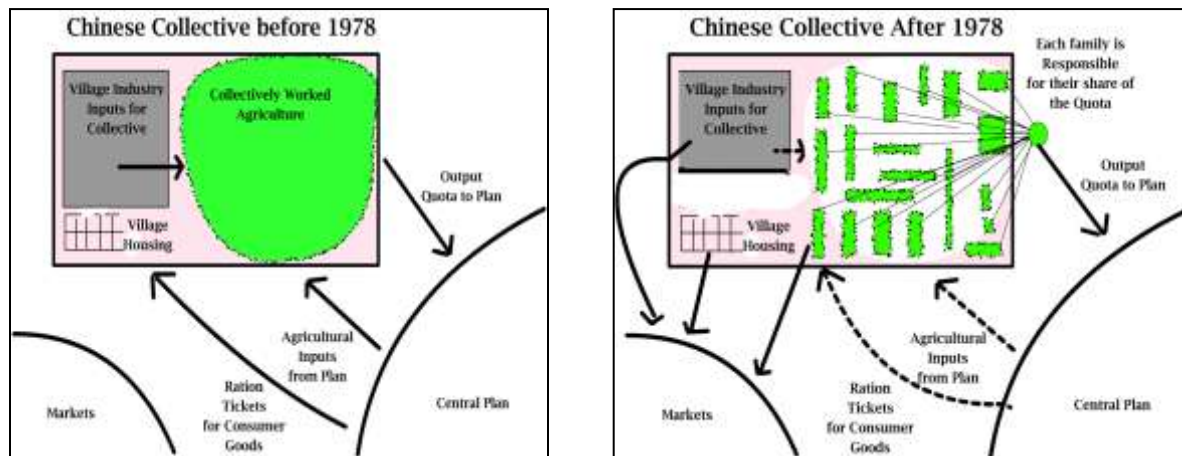


Town and Village Enterprise (TVE)



1. The initial reforms (1978) leading to TVE growth
 - a. Before reform started in 1978, local townships operated industries that served to provide inputs to their collective agricultural production. A township enterprise might manufacture bricks to be in irrigation control, produce fertilizer, or repair machinery and tools. However, before 1978, these township enterprises did not have access to the market.
 - b. In 1978 reforms were introduced allowing
 - i. collectives to allocate (limited) rights individual agricultural land to households under the family responsibility system.
 - ii. Households and township industries to sell “out of plan” production to local markets at market clearing prices.
 - iii. townships to experiment with different ways to organize production (within limits....no privately owned property)

Table 1 China: Shares of Industrial Output Value by Ownership (1978–1993)

	1978	1993	Changes between 1978 and 1993
State-owned enterprises (SOEs)	77.63%	43.13%	–34.50%
Nonstate-owned enterprises	22.37%	56.87%	34.50%
Urban nonstate enterprises	13.28%	10.42%	–2.86%
a. Urban collectives	13.28%	9.72%	–3.56%
b. Urban individuals	0.00%	0.70%	0.70%
Rural enterprises	9.09%	36.29%	27.20%
a. Township enterprises	5.05%*	14.23%	9.18%
b. Village enterprises	4.04%*	12.25%	8.21%
c. Household groups	0.00%	2.21%	2.21%
d. Individual households	0.00%	7.60%	7.60%
Others (large private, foreign, joint ventures, stock companies, etc.)	0.00%	10.16%	10.16%
Total	100%	100%	0%

* Estimated

Source: *Statistical Yearbook of China, 1994* 373,375

- c. Since the township and village industries already existed at the start of the reforms, villages were partially set up to respond quickly in response to new market opportunities.
 - i. For some products, the state industry sold their output at high (monopolistic) prices ($P > MC$) that invited entry by TVES.
 - ii. For other products, there was excess demand (from the plan production at the state price) that TVEs could serve.
 - iii. Other areas were completely unserved by the plan and were wide open for new TVE supply.
 - iv. Another part of the reform strategy was ‘growing out of the plan’. This strategy implied that the state owned enterprise (producers of planned output) would not grow in absolute terms and would decrease in relative terms. (See table above). This strategy also allowed SOEs to “out-source” some of their production to TVEs. This entry path was especially open to townships close to large industrial centers like Shanghai.
- d. The reforms allowed townships to experiment with alternate ways to organize their production and so there is no single description of these TVEs. However, some common characteristics are
 - i. Ownership is at the community level. There are no individual share owners and shares cannot be bought or sold. Households that migrated to work in the urban sector and failed to fulfill their “family responsibility” would lose any rights of township membership. This constrained rural to urban mobility.

- ii. Profits remained in the community to be (1) reinvested in the TVE and (2) allocated to community social welfare (schools, housing, parks, and income support for the disadvantaged...)
- iii. TVEs could use official channels to access credit from the Agricultural Bank of China. Private enterprise did not have this access.
- iv. TVEs did not receive bailouts from the central government. SOEs would receive bailouts so that they would survive to maintain employment in the planned sector. This meant that TVEs faced “harder budget constraints” than SOEs. However, as with any large organization, managers could divert some of the TVE resources (cars, banquets, trips to the city) for their own benefit.
- v. TVE operations were officially supported by the central government and faced low risk that their community level property rights would be taken away in the future. The rights of privately owned firms were not secure during this period. This made in private enterprise more risky.
- vi. TVEs responded to market signals and were not constrained by the central plan to serve specific clients with specific products using a planned production technology.
 1. TVEs chose to enter sectors where production was more labor intensive since they were well endowed with underemployed labor.
 2. TVEs responded to profit opportunities as signaled by market prices. They were already established at the start of the reform and were quick to enter the market where the state prices were set monopolistically high and in market niches not served by the SOEs.
 3. In product markets TVEs faced competition. Competition forced the TVEs to adapt their product mix to better fit changing market demands. On the input side (community labor and investment) the TVE needed to compete against other TVEs in the same community for community level resources, much as different divisions of a corporation would compete against each other for corporate resources.
 4. TVEs in southern China made use of foreign (Hong Kong, Singapore,...) relationships to link to international market opportunities.
- e. TVEs compared to SOEs: From an economic efficiency standpoint TVEs had many advantages over SOEs in the planned sector:
 - i. Production technique based on resource endowments (labor intensive rather than capital intensive).
 - ii. Output based on market prices and costs rather than fixed according to plan. TVEs could expand if $P > MC$, contract if $P < MC$.
 - iii. Provide output to markets not well served by the plan.
 - iv. TVEs faced harder budget constraints and fewer resources were diverted to non productive activities.
 - v. TVE’s organizational form was more flexible and allowed more experimentation

- f. TVEs compared to Private Enterprise: Despite the usual efficiency attributes of private enterprise, during this period TVEs had the advantage due to:
 - i. Limited and uncertain property rights for private ownership during this period.
 - ii. Restricted access to capital markets during this period.

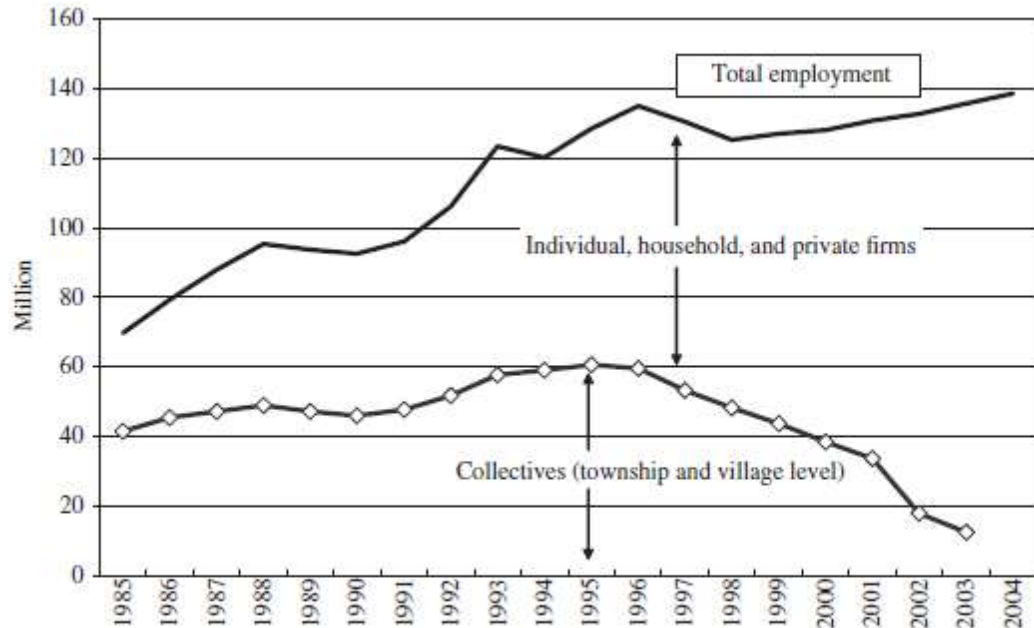


Figure 12.2
TVE employment

- 2. As we can see from Figure 12.2, the “golden age” of the TVE ended about 1996. From 1978-1995, TVEs were a main source of employment growth. After 1995 TVEs became successively less important. While we can’t identify one “smoking gun” that killed the TVE, there were several changes that reduced the benefits of the TVE compared to other more “privatized” producers. Since the Chinese government shies away from the term “privatized” the switch is called “restructuring”. What changed in the economic environment? The text (around pages 285-290) identifies a few factors.
 - a. Increased competition for inputs
 - i. Access to the state run financial markets (e.g. Agricultural Bank of China) was tightened. Allocation of loans was more closely aligned to the ability to repay. This decreased the advantage that TVEs had over private firms.
 - ii. Barriers to mobility decreased allowing skilled workers and managers access to higher paying employment in the urban sector. This increased costs for TVEs and made more resources available for the private sector.

Table 12.2
TVE employment by ownership, 2003

	Million	Percent
Domestic capital enterprises	128.4	94.6
Private firms	38.7	28.5
Other	31.0	22.8
Individually run	29.9	22.0
Collective	12.4	9.1
Limited liability	10.3	7.6
Stock cooperatives	3.7	2.7
Joint stock	1.8	1.3
Jointly operated	0.7	0.5
Hong Kong/Taiwan invested	4.9	3.6
Foreign invested	2.4	1.8
Total	135.7	100.0

- b. Property rights of “restructured” (more privatized) firms became more secure. Existing TVE ownership shifted to more closely resemble private enterprise facing even harder budget constraints and not burdened by employment and social welfare obligations to the township.