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Different Approaches in Two Regions

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# STATE POWER, ELITE RELATIONS, AND THE POLITICS OF PRIVATIZATION IN CHINA'S RURAL INDUSTRY

## *Different Approaches in Two Regions*

\_\_\_\_\_ Jianjun Zhang  
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### Abstract

By comparing “manipulated” privatization in Wuxi and relatively “transparent” privatization in Wenzhou, this paper analyzes the *politics* of privatization in Chinese rural industry. It argues that power relations between government and people, and elite relations between leaders and managers, determine who was included and who was excluded in the process.

Keywords: state power, elite relations, privatization, China

### Introduction

China's rural industry, in particular township and village enterprises (TVEs),<sup>1</sup> was once acclaimed as an alternative to the mass privatization programs initiated in other transitional economies.<sup>2</sup> Rural industry's contribution to China's national gross industrial output rose from about 10% in 1979 to about 40% in 1996; the sector created about

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1. William Byrd and Qingsong Lin, eds., *China's Rural Industry: Structure, Development, and Reform* (New York: Oxford University Press, 1990).

2. Chenggang Xu, *A Different Transition Path: Ownership, Performance, and Influence of Chinese Rural Industrial Enterprises* (New York: Garland Publishing Inc., 1995).

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five million new jobs annually between 1978 and 1996.<sup>3</sup> However, the truly distinctive feature of TVEs is their form of ownership: they are rural public firms owned and controlled by community governments (at either township or village level).<sup>4</sup>

In the mid-1990s, however, TVEs encountered serious setbacks stemming from increased competition, a tighter credit policy, and internal deficiencies associated with public ownership.<sup>5</sup> External political and ideological constraints unfavorable to the private economy were also relaxed. Community governments thus engaged in massive privatization of TVEs. As with their unexpected emergence, the privatization of TVEs was also initiated from below: local and community governments acted without direction or guidance from the central government.<sup>6</sup> The process was thus called a “quiet revolution.”<sup>7</sup> Locally initiated privatization resulted in regional variation: different regions privatized TVEs differently based on local conditions.

This article analyzes the politics of privatization of TVEs by comparing different privatization methods in two regions: “manipulated” privatization in Wuxi versus relatively “transparent” privatization in Wenzhou. While privatization in Wuxi was carried out through secret deals between powerful players—government leaders and TVE managers—without the participation of other stakeholders, Wenzhou’s privatization was implemented more or less transparently and the relevant stakeholders were included in the process.

The irony is that Wuxi was a socialist stronghold both during the socialist period and in the reform era, while Wenzhou was on the periphery of socialism and witnessed capitalist development after the reform. Why did

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3. Jean Oi, “The Decades of Rural Reform in China: An Overview and Assessment,” *China Quarterly*, no. 159 (September 1999), pp. 616–28.

4. Hehui Jin and Yingyi Qian, “Public Versus Private Ownership of Firms: Evidence from Rural China,” *Quarterly Journal of Economics* 113:3 (August 1998), pp. 773–808.

5. James Kai-Sing Kung, “The Evolution of Property Rights in Village Enterprises: The Case of Wuxi County,” in *Property Rights and China’s Economic Reform*, eds. Jean Oi and Andrew Walder (Stanford, Calif.: Stanford University Press, 1999), pp. 95–120; Hongbin Li, “Government’s Budget Constraints, Competition, and Privatization: Evidence from China’s Rural Industry,” *Journal of Comparative Economics* 31 (September 2003), pp. 486–502; Albert Park and Minggao Shen, “Joint Liability Lending and the Rise and Fall of China’s Township and Village Enterprises,” *Journal of Development Economics* 71:2 (August 2003), pp. 497–531.

6. The decentralized nature of privatization is also noted by Hongbin Li and Scott Rozelle, “Privatizing Rural China: Insider Privatization, Innovative Contracts, and the Performance of Township Enterprises,” *China Quarterly*, no. 176 (December 2003), pp. 981–1005.

7. Yi Shi and Xiaojian Zhao, “Sunan Yuyan” [Sunan tale], *Caijing* [Finance], no. 5 (May 2001), pp. 33–50.

socialist Wuxi implement nontransparent privatization while capitalist Wenzhou took a more transparent and thus more egalitarian approach to privatization? The paper will show that the unevenness of privatization is a product of local politics and institutional legacies, originated from the socialist period and strengthened by different development patterns after the reform. Specifically, different configurations of power relations between government and the people, and relationships between economic elite and political elite, determine what kind of privatization policy was adopted and successfully implemented.

It is hardly surprising that privatization involves politics. But so far, few studies of TVE privatization have paid enough attention to political factors. The existing literature concentrates on the reasons for privatization,<sup>8</sup> how the process affected the performance of firms,<sup>9</sup> and other effects of privatization. Few studies explore how privatization was carried out and why it took the forms it did. This paper will try to fill this gap.

The two regions selected represent two prototypical development patterns in China after the reform. Wuxi, in the southern part of the eastern province of Jiangsu, was the heartland of publicly owned TVEs after the reform, a place where local governments played a dominant role in economic development.<sup>10</sup> By contrast Wenzhou, to the south of Jiangsu in Zhejiang Province, witnessed rapid development of private business while local government played only supporting and complementary roles.<sup>11</sup> But publicly owned TVEs also existed in Wenzhou.

The data presented here come from the author's fieldwork in the two regions in 2001 and 2002, totaling 11 months. With the help of some well-connected and influential friends, I was able to gain access to a comprehensive list of privatized firms and other relevant information in several towns and villages in Wuxi city, Zhangjiagang County, and Kunshan County in Sunan,<sup>12</sup> and Cangnan County, Rui'an County, and Yueqing County in Wenzhou. Altogether about 100 informants were interviewed,

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8. Kung, "Evolution of Property Rights"; Li, "Government's Budget Constraints"; Park and Shen, "Joint Liability Lending."

9. Li and Rozelle, "Privatizing Rural China."

10. Kung, "Evolution of Property Rights"; Susan Whiting, *Power and Wealth in Rural China: The Political Economy of Institutional Change* (Cambridge: University of Cambridge Press, 2001).

11. Peter Nolan and Dong Furen, eds., *Market Forces in China: Competition and Small Business—the Wenzhou Debate* (London: Zed Books, 1990); Alan Liu, "The 'Wenzhou Model' of Development and China's Modernization," *Asian Survey* 32:8 (August 1992), pp. 696–711, *passim*.

12. Sunan, literally southern Jiangsu Province, includes Suzhou, Wuxi, and Changzhou. These areas followed a similar pattern of development and had similar experiences in privatization. This paper mainly discusses Wuxi to keep focus.

some of them several times, and many offered unusually candid accounts of the privatization process. Purposive sampling was used to select informants, targeting the major stakeholders in TVEs during privatization, including government officials, TVE managers, workers, community residents, and bank officials. Extensive interviews were used as the major data collection method, with archival data and local statistics as complementary sources.

The paper is organized as follows. It first compares the different approaches to privatization in the two regions. Then it discusses the explanations of why privatization took the form it did, as provided by local officials, and the problems with those explanations. Then, it offers an alternative explanation: local power relations are the fundamental reason for differing privatization approaches. The conclusion summarizes the main findings and discusses the implications for socialist transition.

### Manipulated Versus Transparent Privatization

Privatization simply refers to the practice of transferring public ownership of assets to private individuals. In China, privatization is called *zhuanzhi*, which literally means that one system (public ownership) is “transformed” into another system (private ownership). *Zhuanzhi* from the mid-1990s finalized asset transfer from public ownership to private individuals.<sup>13</sup>

#### *Privatization: Wuxi*

Beginning in the mid-1990s, community governments in Wuxi privatized TVEs under their own official supervision. They first privatized small and unprofitable TVEs, then quickly decided to privatize all public firms. Many places even subjected the process to a strict timetable, treating privatization like a political campaign. In one town, for example, the town government planned to privatize at least 80% of its TVEs by the end of 1997, 95% by the end of 1998. Under such circumstances, the ownership of many TVEs changed hands within a very limited time period. In terms of scale and speed, the privatization in this region can be compared to the mass

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13. *Zhuanzhi* underwent two rounds in some enterprises in Wuxi. The first round transformed TVEs into shareholder cooperatives, a measure roughly equivalent to management-employee buyouts. In this arrangement, managerial personnel and workers all have to buy shares of their enterprises based on their rank in the enterprise. Local governments also held a certain proportion of shares. But this measure proved to be only transitional and temporary. Shortly after, the second round of privatization completed the change of ownership by concentrating shares among new owners. This study mainly discusses the final process of privatization.

privatization, aka “shock therapy,” in some East European countries and Russia.

Privatization in Wuxi was carried out in a nontransparent way. Local governments sold enterprises almost exclusively to the incumbent managers without allowing the participation of other stakeholders. Theoretically, there should be five relevant stakeholders when an enterprise is privatized: local government as the de facto owner; the manager; workers; community residents as nominal owners; and banks, if the enterprise has debts. But in reality, the process was a two-player game between government leaders and enterprise managers.<sup>14</sup> The remaining players—workers, community residents, and banks—were shut out.<sup>15</sup> In most places, only key leaders such as the party secretary and government head had any say in making decisions. Not surprisingly, nontransparent privatization gave rise to closed-door manipulation and bargaining between powerful players, which tremendously benefited incumbent managers, and possibly leaders as well through the collection of bribes.

Take Wutao town<sup>16</sup> as an example to illustrate the process, as I have complete and specific information about privatization there. When an enterprise undergoes privatization, this is the typical procedure. First, government leaders, after discussion with the incumbent manager, decide the method and timing of privatization. Usually, the incumbent manager will be the first candidate to be considered for ownership. Only when the manager is reluctant to take over the enterprise do local leaders consider alternatives. The possible methods of privatization include total sale (complete privatization); partial sale and lease (selling machinery and moving capital, and leasing land and factory buildings); and lastly, total lease.

Then, a ritualized process of asset evaluation is undertaken.<sup>17</sup> The Town General Industrial Corporation—a local government branch responsible for TVE affairs, together with an invited certified public accountant (CPA)

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14. When studying employee share ownership in privatized firms, Dong et al. also noticed that local leaders and enterprise managers determine who could buy and how much they can buy. Xiaoyuan Dong, Paul Bowles, and Samuel Ho, “The Determinants of Employee Ownership in China’s Privatized Rural Industry: Evidence from Jiangsu and Shandong,” *Journal of Comparative Economics* 30 (June 2002), pp. 415–37.

15. Changing lending preferences of banks and tightened credit policy are part of the triggering forces for privatization (see Park and Shen, “Joint Liability Lending,” *passim*), but banks were shut out during the privatization process. Managers and local leaders colluded to evade bank loans, as banks are owned by the central government. See Shi and Zhao, “Sunan Tale.”

16. Names in Wuxi are anonymous.

17. Hui Qin, “Shizi Lukou Kan Xiangqi” [Viewing TVEs at the crossroad: Report on privatization], *Gaige* [Reform], no. 6 (December 1997), pp. 105–15.

agency, takes charge of this process. Asset evaluation is typically based on a firm's book value of tangible assets and debts. The process is neither serious nor accurate, for two reasons. First, Wutao town privatized many enterprises at the same time and thus lacked the ability to carefully monitor everything. Second, account books were subject to manipulation by managers. On the one hand, it is almost certain that incumbent managers would get the enterprises; on the other, the final deal was based on asset evaluation. Thus, managers were motivated to manipulate their accounts, overstating liability and understating assets and profits. According to many informants, manipulation was widespread. The final deal was largely dependent on how "smart" the incumbent manager was in manipulation.<sup>18</sup> Based on the results of the asset evaluation and continued bargaining between government leaders and firm managers, the final buyout price is determined.<sup>19</sup> After the two sides reach an agreement, the town government and the new owner sign all paperwork, finalizing the privatization process. Table 1 describes who obtained enterprises and at what prices in Wutao town. It shows that incumbent managers were the main winners in privatization. Wutao town transferred all township enterprises except one to incumbent managers. In all villages studied, the result was similar. In other words, managerial buyout, or insider privatization, was the prevalent result of privatization in Wuxi.

Table 1 also shows how cheaply the incumbent managers purchased the enterprises. The fixed-asset amount indicates approximately the scale of an enterprise, while buyout price indicates how much the new owner paid (if the figure is positive) or how much debt the local government had to assume from the new owner (if the figure is negative). For privatizing its 18 township enterprises with total fixed assets of 112.99 million yuan (\$13.65 million<sup>20</sup>), the town government only collected 2.73 million yuan (\$0.33 million). Among 16 enterprises for which information about asset liability was available, seven had a net liability after all assets were offset, which means that the town government had to take responsibility for some debts after transferring all assets to the new owners.

Among the stakeholders, workers were the biggest losers. As direct stakeholders, they were not allowed to participate in the process, nor were they consulted. Their interests were thus sacrificed and no compensation was made to them. Though there is no solid legal ground for workers to claim compensation, they had socially legitimate reasons to assert their interest

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18. Shi and Zhao, "Sunan Tale."

19. See Li and Rozelle, "Privatizing Rural China," for a more detailed description about the process.

20. Currency conversion is based on the official exchange rate in the corresponding year.

TABLE 1 *Basic Information of Zhuanzhi of Township Enterprises, Wutao Town, Wuxi* (unit for asset and buyout price: 10,000 yuan)

<i>Case</i>	<i>Time of Zhuanzhi</i>	<i>Who Got the Enterprise</i>	<i>Fixed Asset</i>	<i>Buyout Price*</i>
1	98.3.25	Manager	772	210.53
2	98.3.25	Manager	1,328	-858.71
3	99.4.1	Manager	1,205	-329.75
4	2000.6	Sales manager	3,862	Almost bankrupt
5	98.3.25	Manager	442	460
6	97.10.20	Manager	204	12.08
7	97.10.20	Manager	66	NA
8	97.10.20	Manager	373	-82.64
9	97.8.8	Manager	1,984	260.74
10	97.12.31	Manager	212	333.44
11	97.12.31	Manager	141	242.87
12	97.11.1	Manager	337	-69.58
13	97.9.8	Manager	13	23.20
14	97.1.1	Manager	276	85.70
15	97.10.1	Manager	18	6.16
16	97.2.1	Manager	14	-9.34
17	97.4.1	Manager	44	-13.62
18	97.10.1	Manager	8	NA
Sum			11,299	273.08

SOURCE: Author's fieldwork.

\*Buyout price refers to the price at which the new owner purchased the firm.

because TVEs were originally built upon collective accumulation.<sup>21</sup> As a matter of fact, the issue of compensating workers was not raised at all. When asked about compensation, one informant immediately expressed his surprise: "Compensation? No. Not at all. Nobody has ever mentioned this."<sup>22</sup>

#### *Privatization: Wenzhou*

In contrast, privatization in Wenzhou is significantly different. Wenzhou adopted a case-by-case method to privatize its TVEs in a relatively transparent way. First, various options were offered for discussion among enterprise

21. Kung, "Evolution of Property Rights." Collective accumulation refers to capital accumulation from various sources such as surplus from collective agriculture, low compensation, and welfare during the socialist period, which should be owned by all community residents, theoretically.

22. Interview with a town official in Wuxi, August 2001.

employees before any final decision was made. Second, once it was decided that an enterprise was to be sold, an open auction was conducted (in some cases): thus, competition for ownership exists. Finally, workers are compensated according to the years they had worked in the enterprises.

Take Hongqiao town as an example. In Wenzhou, Hongqiao developed the most famous collective sector in the 1980s, when the TVE model was acclaimed nationally.<sup>23</sup> This is why I take this town as example: it has had rich and notable experience in privatization.<sup>24</sup> From 1993 on, after Deng Xiaoping's "Southern Tour" relieved political and ideological discrimination against private business, Hongqiao began gradually privatizing its TVEs. By the end of 2001, Hongqiao had privatized all its township enterprises except two. In general, the process was transparent. Before privatization of an enterprise, options were offered for discussion. For instance, when a town enterprise was undergoing privatization in 2001, three options (shareholder cooperative, lease, and sale) were raised for discussion. The Town Enterprise Management Office convened several meetings of all employees to discuss the options and even conducted a survey to investigate workers' attitudes. The manager of another township enterprise confirmed the importance of getting workers' approval before privatization. According to him, his enterprise had been in bad shape for many years but was difficult to privatize because "according to the Union Law, only after 70% of all workers agree, could it be privatized. Now even the party committee in the enterprise does not agree, let alone the workers."<sup>25</sup>

Privatization could be implemented only after general agreement (on whether and how to privatize) among all stakeholders was reached. If stakeholders agree to choose outright sale as a method, then an open bid was taken (under some circumstances, as when there are many competitors or the town government does not want to be challenged), although the bid was usually limited to insiders working in the enterprise.<sup>26</sup> When the Milk Product Factory was privatized in 1994, for example, the manager and two associate managers competed. At the end, the enterprise was sold at 4,151,688 yuan (\$490,685) with the manager winning the bid, one million yuan (\$118,189) higher than the starting bid. The new owner was required to provide some mortgages and finish the whole payment in three years.

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23. Shunpeng Zhao and Zhixi Zhu, *Chaoqian yu Liebian* [Pioneers and change] (Hangzhou: Zhejiang University Press, 2000).

24. What I observed in Hongqiao is also supported by my research in Cangnan, Rui'an, etc., and by the findings of local researchers. See *ibid.*; and Zheng Yun, ed., *Wenzhou zhi Lu* [Wenzhou road] (Beijing: Guangming Daily Press, 2000).

25. Interview in Wenzhou, November 2001.

26. The reasons for this include the government's concern for smooth transition, insiders' information advantage, and gaining support from insiders because they are direct stakeholders.

TABLE 2 *Main Differences in the Privatization between Wuxi and Wenzhou*

	<i>Wuxi</i>	<i>Wenzhou</i>
Scale	Mass privatization	Gradual, case by case
Transparency of the process	Full of manipulation, nontransparent	Somewhat transparent
How new owner is chosen	Close door negotiation between leaders and incumbent managers	Open bidding inside enterprise
Worker participation	No	Yes
Worker compensation	No	Yes

SOURCE: By author.

The town government then uses part of the money collected from the sale to compensate workers according to their years of work in the enterprise. For example, workers in the Milk Product Factory got compensation ranging from 10,000 yuan (\$1,812) to 30,000 yuan (\$3,546) based on their length of work. After compensation, the contract between workers and the enterprise is terminated. The new owner and workers can then sign new contracts if both sides want to continue their employment relations.

Table 2 summarizes the main differences in the privatization process in the two regions. The key differences lie in whether the process was transparent and whether workers were allowed to participate and received compensation. The question remains: Why did Wuxi and Wenzhou privatize TVEs in such different ways?

### Local Officials' Explanations and Their Problems

In *Transition and Economics*, Roland outlines various constraints of privatization, including fiscal, political, informational, administrative, and stock-flow constraints.<sup>27</sup> These constraints were mentioned by local officials, though they used a different vocabulary.

Local officials offered three explanations when asked why privatization took its particular form in Wuxi. One explanation was that the urgency to reverse fiscal difficulty prevented deliberation and narrowed available choices. The second explanation was that large-scale, rapid privatization

27. Gérard Roland, *Transition and Economics: Politics, Markets, and Firms* (Cambridge, Mass.: MIT Press, 2000).

was a response to the limited administrative and monitoring ability of government. The third explanation was that “insider control” and information asymmetry were so serious that few outsiders dared make a bid, thus benefiting incumbent managers. These three explanations roughly speak to fiscal, administrative, and information constraints, respectively.<sup>28</sup>

### *Fiscal Constraints*

This explanation states that given the dominant role of TVEs in the local economy, troublesome TVEs seriously affected that economy and also local governments. It thus became urgent for local governments to privatize TVEs in order to rejuvenate the economy. In Wuxi, more than 90% of industrial output was realized by TVEs in most towns before privatization; the community government’s budget derived mainly from TVEs as well.<sup>29</sup> But TVEs ran into serious difficulties in the mid-1990s, for reasons mentioned above. Many quickly became debt-stricken. Industrial growth rates declined dramatically. For example, in Wuxi County, industrial growth rates in 1995 and 1996 were only 5% and 4%, respectively, almost one-sixth of previous rates. The debt-asset ratio of TVEs averaged 95% in 1996. Enterprises that went bankrupt during privatization had a debt-asset ratio of 134%.<sup>30</sup>

The deteriorating performance of TVEs influenced the local economy and bothered officials—their work performance and political careers were linked to local economic development.<sup>31</sup> TVEs, instead of being the cash cows they were in their heyday, became a burden on local governments. One town party secretary had been called to court three times within a month for debt-related lawsuits: the government had guaranteed numerous loans for enterprises, but many of those loans had encountered payment problems, prompting the lawsuits against the enterprises. For the town party secretary, beyond the impact on his career, this was also a personal embarrassment.

Under such circumstances, community governments felt it was imperative to privatize TVEs. Consequently, the urgency to quickly change TVEs made deliberate consideration less feasible, and choosing incumbent managers as the new owners became an easy and convenient choice. It was

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28. Stock-flow constraint is not serious in privatization of TVEs for the following reasons. First, China’s gradual reform has produced some private wealth up to this point. Second, most TVEs were small- or medium-sized; thus, payment is not a big problem. Third, installments, mortgages, and other measures can be adopted to solve the payment problem.

29. Whiting, *Power and Wealth*.

30. Interview with an official in Wuxi, July 2001.

31. The cadre evaluation system links the performance of government officials with the main indicators of the local economy. See Whiting, *Power and Wealth*.

believed that privatization would allow incumbent managers to run their factories more efficiently, without the typical problems caused by public ownership, such as agency issues and difficulty in disciplining local workers. In sum, the dominant concern of reversing the economic downturn determined the nature and speed of privatization.

This explanation has some merit if we compare Wuxi with Wenzhou.<sup>32</sup> In contrast to Wuxi, private businesses contribute a larger share to the local economy in Wenzhou. According to official statistics, in 1990 private business contributed about 75% of Wenzhou industrial output.<sup>33</sup> Local fiscal income also relies more on private business instead of TVEs. Hence, it was not as urgent for community governments in Wenzhou to privatize TVEs in order to rejuvenate the economy.

#### *Administrative Constraints*

The second explanation maintains that rapid privatization was a response to administrative constraints. Once community governments decide to privatize all their TVEs, administrative constraints become significant considering the difficulty for limited government agencies and staff members to evaluate and monitor the assets of many TVEs. For example, Wutao town privatized 13 town enterprises in 1997. The supervisory body—the Town General Industrial Corporation—only had 10 staff members at the time. Even if all these staff members were motivated to monitor the process (they were not, actually), they would not have the capacity to do so. More important, after privatization was initiated in some firms, managers in other TVEs, being aware of the “endgame situation,” started to dissipate the assets of TVEs. They doctored account books, transferred assets, or directly hid expensive machines. One official recounted, “Asset dissipation almost became rampant. Incumbent managers did that almost openly since they clearly knew it was impossible for the government to oversee them effectively with limited hands and eyes.”<sup>34</sup>

Again, this explanation has some value when we compare Wuxi with Wenzhou. Because there were fewer TVEs in Wenzhou, administrative constraints were smaller. However, the difference in administrative constraints comes more from the privatization approach instead of the sheer numbers of TVEs. In Wenzhou, case-by-case privatization spread administrative burdens over a longer period. At any given time, only one or a few TVEs

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32. Li, “Government’s Budget Constraints.”

33. Actually, the real contribution of private business in Wenzhou was much higher since many private businesses were registered as “collectives” at that time. See Kate Xiao Zhou, *How the Farmers Changed China: Power of the People* (Boulder, Colo.: Westview Press, 1996).

34. Interview in Wuxi, August 2001.

were undergoing privatization, which allowed the government to supervise and monitor the process more effectively. More important, some measures Wenzhou adopted helped to relieve administrative constraints. First, open bidding helped, since it was not clear beforehand who would become the new owners. Such uncertainty decreased the possibility of incumbent managers manipulating accounts, since that might benefit others if they ended up not winning the bid. Second, in some firms workers and other managerial personnel were mobilized to monitor the assets of their enterprises. For instance, during the privatization of Hongqiao Furniture Factory, workers elected their representatives to set up a team to monitor the assets and oversee the process of privatization.<sup>35</sup>

### *Informational Constraints*

According to a town official in Wuxi, “Only the incumbent managers know how their enterprises perform. Others have no way to know. So who dares take the risk? Moreover, if you don’t transfer enterprises to incumbent managers, they would make trouble for the new owners.”<sup>36</sup> This means that “insider control” gives the incumbent managers advantages over others in acquiring the enterprises because information asymmetry and high risk discourage other potential bidders from competing.

It is true that “insider control” became striking during the process of TVE development. The link between community government and TVE managers was a type of principal/agent relationship. As owners of TVEs, community governments had the right to select and appoint managers as well as to evaluate and monitor their performance. With heated market competition, however, community governments had to give more and more control rights to managers in order to motivate them.<sup>37</sup> One such control right was managers’ discretion over the appointment of other top management personnel, especially accounting officials. Examples abound of how managers made enterprises their own regimes. In one firm, the manager made his mistress the head of the accounting office. In another case, the manager maneuvered to remove the accounting head, whom he did not like, and then appointed a close friend to the position.

Insider control creates a situation in which no outsiders know exactly how an enterprise performs. Some Chinese scholars have found that many enterprises had three sets of books: one for themselves, one for government

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35. Zhao and Zhu, *Chaoqian yu Liebian*, p. 136.

36. Interview in Wuxi, August 2001.

37. Hongyi Chen and Scott Rozelle, “Leaders, Managers, and the Organization of Township and Village Enterprises in China,” *Journal of Development Economics* 60 (December 1999), pp. 529–57.

agencies such as the tax bureau, and one for creditors.<sup>38</sup> Sometimes an enterprise might look good from the outside but in fact it might have serious problems. Even a town official who had overseen TVE affairs for many years was surprised to discover that many enterprises were in dire financial straits when they were privatized: “Frankly, I used to be very confident that I knew the real situation of our town enterprises since I had taken charge of them for many years. But I came to recognize that I was wrong, when privatization was carried out. Some enterprises should have been bankrupt many years ago.”<sup>39</sup>

Given insider control, outsiders might be fearful of bidding on privatizing enterprises because the risk is too great. And incumbent managers might obstruct or at least create some barriers if privatization is not beneficial to them. Despite that, other managerial personnel within enterprises might have been willing to take the bid, if there were such opportunities, as privatization in Wenzhou shows. Actually, there was an exception in Wanguang town where I did research that exactly counters the claim made by local officials.

In Wanguang town, Weixiao was the only case among township enterprises that was openly bid. The reason why bidding was taken was because the new party secretary wanted to show he was different from his predecessor. Weixiao thus became his showcase. Though the bid was only limited to insiders, it attracted five bidders: the incumbent manager, two sales personnel, the director of a subdivision, and the person who took charge of storage and raw materials. The starting bid was 1,090,000 yuan (\$131,961). After several rounds of competition, the bid rose to 1,560,000 yuan (\$188,862). The highest bidder, the director of the subdivision, got the enterprise.

Thus, it is clear that “insider control” is not sufficient to explain why privatization in Wuxi took the form it did, which favored incumbent managers.<sup>40</sup> In Wenzhou, informational constraints were also significant. But competition mitigated such constraints. Once there is open competition, information constraints become less important because the final price might be irrelevant to the real value of the enterprise.

The above three explanations may account for some aspects of privatization, such as its scale and speed, and advantages incumbent managers

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38. Rong Ma et al., eds., *Investigations on China's TVEs in the 1990s* (Hong Kong: Oxford University Press, 1994).

39. Interview in Kunshan County, July 2001.

40. I admit that information asymmetry might affect other aspects of privatization such as buyout prices, as Li and Rozelle found. See Hongbin Li and Scott Rozelle, “Insider Privatization with a Tail: The Screening Contact and Performance of Privatized Firms in Rural China,” *Journal of Development Economics* 75 (October 2004), pp. 1–26.

had in obtaining enterprises. However, the explanations do not tell why community governments in Wuxi could privatize TVEs in nontransparent ways, nor why workers were not allowed to participate. They do not explain why alternative methods were not even raised and discussed. They do not explain why such a policy could be effectively implemented without substantial resistance.

### Power Relations as the Fundamental Reason

The fundamental reason why the two regions privatized their TVEs so differently, I would argue, lies in the different political constraints each region faced. Political constraints mean two things here. One is government power relative to the people.<sup>41</sup> The other is elite relations between TVE managers and government leaders.

Different power relations in Wuxi and Wenzhou originated from the socialist period and were strengthened in the reform era. Although institutional arrangements were almost the same in the socialist period, government capacity and the power relations between government and the people were not homogeneous across regions because of differing economic conditions, historical legacies, and geographical locations. In Wuxi, an advanced industrial base and strong local government emerged in the socialist period. Such conditions influenced Wuxi to continue its collective path after the reform. The development of TVEs maintained government power as well as nurtured a new social group—TVE managers—in the local power structure. TVE managers have close relationships with government leaders and have gained ascending bargaining power over time. Strong local government relative to the people, and close relationships between TVE managers and government leaders, explains Wuxi's nontransparent privatization at the expense of workers.

By contrast, Wenzhou had a weak collective economy and weak government during the socialist period. Such conditions forced Wenzhou to pursue an alternative way to development after reform, that is, to realize the people's initiative. Private business thus became the main ownership form. The development of private business empowers the people and results in more-balanced power relations between government and the people. Such power relations, together with the insignificant position of

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41. I realize that "people" is a vague word, but it is the word frequently used by informants. In general, "people" is an opposite concept to government. Close scrutiny finds subtle differences in the usage of the word in the two regions: in Wuxi it mainly refers to common people; in Wenzhou, it refers to all community residents outside government.

TVE managers in the local power structure, determined the transparent methods of privatization.

Strong government in Wuxi has historical roots and contemporary rationales. During the decades after the Chinese Communist Party (CCP) took power in 1949, Wuxi formed strong local governments, for two primary reasons. First, the resource endowment of the region helped it develop an advanced industrial base during the socialist period, which strengthened the power of local governments. Wuxi's advanced agriculture allowed local governments to extract more surplus; its geographic proximity to Shanghai provided it access to technology and technical personnel; its modern industrial legacy from the Republican Period (1912–49) helped build necessary skilled labor and management expertise. The predecessors of TVEs—commune-brigade enterprises (CBEs)—were first developed in this region as early as the late 1950s and accelerated during the Cultural Revolution (1966–76).<sup>42</sup> From the early 1970s on, Wuxi County ranked number one among all Chinese counties in terms of rural industrial output. By 1981, the total fixed assets in industry at the commune and brigade level had reached 278.06 million yuan (\$163 million). By contrast, the same indicator in Yueqing County, Wenzhou, was only 21.31 million yuan (\$12 million).<sup>43</sup> Controlling an advanced industrial base provided economic foundations for strong local governments.

Corresponding to the advanced industrial base, the Wuxi government had a high capacity to extract resources from society. Scholars have pointed out the importance of resource control for state capacity.<sup>44</sup> Fiscal income per capita/year in Wuxi reached 258 yuan (\$153) in 1978, which equaled 37% of gross domestic product (GDP) per capita. The same indicator in Wenzhou was only 24 yuan (\$14), 10% of GDP per capita. By controlling an advanced collective economy and rich fiscal resources, governments in Wuxi could effectively control people's lives, assigning employment in CBEs and engaging in income redistribution. In brief, the collective heritage equipped local governments with more power and influence.

Second, Wuxi's advanced capitalist industry in the Republican Period, specifically from the 1920s to the 1940s, made it a unique region during the political campaigns in the socialist period. Strong local government was formed as a result. Wuxi had been one of the cradles of modern Chinese industry. It nurtured many famous modern industrialists and numerous medium and small business persons. With this sort of historical legacy,

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42. Whiting, *Power and Wealth*.

43. *Ibid.*, p. 130.

44. Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: University of Cambridge Press, 1985).

Wuxi became a key region that drew special treatment after the CCP took power. Previous industrialists and business people became the targets in most political campaigns. According to Wuxi County history, 1,373 small crafts people and small business people were mistakenly labeled capitalists during the socialist transformation of industry and commerce, not counting those who deserved such a label.<sup>45</sup> Those people were suppressed and/or mistreated in various political campaigns. In the tide of red terror, a strong state was created. Such a political atmosphere nurtured ideological conservatism. Officials were afraid of making political mistakes and tended to avoid risk. Because of their political strength and ideological conservatism, local governments in Wuxi resisted agricultural reform until 1983, almost four years after all other places had decollectivized. This situation also affected the choice of its development pattern after reform. An official in Wuxi said that the political atmosphere made people afraid of talking about private business; thus, developing the collective economy became a safe alternative for local economic growth.

A collective economic heritage and strong local government channeled the region to continue its socialist path after the reform, i.e., to develop publicly owned enterprises. Such a path helped local governments to maintain and even strengthen their influence and power. Inheriting collective assets and controlling new market opportunities, community governments and leaders assumed the role of entrepreneurs to establish and run industrial enterprises. They played critical roles in decision-making on investment and finance, selection and appointment of managers, remuneration of managers, the overall wage distribution of workers, and the use of after-tax profit for public expenditures.<sup>46</sup> Therefore, although Wuxi had once been a socialist stronghold and followed a collective path in the reform era, such development generated great inequality in power distribution. Just as a socialist economy empowers bureaucrats and technocrats,<sup>47</sup> the collective economy in this region empowered government leaders and TVE managers.

As for elite relations, Wuxi witnessed the ascending influence of TVE managers in the local power structure. In Wuxi, relations between government leaders and TVE managers were manifested in two ways. On the one hand, the groups had close relations with each other. On the other, TVE managers gained growing influence and bargaining power relative to government leaders over time.

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45. *Wuxi Shehuizhuyi Daolu Wushi Nian* [Fifty years of the socialist road in Wuxi], compiled by Wuxi County Party School, p. 125. This was defined as a mistake in 1980.

46. Byrd and Lin, *China's Rural Industry*; Kung, "Evolution of Property Rights."

47. Milovan Djilas, *The New Class* (New York: Fredrick A. Praeger, 1957).

The close relationship between TVE managers and government leaders was an institutional feature of TVEs. Simply put, managers were appointed by leaders to oversee TVEs. Usually, local leaders would try to appoint those people who were close to them. Scholars have found much evidence showing that in many places, managers were either leaders' relatives or their friends.<sup>48</sup> In one village, the village party secretary sent his brother to take charge of the most profitable enterprise and appointed his wife to be the firm's accountant. At the same time, there existed frequent mobility between the two groups. At the village level, joint appointments between village leaders and enterprise managers were very common: some village party secretaries or village heads were enterprise managers; some enterprise managers had joint positions in village governments. At the township level, although joint appointments were rare, mobility between the two groups was also evident: low-ranking government employees or former village leaders could be transferred to managerial positions in TVEs; successful managers could be promoted to be leaders. For example, among six former party secretaries in a village after 1985, two were transferred to town enterprises after they stepped down from their village position. Leaders and managers thus constitute a "power elite," dominating local politics and the economy. Because of this, the economy in Wuxi was widely called an "elite economy" (*jingying jingji*) by local people.

The other side of the elite relations was the ascending influence of managers in local politics over time. Because TVEs were dominant elements, managers were naturally important players in the local economy. Their status and influence were further strengthened when they used their economic advantage to build widespread connections in both business circles and the political arena. They built horizontal connections with their business partners through transactions; they invested in government leaders to make the leaders their patrons. Such social connections gave them more leverage in dealing with government. Some managers could even use their connections to influence the personnel appointment of community governments. One village enterprise manager helped his relative to become the village head and later helped him move to the town government. The influential position of TVE managers in the local power structure made them capable of shaping privatization policy, or at least of resisting policy that was not beneficial to them.

Noting the strong capacity of local governments, the skewed power relations between government and the people, and the close relationship between managers and leaders, it is not difficult to understand why privatization was

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48. Gregory Ruf, "Collective Enterprises and Property Rights in a Sichuan Village: The Rise and Decline of Managerial Corporatism," in Oi and Walder eds., *Property Rights*.

carried out in such a nontransparent way. Manipulated privatization was not an accident. Instead, it reflected the configuration of local power relations. Local government leaders were aware that there would be no critical challenges from workers and local residents and thus were confident in proceeding with their own privatization plans. A town official's account is illustrative:

In Wutao town, the party secretary convened a meeting of all government officials and staff before privatization. He announced the decision on privatization and called for our understanding and support for it. He said that there must be sacrifices for the reform. The whole room was quiet. Though most of us had different opinions, nobody dared to speak out. Workers and community residents don't even have the opportunity to express their opinion, let alone challenge the decision.<sup>49</sup>

The privatization process was thus full of manipulation and secret deals between leaders and managers. In February 1998, the town party secretary told the top managers of the Mechanic Factory (no. 1 in Table 1) that it was time for the factory to be privatized. The general manager and two sales managers visited the party secretary frequently, in order to get beneficial treatment or obtain more shares of the firm. The final deal was that the three of them got 90% of the shares, with the remaining 10% acquired by other managerial personnel. The general manager complained about the differential treatment given to different enterprises. Some enterprises were transformed into shareholder cooperatives that have more shareholders, still bear some collective characteristics, and are subject to higher management fees paid to the town; other enterprises were transformed into private firms or limited liability companies for which lower rates apply. According to the manager, differential treatment was to some extent determined by how close managers were to the leaders. By accident, I encountered the manager in the town party secretary's office in 2002 when I was undertaking a second round of fieldwork. They were discussing registering the factory as a "welfare enterprise," in which the firm would be obligated to hire disabled people and thus would enjoy preferential tax treatment. I was informed later that the taxes saved were shared between the town government and the factory.

The experience of the Home Appliance Factory (no. 4 in Table 1) was more dramatic. The factory had been the most famous enterprise in the town, both in terms of its brand name and profitability. As a reward, the manager, Mr. Qiao, was promoted to be the general manager of the town's Industrial Corporation and later became the deputy director of the town.

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49. Interview in Wuxi, August 2001.

Qiao handpicked as his successor Mr. Lin, an associate manager who was incompetent but loyal to him. The real situation of the enterprise became clear several years after Qiao left the firm. Not only had a lot of unsold inventory been counted as sales, but the firm also had considerable debt. When it was privatized in 1998, the enterprise was almost insolvent.

The town government, with some input from Qiao, required top managers to buy shares. But few people were willing to do so. Because most top managers were party members, the town government threatened to use party discipline on those who refused to comply. Under the pressure of such strong-arm measures, one associate manager chose to quit the enterprise. After many rounds of negotiation and persuasion, Lin became the new owner. However, it soon became evident that he was not able to run the enterprise effectively. One year later, the factory was on the brink of bankruptcy. Town leaders thus had to ask the sales manager to replace Lin in 2000. With a good bargaining position, the sales manager got a very good deal.

By comparison, Wenzhou has very different local power relations. The region was only on the periphery of socialist development, and it started with a weak local government and weak collective economy. It was remote and poor historically. Beijing is far away. Even the provincial capital, Hangzhou, is 400 kilometers distant. The railway was not built until 1993. Because of Wenzhou's status as a front line location (i.e., relatively close to Taiwan) in the 1950s and 1960s, the possibility of war prevented state investment. From 1949 to 1981, state investment was only 655 million yuan (\$384 million, based on the exchange rate in 1981), equivalent to a mere one-fourth of state investment per capita in Ningbo, another major city in Zhejiang Province. Consequently, the state sector was small, the collective economy weak, and the people were poverty stricken.<sup>50</sup> According to statistics, in 1978, the average peasant income was only 118 yuan per year (\$72); fiscal income per capita was 24 yuan (\$14), less than one-tenth that in Wuxi (see Table 3). Under these circumstances, local governments could barely maintain their basic functions, let alone develop publicly owned enterprises after the reform.

Besides its weak collective economy and poor fiscal conditions, historical factors also contribute to weak government in Wenzhou. The city witnessed serious internal fights during the Cultural Revolution. Some officials perished in these fights. The provincial government once had to send troops to maintain social order. Internal fights were a blow to the already weak local government. Even up to the early 1980s, Wenzhou was

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50. Renshou Zhang and Hong Li, *Wenzhou Moshi Yanjiu* [A study of the Wenzhou pattern] (Beijing: Chinese Social Science Publishing House, 1990).

TABLE 3 *Fiscal Income Per Capita and the Ratio of Fiscal Income/GDP in Wuxi and Wenzhou, 1980–1990 (unit: yuan)*

<i>Year</i>	<i>1978</i>	<i>1980</i>	<i>1985</i>	<i>1990</i>
<b>Wuxi</b>				
Fiscal income/capita	258	286	422	513
Fiscal income/GDP (%)	37	30	20	13
<b>Wenzhou</b>				
Fiscal income/capita	24	30	65	134
Fiscal income/GDP (%)	10	9.5	10.7	11

SOURCES: *Wuxi Statistics Yearbook*, multiple volumes; *Wenzhou Statistics Yearbook*, 2001.

NOTE: Numbers are calculated based on the formula: fiscal income per capita = total fiscal income/total population. Fiscal income/GDP = total fiscal income/total GDP.

famous for its chaos. In early 1981, two of China's top leaders ordered the Zhejiang provincial government to solve Wenzhou's public security problem. The Wenzhou party secretary in the early 1980s was previously a provincial leader in charge of public security and legal affairs. He was sent down with a mission to put things in order.

Poor resource endowment and weak government forced Wenzhou to take an alternative path to development. Since governments were not able to develop TVEs as Wuxi did, they had to allow the "capitalist impulse" of their people. In the last two and a half decades, entrepreneurs or other people have been the driving force for development, and private business has become the dominant ownership form. From the late Cultural Revolution period, Wenzhou people started to go out to seek opportunities or engage in "underground" industrial or commercial activities at home. They became engaged in various humble business activities that urbanites were unwilling to do, such as haircutting, shoe mending, peddling, etc. Many informants had experience in leaving Wenzhou to run small businesses or seek labor opportunities. One informant had been a peddler from as early as the 1960s, selling candy and other small commodities. When the reforms started, Wenzhou already had a portion of its population engaged in private industry and commerce.

To use Alan Liu's phrase, Wenzhou's success can be summarized by "three Ms"—mass initiatives, mobility, and markets.<sup>51</sup> Mass initiatives—initiatives from the people or entrepreneurs—are the essential feature of Wenzhou's development. Government only played supportive or supplementary roles such as issuing official documents, helping entrepreneurs to get licenses,

51. Liu, "The 'Wenzhou Model' of Development," pp. 699–700.

and so on. Market forces are the key forces guiding economic activities and people's lives. Markets created relatively equal opportunity for those who have business talents and are willing to work hard. There thus appeared widespread private businesses and private entrepreneurs. Because of this feature, Wenzhou's economy is often called a "people's economy" (*renmin de jingji*) or "entrepreneurs' economy" (*laoban jingji*).

The realization of people's initiative and development of private business have nurtured a new social force and balanced power relations. Up to the year 2000, the total number of private firms was around 47,000, and self-employed industrial and commercial households totaled about 200,000. Private entrepreneurs have become a powerful social group in Wenzhou. On the other hand, since private business developed outside of direct government control and the tax system was ineffective in the initial period of reform, the increase of fiscal income lagged far behind the growth of people's income. As Table 3 shows, fiscal income increased slowly, and the share of fiscal income to GDP remained around 10% throughout the 1980s. In his book, Yuan documented many examples of how the government remained poor while the people (entrepreneurs) enriched themselves quickly. For example, in one town in Cangnan County, collected tax revenue was only 0.767% of total sales in 1985.<sup>52</sup> Even today, township and village governments in many places in Wenzhou are still badly equipped and function poorly. In one village, the village government has to rent a room from a temple as its office. In another village, the party secretary (himself the owner of an enterprise) assigns one room in his factory as the office for the village. Such a state of affairs would be unimaginable in Wuxi.

New social forces and new economic relations have been shaping local power relations. Since their livelihood is not dependent on the government, people are apt to challenge its authority. In the past two decades, Wenzhou has been a national trailblazer on many fronts, thereby illustrating the nature of local power relations: it has the first case of a peasant suing the county government, the first case in which villagers recalled the village director, the first case in which peasants sued the county government for failure to fulfill its duty. Facing such a populace, local governments cannot be as dominant as those in Wuxi. They must adjust their behavior correspondingly while interacting with the people. An official expressed this notion: "What kind of people you have determines what kind of government you can be, and vice versa."<sup>53</sup> Privatization reflected Wenzhou's power relations exactly.

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52. Enzhen Yuan, ed., *Wenzhou Moshi yu Fuyu zhi Lu* [Wenzhou pattern and the road to development] (Shanghai: Shanghai Social Science Publishing House, 1987), p. 255.

53. Interview in Wenzhou, October 2001.

Considering the nature of elite relations, TVE managers in Wenzhou had never gained an influential position in the local power structure as they did in Wuxi. Because of the predominance of private business, TVE managers in Wenzhou were only a small part of the entrepreneurial group. Their influence in the local economy and politics was very limited. For example, in Hongqiao town, only one town-owned enterprise ranked in the top 20 among all industrial enterprises in terms of sales in 2000. All other enterprises were private in origin. In terms of personal wealth, TVE managers lagged far behind private entrepreneurs. Therefore, they were not as capable of influencing local government as were managers in Wuxi. It is also risky for local governments to privatize public firms in a nontransparent way. Quite simply, if privatization was nontransparent, self-reliant private entrepreneurs would raise a challenge: "We got our wealth by hard work. Why could they take advantage of the collectives?" Under such circumstances, community governments in Wenzhou had relative autonomy in the process of privatization without the substantial influence of TVE managers. As a town enterprise manager stated, "It is up to the town government to decide when and how to privatize. We [enterprises] have no say. It has been three years since the town government decided to privatize the Electronic Apparatus Factory, but the enterprise is still not privatized. So we can do nothing but wait."<sup>54</sup>

The account of a town official who was in charge of privatization in Hongqiao expressed the concern of government and best illustrated local power relations. He said that the privatization process had to be transparent, otherwise workers and local residents would protest. Private entrepreneurs would raise challenges too. Nobody in the town government dared manipulate the process. For them, the Wuxi method of privatization was not feasible politically. Secret deals behind closed doors was not even an option. Similarly, transparent privatization was also impossible and not an option for Wuxi.

This concern is based on the official's perception of people-government relations and past experience. The aforementioned Milk Product Factory met with protests during and after privatization. The town government adopted open bidding to privatize the factory and workers received compensation. Even so, workers protested because they thought they deserved a larger share. They even petitioned higher level authorities. Such protests made government more careful in later stages of privatization. Table 4 summarizes the constraints that account for the different methods of privatization in the two regions.

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54. Interview in Wenzhou, November 2001.

TABLE 4 *Different Constraints Each Region Faced*

	<i>Wuxi</i>	<i>Wenzhou</i>
Fiscal constraint	High	Low
Administrative constraint	High	Low
Informational constraint	High	High
Political constraint	Dominant government, close elite relations	More balanced people- government relations

SOURCE: By author.

### Conclusion

This paper analyzes the politics of privatization in two regions. Although fiscal, administrative, and informational constraints can partly explain why privatization methods differed in Wuxi and Wenzhou, the fundamental factor that separates the practices of the two regions is their different political constraints. It is the different power relations in the two regions, as well as elite relations between TVE managers and local government leaders, that explain what type of method was adopted and effectively implemented. The manipulated privatization in Wuxi reflected the area's skewed power relations in which local governments and elites dominated the local economy and politics while workers and community residents were powerless and passive. Wenzhou's more transparent privatization reflected its more balanced power relations between government and the people, which was a result of the people's initiative and the development of private business.

What does this tell us about socialist transition in general? At the superficial level, it seems that regional "shock therapy" jolted the socialist stronghold in Wuxi. But as I have analyzed, privatization policy in Wuxi was not an accident. Instead, it was exactly the result of Wuxi's persistent socialist power relations and institutional legacies. Privatization reflected the power of leaders and managers. In a similar vein, Wenzhou's transparent privatization was also a result of its institutional legacies: its peripheral status in the socialist period and weak socialist institutions led it down an alternate developmental path after market reform. This appears to be producing more balanced power relations. In sum, socialist transition is path dependent: previous power structure and institutional legacies matter.

In Wuxi, by contrast, privatization has had great impact upon wealth distribution and social structure. It became the watershed that marks the emergence of a new capitalist order in which managers became capitalists

while former workers were transformed into capitalist employees. The income gap between the two groups enlarged quickly. Built upon previous collective accumulation, the new owners quickly enriched themselves. The managers of former TVEs became big capitalists in the region. The previous skewed power structure has generated great disparities in wealth distribution, creating a polarized class structure.