Communist authorities repealed this civil code and "it was not until the 1980s that socialist civil legislation was at least codified in China, first with the Economic Contract Law, the Law of Succession, and finally . . . the General Principles of Civil Law").

<sup>18</sup> *See id.* One specific example of this underdetermination is the absence of a uniform law of contract in China until 1999. *See* Hugh T. Scogin, Jr. & Brett D. Braude, *New Contract Basics*, *CHINA BUS. REV.*, Jan.-Feb. 1999, at 36

A second important factor which makes Chinese law underdetermined is the small, albeit rapidly developing, size of China's legal apparatus.<sup>19</sup> China's corps of lawyers is growing almost as rapidly as its laws and regulations.<sup>20</sup> Meanwhile, more attention is being focused on the quality of the judiciary.<sup>21</sup> Despite these important strides, there is still a shortage of lawyers, and corruption remains systemic in the judicial branch.<sup>22</sup> Political interference further undermines the independence of the judiciary.<sup>23</sup>

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(discussing the draft of the Contract Law). Even after the passage of the Contract Law, many types of standard business contracts, including contracts with foreign investors, were still subject to other statutes, which add to or sometimes replace, the Contract Law. *See id.* at 37. Figuring out when one law supercedes, supplements, or complements the Contract Law is yet another challenge facing those trying to navigate China's underdetermined legal system.

<sup>19</sup> To demonstrate China's developing legal system, Daniel Rosen reports that, in mid-1998, only 25% of China's lawyers had undergraduate degrees. *See* DANIEL ROSEN, BEHIND THE OPEN DOOR: FOREIGN ENTERPRISES IN THE CHINESE MARKETPLACE 208 (1999).

<sup>20</sup> The number of lawyers has grown from 34,379 in 1985 to 98,902 in 1997. *See* STATISTICAL YEARBOOK OF CHINA 779 (1998).

<sup>21</sup> The Ministry of Justice designated 1999 as the "Year of Quality Trials," indicating that trials in previous years had been of poor quality. *See* Chen Jianfu, *Enforcement of Civil Judgments and Rules*, CHINA LAW UPDATE, July 1999, at 3.

<sup>22</sup> *See id.* at 5; also Mary Gallaher, *An Unequal Battle: Why Labor Laws and Regulations Fail to Protect Workers*, CHINA RTS. F., Summer 1997, at <http://www.igc.apc.org/hric/crf/english/97summer/e6.html> (visited Sept. 14, 2000) (stating that one source of the failure of laws to protect workers' rights is "the blurred line between the local governments and businesses").

<sup>23</sup> *See Judicial Independence*, 42 CHINA LAB. BULL. 17 (1998) (quoting Liu Han of the CASS Legal Institute who points out the problems of graft and corruption). "Some judges ruled according to slips' given them by local officials[.]" *Id.* Liu further noted that more than seventy percent of commercial cases are decided according to officials' wishes instead of law. *See id.* Judges were also cited for trading sentences for bribes. *See id.* See also David Zweig's field research in which he found that peasants believed that, in Nanjing, "the city's Middle Court would never make a legal judgment that challenged, let alone overturned, a formal decision taken by the city government." DAVID ZWEIG, THE "EXTERNALITIES OF DEVELOPMENT": CAN NEW POLITICAL INSTITUTIONS MANAGE RURAL CONFLICT? 23 (Div. of Soc. Sci., H.K. U. Sci. & Tech., Working Paper No. 45, 1999).

As a result of this underdetermination, China's legal system in the post-Mao period (1978 to present) can be characterized as Rule of Regulation. Like laws, regulations are meant to shape and restrain the behavior of actors.<sup>24</sup> Regulations are promulgated by ministries rather than by the National People's Congress, China's legislature.<sup>25</sup> While both laws and regulations can be revoked and modified, the opaque process of drafting regulations renders regulations less predictable than laws, more subject to short-term political pressures, and more susceptible to reinterpretation by lower-level officials.<sup>26</sup>

What I have termed underdetermination and Rule of Regulation is not the same as lawlessness.<sup>27</sup> They can be seen as part of a continuum, with completely arbitrary rule on one side and complete the Rule of Law on the other. On this continuum, China's current position at Rule of Regulation is closer to the Rule of Law than China's position during the Mao period.<sup>28</sup> But a movement to the Rule of Law does not naturally follow Rule of Regulation, because a country could have a stable legal system in which the Rule of Regulation supports economic and political life well enough to function over the medium term.<sup>29</sup>

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<sup>24</sup> A regulation is a "rule or order, having legal force, issued by an administrative agency or a local government." BLACK'S LAW DICTIONARY 1289 (7th ed. 1999).

<sup>25</sup> See Yujie Gu, Note, *Entering the Chinese Legal Market: A Guide for American Lawyers Interested in Practicing Law in China*, 48 DRAKE L. REV. 173, 188-89 (1999).

<sup>26</sup> Whereas the legislative branch of China's government, the National People's Congress, publicly announces its main sessions and new laws, the myriad ministries promulgating rules makes it much more difficult to track new regulations and amendments to old ones. *See id.*

<sup>27</sup> Lawlessness—*anarchy*—means the rejection of modern state governments, and therefore both laws and regulations. *See generally* PETER KROPOTKIN, THE ESSENTIAL KROPOTKIN 27-43 (Emile Capouya & Keitha Tompkins eds., 1975).

<sup>28</sup> *See Gu, supra* note 25, at 177-79 (noting the arbitrary nature of the justice system under Mao).

<sup>29</sup> The Soviet Union, at least until the Gorbachev period, was a stable society with many rules, but was not ruled by law. *See, e.g.*, SEWERYN BIALER, STALIN'S SUCCESSORS: LEADERSHIP, STABILITY, AND CHANGE IN THE SOVIET UNION (1980) (arguing that post-Stalinist Russia was a remarkably stable and coherent system in which the state provided a modest living standard to the bulk of the population "in exchange for" its willingness to submit to Communist Party

### B. Order, Rule of Law, and Property

Order is the main problem facing TVEs in rural China, because TVEs need order to continue to grow. Order, however, does not necessarily require property rights.<sup>30</sup> Relatively unclear property rights can coexist with the Rule of Law.

In contemporary legal thought, property is seen as a bundle of rights.<sup>31</sup> Thus, ownership of property consists of several different rights:

[T]he core bundle of rights that comprise “ownership” are the right to utilize the asset (utilization right), the right to possess the fruits (and responsibility for the negative outcomes, such as damages and debts) of that utilization (return right), and right to transfer these rights to another agent through gift or sale (alienation right).<sup>32</sup>

Property rights theorists are a relatively diverse group of writers who stress property rights as the crucial aspect of economic or social development.<sup>33</sup> Only some property rights theorists, however, believe that all property rights need to be in the hands of one responsible principal; for others, the disaggregation of property rights improves efficiency compared to monolithic ownership of all property rights.<sup>34</sup>

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rule).

<sup>30</sup> See MANGABEIRA UNGER, *supra* note 7, at 272-74 (discussing different property regimes within the context of a system characterized by Rule of Law).

<sup>31</sup> See Thomas C. Grey, *The Disintegration of Property*, in NOMOS 22 (J. Roland Pennock & John W. Chapman eds., 1980).

<sup>32</sup> Louis Putterman, *The Role of Ownership and Property Rights in China's Economic Transition*, 144 CHINA Q. 1047, 1049 (1995).

<sup>33</sup> See, e.g., YORAM BARZEL, *ECONOMIC ANALYSIS OF PROPERTY RIGHTS* (1997) (arguing that because property rights are difficult to delineate, actors adopt non-market constraints in order to lower the cost of exchange); DOUGLAS C. NORTH, *STRUCTURE AND CHANGE IN ECONOMIC HISTORY* (1981) (arguing that property rights are fundamental to explaining historical change); also Zhiyuan Cui, *Whither China: The Discourse and Practice of Property Rights Reform in China*, 1998, at [http://papers.ssrn.com/paper.taf?ABSTRACT\\_ID=70948](http://papers.ssrn.com/paper.taf?ABSTRACT_ID=70948) (last visited March 23, 2000).

<sup>34</sup> See MANGABEIRA UNGER, *supra* note 7, at 273-74.



Order is different from, and prior to, property rights.<sup>35</sup>

The most important political distinction among countries concerns not their form of government but their degree of government. The differences between democracy and dictatorship are less than the differences between those countries whose politics embodies consensus, community, legitimacy, organization, effectiveness, stability, and those countries whose politics is deficient in these qualities.<sup>36</sup>

Institutionalization is the definition of order,<sup>37</sup> and the prerequisite for economic development.<sup>38</sup> If we assume that actors in rural China are concerned with maximizing their interests, then the focus on order is rational only if establishing order better suits those interests than worrying about property rights. For peasants hoping to make money, order has priority over property rights.<sup>39</sup>

A more general version of this argument tracks the debate that has been raging between advocates of “markets” and advocates of

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<sup>35</sup> See, e.g., JEAN-JACQUES ROUSSEAU, DISCOURSE ON THE ORIGIN OF INEQUALITY IN THE SOCIAL CONTRACT AND DISCOURSE ON THE ORIGIN OF INEQUALITY 212 (Lester G. Crocker ed., 1967) (stating that “this idea of property depends on several prior ideas which could only spring up gradually one after another”).

<sup>36</sup> SAMUEL P. HUNTINGTON, POLITICAL ORDER IN CHANGING SOCIETIES 1 (1968).

<sup>37</sup> The author does not agree with the normative argument that order is good in and of itself, an argument which Huntington seems to endorse (indeed, Mark Kesselman has called him “the Lenin of the Ruling Class” for his emphasis on organization). Historically, governments have performed horrible deeds in the name of “order” and “stability.” Instead, my argument focuses on explaining why certain legal issues are more pressing than property rights in contemporary China. For an excellent critique of Huntington, see Mark Kesselman, *Order or Movement: The Literature of Political Development as Ideology*, 26 WORLD POL. 139 (1973).

<sup>38</sup> “The most fundamental aspect of political modernization . . . is the participation in politics beyond the village or town level by social groups throughout the society and the development of new political institutions, such as political parties, to organize that participation.” HUNTINGTON, *supra* note 36, at 36.

<sup>39</sup> See *infra* Part V.

“institutions” in the rebuilding of post-Communist societies. Institutionalists argue that the institutions of a market economy must be present before changes such as property rights reform can have a positive effect.<sup>40</sup> Other writers argue that changes in property rights are the crucial *first* step to economic development in countries transitioning to capitalism.<sup>41</sup> The institutional approach—market institutions as a necessary predicate to both property rights reform and economic growth—has gotten increased support from Joseph Stiglitz, Chief Economist of the World Bank<sup>42</sup> (one of the institutions initially associated with the property rights position<sup>43</sup>). Some advocates of the “big push” for privatization of property rights now say social institutions, specifically a country’s legal culture, are important in explaining differential economic performance—for instance, in explaining why Poland has fared better than Russia.<sup>44</sup>

Corruption is a long-standing problem in both political and economic development,<sup>45</sup> and has been a huge problem in all formerly Communist countries, including China.<sup>46</sup> “Pirate-ization,” the extra-legal

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<sup>40</sup> See Jeffrey Sachs, *Making it Work*, THE ECONOMIST, Sept. 12 1998, at 23, available at LEXIS, Banking, News & Information (discussing the need for better institutions to manage the global economic system); NELSON & KUZES, *supra* note 10, at 36-86 (1994) (providing an overview of the initial stages of post-Soviet property reform and economic policy in Russia, and arguing that privatization in these circumstances was mistake); generally Michael Burawoy & Pavel Krotov, *The Soviet Transition from Socialism to Capitalism: Worker Control and Economic Bargaining in the Wood Industry*, 57 AM. SOC. REV. 16 (1992) (arguing that Russia lacked the institutions of a capitalist economy necessary to make privatization work).

<sup>41</sup> See, e.g., *The Discussion of Stanislaw Shatalin’s Plan for a 500 Day Transition to Capitalism in Russia*, in NELSON AND KUZES, *supra* note 10, at 26.

<sup>42</sup> See, e.g., *Sick Patients, Warring Doctors*, ECONOMIST, Sept. 18, 1999, at 81, available at LEXIS, Banking, General News & Information.

<sup>43</sup> See, e.g., Stephen F. Cohen, *What’s Really Happening in Russia* (interview), NATION, Mar. 2, 1992, at 259, available at LEXIS, General News & Information (noting the World Bank’s support for rapid privatization regardless of the circumstances in Russia).

<sup>44</sup> See SACHS, *supra* note 14, at 9.

<sup>45</sup> See generally SUSAN ROSE-ACKERMAN, CORRUPTION AND GOVERNMENT: CAUSES, CONSEQUENCES, AND REFORM (1999) (reviewing government corruption throughout the world and efforts to eliminate corruption).

<sup>46</sup> See *The Honeycomb of Corruption*, ECONOMIST, Apr. 8, 2000, available at LEXIS, Banking, General News & Information (noting that \$2.4

taking of formerly public or collective property by current or former bureaucrats, is an especially large problem in Russia.<sup>47</sup> The issue is whether corruption is a problem of “property rights” or a problem of social institutions; in other words, is it an economic problem or a political problem? Corruption is a political problem because property rights are dependent on political institutions. This is evident in the transition from Communism, where property rights are an explicit political creation (including government-sponsored programs of property redistribution, as well as government acceptance of extra-legal property seizures), to a market economy.<sup>48</sup>

The 1997 Asian currency collapse and resulting economic crisis demonstrate the importance of institutions, rather than property, for economic performance and stability. One of the initial reactions to the crisis was to blame “Asian Crony Capitalism” and corruption for the panic.<sup>49</sup> The presence of restricted property rights, in terms of limits on foreign ownership, was seen as a crucial problem in the Asian economies; opening markets and allowing for ownership of domestic companies by international capital was the answer to this problem.<sup>50</sup> Yet, of course, corruption had existed in Asia for decades, decades in which Asia’s economies had grown so quickly that they were dubbed miracle economies, and there was no reason why corruption should suddenly cause economies to collapse.<sup>51</sup> In addition, many developing countries have corruption problems, but they did not suffer similar currency

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billion dollars had been embezzled from the government in the first half of 1999 alone).

<sup>47</sup> See NELSON & KUZES, *supra* note 10, at 50-53; also Galina Rakitskaia, *The Struggle for Property is a Struggle for Power in the Economy*, PROBS. OF ECON. TRANSITION, Sept. 1992, at 14, 23 (arguing bureaucratic privatization “constitutes direct, unconcealed robbery of the working people”).

<sup>48</sup> See NELSON AND KUZES, *supra* note 10, at 50-53.

<sup>49</sup> See Robert Wade & Frank Veneroso, *The Asian Crisis: The High Debt Model Versus the Wall Street-Treasury-IMF Complex*, NEW LEFT REV., Mar.-Apr. 1998, at 3, 7-8.

<sup>50</sup> See *id.* at 14.

<sup>51</sup> China’s economy is rife with corruption, but because of currency controls, China did suffer directly from the 1997 currency crisis. See Robert Wade & Frank Veneroso, *The Gathering World Slump and the Battle over Capital Controls*, NEW LEFT REV., Sept.-Oct. 1998, at 13, 22.

problems.<sup>52</sup> Better banking regulations have gained credence as the most likely way to prevent further crisis.<sup>53</sup> Clearly defined property rights do not necessarily contribute to sound economic policy, and they are not sufficient to insure economic success because they depend greatly on other institutions for their effectiveness.

### III. EMERGENCE OF TOWNSHIP AND VILLAGE ENTERPRISES

TVEs have emerged as an economic force in China's underdetermined legal context. Yet although rural industrialization, particularly the TVEs, is one of the great successes of China's capitalist-style reforms, its origins go back to one of the great debacles of utopian Maoism. During the Great Leap Forward (1958-1960), Mao called on every village (then-commune) in China to establish their own steel works, so-called "backyard furnaces."<sup>54</sup> The backyard furnaces of the Great Leap, for all their irrationality, are the direct ancestors of today's TVEs.<sup>55</sup> As both Mao and reform leaders have recognized, bringing industrialization to the rural areas is important as a means of absorbing surplus rural labor that is freed through more efficient farming techniques, minimizing migration to cities, increasing rural standards of living, and providing inputs which increase agricultural productivity.<sup>56</sup> Although backyard furnaces disappeared rather quickly, rural industry continued to exist under the commune system, forming the basis for post-Mao TVEs.

From 1977, there was rapid movement away from the communal system and towards family farming.<sup>57</sup> This transition was formalized in

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<sup>52</sup> Of course, many countries did catch the "Asian flu," but only Russia and Brazil suffered currency crises. See Wade & Veneroso, *supra* note 49, at 7-8.

<sup>53</sup> See, e.g., Louis Uchitelle, *A Crash Course in Economics: Rethinking What is Driving the Emerging-Markets Crisis*, N.Y. TIMES, Jan. 29, 1999, at C1, available at LEXIS, News (noting a growing consensus for new institutions to deal with globalization).

<sup>54</sup> MAURICE MEISNER, *MAO'S CHINA AND AFTER* 229-30 (1986).

<sup>55</sup> There was a certain amount of "proto-industrialization" in rural China before 1957, but the extent and importance of these industries requires more research. See Louis Augustin-Jean, *Rural Enterprises and the Law*, CHINA NEWS ANALYSIS, June 1997, at 2.

<sup>56</sup> See CARL RISKIN, *CHINA'S POLITICAL ECONOMY: THE QUEST FOR ECONOMIC DEVELOPMENT SINCE 1949* 117-9 (1987).

<sup>57</sup> Generally MAURICE MEISNER, *THE DENG XIAOPING ERA* 220-54

1984, when townships and villages replaced communes and brigades.<sup>58</sup> Industrial enterprises owned by the communes and brigades remained collectively owned, but now the owners were the towns and villages. Economic growth in rural China has been impressive by any measure. One such measure looks at the number of people employed in TVEs. In 1978, rural industry employed 28 million people, while, in 1995, 128 million people were employed in TVEs.<sup>59</sup>

A. *The Need for Rule of Law: the Property Rights Imperative*

There is a standard story about property reform and economic growth in China.<sup>60</sup> Often, the story is a response to a question such as: how is it that China's reforms have become one the century's great economic success stories while Russia and, to lesser or greater degrees, the rest of Eastern Europe, remain bogged down in post-Communist economic difficulties? Many social scientists and legal scholars have looked to the property rights regime in China for an explanation of China's success.<sup>61</sup> TVEs play an important role in this standard story. In China, reforms decentralized power to localities.<sup>62</sup> This decentralization allowed localities to gain control over certain property rights in TVEs, such as rights to profits.<sup>63</sup> Often, local officials "took" these rights from

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(1996).

<sup>58</sup> See *id.* at 2; also Russell Smyth, *Recent Developments in Rural Enterprise Reform in China: Achievements, Problems, and Prospects*, 38 *ASIAN SURV.* 784, 784 (1998), available at 1998 WL 13064627.

<sup>59</sup> See Louis Augustin-Jean, *supra* note 55, at 1.

<sup>60</sup> See Harry Williams, *Words Not Spoken: Recent Writings on Property and Change in China*, *BULL. OF CONCERNED ASIAN SCHOLARS*, July-Sept. 1993, at 34, 40-42.

<sup>61</sup> See *id.*; *supra* Part II.A.

<sup>62</sup> See Gabriella Montinola et al., *Federalism, Chinese Style*, 48 *WORLD POL.* 50, 50 (1995) (arguing that China's reforms are successful as a result of reasonably secure property rights emerging from political decentralization, and that this "Chinese style" federalism has been very effective in creating a reasonably secure property regime).

<sup>63</sup> See Victor Nee, *Organizational Dynamics of Market Transition: Hybrid Forms, Property Rights, and Mixed Economy in China*, *ADMIN. SCI. Q.*, Mar. 1992, at 1, 5.

central authorities in the face of opposition from Beijing; change occurred from the bottom up rather than the top down.<sup>64</sup> By securing these rights, localities had an incentive to make their enterprises efficient because they could keep part of their profits. In addition, a large number of enterprises were involved, so markets became an important force driving economic behavior.<sup>65</sup> Finally, local governments became dependent on TVEs for revenue. Competition, markets, and financial needs of local government combined to put hard budget constraints on these enterprises. To overcome these budget constraints, TVEs became havens of entrepreneurial activity, propelling China's economic growth and making China the most successful post-Communist economic actor.<sup>66</sup> In this story, which has many iterations, property rights play the crucial part in determining the success of TVEs.

Legal scholars and social scientists have studied the relationship between property and economic development for centuries.<sup>67</sup> China's emergence as an economic power over the past two decades has fueled much research and even more speculation about the relationship between property and economic growth in China,<sup>68</sup> particularly in China's rural enterprises, the TVEs.

From the perspective of neoclassical economics, China's TVEs will suffer from inefficiency because they lack clear property rights.<sup>69</sup> For some neoclassicists, all the aspects of ownership must be combined in one principal to insure efficiency;<sup>70</sup> for others, it is simply important that each

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<sup>64</sup> See generally DANIEL KELLIHER, *PEASANT POWER IN CHINA* (1992) (arguing that China's reforms are driven by grass-roots activities rather than top-down policy decisions).

<sup>65</sup> See Nee, *supra* note 63, at 1.

<sup>66</sup> See generally Jianhua Che & Yingyi Qian, *Institutional Environment, Community Government, and Corporate Governance: Understanding China's Township-Village Enterprises*, 14 J.L. ECON. & ORG. 1 (1998).

<sup>67</sup> See, e.g., PROPERTY: MAINSTREAM AND CRITICAL POSITIONS (C.B. Macpherson ed., 1978).

<sup>68</sup> See *supra* text accompanying notes 3-7.

<sup>69</sup> See BARZEL, *supra* note 33, at 16. Ambiguous property rights result in leaving some valued property in the public domain, where it is likely to be wasted. See *id.*

<sup>70</sup> See Cui, *supra* note 33, at 6-8.

right in the ownership bundle is clearly defined.<sup>71</sup> The absence of clearly defined TVE property rights has presented analysts with a problem; despite unclear property rights, however, TVEs have arguably been the most dynamic sector in China's extremely dynamic economy.<sup>72</sup> To explain the paradox of TVE growth in a situation of ambiguous property rights, academics have generally adopted one of three stances: that TVEs enjoyed transaction costs advantages partly because of their ambiguous property rights; that TVEs took advantage of cultural factors which, in turn, made the ambiguous property rights situation helpful rather than hurtful to growth; or that TVEs represent a new form of community-socialist property which allows for collective ownership and efficiency.<sup>73</sup>

#### B. *Transaction costs*

Transaction costs are central to neoclassical explanations of the Township and Village Enterprise phenomenon in China.<sup>74</sup> The argument is straightforward: TVEs have the advantage of reduced transaction costs, and this advantage can be explained through property rights and other tools of neoclassical economics.<sup>75</sup> In the post-Mao period, China's state firms remained tied first to a centralized plan and then to the political considerations of the center, and private firms faced political and popular backlash.<sup>76</sup> Collective firms, such as TVEs, maintained a middle ground.<sup>77</sup> Unlike state firms, TVEs are largely free from central plans and can devote their entire output to economic markets.<sup>78</sup> Yet, TVEs are

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<sup>71</sup> *See id.*

<sup>72</sup> *Cf.* David Zweig, *Rural People, the Politicians, and Power*, 38 CHINA J. 153, 159 (1997). According to David Zweig, "rural industry boomed in areas where decollectivization was slowest and where more resources remained in the hands of the local state, not private hands." *Id.*

<sup>73</sup> *See supra* Part II.A.

<sup>74</sup> *See Nee, supra* note 63, at 2.

<sup>75</sup> *See id.*

<sup>76</sup> *See id.* at 1.

<sup>77</sup> *See id.* at 4-6. Nee's explanation seems to ignore the tremendous range of TVEs in China, and focuses on former brigade and commune enterprise which retain their formally collective ownership status. *See id.*

<sup>78</sup> *See id.* at 1.

distinguishable from private enterprises in at least two ways. First, because local governments depend on TVEs for revenues and job creation, TVEs have political connections that allow them more security than private entrepreneurs.<sup>79</sup> Second, TVEs are “semi-socialist” and, therefore, not subject to confiscation.<sup>80</sup> Since community-owned TVEs are considered part of the government, they reduce their transaction costs by avoiding confiscation by government agents. Indeed, many TVEs are apparently private enterprises that have been registered as TVEs to gain the protection TVEs enjoy.<sup>81</sup> TVEs enjoy reduced transaction costs because they suffer from less government interference with their operations.

Yet, TVEs still face high costs for doing business. For example, local governments expect TVEs to contribute to “community welfare,” such as building schools, partly to reduce social tensions created by disparities in wealth.<sup>82</sup> Whether the reduction in central government interference outweighs the cost of local government interference is speculative. Increasing complaints about arbitrary local taxation, however, do call into question the transaction cost advantages of TVEs.<sup>83</sup>

### C. *Cultural explanations*

Some scholars posit that Chinese culture is the key to explaining TVE success.<sup>84</sup> In this context, TVEs are “vaguely defined cooperatives.”<sup>85</sup> The chief characteristics of these cooperatives are the deep involvement of the local government and an ill-defined legal system.<sup>86</sup> Despite ill-defined property rights, TVEs, however, are

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<sup>79</sup> *See id.* at 4-6.

<sup>80</sup> *See id.* at 3-4.

<sup>81</sup> *See Fujian Accelerates Rural Property Rights Reform* (Xinhua News Agency radio broadcast, Feb. 14, 1998) (transcript available at Foreign Broadcast Information Service (FBIS) file FBIS-CHI-98-044).

<sup>82</sup> *See Minchuan Yang, Reshaping Peasant Culture and Community: Rural Industrialization in a Chinese Village*, 20 *MOD. CHINA* 157, 169 (1994).

<sup>83</sup> *See infra* note 180.

<sup>84</sup> *See Xu, supra* note 6, at 79-80.

<sup>85</sup> *Id.* at 62-63.

<sup>86</sup> *See id.*



efficient.<sup>87</sup> Chinese culture explains this discrepancy between economic theory and empirical reality. Specifically, the Chinese propensity to solve conflicts “internally, without explicit rules, laws, rights, procedures and so forth”<sup>88</sup> has allowed TVEs to thrive in what is, from an economic and legal standpoint, a very difficult, ambiguous situation.

The cultural theory of TVE success is ultimately unsatisfactory. The theory is too vague and general to encompass the myriad TVEs existing in diverse villages throughout China today.<sup>89</sup> Cultural explanations require great specificity because culture is too broad a concept to have much explanatory power.<sup>90</sup> Finally, if the cultural theory hypothesis were correct, state-owned enterprises, which have very communal atmospheres,<sup>91</sup> would also benefit; yet, state industry has been an increasingly weak sector of China’s economy over the reform period.<sup>92</sup>

#### D. *TVEs as a new type of socialist property*

From the vantage point of neoclassical economics, the property rights of TVEs are murky. From another vantage point, TVE property rights are the harbinger of the “disaggregated” property that will be

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<sup>87</sup> *See id.* at 65.

<sup>88</sup> *Id.* at 79. Xu attempts to further bridge the gap between economic theory and cultural explanation by arguing that Chinese culture creates an environment that simulates a repeating game, while property rights theory has traditionally focused on single-play games. *See id.* at 80.

<sup>89</sup> For example, are factories in Shenzhen making shoes for Nike to export around the world really like a traditional Chinese village? For a general discussion of the diversity of TVEs within Chinese villages by a conservative critic of China’s economic reforms, see Zhimin Zhao, *Rural Collective Problems: Some Problems Facing the Rural Collective Economy*, ZHENLI DE ZHUIQIU [SEEKING TRUTH], Oct. 1997, at 19, available at <http://wnc.fedworld.gov> (Jan. 2, 1998) (doc. FBIS-CHI 97-364).

<sup>90</sup> Xu fails to provide this specificity. For an excellent example of debunking cultural explanations, see PATRICK SMITH, *JAPAN: A REINTERPRETATION* (1997).

<sup>91</sup> *See China’s Private Surprise*, *supra* note 1 (discussing the continuing problems of China’s state-owned industries). State-owned enterprises in China are “less an economic enterprise than a social institution.” ANDREW WALDER, *COMMUNIST NEO-TRADITIONALISM* 28 (1986).

<sup>92</sup> *See China’s Private Surprise*, *supra* note 1.

characteristic of a future progressive (or socialist) society.<sup>93</sup> Karl Marx had a simple vision of Communism: Communism sought the “[a]bolition of private property.”<sup>94</sup> Yet, the revolutions that Marx helped inspire had trouble putting that statement into practice. In China, issues arose such as whether socialist property required worker control at the factory level, Party control, or state control; whether control should be separated from ownership; what role should unions play; and whether there was a difference between land and other productive property.<sup>95</sup> The “abolition of private property” did not eliminate the property question, but simply restated it in different terms. Recognizing this, some scholars argue that rather than “abolishing” private property, “progressives”<sup>96</sup> need to break up the rights associated with property and vest these powers in different groups.<sup>97</sup>

The disaggregation of property rights is part of the democratization of the economy.<sup>98</sup> This disaggregation will take place in the course of a progressive decentralization of access to productive resources and opportunities, *i.e.*, the changing relationship of finance to production.<sup>99</sup> The goal is to lift up backward sectors of the economy, by improving not just consumption but also access to productive resources.<sup>100</sup> As reforms are deepened or radicalized, different property regimes will emerge. For example, public investment funds would become the center of a small

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<sup>93</sup> See MANGABEIRA UNGER, *supra* note 7, at 101-05.

<sup>94</sup> Karl Marx, *The Communist Manifesto*, in THE REVOLUTIONS OF 1848 80 (David Fernbach ed., 1973).

<sup>95</sup> See generally STEPHAN ANDORS, CHINA’S INDUSTRIAL REVOLUTION: POLITICS, PLANNING, AND MANAGEMENT, 1949-PRESENT (1977).

<sup>96</sup> Mangabeira Unger states that a progressive person today “insist[s] upon crossing the boundaries of the established institutional settlement in a democratizing direction.” MANGABEIRA UNGER, *supra* note 7, at 275.

<sup>97</sup> Indeed, some scholars argue that this breakup of property rights has already occurred. See Grey, *supra* note 31, at 71. Mangabeira Unger wants us to embrace this idea and use it to promote a more egalitarian economic system. See MANGABEIRA UNGER, *supra* note 7, at 273-75.

<sup>98</sup> See MANGABEIRA UNGER, *supra* note 7, at 5 (referring to the democratization of the economy as “democratic experimentalism”).

<sup>99</sup> See *id.* at 187-99.

<sup>100</sup> See *id.* at 40-41.

network of cooperative-competitive firms, and the rights to the capital would be pooled among firms in a much more intimate way.<sup>101</sup> The general thrust of reforms produces decentralization and democratization of opportunities and access to capital and productive resources, as well as a decentralized partnership between government and private parties.<sup>102</sup> In time, deals between firms and financial intermediaries would produce alternative regimes of property. These alternative regimes of property would continue to exist experimentally within the economy; thus, a single economy could contain multiple conceptions of legal property rights.<sup>103</sup>

What are unclear property rights from the perspective of neoclassical economics is, for progressive democrats, a democratization of the economy. At least on paper, TVEs seem to represent these new forms of property that are neither pure private property nor state property. Indeed, many TVEs have been converted to shareholding cooperatives, where ownership is divided between labor, state, and private groups.<sup>104</sup>

These reforms, however, lack any political or even rhetorical force to further or deepen them.<sup>105</sup> TVEs remain important as “an original form

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<sup>101</sup> *See id.* at 197-99.

<sup>102</sup> *See id.* at 196.

<sup>103</sup> *See id.* at 101-05.

<sup>104</sup> One reason for the qualified enthusiasm of progressive authors is that the largest and most important recent attempt to “corporatize” TVEs has created what is formally a novel form of corporate organization. *See Smyth, supra* note 58, at 795. Shareholding cooperatives (*gufen hezuozhi*), as this new form is known, have four main features. *See id.* The four main features are: 1) management and workers both bear risks; 2) each worker has about the same number of shares; 3) ballot-based decisions are determined on the basis of one-worker, one vote, not one share, one vote; and 4) profits are shared between management and works according to amount invested and performance. *See id.*

At least in theory, this new system clarifies the government’s relationship with the enterprise, gives workers better incentives, and helps raise funds. In a shareholding cooperative enterprise, employees are laborers as well as investors holding shares in the enterprise, and employees and management enjoy equal rights in managing the enterprise.

<sup>105</sup> “The material of institutional innovation is there lying all around, ready to be taken as a starting point for the development of an alternative. It remains, however, truncated by the consequences of a political paradox.” MANGABEIRA UNGER, *supra* note 7, at 105. The paradox is that, although the current Chinese regime stifles democratic economics, it also protects against the imposition of IMF-style neoliberal economic policies, policies that would

of association between government and ‘private’ initiative” that “show[] how quasi-public entities can compete and innovate in a market just as well as traditional Western-style firms.”<sup>106</sup> TVEs, however, are not viable alternatives to Western-style firms, partly because of the emphasis on Western-style property in the legal development of TVEs.<sup>107</sup>

#### IV. REGULATION AND LAWS OF TOWNSHIP AND VILLAGE ENTERPRISES

Like Western writers on TVEs, the Chinese government, led by their own Western-oriented economists, has focused on property rights in its TVE legislation.<sup>108</sup> This section outlines the development of TVE law, and Part IV presents evidence that this focus on property rights is misplaced.

##### A. Early Regulations

The first post-Mao regulations on TVEs, promulgated in 1984, clarified the rights and responsibilities of rural enterprises owned and operated by communes (and brigades which were subdivisions of the communes).<sup>109</sup> It was not until 1984 that Regulations were released that covered enterprises outside the commune system, and it was even later, in 1990, that the Ministry of Agriculture issued a full set of regulations governing TVEs.<sup>110</sup>

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undermine TVEs. *See id.*

<sup>106</sup> *Id.* at 106.

<sup>107</sup> *See supra* Part III.

<sup>108</sup> *See* Cui, *supra* note 33. Chinese economists, like their Western colleagues, have also used neoclassical economics to explain China’s transition. For instance, many Chinese economists accept the notion that there must be an “ultimate agent” to take care of the state’s property interest. *See* Zhang Chunlin, *Cunzi daode fengxian de weituo daili guanxi* [*Changing the Risk Allocation Between Principals and Agents*], JINGJI YANJIU [ECONOMIC RESEARCH], Aug. 1995, at 5-6, 8. Unfortunately, neither “the people” nor the state can properly fulfill the role of principal. From the perspective of Western property rights theorists, state-owned enterprises are inefficient. *See id.* at 6.

<sup>109</sup> *See* RISKIN, *supra* note 56, at 213-15.

<sup>110</sup> Che & Qian, *supra* note 66, at 4.

B. *1990 Regulation on Township and Village Enterprises*

The massive growth of TVEs in the late 1980s was followed, in 1990, by the promulgation of the Regulation on Township and Village Enterprises of the People's Republic of China ("1990 Regulations").<sup>111</sup> The 1990 Regulations were the most comprehensive legal regulation prior to the enactment of the 1997 Law on Township Enterprises ("1997 Law").<sup>112</sup> The 1990 Regulations were very much directed towards former commune enterprises, as is shown by its continued definition of TVE assets as owned collectively by all rural residents of the township or village.

Under the 1990 Regulations, the township or village ran the enterprise.<sup>113</sup> Ownership rights were exercised by the rural residents' meeting (or congress), or a collective economic organization that represented all rural residents of the township or village.<sup>114</sup> Ownership rights did not change when the enterprise entered agreements such as a managerial contract responsibility system,<sup>115</sup> leasing, or joint operations with enterprises of other types of ownership.<sup>116</sup> Townships and villages retained rights concerning spin-offs, mergers, relocation, and bankruptcy.<sup>117</sup> The enterprise retained at least sixty percent of the total net earnings and had power to determine the precise amount.<sup>118</sup> The enterprise used after-tax profits to develop production and upgrade technology, as well as to increase welfare and bonus funds.<sup>119</sup> The 1990

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<sup>111</sup> *See id.*

<sup>112</sup> *See id.*

<sup>113</sup> *See id.* at 4-5.

<sup>114</sup> *See id.* at 6.

<sup>115</sup> Under a contract management responsibility system, an enterprise manager contracts with the owner (usually the local or central government) for output, profits, and other targets, and is paid according to how well he or she fulfills these goals. *See* William A. Byrd, *Contractual responsibility Systems in Chinese State-owned Enterprises*, in *ADVANCES IN CHINESE INDUSTRIAL STUDIES* 18 (Nigel Campbell et al. eds., 1991).

<sup>116</sup> *See* Che & Qian, *supra* note 66, at 6.

<sup>117</sup> *See id.*

<sup>118</sup> *See id.* at 4-5.

Regulations mandated that “the part remitted to the owner of the enterprise should be used mainly for the support of construction of agricultural infrastructures, agricultural technology services, rural public welfare, renewal and transformation of enterprises, or development of new enterprises.”<sup>120</sup>

### C. *Persistent Problems of TVEs*

Despite their rapid growth, China’s TVEs face persistent difficulties, including slowing investment.<sup>121</sup> A Ministry of Agriculture report noted four main problems in the TVE sector.<sup>122</sup> First, TVEs invested without regard to market needs or possible returns, leading to over investment.<sup>123</sup> Second, poorly defined property rights led to performance and incentive problems.<sup>124</sup> Third, many TVEs suffered from poor management, high debt, poor quality and low efficiency.<sup>125</sup> Finally, excessive pollution had become a major problem with TVEs.<sup>126</sup> Other reports noted similar problems, such as low quality products, poor technology, and a lack of qualified technical personnel.<sup>127</sup> There were

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<sup>119</sup> The 1990 Regulations mandated that “the part remitted to the owner of the enterprise should be used mainly for the support of construction of agricultural infrastructures, agricultural technology services, rural public welfare, renewal and transformation of enterprises, or development of new enterprises.” *See id.* at 5. The inclusion of rural public welfare was an acknowledgment of the kind of community demands placed on TVEs. *See supra* Part II.A.

<sup>120</sup> *See id.* at 5 (citing 1990 Regulations art. 32, ch. 5).

<sup>121</sup> *See Total Investment in New Plan to Exceed 21 Trillion*, ASIAINFO DAILY CHINA NEWS, Apr. 19, 2000, available at LEXIS, General News & Information (noting the slow-down in economic growth in rural China).

<sup>122</sup> *See China: Township Enterprises Report: Full Text of the Ministry of Agriculture’s Report on the Situation of Township and Town Enterprises in China and Suggestions for Reform and Development in the Future* (XinhuaNews Service broadcast Apr. 23, 1997), available at <http://wnc.fedworld.gov/> (doc. FBIS-CHI 97-081) [hereinafter *Ministry of Agriculture’s Report*].

<sup>123</sup> *See id.*

<sup>124</sup> *See id.*

<sup>125</sup> *See id.*

<sup>126</sup> *See id.*

also problems of leadership succession; well-run collectives were having trouble finding replacement for aging leaders.<sup>128</sup> By the end of 1997, approximately 520,000 rural enterprises or one third of the total had been sold, annexed, declared bankrupt or transformed into shareholding cooperative companies.<sup>129</sup>

Given these problems, the solutions seemed relatively clear: separate administration from management, optimize operational and motivational mechanisms within enterprises, and increase the value of collective assets.<sup>130</sup> Put simply, "Township and town enterprises' ownership and autonomy in management should be protected by laws; units and individuals are prohibited to occupy the properties of township and town enterprises."<sup>131</sup> The method of achieving these goals was a new Law on Township Enterprises.

#### D. *1997 Law on Township and Village Enterprises*

Since many of the problems of TVEs were widely discussed in China in the 1990s, one would expect that the 1997 Law on Township Enterprises ("1997 Law"), which supplanted the 1990s Regulations, would address these problems. This, however, is only partly true. The 1997 Law largely followed the 1990 Regulations with few modifications, the most important being an emphasis on property rights, including private property rights. The 1997 Law, however, has not fundamentally changed the environment for TVEs or improved their performance.

The drafting of the final of version of the 1997 Law was very contentious.<sup>132</sup> Some members of the National People's Congress (NPC),

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<sup>127</sup> See Xia Jun, *China: Series on Township Enterprises (1): New Challenge and New Opportunities—Report from Township and Town Enterprises*, RENMIN RIBAO, Feb. 5, 1998, at 2, available at <http://wnc.fedworld.gov/> (doc. FBIS-CHI 98-043).

<sup>128</sup> See Zhao, *supra* note 89.

<sup>129</sup> See *China Saving Township Assets, State to Curb Drain of Capital*, CHINA DAILY, June 15, 1998, available at LEXIS, China, News.

<sup>130</sup> See *Ministry of Agriculture's Report*, *supra* note 122.

<sup>131</sup> See *id.*

<sup>132</sup> See ZHONGGUO XINWEN SHE [CHINA NEWS SERVICE], *Further Revisions to Draft Township Enterprise Law Proposed*, Oct. 29, 1996, available at <http://wnc.fedworld.gov/> (doc. FBIS-CHI 96-210).

China's legislature, sought to insert language giving workers more rights.<sup>133</sup> Others worried about pollution (township enterprises are notorious polluters). The majority of legislators, however, were most concerned that the law protects the interests of rural enterprises, including property rights, against encroachment by government entities.<sup>134</sup> The debate over the law was characterized by the normally understated official Chinese news service as "fierce."<sup>135</sup> In the end, the language on worker rights, as well as on pollution, was included. The law itself, as well as subsequent commentary, however, demonstrates that clarifying property rights was the most important innovation in the law.

Despite its focus on property rights, the 1997 Law did not solve most TVE problems; in fact, it may not have solved anything. Lu Guanqiu, the entrepreneurial chair of the Wanxiang Group, a Township Enterprise, stated that, by 1999, TVEs had entered a period of unprecedented difficulties.<sup>136</sup> The key to solving these problems is for "all levels of government" to create "a good and relaxed environment" for the development of TVEs.<sup>137</sup> Lu's solutions include increasing government support for TVEs and freeing TVEs from obligations such as welfare, health insurance, and vacation benefits; Lu, however, does not mention property rights.<sup>138</sup>

If the 1997 Law was not so different from the previous regulations, why was so much importance attached to it? The reason is a mistaken belief in the importance of property rights to TVE performance—a belief echoed back and forth between Chinese officials and academics and Western academics and institutions. Certainly, property rights are important; it is too early in the process of China's transformation, however, to emphasize property rights reform.

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<sup>133</sup> *See id.*

<sup>134</sup> *See XINHUA NEWS SERVICE, NPC Debate on Draft Law on Rural Enterprises said "Fierce": Draft Law on Rural Enterprises under Heated Debate*, Oct. 25, 1996, available at <http://wnc.fedworld.gov/> (doc. FBIS-CHI 96-208).

<sup>135</sup> *See id.*

<sup>136</sup> *See Xia Jun, Create Relaxed Environment for the Development of Township and Town Enterprises*, RENMIN RIBAO, Mar. 20, 1999, available at <http://wnc.fedworld.gov/> (doc. FBIS-CHI 1999-0326).

<sup>137</sup> *Id.*

<sup>138</sup> *See id.*



## V. AN ANALYSIS OF LEGAL CASES INVOLVING TVES

Legal reforms in the TVE sector have emphasized property rights,<sup>139</sup> but an analysis of legal issues published in the *China Township and Village Enterprise Daily* reveals that corruption, swindling, and crime are the crucial issues facing TVEs. Pushing property rights in this “wild west” atmosphere puts reform at risk of delegitimizing new forms of property.<sup>140</sup>

A. *Curbing Internal Enterprise Corruption and Deterring External Property Crime*

The following survey of legal issues in TVEs comes from the *China Township and Village Enterprise Daily (Zhongguo Xiangzhen Qiye Bao)*.<sup>141</sup> The author has classified news stories according to the following categories: taxes (encompassing both complaints about excessive taxes and problems with collecting taxes); agriculture (issues specifically dealing with land contracts or other agricultural issues); business and contracts, dealing with general business questions; worker issues, dealing both with workplace safety, wages, and labor contracts; general legal (often these are stories publicizing a certain law or how to navigate the legal system); women’s issues; criminal activity; corruption (by factory officials or government officials) and swindling (fraud by outsiders); and property rights and ownership.<sup>142</sup>

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<sup>139</sup> See *supra* Part III.

<sup>140</sup> See *supra* Part IV.B.

<sup>141</sup> The newspaper is published Monday through Friday in Beijing. At least twice each month, the newspaper publishes a full page of stories about legal issues facing TVEs. The section is called *Falu Guangjiao*. The stories analyzed here appeared in this section or on the front page of the paper.

<sup>142</sup> These categories are not meant to be scientific. For instance, it is impossible to tell where a fraud ends and crime begins, although violence belongs in the crime category. These categories are meant to be suggestive about the scope of legal problems being faced by TVEs and reported by the press. I have, however, cross-checked the data in a couple of ways. First, I read through several months of the *Sichuan Legal Daily (Sichuan Fazhi Bao, Jan.-May 1999)*; *Anhui Legal Daily (Anhui Fazhi Bao, Jan.-Mar. 1999)*; *Jiangsu Legal Daily (Jiangsu Fazhi Bao, Jan.-Mar. 1999)*; *Legal Daily (Fazhi Ribao, national legal daily published in Beijing, Jan., Feb., Apr., and May 1999)*; and the magazine *Democracy and Law (Minzhu yu Fazhi, July 1998-May 1999)*. I was looking specifically for articles related to TVEs, especially those that dealt with property issues. I found very few such articles, strengthening the general trend seen in

As the small number of reports dealing with property rights in the following chart shows, property rights are a minor legal issue in rural China today. This does not mean, however, that property rights are well-defined. Instead, it signals that property rights are a relatively small cause of problems for businesses

Type of Case	Number of reports	Percent of reports
Corruption and Swindling <sup>143</sup>	40	29.6%
Crime <sup>144</sup>	27	20.0%
General legal <sup>145</sup>	23	17.0%
Taxes <sup>146</sup>	14	10.0%

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*Township and Village Enterprise Daily.*

On the other hand, my results could be a by-product of government control of the Chinese press, with the government demanding that certain types of articles be published. I have discussed the selection of articles with editors and reporters from the *Township and Village Enterprise Daily*. According to these sources, the articles are chosen to be representative of typical problems facing courts and TVEs in rural China.

The method by which the newspaper obtains its stories underscores the importance and appropriateness of this newspaper as a source for determining the legal issues facing TVEs. Each county in China has a branch of the Ministry of Agriculture. These branches often have their own newspapers and/or legal staff. These reporters and staff send stories to the offices of the *Township and Village Enterprise Daily* in Beijing, whether or not they were published at the local level (I was not, however, able to read through the letters to check them against the stories published). This is the most complete collection of information on legal cases facing rural Chinese enterprises, and is thus the most appropriate source for determining the legal issues facing rural Chinese industry.

<sup>143</sup> Focused on corruption and swindling by government officials and managers.

<sup>144</sup> Focused on theft by force and violence against another person.

<sup>145</sup> Focused on general legal issues rather than specific cases, including explanations of how laws work and urging the further development of legal practices in TVEs.

<sup>146</sup> Included enterprises not paying taxes.

Business to Business Conflicts <sup>147</sup>	12	8.9%
Workers <sup>148</sup>	9	6.7%
Agricultural <sup>149</sup>	7	5.2%
Women's issues <sup>150</sup>	2	1.5%
Property rights <sup>151</sup>	1	.74%
Total	135	99.64%

A defender of the property rights approach may argue that corruption, swindling, and even some crime results from ill-defined property rights. This argument is misplaced, as demonstrated in the following case involving swindling.<sup>152</sup> Chen Guoping of Yan City, Jiangsu province was a former soldier.<sup>153</sup> The business he had set up after he left the army fared poorly and closed.<sup>154</sup> After this, he and several associates got a friend who was bank teller to fake deposits of hundreds of thousands of Yuan.<sup>155</sup> The false bank accounts allowed them to get a business license and to set up a shell company.<sup>156</sup> They used the shell company to swindle small amounts of money from a large number of victims, including small and medium-sized TVEs.<sup>157</sup> Many of these TVEs

<sup>147</sup> Included business-to-business problems, such as contract violations.

<sup>148</sup> Including workers' compensation for injuries on job.

<sup>149</sup> Focused on land use issues and other problems of farming.

<sup>150</sup> Focused on special problems women face.

<sup>151</sup> Focused on conflicts about ownership of enterprises.

<sup>152</sup> See Gen A, *Yi ge shuan bian xiangzhen qiye de pibao gongsi* [*The Shell Company of An Expert at Swindling TVEs*], ZHONGGUO XIANGZHEN YIYE BAO [CHINA TOWNSHIP AND VILLAGE ENTERPRISE DAILY], Dec. 16, 1998, at 3.

<sup>153</sup> *Id.*

<sup>154</sup> *See id.*

<sup>155</sup> *See id.*

<sup>156</sup> *See id.*

<sup>157</sup> The report does not specify what Chen did to get money from the

were struggling to make money, and Chen calculated that the difficulty and expense of launching a lawsuit would deter most of the fraud victims from pursuing the case.<sup>158</sup> Even if they did launch a suit, the inefficiency of China's court system would still protect Chen.<sup>159</sup> Although Chen and company were eventually caught, the money was apparently not recovered.<sup>160</sup> This is not a case of unclear property rights, but instead demonstrates a poor regulatory environment, as evidenced by the bank auditors' failure to catch the fake deposits and the poor business judgment on the part of the victimized TVEs.

The following situation provides a stronger case for theorists advocating that ill-defined property rights contribute to criminal problems; yet, even this case demonstrates that property rights reform may not deter such criminal activities. This case involves a man from Fujian Province, Minhou County, who was arrested for embezzling from his employer.<sup>161</sup> The man claimed that because the prohibition against embezzlement required the victim to be a Chinese company and because his employer, a foreign-invested TVE, was a "foreign" company, his actions did not constitute stealing.<sup>162</sup> Nonetheless, a court upheld the property and other rights of the TVE.<sup>163</sup> Chinese law protected foreign companies in such cases.<sup>164</sup> The employee's argument was a "typical" pleading in such cases. From this, it may be inferred that foreign companies that invest in TVEs suffer from ambiguous property rights. Such pleading, however, seems more likely to have been the result of a cynical attempt to play on nationalist emotions that unclear laws or property rights.

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TVEs, but it appears he offered services to TVEs that were never delivered.

<sup>158</sup> See A, *supra* note 152, at 3.

<sup>159</sup> See *id.*

<sup>160</sup> See *id.*

<sup>161</sup> See Zezhou Chen, *Wei zhao sheng yin zi pu shang hong de* [To get business investment spread out the red carpet], ZHONGGUO XIANGZHEN YIYE BAO [CHINA TOWNSHIP AND VILLAGE ENTERPRISE DAILY], Dec. 16, 1998, at 3.

<sup>162</sup> See *id.*

<sup>163</sup> See *id.* It is unlikely any county or province would risk foreign investment in the name of allowing a few employees to embezzle for their own benefit. See *id.*

<sup>164</sup> See *id.*

Corruption covers a large number of activities, including the diversion of property rights.<sup>165</sup> The following examples demonstrate how corruption differs from property rights cases listed in the chart. In one case, Xu Jingxin of Nontong City, Jiangsu Province falsified accounts of one TVE and a state company, stealing a total of 130,00 Yuan.<sup>166</sup> His status as a local government employee made this a case of corruption rather than embezzlement. In another corruption case in Linyi City, Shandong province, the secretary of the city and the chief of the Public Security Bureau had fifteen people beaten, repeatedly, in an attempt to monopolize the local wholesale market for a municipally-run company.<sup>167</sup> The officials also used punitive fines to run competitors out of business.<sup>168</sup> Neither of these cases arises from disputed property rights, but from the personal greed of a person in a position of governmental power.

Finally, the following criminal case demonstrates the differences between corruption, embezzlement, swindling and "crime." This case involved a man from Anyang, Henan,<sup>169</sup> who committed fifteen thefts of between 100 and 1000 Yuan in goods from various warehouses. The thief took a total of about 8000 Yuan of goods to sell on the black market.<sup>170</sup> This act constituted crime rather than corruption or embezzlement because (1) though the thief worked within the company, he was not a manager, and (2) he was stealing goods rather than changing accounts or stealing funds or using other methods of deception.

In all of these cases, the people who sought to swindle and defraud TVEs were counting on lax enforcement of existing laws rather than unclear property rights for the success of their gambits.<sup>171</sup> Given the

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<sup>165</sup> See NELSON & KUZES, *supra* note 10, at 53.

<sup>166</sup> See Xingzhu Ren, *Xu Jingxin bei yi shenpan chu 16 nian tuxing* [Xi Jingshen sentenced to 16 years in jail], ZHONGGUO XIANGZHEN YIYE BAO [CHINA TOWNSHIP AND VILLAGE ENTERPRISE DAILY], Jan. 20, 1999, at 3.

<sup>167</sup> See Lang Zhen, *Lin Yi qingchu shichang eba* [Lin Yi City's eliminates local market's tyrant], ZHONGGUO XIANGZHEN YIYE BAO [CHINA TOWNSHIP AND VILLAGE ENTERPRISE DAILY], Jan. 27, 1999, at 3.

<sup>168</sup> See *id.*

<sup>169</sup> See Fan Liuping & Wu Liping, *Faan bubao 16 ci bei dao* [Case of a 16-time Thief], ZHONGGUO XIANGZHEN YIYE BAO [CHINA TOWNSHIP AND VILLAGE ENTERPRISE DAILY], Jan. 27, 1999, at 3.

<sup>170</sup> See *id.*

<sup>171</sup> See *supra* notes 152-170 and accompanying text.

prevalence of these types of illegal activity in rural China today, it is not surprising that TVEs are more concerned about “being hustled” and having nowhere to turn for help than clarifying property rights.

### B. *Corruption, Legitimacy, and Property Rights*

For the past several years, the Chinese government has stressed the importance of the Rule of Law.<sup>172</sup> In rural China, the government’s Rule of Law initiatives are focused on two issues: clarifying property rights<sup>173</sup> and rooting out cadre corruption.<sup>174</sup> This section briefly sketches how the problem of corruption reinforces the notion that property rights reform should follow other legal reforms in the TVE sector.

Corruption<sup>175</sup> is a chronic problem in post-Mao China.<sup>176</sup> Periodic campaigns against corruption have had little effect,<sup>177</sup> and corruption has led to massive protests against the government.<sup>178</sup> Corruption is one of the main foci of legal life in rural China, accounting for fourteen percent of the cases in the *Village and Township Daily*.<sup>179</sup>

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<sup>172</sup> See Weicheng Wang, *China's Program of Action in Run Up to New Century--Several Points of Understanding of Comrade Jiang Zemin's Report to the 15th CPC National Congress*, RENMIN RIBAO, Sept. 23, 1997, at 9, translation available at <http://wnc.fedworld.gov/> (doc. FBIS-CHI-97-288) (Oct 15, 1997) (urging China to adopt rule of law).

<sup>173</sup> See *supra* Part III.D.

<sup>174</sup> See *infra* notes 179-180 and accompanying text.

<sup>175</sup> As defined in this paper, corruption is using a position of authority for personal gain. The Oxford English Dictionary defines corruption as “[p]erversion of a person’s integrity in the performance of (esp. official or public) duty or work by bribery etc.” 1 THE NEW SHORTER OXFORD ENGLISH DICTIONARY 518 (1993).

<sup>176</sup> See, e.g., *The Honeycomb of Corruption*, *supra* note 46, at 8.

<sup>177</sup> See, e.g., MEISNER, *supra* note 57, at 355 (noting armed peasant resistance to the government as early as 1985).

<sup>178</sup> For instance, the main focus of the demonstrators in the 1989 Democracy Movement was official corruption. See *What did Xu Wenli Actually Say?*, CHINA LAB. BULL., Jan.-Feb. 1999, at 7. Xu Wenli, an activist in the China Democratic Party, is convinced that mass layoffs and closures in China’s state industry, and the subsequent drastic drop in worker’s standard of living, can be blamed on corruption. See *id.*

<sup>179</sup> In the table, the author combines corruption with swindling, which

The government's priority in the rural areas is corruption by cadres, viewed as the prime cause of peasant protests.<sup>180</sup> Yet, the corruption TVEs face rarely disturbs enough people to cause a mass protest and is, therefore, not a priority for the government. The problem of "order" can be viewed from two different perspectives. The government seeks to use the Rule of Law to impose order on its cadres in rural areas and to prevent mass protests that could challenge government rule. For TVEs, however, the problem of order is less dramatic but equally pressing, and it involves both government corruption and non-government actors committing fraud, as well as the difficulty of prosecuting either type of case through the legal system. Although TVEs and the government both want the Rule of Law, they have different priorities. So, TVEs slowly bleed from the pinprick wounds of small-time corruption and fraud because the government is too busy trying to suture the larger lesions created by cadres cheating peasants.

Corruption cannot be separated from property rights and legitimacy.<sup>181</sup> A property rights regime must be stable in order to provide

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together make up thirty percent of the cases.

<sup>180</sup> One example of the type of corruption that the government most fears because it spurs peasant protests involves a lawsuit brought by 12,000 farmers in Shaanxi Province. *See Shaanxi Villagers' Grievance*, CHINA LAB. BULL., Mar.-Apr. 1999, at 9. The peasants filed the lawsuit claiming that the Chief Secretary of the Jia Wan Village Communist Party ordered that eight "arbitrary" taxes be collected from the villagers despite a severe drought in 1996. *See id.* When more than twenty peasants refused to pay the extra taxes, they were arrested. *See id.* The lawsuit was then filed on behalf of the whole village. *See id.* A court ruled three of the eight taxes invalid but that the farmers should not be compensated. The peasants are appealing the decision to the Shaanxi Province Higher People's Court. *See id.* The villagers are asking for a full rebate and reversal of the decision ordering them to pay court costs. Cases such as this are common, and their usefulness to the government is threefold. *See id.* First, the case alerts higher levels of the Party and state about a potentially volatile situation. *See id.* Second, it alerts the government to local government problems that might otherwise be covered up by local officials, in this case possibly a lack of funds to run basic services. *See id.* Finally, it helps the government discover genuinely corrupt officials. *See id.*

<sup>181</sup> Legitimacy can be defined as a reciprocal relationship between rulers and ruled whereby both believe in the right of the rulers to make and enforce rules and the obligation of the ruled to follow those rules. *See* T.H. Rigby, *Introduction to POLITICAL LEGITIMATION IN COMMUNIST STATES 1* (T.H. Rigby & Ferenc Feher eds., 1982).

incentives for economic development.<sup>182</sup> Rural China today, where corruption is rife,<sup>183</sup> presents the worst possible situation for establishing a new property regime. If the government pushes TVE privatization, corrupt officials and others with ill-gotten wealth will end up with the lion's share of TVE property.<sup>184</sup> These officials, who gained their power and wealth on the basis of political or criminal acuity rather than economic success, are hardly well-placed to help TVEs out of their current slump.<sup>185</sup> Rural Chinese, already turning out for frequent demonstrations against corruption,<sup>186</sup> are likely to view a property regime that emerges from this situation as illegitimate.<sup>187</sup> Prioritizing property reform in this corrupt atmosphere thus poses the risk that the new property regime will be challenged repeatedly after its establishment. A stable and legitimate legal system must begin functioning in rural China before property rights are permanently assigned in order to insure that the new property regime is widely recognized as a legitimate distribution of economic power.

## VI. CONCLUSION

Order, not property rights, is the main issue facing rural Chinese enterprises today. This is the conclusion that must be drawn from reported cases and interviews with reporters and TVE managers. The government and TVE managers have different conceptions of the Rule of Law and different definitions of "order." The government focuses on containing protests, while TVE managers focus on the need for stable business law, such as enforcement of contracts. Ideally, the sequence of change towards the Rule of Law should be determined by events "on the ground" and

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<sup>182</sup> See generally Cass R. Sunstein, *On Property and Constitutionalism*, 14 CARDOZO L. REV. 907 (1993) (stating that a property regime's creation of stable expectations crucial to economic growth and democracy).

<sup>183</sup> See *supra* notes 176-179 and accompanying text.

<sup>184</sup> This was the situation in Russia. See NELSON & KUZES, *supra* note 10, at 50-53 (describing the illegitimate seizure of property by corrupt Russian officials).

<sup>185</sup> See, e.g., *New Years Resolutions*, ASIaweek, Jan. 14, 2000, at 22, available at LEXIS, Asiaweek (noting that corruption in Indonesia poses a barrier to economic growth).

<sup>186</sup> See *supra* notes 176-179 and accompanying text.

<sup>187</sup> See NELSON & KUZES, *supra* note 10, at 50-53 (describing the illegitimate seizure of property by corrupt Russian officials).



reflect the real needs of rural entrepreneurs rather than the tenets of Western social science theory. The property question, that is, what property rights regime is best for China, surely lies before rural China, but the answer to this question will be better answered after order is established. If property rights are set in the corrupt, chaotic atmosphere of rural China today, the results are likely to be unfair and lead to further unrest, helping neither TVEs nor the government.

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