

# Possession, operation, and governance as three conceptual dimensions of town and township enterprises: An analysis going back to the classical social sciences (Part I)\*

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## Abstract

Through a review of the representative sociological studies on the ownership of town and township enterprises, this article uses the three classical theoretical concepts of possession, operation, and governance to analyze the formative and the operational mechanisms of town and township enterprises. In terms of possession, these enterprises comprise different elements of public, common, and private ownership. In terms of operation, they utilize land contracts, enterprise contracts, and the financial responsibility system in the institutional context of the two-track regime. In terms of governance, they fuse different mechanisms of institutions, knowledge, and other dimensions together and free up traditional familial, kinship linkage, and customary resources for practical reform and creativity. As they occupy a key position in the social process of multiple elements and moments, town and township enterprises not only provide opportunities for institutional innovation, but they also embody the institutional spirit of the reform period, which combines tradition, regime, and new

market mechanisms. Enterprises also foster an enriched process of social development. This framework, which goes back to classical social science theories, may stimulate reflection on other phenomena of organizational and institutional change that are associated with social and economic reform.

### **Keywords**

Town and township enterprises, ownership, possession, operation, governance

### **Conceptual issue**

For the last 30 years, China's enterprises have changed and moved forward with changes in China's entire social structure, and China's enterprises have even become the driving force stimulating reform in some major fields. The change has been rapid, with multiple manifestations, thus creating plenty of challenging difficulties for the academic world. Apparently, it is quite difficult to explain the various phenomena associated with the development of China's enterprises in terms of standards proposed by western economists or sociologists. The reason is not just that China's enterprises take various forms and their complexities are embedded into an equally complicated social system and social network, but that from the perspective of mechanism, the formation and operation of Chinese enterprises involve many local systematic and cultural resources. This complexity has led to scholars making analyses using ambiguous concepts such as 'flexibility', 'collusion', 'adjustment', and 'reliance on the path'.

Essentially speaking, the above-mentioned concepts are not good for strict academic analysis, since most of them are based on a descriptive explanation. These concepts depict gray areas and delicate mechanisms in some social phenomena, but the phenomena that an analysis using them demonstrates are, like those social phenomena they are trying to explain, often obscure and gloomy. The same thing occurs with the differentiation between the concepts of 'formal' and 'informal', which has an ambiguous effect: emphasis on the effect of 'informal' factors tends to diminish the 'formal' factors into micro and incomplete explanations and thus overlooks the enforcing effect by the whole system; meanwhile, the differentiation is a theoretical acknowledgment of the legitimate foundation of the structural factors, since the so-called 'informal' concept happens to be a deviated form of the 'formal' system standard. Liu (2006) pointed out in his research on ownership of town and township enterprises that for a country like China that is constantly in a deviated status, the informal concept may tempt readers to believe that the factors contributing to the deviated status cause the interruption and chaos. However, the results of this kind of research usually tell people what they are *not* supposed to be rather than what they are supposed to be.

The organizational phenomena in China's social changes are extremely complicated and intermingled with a number of complex factors, which could be generalized and analyzed from several theoretical perspectives. Some factors relate to

social systems or conventions and historical heritage or foreign experiences; factors may be national or regional (social), personal or public, compulsory or voluntary, and structure-related or network-related. These analytical concepts of different levels, however, can easily be confused with one another, making the complicated phenomena even more difficult to understand. The truth is that, like any analysis in economics, sociological analysis needs a clear and definite conceptual system that has a first-level analytical concept and gradually establishes second-level or even third-level analytical concepts, thus forming a chain of explanations that are continually upgraded, expanded, and modified (Sun, 2007).

In this respect, there are three issues to be considered. First, sociological research should not evade the classical theories of other social sciences (such as law and political economics), but should emphasize that the premise of conceptual innovation in sociology is the deep understanding of the significance these classical theories have for history and human experiences and should establish a chain of explanations with lucid logic based on original concepts. The reason for this emphasis is that in the first 60 years since the establishment of the People's Republic of China and in the last 30 years, since the opening-up policy was implemented, Chinese society has undergone a fundamental, society rebuilding process, in which basic elements of modern society have been formed, combined, and evolved, and past observations of this process have not been divorced from the grand vision of classical theories. In addition, sociological researchers should not just take a singular perspective and look at social phenomena in an isolated way; instead, they should start by explaining a chain of original concepts with real, historical experiences and gradually establish a general framework of explanation, a basic network consisting of structural analysis based on the connections between social phenomena and general social structure. This formulation is necessary because any insignificant incident in social transformation can affect all of society, reflecting the influences of structural changes. In a word, sociological analysis must not be confined by the specializations of branches of science. Lastly, a structural analysis should be more than generalizations about the characteristics and genres of town and township enterprises and should lead to further exploration on every motivation mechanism in structural social change.

Essentially speaking, in social transformation, all the social processes and their mechanisms are of great importance for historical analysis. Any mechanism may contain the seeds of further change, beneath which may hide some logical opportunities. Furthermore, the social transformation in China is not simply a copy of any foreign system, but a delicate exchange between factors relying on systems and local (or traditional) resources. The so-called 'China experiences' with theoretical significance happen to have been brought about in this way.

### **Experiential issues: case studies relating to possession**

In the past two decades, there have been numerous sociological studies on the organization and evolution of Chinese enterprises, with many analytical concepts

and perspectives being formed, among which studies on ownership have been the most distinctive and innovative. The theoretical breakthroughs of these studies came from the dynamics of the experiences being studied and have challenged the common ownership system reforming strategy in the economic research field. In addition, the theoretical explorations have tried to establish a new mode, which could embrace all the basic questions in enterprise organization study by applying ownership analysis to enterprise organization. This paper specifically discusses five representative possession studies.

### *Study 1*

Zhang (2005a) conducted an experience analysis of a village-run property dispute and found that there was a kind of 'dualism of integrated order' in the ownership structure in many village-run enterprises in China in the 1990s. In this case, the village-run coal factory was originally established by nine villagers; however, the villagers' committee spent large amounts on loans, migration compensation, equipment, and public facilities. Thus, the nine villagers and the villagers' committee were in dispute about the ownership of the factory property from the standpoint of private versus public investment. Finally, the court mediated the dispute using a flexible method, namely, by handling 'ownership' and 'interest distribution' separately. On the one hand, the method did not identify the exclusive rights of the original investors entirely based on the private property nature of ownership; on the other hand, by converting rights into interests, this method allowed the villagers' committee to pay interest compensation to the original investors. In this way, the method actually confirmed the ownership rights of the administrative management and public services, and the investors 'voluntarily granted' the coal factory to the villagers' committee. Zhang ascribed 'right assertion' and 'interest distribution' as two legal resources of the 'dualism of integrated order', believing that the former has a more systematic meaning, being a formal legal expression about rights, while the latter is a tacit concept which stresses 'actual balance among various social interests', which can 'neutralize the social divergences implied in right assertion, and in the meantime try not to relate to the formal expression of right assertion' through the restorative function of interest distribution (Zhang, 2005a: 17).

Apparently, this analysis included the ownership process as part of an informal but effective social area, stressing that the nature and definition of enterprises are not entirely fixed by the original ownership structure, neither being an exclusive possession. On the contrary, the social conditions, environment, and customs in which an enterprise was embedded constituted another legal basis for the enterprise's organization. However, although this explanation expanded the ranges of ownership, it did not surpass Samuelson's (1954: 387–389) question domain,<sup>1</sup> which defines rights based on the differences between 'private products' and 'public products'. Here, the inclusion of social elements finally formed 'dual recognition', and the property ownership became the outcome of a compromise.

Although this explanation expanded the denotation of the concept of ownership, it did not define ownership itself theoretically; furthermore, it risked the public investment by the village administration seeming like the last justification for social morality, which was supposed to have existed during the socialist transformation in China in the 1950s. Apparently, the balanced order realized that compensating rights through interests is merely a temporary solution. Can we say that all operating organizations with public investment can confiscate private property by exchanging interests with rights? When the government partitions and confiscates private property in the name of social integration, the individuals will by no means 'voluntarily release' the property. Even from the standpoint of conventional social opinions, this flexible method is merely a matter of expediency and possesses no ultimate basis for justice. Hence, this case raised a theoretical question: does the so-called public investment of the village administration possess justifiable ownership in a deeper sense, or does it have a clearer basis for rights based on the group or community? This question needs further exploration in the future.

### *Study 2*

Shen and Wang's (2005) analysis on 'collective property rights' expanded the research perspectives of the prior questions. Their subject was not directly related to enterprises' organization, but closely related to it theoretically. After studying a case of land expropriation in rural mainland China, they pointed out in their paper that a property rights relationship based on collectivity is not an explicit relationship structure with stable performance after it is formed; rather, it is a dynamic and balanced process in a specific social environment. Specifically, 'both dealers would realize the release of property rights under appropriate agreements in dealing with an explicitly defined property' (Shen and Wang, 2005: 119).

Why should the research on property rights embark on a dynamic mechanism in China? The reasons originate from the complexity of collective property rights. On the one hand, in the process of 'turning rural land into urban land', the village collectivity, as the original owner of the land, should enjoy the profits from land remise. On the other hand, since the land responsibility system was adopted in China, the farmers possessed long-term and stable land use rights on the contracted land, enjoying the controlling rights of the surplus profits of the land; furthermore, land as a basic means of production is exclusive for use in nature, and thus this kind of land use right is exclusive and has the nature of a 'property right in disguised form' from the farmers' standpoint. In addition, the so-called intrinsic contradiction of collective property rights is the correlation between the property system collective possession of land, which is the non-exclusive domain of the higher authorities, and the contracted land use right, which is exclusive to farmers. The correlation lies essentially in the fact that the individual farmers exercise their rights as 'quasi-owners', which encourages them to comprehend their position in the collective ownership system in terms of 'member rights'. In other words, their

position is ‘with the definite characteristic of exclusivity of individuals out of the collective as well as jointly possessing properties non-exclusively with other collective members’ (Shen and Wang, 2005: 135). Therefore, the essence of collective property rights lies in the fair distribution among members of the collective, and land expropriation and compensation should follow this basis.

Although this study did not finally analyze enterprises’ organization, its discussion on collective property rights structure was of great help to those doing related research studies. Shen and Wang’s (2005) paper went far beyond the analysis domain of private products and public products and solved the problem of clarifying property rights in collective ownership by avoiding the contradiction between non-private and public ownership. In the discussion in this paper, we can see that the most complicated question related to property rights with the most Chinese characteristics is the theoretical challenge proposed by ‘common ownership’. However, this kind of ownership system is neither the simplified mode raised by western scholars,<sup>2</sup> nor merely the common field system of ancient Europe (Dahlman, 1980). It is not typical common ownership; rather, it is embedded into the national administrative system and is not a typical common ownership system with exclusiveness in limited aspects (Liu, 2006).

Thus, rights in the collective ownership system lie within multiple layers of contradictions. First, the tracking terminal of the membership rights is the village collective, whose ownership rights are only exclusive to its members or other collectives in the same administrative level and lack the entire exclusivity of the higher authorities in the administrative system; thus, a contradiction between collective possession and national administration was generated (Zhang, 2003), and the members of the collective cannot demand property rights from higher authorities. Consequently, they are unable to protect their collective property rights. Second, so-called ‘quasi-ownership’ and ‘membership rights’ are abstract concepts in their own right. In reality, it is of critical importance who is chosen to act as the agent of collective property rights and shoulder the responsibility of protecting the common rights. In fact, Cao (2007) showed that the principle of defining the property rights of collective land is neither completely determined by law, nor the outcome of spontaneous evolution; it is an outcome of the game between the agent of the collective rights and the collective members. Under the condition of incomplete exclusivity of collective property rights and inadequate tracking of membership rights, the maintenance and protection of collective property rights rely on the practical ability and moral credibility of the agent of the collective property rights (She and Chen, 2000). If the collective common ownership lacks social education and public opinions at the basic level, it is difficult to realize social solidarity through supporting the poorer members; when the membership right is threatened, there is only one expedient way out: through exchanging interests for rights and exchanging ancillary rights for land (Zheng, 2010). Hence, even if the case resembles the Shen and Wang (2005:128) statement that ‘the collective property rights with the characteristics of “common possession” are by no means “vague” among

collective members', the subject form of the property rights cannot be explicitly identified from the perspectives of defining property rights through exclusivity of collective property rights and agent mechanisms.

### *Study 3*

In study 1, the tug-of-war between private and public investment constituted an ambiguous area in defining property rights. In study 2, it can be seen that the common ownership established in the collective ownership of land is the basis of the common rights structure, but it is incomplete. The two key contradictory elements were conveyed in the 1990s, in a very dramatic way. She and Chen (2005) perceptively described the privatization process of collective property in one township enterprise in the south Jiangsu province. In their paper, they pointed out that the formation of a village industrial community is not merely defined by the farmers' membership identities as endowed by the nation, but by their identities as 'land-use rights owners' and 'joint entrepreneurs'. They stated that overall a collective property right is not a type of market-contracted property right but a socially contracted property right, which takes on the form of an implied contract that is tacitly approved by an acquaintance society; it is always in a specified social relationship coordination process in a rural community. The farmers' trust and the cooperative's actions to the collective economy and the anticipation of obtaining repayment through mutual benefits are considered in the area of providing non-agricultural jobs, ensuring employment, and improving community welfare. The collective property rights are regarded as a kind of 'conventional property right' as they rely on the reasons and conventional rules in social relationships and thus perform the functions of easing contradiction and providing coordination in cases of property rights conflict when a market contract is defective.

However, when the system environment in which a property right is embedded changes dramatically, especially when all levels of administration start to undertake enterprise reform, the previously mentioned social contract cannot last long. First, village leaders convert the collective property rights into investment property rights through a joint-stock system. In the process, most of the collective properties are jointly possessed by private capital, and some are distributed to individuals as stocks. In this way, the 'big stock of the collective' is separated from individual members. Afterwards, in the company management system reform process, the properties of the village collective are separated from the property of the company (the separation of village functions from company management). Through a process of distributing stocks, new property rights subjects are created, and the company operator and employees' stock ownership committee begin to form their assets, which can be claimed, priced, and transacted respectively according to corporation law. Finally, through the strategies of realization, listing, or purchase, the original property rights of the collective properties structure will no longer exist. She and Chen (2005) pointed out in their analysis that the collective property rights were not originally maintained by a market contract, but on a social contract,

which is a kind of contract made by public opinion and based on the rationality principle, without an 'original contract'.

As most of the enterprises earn profits by order processing, the enterprises' agents in reality control, handle, and transfer the assets of the enterprises by taking advantage of incomplete market information. Thus, the enterprises' agents make a 'second contract' with their operating partners (Liu, 1999). As the second contract is exclusive in operation, a glitch may occur in the principal-agent process; namely, the enterprise's agent possesses the assets through operation, and the collective principal who does not possess any clear rights cannot effectively supervise the actions. When the operator starts undertaking village public affairs in the name of the 'enterprise creating net profits for the village collective', the collective properties are converted into enterprise assets mentally, placing the enterprise property principle above the village collective. Thus, the same situation occurred as in studies 1 and 2; the enterprise applied reverse sequence arithmetic to derive the bottom line objective on the basis of catering to the public welfare and purchased the least sum in public welfare anticipation at low expense. In this way, most of the collective properties were stealthily privatized through segmentation, loss, and misappropriation. Interestingly, in the very exquisite case studies above, although a social contract played an essential role in 'defining before the event' and 'defining after the event' as the authors mentioned, what we saw finally was the invalidity and termination of the contract. Although the process did not mean essential change of collective ownership of rural land, when the land was expropriated and the farmers' land use rights were substituted for individual employment and public welfare rights, the township enterprises were privatized. They were like specters haunting and nibbling at the farmers' land, leaving the so-called collective ownership of the land without any room for game playing. Thus, in eastern China, once the social contract based on collective ownership of the land went through the process of collective properties becoming township enterprises, the farmers gradually lost their insurance of land use rights. Seen from the perspective of dynamic effects, the game-playing ability of the social contract gradually diminished and delivered a serious blow to rural community services.<sup>3</sup> Here, two questions are raised accordingly. How are the collective rights related to land different from those related to township enterprises? Can we track the property rights of the latter directly from the former?<sup>4</sup>

Obviously, although the systematic basis of township enterprises has a close property rights relationship with collective land ownership, it is also closely related to the legacy of the people's commune system initiated in late 1950s China.<sup>5</sup> While the latter was far beyond the domain of property rights, it was an important part of the national governing system. At the primary stage of the reform, rural systematic reform implemented the 'contracting principle'. First, this principle was applied to land contracts in agricultural production, and then it was applied to operating contracts by township enterprises. It is worth noting that the contracting system essentially abides by the two-track system. On the one hand, it suspends the remaining part of the property rights, and on the other hand, it expands the surplus

part of the use rights, i.e. the release of operational rights (Qu, Zhou and Ying, 2009). In other words, compared with the collective ownership of the land and the family contract system, the complexity of township enterprises lies in the fact that they integrated the collective property rights in possession, the enterprise operation rights, which are derived from the property rights, and the systematic factors in state governance. Township enterprises cannot be explained simply in social contract terms. Therefore, the above-mentioned phenomenon of 'no initial contract' is in fact a representation of the embedding of the enterprise system; it also shows the significance of the non-inclusiveness of the higher authorities in the property rights. Against the background of state governance maintaining the characteristic of dominance in general and most farmers preserving the historical memories of the people's commune system, collective ownership only has fuzzy boundaries with state ownership.<sup>6</sup>

From the 'second contract', it can be seen that enterprises' operators have taken full advantage of the double-track system. On the one hand, they suspended ownership, and on the other hand, they expanded the exclusiveness of the operational rights through unclear principal-agent relationships and tried their utmost to change operational rights into exclusive rights with absolute controlling power. In this process, the 'surplus' of the collective property rights was always taken as the surplus in land profits, but not the surplus in enterprise operation. When the weight of operational rights largely exceeds ownership power, the contract rights tend to obtain legitimacy and make village enterprise separation a logical outcome of the double-track system. In general, the intermingling and integration of possession, operation, and governance has resulted in a complicated system of township enterprises in property rights and their evolvement and constituted the historical opportunity for the smooth privatization of the township enterprises.

#### *Study 4*

Zhou's (2005) analysis on the social composition of property rights achieved a breakthrough in comprehending property rights from the economist's perspective. He directly proposed the concept of a 'relationship property right', which replaced the notion that a 'property right is a bundle of rights' with the notion that a 'property right is a bundle of relations'. He also stated that the property rights structure and form of an organization is the outcome of the organization establishing long-term and stable relationships and adapting itself to its environment. Thus, the foundation of the property rights is not an individualized property structure, but rather it reflects a stable relationship and communication between the organization and its environment, including other organizations, the systematic environment, and the different groups within this organization.

In the transformation of China's economy, there are some phenomena of 'incomplete property rights', namely, an 'incomplete decision right' in property handling, an income disposing right weakened by charges imposed by the government, a seriously limited property assignment right, etc. These phenomena are

probably the strategic choices of enterprises trying to adapt to a specific systematic environment as stated by Zhou (2005: 8), 'The enterprises set up a stable and favorable environment through strategies like compromise, sharing and remission of property rights'. In this sense, the enterprise purposely gives up exclusivity of some of the property rights and starts the dynamic process of property rights through relationships, with the real intention of breaking the restrictions of enterprise organization boundaries and paving the way for obtaining resources, opportunities, and political protection.

Relational property rights have the potential to establish an embedding structure characterized by a 'belongingness within the circle' relationship. In this way a patron–client mechanism is formed. Especially when it is difficult to distinguish the belonging status of resources and production factors, the interests of all parties are tied together. Furthermore, embedded property rights relationships are more stable than other social networks, although they are also more prone to economic transactions and collusive political relationships because of their linkages to both interests and risks. This phenomenon is especially reflected in the property rights issue of township enterprises. For example, in some cases, private enterprises blur their own natures under the guise of 'collective enterprises', and even 'state-owned enterprises' draw regional governments or officials over to their 'own partial property rights' and adjust resource distribution and resource transfer strategies according to the distributing status and allocating mechanism of information, resources, opportunities, and risks in the real society.<sup>7</sup>

From the perspective of studying relationships in order to comprehend the structure of property rights, Zhou (2005) achieved breakthroughs in analyzing property rights based on the property owner or the individual enterprise organization. He even raised the question of externalities of property rights (Coase, 1960; Demsetz, 2007) and pointed out the further feasibility of research in this area. However, the question of externalities that Coase (1960) and Demsetz (2007) raised was meant to solve the problem of cost internalization, which reflected the organization's effect on the internal structure of enterprises. The relational property rights theory concerns the influences of the institutional environment and the relationships on changes in and the adjustment of property rights; it does not, however, further explain the influences of the enterprises on transactions, management, and operation.

Although in the experiences in China, the organizational boundaries of enterprises are fuzzy, this does not mean that the boundaries can be extended without limitations. If we define property rights only in terms of relationships, the risk of substituting relationships for property rights (namely, the legitimacy of rights) will eventually exist all the time. From the research of She and Chen (2005), we can see that in township enterprises, because of the limitations of the collective possession basis and other social conditions, the property rights relationships are restricted by both the higher authorities and the subordinate ranks. In the relationship of employer and employees within enterprises, however, the question of collective property rights distribution and surplus also exists. If the property rights cannot

be remised by operators at will, then what structural conditions can explain property rights transfer? What can and cannot be transferred? Why do property rights that can and cannot be transferred have different properties? In what ways can the right relationships within organizations and governance structures hinder property rights transfers?

Even if we comprehend the concept of relational property rights from the perspective of relationships between organizations, we cannot analyze this concept in the same fuzzy way that we do with its exterior phenomenon. 'Relation' is not an ultimate analyzing concept; even the sentence 'a property right is a bundle of rights' contains various kinds of contract relations. In fact, the proposal of relational property rights is not merely in the relationship domain; moreover, it is a different definition of rights. In the past, economists tended to comprehend property rights from the angle of 'legal monopoly', and regarded them as 'the right to choose a certain kind of economic goods which is implemented by force in one society' (Alchian, 1992: 1101–1104); thus, the various contract relationships included in property rights all possess the element of force associated with freedom. However, in light of experiences in China, this kind of freedom is probably not the best way for people to maintain and handle property rights, and the social environment has immense power in breaking the 'legal monopoly' of property rights to force property owners (or users) to release actively their own rights and freedoms. In this way, a huge, embedded social network is formed.

This kind of 'de-freedom' release, however, cannot be discussed generally through the relationship concept; it should be studied to find different mechanisms and logic from different relationships. For example, the release of some rights is totally determined by administrative authority formed by the national governance system; especially when the township enterprises are in the developing stage, the justification of property rights is always suppressed by the justification of power, while the first prerequisite of rights release is the hierarchical difference in power relationships. The rights release formed under this circumstance is, in fact, the outcome of seeking power shielding.

In the condition of power becoming superior to rights, property rights can only be applied as a secondary concept for analysis, which should not exceed the compulsion given by power and authority from the general governance system. Equally, under the influence of the two-track system, and also in the condition of the local financial responsibility system, property rights relationships are always laid aside, and local government pays close attention to the profits of enterprises (which have a close relationship with local financial revenue), and thus the legal status of the enterprise operation far exceeds that of the property rights structure. For enterprises, it is essential to maintain transactions stably (even under insufficient market conditions), lower cost, and increase efficiency. Under the condition of managing rights exceeding ownership power, the operators and contractors of various professions and trades have tried every mean to buy all kinds of relationships to ensure the exclusiveness, monopoly, and sustainability of their dealings.

The third type of relationship related to property rights, namely, the collective ownership of land and social customs in rural communities, forces operators and collective members to maintain a kind of linkage in possession. In this way, the operators have to obey the recessive social contracts to some extent, provide public welfare to farmers, and maintain social solidarity determined by kinship.

In conclusion, the property structure established by relationships constitutes a theoretical challenge to the concept of property rights itself. The rights release decided by relationships illustrates that property rights are decided by relationships with different logic and mechanisms. Here, the relationship is not an ultimate analysis concept; the different logic and mechanisms determine the methods and characteristics of property rights release. In summary, first, regarding the governance structure, in the authority framework, the rights release generated only through obeying political relationships (for example, put on the 'red cap') and interest transfer through relationship transactions (for example, by part of the property rights owners) can enable the operators to obtain resources and opportunities and avoid risks by taking advantage of the patron–client relationship. Second, the operating structure determines the transaction mechanism as well as the construction of a transaction network. The principle of supreme utility emphasizes the importance of the market contract. Only under the circumstance of fuzzy ownership does this kind of contract become the collusion of all parties to the transaction through rights release to share the profits, transfer property, and maintain monopolistic status in holding transaction information. Finally, the possession structure determines the social linkage mechanism. As the enterprise organizations exist within rural communities, they have exceeded the abstract individual linkage domain in general property rights theory and have implemented public responsibilities to some extent within acquaintance relationships.

### *Study 5*

The concept of relational property rights is a concise theoretical version of property rights analysis in sociology, but in the meantime, it contains fundamental theoretical problems. Liu (2006) criticized some specious strategies in property rights research and pointed out that although experts' extended analysis enlarged the research boundaries of the concept, they also blurred it. Therefore, it is essential to 'find a more fundamental concept compared with property rights as a tool to explain the concept of property rights and see through the complicated Chinese economic system and its evolving process' (Liu, 2006: 4).

Liu (2006) took possession as a fundamental concept, analyzed it in terms of two important dimensions, and re-explained the complemented property rights phenomenon in township enterprises. First, after tracking the possession status in the leading body of the people's commune, he pointed out that although the possession of economic elements was achieved in the people's commune, the production brigade, and the production team, in the hierarchical structure, the phenomena of the non-exclusiveness of the higher authorities and the softening of the vertical

exclusiveness exist. This situation exists because the hierarchical structure of ownership is actually operated through the top-down administrative instruction system, and the lower ranks definitely cling to the higher ranks in administration. In the 1970s, the possession range of commune enterprises gradually expanded, and their property utilization range and transaction rights were usually approved administratively through flexible means by local governments.

After the policy of reform and opening up began, the actions of the national government as the primary owner directly interfering with rural economics decreased, and the administrative clinging of the lower-ranking government to the higher-ranking government weakened, especially in that the ratio of the self-raised funds in the financial revenue of the township government increased. Furthermore, driven by the macroscopic policies of national finance and taxation responsibility, the overall boundaries of all economic entities possessing properties became more explicit, and the bargaining mechanism between the township and the higher-ranking governments and other government departments was formed. Thus, the vertical exclusiveness was strengthened. On the other hand, with the extension of the duty contract system, the managing autonomy of enterprise managers (i.e. factory directors) was expanded.

The higher-ranking governments no longer interfere with industry adoption, product choosing, production organization, and sales modes of the enterprises, which means restricting the range of possession rights of managers by setting operating targets. On the contrary, they supervise the targets, process management, and possession rights, which means designating the boundaries of possession rights in employment, in the compensation system and in property dealing. The contract system is established by the contract with the township government, and the prescribed content of the contract and the period of execution are both restricted by government instructions. Thus, Liu (2006) called the exclusiveness of these management and possession rights 'restricted exclusiveness' in limited respects. He also pointed out that the operation of township enterprises takes in a large proportion of the informal interpersonal relationship network, which is utilized by managers (factory directors) to obtain all kinds of opportunities for scarce resources and private interests and to ensure their status and the least possibility of being replaced. Therefore, the relationship network itself is, to some extent, exclusive and makes it possible to possess property in the form of operation.

When property rights analysis becomes over-formalized because of relationships, it is necessary to re-examine the essence of the possession concept. After all, we can see from a large number of phenomena of township enterprises transforming into private enterprises that a fundamental question exists surrounding who will possess the enterprise property rights. In other words, in the final transfer of possession rights, the relational analysis only has descriptive meaning and cannot explain the transforming process fundamentally. In the 1990s, economists emphasized that property rights reform had practical meaning; otherwise, the market reform thereafter would not make preparations for conditions of possession, nor would it be able to explain the phases and structure of the evolving

process.<sup>8</sup> However, when study 5 tried to replace the concept of property rights with the concept of possession to explain all the related phenomena, the analyzing function of the concept of possession was enlarged unwittingly.

According to Liu (2006), in the *Regulations of Collective Ownership Enterprises in Rural Areas of the People's Republic of China* that were promulgated and implemented in 1990, the property of rural collective ownership enterprises 'belongs to all farmers of the town or village who started this enterprise and exercise ownership of enterprise property as the collective economic organization of all farmers'. Thus, we can assume that the regulation acknowledged the role of a township government owner. Especially in the organizational structure of many towns and villages, the administrative identity and the position in enterprises are set as counterparts, from which we can infer that the township government has the possession rights over the enterprises. In fact, this deduction is a little incorrect, as ownership clearly stipulates that the enterprise is possessed by all farmers, which means that the legal right form of possession is explicit; the *Regulations* stipulated that the main body to execute rights is the 'residents' meeting (farmer representatives' meeting) or collective economic organization which represents all farmers'. The meeting or organization was the intermediate link to realizing the principal-agent relationship of ownership and was the rights entrustment organization of use rights derived from ownership. In this sense, the residents' meeting and Workers' Congress of State-owned Enterprises (worker representatives' meeting) have the same structure in the rights setting; both meetings have the right to entrust the representatives with executing use rights, but without the right to let use rights possess ownership. At that time, the reform of elections at the basic level in rural areas was not initiated, the residents' meeting was nothing but an empty shell, and the agent of collective ownership was the town or village leaders. However, this does not mean that the township government owns properties. Even in some places, the administrative position and enterprise position were set as counterparts, reflecting a kind of principal-agent relationship.

In this case, the enterprise operation managed by the factory director (manager) was no longer a manifestation of a possession relationship, but was a manifestation of an operation relationship. Under the condition of the contract responsibility system determined by the double-track system at that time, people tended to confuse ownership with use rights as determined by national policies, although in reality they always believed that the functions of management rights were much greater than those of ownership rights (Rozelle and Li, 1992).

In fact, in the analysis in study 5, Liu (2006) emphasized the concept of operational possession. The basis of this concept is that the financial contact system has strengthened exclusive management vertically. Thus, on the one hand, the profit made by the factory director (manager) and contract target are coupled with one another, and on the other hand, the factory director (manager) can make independent decisions on enterprise production and transactions. In this sense, the factory director (manager) played the role of the owner of the enterprise property. In the meantime, exclusiveness formed by the interpersonal relationship network

has weakened the substitutability of ownership, which helped the director to transfer informal exclusive ownership to formal exclusive ownership.

In reality, by observing the historical experiences of the enterprise system transformation since the 1990s, we can see that the reason for the evolvement of ownership was not the outcome of the evolvement of operational possession; in this process, to achieve the leaping transformation of use rights to ownership, the factory directors (managers) always resorted to powers other than possession and operation, such as polity circumstances, system gaps, tolerance in reason, and shielding by factions, which were utilized to implement the 'reasonable choice' of 'opportunism in the last contract' (She and Chen, 2005: 37). Here, we can call this a 'multiple operational relationship'.

Two aspects of the utilization of operational relationship can be discussed.<sup>9</sup> The first aspect is the social solidarity of local society and its legitimacy in customs. As rural society in China is not a possession standard society, the commonly accepted customs, habits, and conventions tend to blur the boundaries of ownership when consanguinity and kinship are involved. The second aspect is the policy and ideological elements in national governance, which create changeable policy circumstances and influence people's cognitive schema in terms of ideology. Liu (2006) described people's special trust structure regarding the form of the ownership system as a downward sequence of trust, from enterprises owned by all the people, township enterprises, village enterprises, individual households, to private enterprises. This sequence forced some individual household enterprises to register legally not as private enterprises, but as township or village enterprises, with a tacit understanding with the township and village governments and with the initiator appointed as the general manager.

This phenomenon fully illustrates how the power of the governance system always exceeds the influences of the relationship of possession or management, and that such a mode with the characteristics of power determines the final evolving trend of the possession structure. In fact, when starting from the overall structure, it is not enough to take township enterprises as a specified field of research, as from the research studies above, it can be inferred that the unit system in urban areas has a substantial interdependent function in rural society.

From these five studies on property rights, we can see that the structural and systems analyses in such research have enriched the theoretical meaning and connotations of enterprise experiences in China. At the same time, however, these studies only emphasize one side in the overall structure linkage, and the unified concept analysis lacks explanatory power. Inspecting them more closely, we can also conclude that the different social linkages in the three perspectives of possession, operation, and governance and the different logic among them have put the organization of Chinese township enterprises in a dynamic, perpetually-evolving process, as the interactions and adjustments among the three dimensions under different circumstances have taken on developmental characteristics in stages. Thus, it would be a significant research project to re-explore and clarify the concept of township enterprise organization.

In this paper, we consider three dimensions—possession, operation, and governance—of township enterprises and attempt to judge the quality of township enterprises and their boundaries and, through the linkages among the three dimensions, to reveal the political, economic, and social implications of enterprise organization. In reality, the quality of enterprises determined by the three dimensions not only stipulates the organizational structure, system arrangement, and resource distribution of the enterprises, but also influences the identities and qualifications, rights patterns, and behavior modes of the members in the enterprises. All these elements can help us to understand the operational and development laws of enterprises under the real, specific historical environment of China as a whole.

## Possession

In terms of theory or history, the concept of possession was established earlier than that of property. In his classic definition, Locke (1689) stated that God gave people everything on the land to let them use it and make it their possession based on the principle of natural law. People can use their abilities, personalities, and possessions to preserve their lives. The freedom of possession, together with actions and applications, is the precondition to preserving lives. In this world, all people deserve to enjoy what they have, and this is man's natural right (Laslett, 2007: 131).

According to Laslett (2007), in the era dominated by Locke (1689), property and propriety could be confused. However, people have possessiveness that goes beyond their own needs. Disputes are inevitable if possession rights are not established. In this case, workers may suffer a loss of possessions (Locke, 1689). Therefore, property rights have become fundamental in legal theory. Their purpose is to avoid inequality in terms of possessions arising from power infringement by protecting property, but this situation also leads to the condition of acquiring possessions for nothing.

### *Three ideal types of possession*

There are three ideal types of possession as a concept: private ownership, public ownership, and common ownership.<sup>10</sup>

*Private ownership.* The dilemma concerning possession proposed by Locke (1689) constituted the basic theoretical structure of the capital and labor relationship in later ages. In *The Political Theory of Possessive Individualism: Hobbes to Locke*, Macpherson (1962) writes that ownership determines the fundamental rights and power structure of business owners and employers by the possession of 'capital-objects'. The enterprise is precisely the modern organizational form that fosters the natural equality of rights along with unequal social relationships. In this sense, many people think business organization is, in essence, a series of possession relationships or an ownership structure formed by a series of contractual relationships (Coase, 1994; Eggertsson, 1996: 139–142).

The possession form based on private ownership is the theoretical basis of classical liberalism in general. Ownership defined by property acquisition and inheritance affirms the premise of unequal possession of wealth and therefore establishes business organization as the subject of private possession. Thus, the operation of business organizations will pursue self-interest with principles of capital accumulation and benefit maximization. Based on legal rights, an enterprise is privately owned. The owner is the ultimate subject of the rights. The owner's rights and the transfer of power are determined by the owner or, in some cases, conducted by commissioned agents. In this ideal type, the rights of the enterprise are not in the divided form, which means that the possession is exclusive in the strictest sense, which establishes the typical free enterprise system and corporate governance structure, namely a business organization's 'legal monopoly' by the possessor. It is noteworthy that, in an ideal form, private property has legal implications constitutionally—not only economic implications, but also political implications. Therefore, in the free economy, business organizations are the main component of the socio-economic structure, with a market exchange relationship that continues and is controlled by contracts.<sup>11</sup>

*Public ownership.* Based on the above-mentioned critiques of the private ownership theory, socialists believe that a reasonable form of society is to put the entire production structure into the rational resource redistribution structure. Therefore, the structure of the rights in public ownership is based on universal possession, and the priority principle is generally not capital accumulation but equal rights for all people and their protection mechanism. The transfer of rights follows the representation. The workers' congress system, effective for 30 years after the founding of modern China, was a nominal representation system.

Under ideal conditions, the running of enterprises is safeguarded by participation relationships among all classes, systems, and mechanisms. Workers as the subjects of rights may transfer the rights of business management and governance to their representatives, i.e. elected representatives of the workers perform the highest-level decision-making in the enterprise, or to a centralization system, which establishes the basic rights structure and the highest authority of the enterprises. Therefore, the core of the public economy is distribution and redistribution, i.e. capital and objects are allocated by central agencies from the top of the hierarchy to the bottom.

However, in the ideology of public ownership, the possessors are all the people, who constitute the only personality foundation of possession. Therefore, in the specific economic process, agents (representatives) are needed to complete each step of the processes of production, exchange, and transportation, which are decided by the planning system of redistribution. Only a bureaucratic government has the hyper-rationality (Heller, 1983) and execution efficiency to perform this function. Therefore, government at all levels becomes the main agent of possession rights and the core of social and economic operation in lieu of business organizations, as is clearly seen in the study of the unit system (Li and Li, 1999). Szenlenyi,

Beckett, and King (2010: 42–43) believe that, in contrast with the free market economy, the goal of which is to maximize production, the redistribution system works to minimize personal consumption in order to guarantee collective consumption. Thus, consumption decision-making power is transferred from individual consumers to the government, and the residual income is reallocated from profitable enterprises to unprofitable ones in order to protect equal rights between enterprises.

Kornai (1959) believes that the redistributors usually try to maximize the residual income within their control to expand their power in redistribution. As a result, it is difficult for the single agent of public ownership to rely on the central government's rational planning to run the entire economy successfully, just as the individual rationality determined by private ownership leads to periodic economic crises because of losing efficacy in relation to the entire market. Anarchy of plan may replace anarchy of market.<sup>12</sup>

*Common ownership.* Compared to private and public ownership, common ownership generally emphasizes the traditional customs and cultural resources of the community. This type of ownership assumes that business organizations are built on a common possession basis and that they somehow have structural characteristics like those of churches, fellowships, guilds, villages, or family communities in the conventional sense. Take the corporation, which Durkheim (2003) said is different from liberalism and socialism in that the former takes the clear property rights of the bourgeois capital owners and investors as the deciding principles of the business organization, and the latter determines the ownership of the enterprises by labor and collective possession. Relatively speaking, common ownership places more emphasis on the concept of community members, proposing the natural division of labor and the historical division of labor between members as standards by which to measure rights and powers. Hence, it is collective possession that pursues maximum average income for the members, which blurs the dialectical concepts of capital and labor as well as the boundaries of state power. It focuses on the concept of dividing and possessing based on the identities of members.

Common ownership is, to some extent, a collective ownership system, placing special emphasis on the associated factors within the organization, such as customs, ceremonies, reasons, intimacy, and other traditional moralities, namely members' sense of belonging and identification with the organization. This business organization shows non-capitalistic characteristics, basing the nature of the enterprise more on occupational stratification. Among enterprises, the above mode easily transfers some rights of the business organization to inter-industry social organizations to reduce the risks of competition through industry partnerships, to sustain a sense of belonging and identification, and to strengthen social solidarity (Durkheim, 2001, 2003). However, as Demsetz (1994: 113) said,

In the common property regime, many costs are ignored in maximizing common property. To an owner of common rights it is impossible to refuse to share the

fruits of his efforts with others. And the negotiation of all the members to reach an optimal behavior agreement costs a lot.

Therefore, it is difficult for the common ownership of collective possession to adapt to the modern competition of the free market, and it can very easily be destroyed by the political authority of the overall system.

### *Intermediate states*

In the history of enterprise evolution, since the 20<sup>th</sup>-century, there have been some intermediate states concerning the three ideal types of possession. The possession system with private ownership as its main principle improves itself by absorbing other possession forms, such as employee stock ownership, participatory management, sharing benefits, stakeholder management, labor–management cooperation, conflict management, and a series of new ways to maintain and develop the capitalist enterprise system, resulting in varying degrees of rights transfer in three sectors. First, Ellerman (1998) proposed the ‘system of democratic corporation’, drawing reasonable elements from common ownership and constructing another form of the enterprise based on the contractual relationship, so that the company’s employment system is replaced by membership. This organization not only gives those enterprise members who had no prior possession rights the right to vote, but also creates a theory of labor and property in which enterprise members have the rights of residual income and net income.

Ellerman’s (1998) argument is that the abolition of the employment relationship does not abolish private property, the free market, and entrepreneurial power, but it changes the scope and nature of these systems. The system tries to interpret employed labor as possession rights. However, these rights cannot be owned by workers as property, which can be bought and sold. Therefore, laborers do not have entire possession rights. Workers’ membership does not challenge the possession relationship in an absolute sense but partly converts the ownership and transforms the employment relationship in the business and governance sense.

Second, ‘share economy theory’ refers to an organizational model in which enterprise employees participate in profit distribution and revenue sharing. For example, employees, together with possessors, share the total revenue of the business operation in addition to wage income by means of bonus systems, profit sharing, incentive wages, profit-sharing systems, net revenue sharing systems, and so on (Meade, 1989). This model is also an attempt to include some elements of common ownership in private ownership. The sharing system is essentially an institutional arrangement that distributes property rights among human capital owners and non-human capital owners. It is merely an income distribution system of the enterprise, which is different from the wage system (capital exclusive system) and labor exclusive system. Capital possessors still hold decision-making authority (Liu and Zhang, 2002). It is important that the private property rights can not only promote specialization of production but also integrate social capital

to promote production and other economic activities by its divisible, detachable, and transferable features. The modern shareholding system or shareholding enterprises expand the organization's boundaries to include all of society, establishing an aggregation of social capital in the possession sense. It gathers sufficient capital as exclusive business resources for large-scale management and separates the decision-making power of exclusive business resources from the implementation results of market value, resulting in specialization of both control power and ownership. However, because the possession structure of shareholding enterprises is determined by the equity ratio, it does not assign equal rights but eventually allocates rights based on asset class.

The possession system with public ownership as its main body also absorbs some factors of other systems. During the Second International period, scholars tried to combine concepts of market and nation with the perspectives of class analysis.<sup>13</sup> The basic proposition of this middle way is that with a precondition of admitting democracy, the position of collective bargaining is established in a legislative mechanism in the form of parliamentary politics at the national level, and the law of workers' rights protection is introduced by workers participating in the legislation.

Enterprise law is more of a constitutional principle than a civil law principle. Within an enterprise, a form similar to the parliamentary system gives employees the opportunity to participate in business decisions, which determines the possession rights structure of the business organization and also the rights and obligations in its application. The Social Democratic Party eventually maintained workers' possession rights through multiple links such as parliamentary legislation, judiciary, labor unions, enterprise parliament, etc. rather than through a purely contractual relationship. This change in public ownership aims to resolve the principle of universal possession into the principle of workers' possession based on business organization through the legal basis of constitutionalism, which will return the possession rights to business organizations, reducing the absolute risks incurred by the overall system.

In addition, according to the eastern European experience, the research by Szenlenyi et al. (2010) showed that the planning system of public ownership was never alone but had two economic sectors: a dominant redistribution sector and a subordinate market integration sector. In the latter, various types of small, state-owned, collective, and private enterprises arising from market integration constituted a 'mixed economy' together with large enterprises within the planning system. The phenomenon of 'double-circulation accumulation' diversifies the overall system of possession, which generates a series of free-flowing resources and solves the consumption and efficiency problems under the planning system. However, the so-called diverse possession forms are always in the shadow of the ownership by all the people. They do not have sufficient legitimacy ideologically.

The possession state of common ownership also made adjustments accordingly. Corporatism still defines the structure of possession rights based on collective public opinion in terms of business organization. However, it emphasizes that

business organization plays the role of the intermediary and makes adjustments for community and national public policy-making. It also emphasizes the orderly interaction between business organizations and local governments as well as the organizational role of state authority (Zhang, 2005b). In this sense, corporatism assumes that business organizations extend their ranges in bidirectional ways. First, they expand the boundaries of some enterprises to the industrial or regional scope, creating an entire organizational environment and establishing a large-scale social cooperation system (Streeck, 1982: 72–73). Second, they bring themselves into the country's governance system or connect local governments, communities, and enterprises in a community of interests and rights. Thus, a set of local protection systems is established, in which the government raises funds, provides technology, promotes sales, and deducts taxes for the enterprises while the enterprises bring in a lot of fiscal revenue for the government, providing employment opportunities and welfare facilities for the community (Chen, 2010; Oi, 1999).<sup>14</sup> As for the concept of corporatism, apparently the business organizations strive to blur and expand the boundaries of the possession structure as much as possible in order to obtain a greater public advantage. This situation reflects the cooperation of the corporation organization and the various local customs and traditional resources it relies on, which help to resist the harm of stronger power and greater capital.

### *An empirical investigation: the triple possession relationship of town and township enterprises*

We now take town and township enterprises as an example with which to discuss the complicated composition of possession structure. First, if we look at these types of enterprises from a longer historical perspective, the institutional bases of town and township enterprises are the commune and brigade enterprises<sup>15</sup> that existed before the reform of the people's commune. Though it was categorized as collective ownership, the institutional progression from the mutual aid team and cooperative team to the people's commune was also a progression in which farmers gradually lost control over the means of production. During the period of mutual aid and cooperative teams, farmers could still supervise and restrain the collective production and operation activities by using withdrawal rights, but during the period of the people's commune, 'the collective ownership in the legal sense was combined with the household registration system, so farmers were deprived of withdrawal rights' (Qiu, 1999). Therefore, the volunteered assets combination and cooperation were replaced by the government's control over collective assets. As the collective assets had all the features of state-owned assets, this possession form was in no obvious way different from the progressive proxy system of the people's ownership by various administrative hierarchies.

Second, rural enterprises collectively-owned by all farmers and the residents' assembly had the decisive vote on the exercising of collectively-owned enterprises that were stipulated in the *Regulation on Rural Collectively-owned Enterprises* to be the same as those in the *Regulation on Urban Collectively-owned Enterprises*.<sup>16</sup>

Also, in the rural areas, not all farmers could exercise possession rights as the enterprise's staff. It is hard to imagine that local farmers who were not employed by the enterprise could fulfill the possession rights of the enterprise. Hence, this notion was just an ideological wish that all people could be represented by all farmers in the possession of an enterprise, which illustrates the dimension of public ownership in a collectively-owned enterprise.<sup>17</sup> Therefore, a township government, as a proxy of collective rights, was legitimate in acting as an agent of possessive rights in this dimension. The phenomenon of 'lacking the initial contract' in study 3 can be explained by the fact that this kind of possession is not defined by a contract.

Although all farmers had nominal possession rights regarding rural collectively-owned enterprises, the representation system of the residents' assembly (farmers' congress) was, in essence, non-existent. Farmers (especially those who were not employed by the local enterprises) could not actually enjoy these rights. However, according to the meaning of common ownership, i.e. under the condition of collective ownership of rural lands, farmers should obviously enjoy possession rights. In the vast rural area, where the farmers had cultivated the land generation after generation, they could thoroughly understand the basic earning ability of the land and the land system that decided what their lives and family possessions would be like. As for those who worked in collectively-owned enterprises or whose land was expropriated by the enterprises, they would evaluate their economic earning or loss by calculating the earning or loss in land cultivation.

As for the residual income of the collective property, first, the farmer would do an overall evaluation of the economic returns of his loss of collective land by calculating the benefits of land cultivation for many years (including the output value of the non-cultivated land when the farmer took a job), and then the farmer could come up with a residual income. Second, the farmer would take his share of the enterprise's profits as a collective owner for another type of residual income. Of course, the calculation and claims of the latter were uncertain and not bound by any business contract, so they can only be calculated according to the contract and share of the land being contracted.

To summarize, in collective ownership, the possession relationship with features of common ownership had the fundamental basis of land collective ownership. Apart from the requirement of converting the economic return of the land cultivation, the additional requirement of farmers belonged to the operational dimension. Otherwise, it is hard to explain the function of a 'land contract' as an intermediate link. The contracting system under the framework of land collective ownership resulted in the dual-possession concept of farmers. The contracting system defined the calculation range of the land economic returns. That is, it was calculated based on the family, not on the collective. At the same time, due to the protection of collective ownership, farmers would conceptualize the use rights as the possession rights during the contracting period because the national policy made stable commitments. It is interesting that the farmers' attention to the possession rights of town and township enterprises and the relating residual income was not generated by the enterprise or the contractual relationship itself, but by

their land rights. Meanwhile, the claims resulting from land collective ownership and the requirements of social welfare of rural community members cannot be treated equally.<sup>18</sup>

Of course, the establishment and operation process of a town and township enterprise was a process of continually inputting resources such as technology, capital, material, information, and networking by individuals, and this situation resulted in the phenomenon of a second-time contract. The problem of possession under private ownership also appeared. According to the regulations of the above-mentioned ownership, the factory director (manager) served as an agent to operate the enterprise, without the issue of possession rights being involved. However, in fact, these agents cherished factories as their families and continually inputted all kinds of resources and capital during the commission operation, so they clearly met the requirements for possessing the residual income. This claim was not specified by a pre-existent contract, but its legitimacy cannot be denied.

In a general sense, changes in the structure of an enterprise's ownership are usually confirmed with capital input as the first condition. During an enterprise's operation, any capital investment by the individual is partly dividing and possessing ownership, i.e. the process we call 'taking shares'. However, without a specific contract, it is impossible to judge what residual income individuals' investments merits, but we cannot totally deny the validity of the investors' claims for possession rights. This claim is not formed based on an exclusive operation monopoly and social network as study 5 defined them, but on the definition of possession itself. Of course, as the ownership of town and township enterprises is a composite, no individual investor has reason to take it as his own.

It is interesting that the private dimension of town and township enterprises was not limited to individual investors, but was also reflected in a special shareholding system transformation. Judging from the examples provided by study 3, this process was special in that it was not an actual shareholding system transformation, which aimed at configuring and dividing the equity. It secretly replaced two of the above-mentioned enterprise ownerships with an equity configuration, and thus public and common ownership was replaced by the private ownership inherent in the shareholding system. The essence of changing public or common ownership into a corporate system is not just dividing and taking up shares, but changing the nature of the enterprise's ownership during the policy-driven transformation campaign. The non-private aspect of public ownership was replaced by private ownership based on the equity ratio. In a one-time equity configuration, the most important change was to replace common or public community ownership with private enterprise ownership. Moreover, if we calculate the possession structure accurately, the shares given to farmers may have been significantly lower than the accumulative benefits they might have earned from cultivating the contracted land. This situation can partly explain why local capital quickly accumulated during the enterprises' shareholding transformation process in the 1990s. This transformation fundamentally changed the possession system, at the cost of depriving farmers of their possession rights.

Proceeding on from the three ideal types of possession, we can see that the possession form of the town and township enterprise reflected a very delicate and peculiar phenomenon. The township government considered itself to be the possessor, as did the collective or the members of the collective and the individual investor. Since the first kind of consideration was decided by the country acting as an agent of the people's ownership, this consideration is the most ambiguous. The second consideration narrowed the range of possession to the collective, which was not directly reflected in the enterprise's property rights but in the collective ownership of the land. Though the third consideration recognized the rationality of possession resulting from investment to some degree, it usually mixed what was public with what was private and displayed the feature of informality. Therefore, the complicated composite of possession structures cannot clearly confirm the possessor of the enterprise, and different possession forms are intertwined and mutually restraining. This situation is what economists call the 'fuzzy property rights' phenomenon (Li, 1995). In contrast, town and township enterprises in the south Jiangsu province, with solid foundations of commune and brigade enterprises, had obvious institutional characteristics and collective property. Their assets and capital structure usually came from the institutional characteristics and collective property. The three kinds of possession forms easily approached convergence and generated the so-called 'governmental factory' phenomenon.

Naturally, in the transformation process that followed, loopholes developed among the three kinds of possession systems. Some people with political or capital power took advantage of national policies and subtly maneuvered between the boundaries of the possession systems, secretly substituting the contents of possession systems in different dimensions to promote the privatization of town and township enterprises. Compared with factors such as failing in market competition and lacking technology and capital, the above-mentioned factor provides a better explanation for the decline of town and township enterprises.

## Operation

If, in the concept of possession, enterprises' rights, structure, and types of work are more clearly defined in the political and jurisprudential perspective, then the concept of operation is another important factor that defines enterprises' organizational behavior. Weber believed that any form of possession modern enterprises take could be regarded as a kind of economic behavior, which is not focused on domestic consumption, but carried out with rational purpose and calculation in continuous business activities (Swedberg, 2007: 45–52). Therefore, the nature of enterprise lies in the continuous business activities organized by operating bodies, the principle of enterprise is making profits and efficiency, and the core of molding the concept of enterprise is capital accounting<sup>19</sup> under the formal rationality.

Accordingly, some operating premises are required for a legitimate enterprise: (1) a capital accounting system, including accounting and books of accounts; (2) economic principles of the free market: currency payment and the principle of good

faith in currency exchange; (3) the concept of a profession is formed by the heteronomous labor distribution and livelihood provided by the economic regulators (unfree profession differentiation); and (4) the main forms of organization under the relationships between possession and market: evolving from cottage industry to exclusive customer industry (manor system), then developing into enterprises of free industry (industrial association).<sup>20</sup>

Operation refers to enterprises setting up management systems and personnel arrangements to gain profits. This aspect of operation is so important that it constitutes the fundamental difference between enterprises and other organizations in society. Enterprises are after profit, and have the right of disposition in financial affairs, which is an essential characteristic in business activities. Calculating the currency gained from rational economic activities is called capital calculation, evaluation, and supervision concerning the opportunities of profit gains and losses. In general, operators are in the upper and middle classes in enterprises, usually being decision makers, executors at all levels, and supervisors, and have a close relationship with the utility feature of enterprises. The operating structure of an enterprise is a top-down command system, a type of bureaucracy.

A fundamental difference between possession and operation is that possession is the precondition of operative activities, a basic power structure, while operation is a series of activities intended to obtain profits. The possession structure determines where and how to perform business activities, while operation is the system that determines how to maximize efficiency in a rational way. In possession, the possessor dominates the business activities, while in operation, the whole crew of an enterprise, especially the managers, dominate instrumentally rationalized behavior.

### *Three ideal modes of operation*

We can best understand business activities by considering their three modes: authoritarian mode, jurisprudential mode, and surrogate mode.

*Authoritarian mode.* Authoritarian enterprises usually appear in the early phases of capitalism and the start-up period. The possessor of an enterprise is also the operator, running the business and managing the capital by relying on the possessor's personal business philosophy, motive, money, and ability. The possessor is the despot in every aspect of the business operation, with an absolute monopoly in the enterprise. In different forms of possession, such as private ownership, public ownership, or joint ownership, the authoritarian type of operation is manifested in different forms, such as a business owner's dogmatism, the government's order, or, in late medieval times in Europe, the monopolized power of a parent, patriarch, or guild master. The latter are the traditional forms of authoritarianism.

In these enterprises, the possessor either already exists as an individual or a group becomes the authority that dominates business activity. The rights of possession and operation are completely united. Therefore, order and discipline in authoritarian operation can be fully executed and have maximum effect.

However, serious doubts remain as to whether the possessor can realize the goal of operation.

*Jurisprudential mode.* According to Weber's (2005b) classical definition, the jurisprudential mode can be generally described as a business organization under unified leadership with discipline and expert knowledge and is the most rational operation model. The typical structure in the jurisprudential mode is bureaucracy. In this case, the right of operation is not entirely subordinate to the right of possession; nevertheless, enterprises' resources, forms of organization, and marketing channels are reasonably allocated according to technical, specialized, and knowledge requirements, and the organizational divisions and management systems are designed according to the internal requirements of production procedures, techniques, circulation, and sales, so as to maintain reasonable order in and achieve the overall goals of operation. Bureaucracy of operation highlights the rational spirit of formality, treating the operators as specialized talents with expertise. The apparent characteristic of formality is the reason why the organizational spirit, apart from personal influences, takes the leading role, with its responsibility being irrelevant to personal feelings and will (Weber, 2005b: 307–322). In another words, in jurisprudential business organizations, the inherent request to meet the operation goal is more important than the decision-making power of the enterprise possessor. In some large-scale enterprises, the real owner or top manager seems almost invisible, yet the operation activities may be carried out systematically.

In authoritarian business operations, the right of possession determines the right of operation. In jurisprudential operations, however, the right of possession is inactive, while the right of operation is active, not for some specific operators, but in revealing certain intangible characteristics. A bureaucracy means that operation activities can be run by the rule of knowledge. On the one hand, expert knowledge puts one in a position of power; on the other hand, within the bureaucratic system, expert knowledge can only be attained within someone's own expertise ranking, and employers can only accumulate their experiences and knowledge within their own business fields, obtain the truth about every corner of the business operation, and have access to information limited by their ranks. Therefore, bureaucratic enterprises have distinctive administrative characteristics, which may take shape under either capitalism or socialism. In both planned and market economies, this kind of jurisprudential enterprise may exist. In a large, state-owned enterprise under a planning system or a giant group company in a market system, such an enterprise is a programmed organizational chain with rigid stratification, and the overall objective of operation is decomposed into each level's work schedule and is supervised afterwards. This kind of organizational mode displays a contradiction. Since employees at their own particular levels of operation only need to be responsible to their superiors, hardly anyone can truly understand the overall objectives and rational operation goals of the enterprise. A bureaucratic system is a top-down structure, but for operators and business activities in this system, differences are level except in terms of rank (leveling).

*Agent mode.* To build an entrusting relationship is to transfer the possession rights of the consigner into the operative rights of the agent, realizing an actual power transfer. The precondition of this mode is that the consigner has the right of possession, and entrusts the right to use assets to the agent, who usually does not have the right of possession; in other words, the consigner allows the agent to execute the rights of the enterprise's operation and decision-making. In an entrusting relationship, the identities and rights of the two parties are clear, due to the actual separation between the right of possession and the right of operation, and the fact that the possessor voluntarily transfers the rights of operation by a contract. This situation is different from a bureaucracy in jurisprudential mode, in which the rights of operation are divided into multiple levels of rights, each of which has its own operation objective as part of a chain of operation objectives, while professional agent managers have complete freedom in exercising their rights of operation. In bureaucratic contractual relationships, only employers are responsible for providing superior leadership, not the possessor, while in agent relationships, the agent is directly responsible for the possessor, since the objective of the consigner is to maximize the capital profit, while the agent is bound by a contractual obligation within a fixed term.

The existence of the agent mode lies in the fact that the agent has distinct comparative advantages in business management, expert knowledge, or information access (Grossman and Hart, 1983: 7–45). Therefore, in the right structure of the agent mode, there exists the problem of asymmetric information, mainly in two forms. One is adverse selection, in which before the agent is contracted, an inadequate consigner might not be able to select the right agent. The other is the agency hazard, in which after the agent is contracted, the agent with information advantages may use the asymmetric information to harm the consigner's interests while benefiting himself or herself. Thus, based on these factors, the consigner needs to find appropriate solutions to effectively supervise and motivate the agent (Jensen and Meckling, 1976: 305–306). It is worth mentioning that the agent mode of operation is ubiquitous in society, and its examples can be found in the relationships between the state and state-owned enterprise managers, the state-owned enterprise managers and their employers, the state-owned enterprises and their certified public accountants, company shareholders and professional managers, and voters and government officers.

### *Empirical observations: the rule of business first under the responsibility system*

The successful formation and operation of township enterprises have everything to do with the institutional environment during the first 10 years after the implementation of China's reform and opening-up policy. In the first years of the reform, the township enterprises benefited from the double-track system. In some ways, the double-track system has a 'suspension effect' by which the right of possession is protected and blocked, the basic structure of the original

institution is maintained without fundamental change, the right of operation is strengthened, and the increments are developed to increase liquid resources (Zhang J, 2006). In fact, the double-track system is a segmented juxtaposed structure of the social economy. On the one hand, the basis of ownership under the planned economy, in other words, the structure of possession, is left unattended; on the other hand, the right of land use or management power of the enterprise that was restrained by the original ownership is freed to stimulate the growth of key elements in all fields of the social economy and uses indirect methods to improve the transaction efficiency by incremental logic, so as to change the social structure.<sup>21</sup>

The emancipation of the rights of use and operation has been realized through the responsibility system. In the first 10 years of the reform, three aspects of the responsibility system were implemented. The first aspect was the household contract responsibility system, which separated the land use rights from the collective land ownership. This changed the principle of rural land possession, bestowing the rights of land use on family units, which is also known as 'fix output quotas on a household basis' or 'work contracted to households'.<sup>22</sup> First, the household contract responsibility system established a double-track layout in which the individual household uses the land and the collective possesses it. The subjects of the rights of land ownership and use were no longer the same. Second, the system established a type of performance-based work awareness in vast rural areas in that production efficiency and profit became top priorities, and thus the operation of land was positioned higher than the possession. Third, the system allowed the state or collective ownership to have a personalized foundation for operation, which meant that a quasi-contract between the product and the commodity was formed, driving the non-state economic sectors to begin to search for market laws concerning production as well as sales and pricing under the administration of local governments and driving these sectors to establish a totally different incremental logic.

The household contract responsibility system was expanded from the agricultural field to industrial production in rural areas, making the separation between land ownership and land operation a legitimate foundation for the separation between the ownership and operation rights of collectively-owned enterprises. Meanwhile, the right of operation of rural enterprises was forming a more complicated structure. According to the provisions of Clause 3 in Article 6 of the *Regulations of Township Enterprises under Collective Ownership*, township enterprises under collective ownership shall be independent in management and accounting, and responsible for their own profits and losses. They can implement various management responsibility mechanisms, and they can absorb capital investment under the premise that the nature of collective ownership stays unchanged. These provisions have had three manifestations. First, the independent operation of township enterprises is now based on township enterprises having the right to dispose of their own profits. Thus, they are no longer controlled by either the original distribution system or the restraints of the ownership system, allowing them to become relatively independent operators with characteristics of those in a

market system (Szelenyi et al., 2010: 42–53). Second, management responsibility pluralism acknowledges the independent status of the factory director (manager) under the contracting system, leasing system, or joint operation system. The client–agent relationship, the personalized operation, is established. Third, it is a revolutionary change that private capital investment is allowed and established, on the structure of possession, although it cannot disrupt and change the nature of the collective ownership. In fact, the full right of operation enjoyed by the agent and the investor are implicit in the last two regulations.

The *Notice on Rural Work of 1984*, the most important central document issued in 1984, the *Regulations of Rural Enterprises under Collective Ownership*, issued in 1990, and the *Law of the People's Republic of China on Township Enterprises*, issued in 1997, all emphasized the nature of collective ownership of township enterprises, the collective right of decision-making in product orientation, asset disposal, and distribution principles, and the public duties enterprises owed to collective members and rural communities. Three principles were clarified on the establishment of operation rights: (1) the enterprise operator is the factory director (manager); (2) the factory director (manager) is fully responsible for the enterprise; and (3) the factory director (manager) exercises his/her functions and powers on behalf of the enterprise. Apparently, factory directors (managers) under the contracting system are endowed with the full authority of operation by these documents, regulations, or laws; in other words, 'to exercise its functions and powers on behalf of its enterprise' means that the rights of decision-making in operation are completely in the hands of the factory director or manager.

There are two key issues concerning operation rights. First, who appoints the factory director (manager), and how is this done? Answering these questions would involve the issue of state or collective ownership forms and confirming the agent who executes the rights of operation. When selecting an agent, what is the middle passage between the rights of possession and the rights of operation? Who gets to decide about the client–agent relationship?

Second, how does the factory director (manager) gain the rights of operation and decision-making through official means in the daily operation of the enterprise? In other words, what is the method of power transfer inside business organizations? According to the *Regulations of Rural Enterprises under Collective Ownership*, the factory director (manager) shall be appointed through open recruitment procedures or recommendations. Thus, the selection of the agent is not done by the residents' meeting (farmers' representative meeting) under collective ownership, resulting in the phenomenon of no initial contract as described in study 3. In the client–agent relationship of the rights of possession and operation, the client is not the real subject of the rights of collective ownership. The real subject is the administrative agent appointed by the local government under the national governance institution. In the transfer of the possession and operation rights, some rights of possession in the rights of operation were lost, leaving space in the system for the transfer of the operation rights to the possession rights in the enterprise reform in the 1990s (Tian, 2000: 247–268).

The second issue illustrates the fact that in a business operation with the factory director (manager) in place, an effective power mechanism is not fully implemented to restrict the rights of decision-making and operation in business organizations. In the *Regulations of Rural Enterprises under Collective Ownership*, employees have the right to participate in the democratic management of the enterprise and to criticize and accuse the factory director (manager) and other managerial staff; the employees' congress has the right to give advice, to make suggestions concerning problems in business operations, and to appraise and supervise the factory director (manager) and other managerial staff so as to safeguard employees' lawful rights and interests. However, in most township enterprises, the employees' congress has almost disappeared. Even if the congress has the above-mentioned rights of suggestion, appraisal, and supervision, these rights are no longer considered the most important rights in the collective ownership. In other words, the employees have basically lost the rights of participating and decision-making, which were bestowed on them by the collective ownership.

Therefore, under the contract management responsibility system for enterprises, the selection of the factory director (manager) and the business operation are no longer focused on the relationships with rights under the collective ownership. In study 5, 'operative possession' became the well-known 'real illusion', although it did not conform to the actual connotations of the two concepts, possession and operation. The separation of possession rights and operation rights was realized not by normalizing their relationships, thus resulting in the phenomenon of operation rights overstepping possession rights. The second contract mentioned in study 3 played the leading role in the operation of township enterprises and even became the basis for understanding the orientation of rights and their nature.

In the 1980s, the contract management responsibility system manifested again in the fiscal relationships between governments at all levels. Because of the so-called 'financial contract system', the state did not directly interfere with rural economic activities as the first possessor anymore, the township government became less reliant on the fiscal support of upper-level governments, and the ratio of self-financing gradually increased (Zhang Y, 2006). The phenomenon of 'stiffened vertical exclusiveness' mentioned in study 5 appeared. The most important thing about the contract management responsibility system is that it turned local governments into active parties with clear objectives and interests. Local governments made many efforts to increase disposable revenue income, and they kept the excessive revenue. They negotiated with the central government for lower responsibility standards and higher ratios of excessive revenue (Qu et al., 2009). The taxation of the financial contract system was mainly in the form of a product tax, meaning that as long as enterprises were operating, they had to pay the tax with the value of the output or added value as a basis of whether the operation was beneficial or not. Therefore, the administrative power of local governments quickly turned into operation rights. Local governments worked hard to increase their revenue income by opening large township enterprises with loans, a practice known as 'pooling the water to farm fish'. In addition, local governments strengthened their interference

into the operation of local key enterprises; some governments even adopted the strategy that allowed the village party branch secretary to hold his or her post concurrently with that of the chair of the village enterprise. In this way, the village and the village enterprise were run by the same administration, with the client of the collective ownership becoming the agent of the enterprise operation, and a group of factory governments and institutional entrepreneurs appearing (Oi, 1992; Zhou, 2002). The financial contract system further enhanced the role that operation rights play in township enterprises' internal organization relationships and external administrative relationships. The law of 'business first' had already reached into every aspect of rural social life, as manifested in the selection of the factory director (manager), the formation of the business mode, the governments' efforts in building institutional environments for business, and the governments' direct interference into business operations. Sometimes they even became operators themselves.

Therefore, compared with possession rights, operation rights display their advantages in three respects: (1) the contract system of agricultural production first reduces the land collective ownership to the individual (family) land usage rights; (2) the contract system of industrial production releases the operation rights of town and township enterprises from the constraint of possession rights to a large extent and establishes the principles of putting operation and benefit first; and (3) the contract system of finance in local governments makes the local governments responsible for their own revenue and expenditure, extending the range of operation rights beyond the enterprises in the economic activities directly controlled by the local governments, confusing the actual boundaries of the enterprises. For the above-mentioned reasons, the management structure of town and township enterprises demonstrates many special characteristics.

First, concerning the scope of the enterprise's organization, the dual-track system has a shelving effect. In other words, as ownership was transformed into stocks, the collective ownership was unable to provide protection to all members. Because the institutional environment of the contracting financial system only constrained the internal management of an enterprise based on the results but not on the process, the factory director (manager) was endowed with supreme operation and management power. For a very long period, this typical authoritarian type of operation system left little institutional room for the enterprise's members (staff) to participate in the operation, and all activities in the enterprise centered on production and sales. The reliance on an authoritarian regime and the arbitrary inertia of administrative directives passed down from the commune and brigade enterprises granted dominant power to the factory directors (managers) who 'were in charge of all business' and 'exercised authority on behalf of the enterprise' in the business operation. Against the backdrop of weak market conditions and inadequate product supplies, the contracting operation could carry out effective economic activities and form a competitive edge only through power concentration. At the same time, the power monopoly in an enterprise could guarantee external trade without attracting much attention, thus reducing the political risk of the operation.<sup>23</sup>

Comparatively, researchers on property rights are more willing to pay attention to the commission-agent relationship in these kinds of enterprises. In essence, the commission-agent relationship is decided by the structure of the possession relationship. As was previously mentioned, the triple possession relationships are incomplete and unclear, and neither can establish a complete commission-agent contract. Due to different specific conditions and possession ratios, the three types of possession relationships can form different commission-agent relationships and different subsequent ways of these relationships being transferred to possession rights.

In places like the south Jiangsu province, where the township governments considered themselves possessors that were self-commissioned, the governments and enterprises were mostly combined. This combining of the commission-agent relationship to a large extent created township and village governments as operation entities with the characteristics of factories and enterprises (Oi, 1995). Stimulated by the contract system of finance, the local governments were subjects of the contract system in the administrative sense, or subjects of earning profit in the operational sense. The possession and operation relationship, as study 3 suggested, needs no initial contract (Zhang, 2000).<sup>24</sup>

The operation mode with the features of rural communities, represented by Huaxi village, however, is more complicated. It is reasonable that Zhou (2006a, 2006b) called this mode 'post-collectivism in the transformed economy'. In fact, collective operation, which is greatly different from the state agent, blurs the ideological boundaries between public and private ownership. The collective operation, which is transferred to a unit and becomes an integrated mechanism of the village community, can combine enterprises and other economic units under the control of the village community into a complete community organization that is jointly shared by collective members, changing the distribution and return structure of public or private ownership. The concept of membership rights mentioned in study 2 is elevated to the possession and operation entity. Therefore, in this sense, the operation goal of this type of enterprise has neither the features of a governmental factory with a state agent, nor the economic benefits of a single operation unit, but consists of the redistribution of benefits among collective members. Of course, as Zhou (2006a, 2006b) discussed, this collective operation mode fully absorbed traditional factors and integrated many of them, such as the tradition of collective consumption, forced obedience to village regulations, and authoritarian orders of family politics.

Comparatively, some other places tend to see individual investors or investing entities as possessors like Wenzhou city. The operational activities on this basis place more emphasis on the idea of 'individual investment' in the statement 'collectively-owned village enterprises absorbing investment as shares on the premises of unchanging collective ownership'. This idea puts not only universal ownership aside, but also puts collective ownership aside.<sup>25</sup> However, though this operation mode is not bound by the administration of local governments or the collective, it can easily lead to authoritarian regimes and powerless employees.

In actuality, the three above-mentioned situations mix and co-exist. In other words, because of the co-existence of three types of commission-agent relationships, three different possession rights and operation rights with various boundaries intertwine, making the solution of the 'agent risk' problem more difficult. More importantly, the commission-agent relationship between possession and operation rights is not established finally by a contract. In reality, as the contract has conventional features, it is sometimes unwritten and unsigned officially. Because of reverse selection, the commissioner always chooses the agent several times, which leads to the situation of changing or replacing agents.

The problem is far more complicated than this simplified version. Liu (1999) pointed out, after systematically examining the premises and structural elements of Williamson's (1998) relationship contract, that the operation processes of town and township enterprises are associated with the phenomenon of 'second-time involvement' before and after contracting. He found that the initial contract between the possessor and operator can only realize a kind of possession with limited exclusiveness and limited selection range in a limited period because the contract 'involves the system of hierarchical relations'. Second-time involvement can change this situation. This change is because the operator involves his own relationship network in the second contract and greatly obstructs the direct connection between the township government, the village leader, and his network, setting up special and informal exclusiveness. Under this condition, the operator has stronger control over the enterprise (Liu, 1999: 86). This situation is the agent dilemma proposed by the researchers in studies 3 and 4. By discussing the 'exclusiveness formed by relation networking', the researcher in study 5 revealed the problem of 'low replacement' resulting from relying on private social relationships when operating a business in a contracting system.

The omnipresent phenomenon of relaxed contract constraint in town and township enterprises (Liu, 1999) presents a problem and a magnificent opportunity for the agent. First, as neither the commissioner nor the agent has to comply fully with the contract, the agent has the advantage of being able to eliminate the constraints of the contract while easily losing its protection. Therefore, the agent usually solves the reverse selection problem for the commissioner and actively cultivates a stable relationship featuring dependence and protectionism (in a typical case, some private enterprises are willing to be affiliated with the government). Meanwhile, the agent fully utilizes the condition of the relaxed contract constraint to tightly control or actively expand the scope of the operations. The operations mentioned here go totally beyond the normal business scope of the enterprise. As in the discussion of study 3, the agent not only grasps the lifeline of the enterprise, controlling both the power of receiving orders and the power of finance, but also extends its involvement into other business. Liu (1999: 83) stated, 'the relationship between the commissioner and the operating agent and that between the operating agent and his business partners are very close, and even the commissioner and the business partners of the operating agent have a close, direct connection'. Actually, the agent puts extra effort into constructing an operational network. As with the 'insider

networking' referred to in the discussion concerning study 4, the agent not only uses his private relationship to seek protection from higher-ranking authorities above the commissioner, but also utilizes his local relatives to cultivate intimacy with the commissioner's elders and other relatives who can influence the commissioner. For example, the agent can take advantage of the dual-track system and return benefits or sales commissions to establish a strategic partnership with a high-ranking, state-owned enterprise for the purpose of constraining the commissioner, and the agent can obtain a key technology or employ an indispensable technical staff member to reduce the replacement risk. The agent operates the business using his social networking and private relationships, a situation which goes beyond the scope of possession and even beyond the operational scopes of the contract and the enterprise. Theoretically, this phenomenon also goes beyond the explainable and analyzable scope of the property rights and contract theories.

From this perspective, Williamson's (1998) implicit hypothesis in his research on contractual relationships is meaningful. He tried to limit the discussion of this question to the scope of economic analysis. At the same time, Liu's (1999) analysis on the agent relationship of second-time involvement is effective and applicable to the trading relationship. However, in reality, the operators of town and township enterprises construct social networks, which are impossible to transfer to social bondage that can be analyzed in terms of trading cost. This kind of social networking may include political factors and mobilize local tactical knowledge, family ethical relationships, or even underground social forces. At the same time, when the complex social networking continues to expand, the boundaries of an enterprise's organization keep expanding, and the key lifeline of operations will be imbedded in external factors. If these operations can be integrated into the structure of the property rights or contract analysis, the latter's explanatory power will be reduced because of the unlimited expansion of the enterprise's boundaries.

In fact, Williamson (1998), who constructed this analysis paradigm, saw clearly the theoretical limits of further developing this research field. He explicitly pointed out that his contract research was carried out within the governance structure. Here, the specific institutional background or conditions are extremely important to the research. Therefore, Williamson's (1998) research on contractual relationships is based on a commonly recognized premise that the society possesses structural elements such as an existing legal system, political structure, market order, and ethical standards of transaction. During the social transformation in the 1980s, however, Chinese society did not have such outstanding structural features on which the default premises of transaction analysis could be formulated. For these reasons, second-time involvement in the operation process became very important; thus, we have to find another dimension, i.e. the governance dimension, to research further the hidden mechanisms of enterprise operation.

### **Acknowledgments**

This article was translated with the help of Jun Yan (yanjunjack01@hotmail.com), Rong Zhou (lotus820726@sina.com) and Qing Li (alice032316@163.com).

## Funding

This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

## Notes

1. Samuelson (1954: 387–389) believed that private products had exclusiveness in utilization, which is a resource of the nature of rights.
2. Demsetz (2007: 183) stated simply, ‘common property rights allow anyone to use land, and under this system, all people should reach a land use agreement’. However, the externality accompanied by private ownership of property does not influence all people.
3. The corrosion of marketization conditions and non-agricultural life into rural collective rights is further studied by Caldeira (2008) and Mao (2010).
4. A discussion about these questions can be found in detail in Cheung (1983) and Zhang (2002).
5. Qiu (1999) believed that the origin of collective ownership could be traced back to the period of the cooperative transformation of agriculture, but formed as a system during the period of the people’s commune system. One important element of the people’s commune system is the ‘taking production brigade as the foundation of collective properties which are owned by three ranks: group, village and town’. This is a collective ownership system and does not admit that individuals possess means of production. Under this system, all means of production should be possessed by a small production brigade, a large production brigade, and the people’s commune, while small production serves as the basic accounting unit. This kind of ‘collective ownership’ is a different concept from ‘collective ownership by community members’, as most people understand it. When the commune enterprises were renamed township enterprises during the people’s commune period, the leaders’ controlling rights to collective properties did not change. When the people’s commune system completely ended around 1984, although the land was contracted to farmers, and some means of production were sold to farmers, the town leaders’ groups still possessed the controlling rights over the township enterprises, and thus the collective system was maintained.
6. Zhou (2002) believes that township enterprises do not mainly follow the contract logic of the market; they bear a closer resemblance to state-owned enterprises.
7. Zhou (2005) approved the researching modes of ‘patron–client’ and ‘regional corporatism’ (Lin, 1995; Oi, 1992), while at the same time he believed that these phenomena could not be analyzed from the perspective of institution structure. The reason for some enterprises benefiting from the patron–client relationship and other enterprises without any benefits lies in the function of ‘belongingness within the circle’ defined by relational property rights.
8. Privatization and marketization are complementary and have a very complicated process, which is, largely, begun and promoted by the central and local governments (Qu et al., 2009).
9. The definition of the concept of operation will be illustrated in detail in the following text.
10. Many economists have discussed these three ideal types (Alchian, 1992; Demsetz, 2007).
11. Western economists usually take contract and exclusiveness and market and transaction cost as the basic concepts of property rights analysis. Polanyi (1957) had insightful opinions in this regard.

12. Kornai (1980) proposed the concept of ‘soft budget constraint’ exerted by the planning system on state-owned enterprises and revealed a strange phenomenon in economic entities’ functioning, in which an unprofitable enterprise keeps running, meeting consumers’ needs, and providing enough job opportunities, resulting in a demand surplus.
13. For example, Zoll (1976) believes that the labor union system is based on this idea, which leads to the labor union’s dual personality, in that it works in established production relationships and fights for the basic rights of employees through bargaining.
14. Some scholars describe local protectionism as ‘honeycomb politics’ (Shue, 1988).
15. The town and township enterprise was known as ‘cooperative industry’ before the period of the people’s commune, and the ‘commune industry’ in the early period of the people’s commune. From the 1960s to 1984, it was called the ‘commune and brigade enterprise’, and in March 1984, it was called the ‘town and township enterprise’ for the first time. In 1983, the central government decided to abolish the people’s commune and set up a township government, so the name of the commune and brigade enterprise needed to be adjusted accordingly. After the cancellation of the commune system, the original enterprises of cooperative industry fell into the administration of each administrative department, so the name and content of the commune and bridge enterprise were defined clearly.
16. The *Regulation on the Urban Collectively-owned Enterprises of the People’s Republic of China* was published in 1991, and came into effect in 1992.
17. See Nee’s (1989) explanation of why collective ownership is part of the redistribution system in Nee’s (1989) research.
18. Chen (1995: 22) maintains that the property boundaries of town and township enterprises are ‘defined during the trading between the community and the government and the necessary factors (land, labor, capital) of the enterprise’s operation need to be provided by the community and government. The government divides the business net surplus and the decision-making rights of the enterprise. In this reciprocity transaction, the acquisition factors become the prerequisite for defining a property boundary’.
19. Weber (1978: 96) used the concept of *Erwerb* to define the operation, by separating the usage of *Erwerb*’s chance and the market chance in the sense of enterprise organizations. *Erwerb* is realized by the *Haushalt* (budget).
20. In this sense, Weber (2005a: 123–124) has the following unique understanding of capitalist institutions: (1) entrepreneurs dominate monetary operations to prepay the laborers and have disposition rights based on product credit and product, and thus also have managerial rights that control profit production; (2) since they have the exclusive privilege of market information, capitalists own the trading rights for products as well as the monetary operation approaches of market chances in accordance with exclusiveness order; (3) laborers are internally disciplined; (4) laborers are separated from their means of production; and (5) all the means of material production turn into capital. Managers are also separated from the means of production and become bureaucrats in form. Enterprise owners actually become the agents of their credit provider (bank).
21. For example, in order to explain the phased changes in Chinese rural areas’ social systems in the 1980s, Yang, Wang and Wills (1992: 1–37) used 12 indexes to describe the transaction efficiency of three rights (use, transfer, and profit) for four properties (product, labor, land, and financial assets). In the first phase, the transaction efficiency of the rights of use and profit for production and the rights of use for labor and land was

dramatically improved. In the second phase, the transaction efficiency of the rights of transfer on production and labor and the rights of profit on labor is increased. In the third phase, the transaction efficiency of the rights of financial asset and land is further improved.

22. Work contracted to households means that all contracted households pay an agriculture tax to the state, deliver the contracted products, hand in a housing fund, public welfare fund, and other public funds to the collective, and keep the rest of the profits for themselves. Fixing output quotas on a household basis is to let households fix a production output, investment, and workload, keep the excessive production to themselves, and compensate under-production to the collective. At present, the majority of households choose contracted work. In earlier times, there was a well-known saying in rural areas that after finishing the work of the state and turning an adequate amount over to the collective, then the rest is ours, which vividly demonstrates the priority of the rural land use rights.
23. Of course, knowing about this authoritarian state is not enough. Those who consider town and township enterprises to be an extensive management mode do not realize the spontaneous rationality motivation created by the principle of putting operation first. First, workers are more disciplined. Farmers are gradually trained into employers during the strict production regime. Second, the enterprise has greater ability to acquire expertise. Most of the town and township enterprises do everything they can to recruit talents from other enterprises, steal technology, use others' brands, and optimize the production process. The enterprise improves all economic activities, including the production process, techniques, transportation and sales, etc. The enterprise, starting from the internal management, allocates the resources reasonably and optimizes the organizational structure and sales channels. All these activities aim to grab benefits according to the principles of rational management and profit maximization. Although the rationality motivation only comes from the operator, some typical features of rational economic activity appear just as Weber (2005a: 10, 14) suggested, including the opportunity to obtain disposition rights based on effectiveness and adopting all means of procurement to produce or transfer effectiveness according to the plan. These activities all appear in the operation process as monetary earnings.
24. See the research of Yang and Su (2002) concerning 'commissioning the governmental operator' and 'the profit-driven government operator'. However, according to the understanding of all the people's ownership commissioned by the state, these two phenomena do not logically contradict each other.
25. Zhang (2005) analyzed the features of Wenzhou's socio-economic structure. He pointed out that the structural advantage of private economy helped the local people to understand the town and township enterprises from the perspective of capitalism more easily. Actually, the real contribution made by the private economy to Wenzhou is far bigger than the statistical figures shown by the authority, because many so-called collective enterprises are 'red cap' enterprises, which are in fact private enterprises affiliated with the government. In 1990, the proportion of private economy to Wenzhou's industrial output exceeded 75%, while 98% of the industrial output in the south Jiangsu province was realized by the town and township enterprises. Furthermore, local governments have little reliance on town and township enterprises for fiscal revenue. Therefore, Wenzhou's local governments did not reconstruct the town and township enterprises in order to reverse the demands of the local economy.

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