Chinese Township and Village Enterprises:

A Model for Other Developing Countries

Submitted April 24th, 2006

by
Jason Field
Michael Garris
Mayuri Guntupalli
Vishaal Rana
Gabriela Reyes

Prepared for the International Economic Development Program, Ford School of Public Policy, University of Michigan

Table of Contents

EXECUTIVE SUMMARY

This policy brief examines the applicability of the success of Township and Village Enterprises (TVEs) in China to other developing countries. This paper will begin by explaining the economic history that led to the development of TVEs and their role in Chinese economic reforms. This will then lead into a review of the revolutionary structure and ownership of TVEs that distinguished them from traditional SOEs and contributed to the success of TVEs. Then we will review how the gradual decline of TVEs in the 1990s coincided with the greater push toward free market enterprise in China, thereby completing the transitory role of TVEs. Finally, and perhaps most importantly, we will examine the value and applicability of the TVE model for other developing countries. While all aspects of the TVE model cannot be applied to other countries there are lessons to be learned from the success of TVEs that would help most countries transition to a free market economy.

HISTORICAL BACKGROUND THAT LED UP TO TVES

In an ideologically Marxist country such as China, the term “entrepreneurship” or free enterprise does not seem to have a place within the economic activities performed in the country. When Mao Zedong came into power in 1949, the Communist regime actively suppressed capitalist activities for decades. Maoist prosecution of the bourgeois reinforced the perception of retailers and businessmen as low social status individuals, resulting in entrepreneurial activities causing public humiliation and prosecution. (Liao and Sohmen, 2001) However, entrepreneurship was never entirely suppressed. It flourished in the black market and the underground economy.

Liao and Sohmen identify three types of Entrepreneurship: (1) small scale and subsistence (*getihu*); (2) large scale and all sectors operated (*siying qiye*); and (3) more recent ventures led by foreign educated Chinese entrepreneurs. Through the early 1980s, small scale retailing and services activities were performed by the "self employed" as a way to subsist. The end of 1980's saw a shift to larger businesses ranging from restaurants to transportation to manufacturing. These businesses were often run by engineers or managers of State Owned Enterprises (SOE). More recently, the technology sector has been promoted by the government and flourished enough to encouraged foreign educated or trained Chinese managers to return home to start high-tech ventures.

Township and Village Enterprises (TVE) fit into the second category listed above and play an important role in rural industrialization in China. China's 1997 Law on Township Enterprises defines TVEs as "the different types of enterprises that are established in townships (including the villages under their jurisdiction) with the bulk of the capital being invested by the rural economic collectives or farmers." (Ding, Ge, Warner, 2004, 836-852) The following section will describe the evolution of rural industry policies that led to the creation of TVEs.

Chinas' Rural Industrialization Evolution

In the late 1950s, the government attempted to promote rural industrialization with the establishment of the people's commune system. The vast majority of commune enterprises were backyard iron and steel furnaces and others were intended to provide products to meet local agriculture needs. Many commune enterprises were set up in a predatory fashion and rushed into production of substandard and even unusable goods. The second Five year Plan or Great Leap Forward, which was announced to last from 1958 to 1963, turned out disastrously for the economy. The number of commune enterprise to plummet from 2.6 million in 1958 to 45,000 in

1961. (Zhang, 1990). During the period of 1961-65, rural enterprises and all other non-agricultural activities were essentially banned as rural industrialization came to a halt.

By the end of the 1960s, the government made agricultural mechanization and modernization a priority by sponsoring programs to develop the "five small industries" (*wuxiao gongye*) - iron and steel, chemical fertilizer, cement, energy (coal mines and hydropower), and farm machinery. In addition, commune and brigades enterprises (CBEs) were revived. In 1976, the State Council established a special agency to administer CBEs and promote rural small-scale industries. Thus, the main objective of rural industry polices was to support national agriculture and the needs of the rural population. However, because CBEs and the five small industries' support programs were decentralized, all of these efforts were plagued by a conflict of interests between central planners and local authorities.

Township and Village Enterprises and Rural Industrialization

It was not until the late 1970s, following the introduction of economic reforms, that rural enterprises began to take off. In 1984, the name "Commune and Brigade Enterprise" was replaced with "Township and Village Enterprises" (Zhang, 1999). The role of TVEs was elevated making them an instrument of the government to achieve agricultural modernization, absorb surplus labor from agriculture, and alleviate poverty. The economic environment coupled with the government policy was conducive and crucial to the subsequent TVE phenomenon.

TVEs contributed to China's economic growth and development, especially in rural areas. World Bank estimates show that annual growth rate of TVEs from the mid-1980s to the mid-1990s was about 25%. (World Development Report, 1996) By 1995, TVEs accounted for approximately a quarter of China's GDP, two thirds of the total rural output, and more than one third of China's export earnings. (Zhang, 1999).

In addition to the flexible structure of TVEs[1], which allowed them to adapt to economic and political conditions, several other factors and contemporaneous events drove the development of TVEs. First, the successful agricultural reform in the late 1970s and early 1980s caused rural labor to be more abundant for rural enterprise activities and provided capital as farmers' income increased. Second, support from local government was guaranteed as TVEs were often the single most important source of local government's revenue. In addition, scarce competition and state monopolies allowed TVEs to make high profits. Over time, this favorable market environment changed with increased competition leading to the steady decline of TVE profitability. The next sections highlight what drove the success and the decline of TVEs.

OVERVIEW OF TVE STRUCTURE AND SUCCESS

The key factor for TVE success is that the capital invested in TVEs originates from local sources. Accountability to local investors has forced TVE managers to make economically rational decisions and freed them from some (but not all) political restraints in order to maximize the return on invested capital.

Structure of TVEs

The term TVE is non-specific and covers a wide range of business types and complexities from the smallest cottage industry producing goods for strictly local consumption to complex factories with foreign investment producing goods for export. Township and village governments (TVG) are the dominant players in most TVEs, and usually exert de facto control over TVEs regardless of their industry, capital structure, or governance style. TVEs can be classified into

[1] This issue will be discussed in further detail in the second section of this paper.

one of three models, based on the sources of initial investment, structure of ownership, industrial orientation, income distribution and management systems. The three models are:

1. the Southern *Jiangsu* model, which depended on principal investment from township and village government;
2. the *Wenzhou* model, with private ownership under a pretended "socialist" ownership structure;
3. the Pearl River Delta model of foreign direct investment and export-oriented manufacturing.

The *Wenzhou* and the *Pearl River Delta* models of development can be considered unique to Chinese development history, and are probably not replicable outside of the Chinese economic context of the 1980s-1990s. The *Wenzhou* model appears to have been a reaction by entrepreneurs to invest while avoiding any uncertain government reaction to supposed "capitalist-road" actions. The Pearl River Delta model can be associated with the complexities of foreign investment in export-processing zones. As the importance and significance of export processing zones recedes this model is less recognizable and of shrinking importance. The applicable model for potential transfer to other developing countries is thus the "true" *Jiangsu* model TVE.

Within the *Jiangsu*[2] TVE model there are five-ownership and institutional governance types each with significant TVG participation and listed below in order of complexity and frequency of use. This paper will concentrate on the first four governance types because publicly listed TVEs have "graduated" to the big leagues of Chinese industry.

[2] Future references in this paper to "TVE" refer to the *Jiangsu* model.

Responsibility systems (*zerenzhi*): Under this system the enterprise management signs a contract with the TVG to meet operational targets for production, profitability, and other key indicators. The contract is renewable and adjusted annually.

Collateral or non-collateral contracting (*diya chenbao* or *wudiya chengbao*): Here the TVG contracts with a high bidder for total authority over the firm in exchange for a rent payment. Winning bidders may not make major changes in the firm's assets.

Joint ventures with foreign investment (*heziqiye*): This form of TVE is preferred by the central government in order to transfer knowledge and technology to Chinese partners.

Joint stock firms (*gufen gongsi*): This form of governance was established by the government to allow inefficient TVGs to modify TVE ownership by distributing shares to stakeholders, often allowing full privatization.

Publicly listed companies (*shangshi gongsi*): Few TVEs meet the qualifications for listing on the Shanghai or Shenzhen exchanges, but many aspire to eventual inclusion.

These governance models indicate flexibility for TVGs when setting up a TVE appropriate in an economy as large and dynamic as China's. This flexibility is appropriate for transfer to other developing countries, but there are important factors specific to China's development that must be considered when recommending transfer of the TVG model. First foreign investors were clamoring for a chance to enter the Chinese market because of the potential to sell to more than a billion consumers, a situation that cannot be transferred. Second, the command and control nature of the pre-reform Chinese system gave that system a unique capacity to manage complex structures. Therefore, we will concentrate on the responsibility and contracting of TVE systems as the most likely candidates for transfer to other developing countries.

Success of TVEs

There are three competing theories that attempt to explain the success of TVEs. The first postulates that TVE stakeholders in the community cooperate based on implicit contracts and this cooperation leads to efficiencies.(Weitzman and Xu, 1993) The second is that long-term relationships among village residents involved in TVEs creates forms of income-sharing otherwise absent as a result of China's underdeveloped legal system. (Nee, 1992) The last theory is that the success of TVEs is due to their special legal structure, which gives them the abilities to adapt to and configure with the external competitive environment. (Luo and Tan 1998)

The nature of implicit contracts and the efficient cooperation they stimulate is especially relevant to the initial years of economic reform in China. TVEs were mostly based in rural areas with high levels of collectivization and low levels of experience with a market-based system, perhaps leading to a suspicion of the motivations of those forming private businesses. A capitalist system is based on trust, or the sanctity of contracts and the rule of law that ensures proper follow through. A TVE was able to engender trust because of its relationship to the TVG and its implicit social contract with the local community. Stakeholders thrust into an unfamiliar economic situation were thus able to cooperate in an environment of trust that led to efficient production. However, this theory cannot explain how TVEs continued their successful economic activity after the wide acceptance and understanding of a capitalist, market-based system with private industry. TVEs are generally as successful as private concerns, even after the acceptance of a market system in China. We can conclude that this theory is relevant to the early years of TVE formation but does not explain the continued success of the TVE model.

Weitzman and Xu (1993) offer an important contribution to the discussion with their theory of income distribution through TVEs as a result of a strong social contract among villagers. In the early days of the market reform in China the rule of law was shaky and the sanctity of contracts was undeveloped. Strong social ties in the village unit were undoubtedly important to maximize income in these early days of uncertainty. This theory's failings are similar to those of the "contract-cooperation" hypothesis in that it does not explain TVE's continued success after the development of a basic contract law enforcement mechanism in the Chinese system.

Therefore, Luo and Tan's theory of TVE success arising from their special legal structure is the most compelling of the three competing theories and the one that we will base our arguments upon.

Combining the Public and Private Sector Attributes

There are three types of business enterprise in China: SOEs, private firms, and TVEs. Chinese SOEs tend to respond to increased competitive uncertainties with conservative and risk-adverse strategies, (Tan and Litshcert ,1994) while Chinese privately owned firms tend to respond to these uncertainties with more dynamic and risk-taking strategies. (Tan,1996) Chinese TVEs blur the distinctions between SOEs and private firms because of their significant TVG ownership or control. Strategic direction and governance is developed at the business level under a manager with private-sector incentives. In a Chinese business environment characterized by weak property rights and rule of law and given uneven central or regional government regulatory enforcement, TVEs are perhaps best suited to thrive because of their unique strategic situation. TVEs are exposed to a highly competitive market, which forces managers to innovate, take risks, and perform intense analysis of market changes.

At the same time, TVEs are partners with local TVGs, who can provide protections from some of the excesses of the Chinese business environment, including predation from SOEs and other favored market players. (Luo, Tan, and Shenkar,1998) TVE relationship with a local government powerbase made it less likely for the government to demand that TVEs support SOEs through uneconomic politically-motivated purchases or transfer of labor from SOEs to TVEs. From the viewpoint of the SOE the true powers behind the TVE were opaque, which likely translated into a reluctance to provoke a response from a TVG or its political allies.

A substantial contribution to TVE success was the ability to defend their private property. In the 1980's, Chinese society was still relatively anti-capitalist and viewed government powers as supreme in every sector. "People who undertook non-public or non-collective productive activities were at risk of 'taking the capitalist road', and capitalist-road-takers would have to 'cut the capitalist tail'. Under such a political environment, private property rights are insecure or at least inferior ideologically." (Chen, 2000, 54). Thus, it was important for businesses to be capable of defending themselves against the state and other parties. The involvement and support of local governments created this defense. For example, not only would it be illegal to seize the assets of a TVE business, but it would also now offend socialist ideology. Moreover, if a governmental authority attempted to encroach on the business, the local government leaders would robustly defend the business – because they are joint beneficiaries of the business (Chen, 2000). Finally, if the TVE faces a conflict with a competing interest or firm, the local government can be more effective in negotiating and protecting the TVE's interests. From the most basic "responsibility system" to the most complex joint-venture, Chinese TVEs operate outside of the central government's industrial plan and outside of their control, unlike their SOE competitors. They are collectives in name only, as they are controlled by the TVG with the benefits of the TVE flowing to citizens only in the sense that a profitable TVE will allow the TVG to reduce taxes or to fund infrastructure or social spending.

Access to Capital

Many TVGs count on TVEs for their main source of funding, which gave TVEs tremendous influence and benefits due to China's still incomplete market transformation. In other ex-socialist economies start-up companies have major difficulties gaining access to capital, technology, materials, market information, and distribution channels, and therefore remain cottage industries because they cannot grow. (Roman, 1986)

Since the market reforms Chinese banks have been unreliable sources of capital for private enterprises or TVEs because most bank lending has been directed to SOEs by the national government. TVGs were able to lend or invest modest amounts of locally accumulated capital in TVEs because of a simplified decision making authority, an inherent interest in seeing the local TVE succeed, and a willingness to take acceptable economic risks.[3]

The ability to procure production inputs, such as capital, is another advantage that was instrumental for TVE's success in China. Raising private capital for starting and expanding a business is an essential aspect for any business environment. In China, local government involvement made the process more successful for TVEs. The close nature of the relationships between banks and local governments – often actualized through favors for one another – made refusing a request from a government party nearly impossible for banks. Banks also favored lending to TVE's. As Chen writes "it is relatively easier for collective TVEs to obtain loans than

[3] Access to capital through TVE-TVG partnership will be discussed later in this paper as valuable for other developing countries.

private enterprises under such rules, since collective TVEs have the community government backing them up." (Chen, 2000, 62) In effect, the local government would guarantee the loan, and that makes it substantially more attractive to the lenders.

Private firms in China have an additional threat of government expropriation in the form of bribes or demands for oppressive tax payments. Despite central government attempts to curb extensive corruption such abnormalities remain extant. The protection afforded to TVEs from TVGs either precludes national government officials from pursing bribes or other shakedowns, or the connections of a TVG affords opportunities to appeal to higher authorities for relief.

The TVE model also suppresses corrupt local officials. With the TVE model, local leaders lose their incentive to demand illegal payments from businesses because government salaries and revenue depend on the profitability and competitiveness of their local businesses. China's TVEs can depend on their TVG stakeholders for access to factors for production and to capital, and to protect them from the regional or central government. In essence TVEs are of the government, yet at the same time separate from it.

Flexibility of TVE Structure

The structure of TVEs allows them to sell with equal ability to the private and state-controlled sectors of the Chinese economy. TVEs are more flexible than SOEs in their hiring practices and can assume or release workers as needed. In periods of labor shortages they can tap into labor from state farms or other enterprises controlled by TVGs. TVEs are subject to the competitive pressures of the market place just as private firms must deal with this uncertainty, however, they have more flexibility because of their access to capital through the TVG. TVEs are smaller and more nimble than SOEs, and the managers tend to have more authority and autonomy. (Luo, Tan, and Shenkar, 1998) To summarize, TVEs are more successful because they are the perfect entity for a specific context: able to access government munificence and protection while making market-based business decisions. Considering the commonality of aspects of this context, other developing countries could also learn from the TVE model.

TVE TRANSITION IN THE 1990S

In the late 1990's, the role of TVE's evolved from a bridge between command and quasi-free market economic systems to a transitory mechanism. In this decade, emerging private businesses that were neither a SOE nor a TVE gained in prominence, often supplanting the business model from which they had emerged. While some government protected SOEs were able to inefficiently support operations, TVEs began disappearing in number and influence, as the new private businesses competed better in the growing Chinese and global marketplace. Understanding the transitional role of TVEs also emphasizes the importance of the economic and social environment that gave birth to government policies that encouraged TVEs. Without all of these factors it is questionable whether TVEs would have been successful in China let alone other countries.

Chinese economic growth slowdown in 1990's

Between 1992-1995 China's GDP averaged more than 12% growth, but between 1996 and 2002 it slowed to less than 8% (Pingyao, 2003). This GDP slowdown was associated with higher rates of unemployment, especially in urban areas (Pingyao, 2003). A main driver of this slowdown was large SOEs rationalizing some of their workforce under modified employment laws that gave them some ability to fire workers, while still providing some welfare benefits ("xiagang" system). The purging of workers from the SOE system is evident in Figure 1 below, which applies a compounded annual growth rate (CAGR) to key segments of the Chinese labor pool.

Chart 1: Employment (10000 persons)

Source: Pingyao, Lin. "China's Economic Growth: New Trends and Implications." *China and World Economy*, Number 1, 2003, pgs. 9-15

	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**CAGR**
Urban Employed Persons	18653	19040	19922	20781	21616	22412	23151	23940	**3.17%**
State owned Units	11214	11261	11244	11044	9058	8572	8102	7640	**-4.68%**
Collectively Owned Units	3285	3147	3016	2883	1963	1712	1499	1291	**-11.02%**
Private Enterprises	332	485	620	750	973	1053	1268	1527	**21.01%**

*CAGR calculated as year over year growth rate over certain amount of time (n=8 in this case)

The data and growth rate in Chart 1 suggest a number of implications about the changing nature of the Chinese economy in the 1990s:

- Urban employment began to accelerate in the late 1990s, suggesting greater opportunity and/or migration to the cities (note that urban *un*employment in urban areas grew even quicker, driven by the same issue of labor coming into cities)
- State-owned enterprises were systematically reducing head count at around 5% per year-gradual but important because of the large number of people impacted
- "Collectively owned units" are a proxy for TVEs and the decline in TVE employment was pronounced over the second half of the 1990s, at more than 11% per year
- Conversely, private enterprise employment grew at a dramatic rate of more than 20%, starting from small base, but surpassing TVEs in 2001; this inverse relationship is not coincidental, as many TVEs morphed into private enterprises

These net declines in employment suggest some economic stagnation in China from 1994 to 2001. Numerous reasons exist for this slowdown, but one compelling argument is that “the efficiency/technology differences between the state-owned and non-state-owned enterprises become large, more and more state-owned enterprises become loss making” (Pingyao, 2003, 12). Essentially, as the historically closed Chinese economy became more open, state supported enterprises became less competitive compared to emerging private businesses. Private businesses were less insular and flexible in the market place, especially in applying new information technologies and supply chain management techniques that became prevalent in the 1990s. Thus, the rebalancing of the labor pool is a consequence of moving from SOEs and TVEs to private sector businesses.

Implications of TVE Decline

With the slowdown of Chinese economic growth in the 1990s, TVEs experienced a slowdown in output and a decline in employment. The repercussions of this development are numerous and important in a review of Chinese economic development. First, the TVEs were designed to be transitory and their decline was inevitable. The data in Chart 1 does not suggest a dramatic short-term collapse of the TVE, but rather a steady shift away from the business model, aligned with the approach of gradual transition and reform. Second, the labor pool rebalancing is also not surprising, given this driver of moving the Chinese economy into a new free market era. One part of TVE design was to absorb rural workers in productive enterprises and prevent large amounts of urban migration. With the decline of TVEs, however, urban migration grew reaffirming that the TVE was achieving its objectives, but now creating new socioeconomic challenges in coastal cities absorbing ex-TVE workers. Third, while many TVEs evolved into private enterprises, “private enterprises are not able to substitute TVEs as a new engine of growth” (Pingyao 2003, pg. 15). This presents a key challenge to the Chinese economy following the TVE- how to absorb excess labor supply, an issue at the historical core of development in China. One reason why TVE labor may not be able to easily transition into private enterprise is because the insularity of the TVE precluded many workers from having the marketable skills to join new companies. The lack of skills, coupled with the explosion of better educated, younger workers coming out of Chinese universities[4], exacerbates the labor supply issue. While the Chinese government is aggressively using public sector means like large infrastructure projects and high tech zones in inland cities like Xian to spur private economic growth, employing the millions of rural workers that were once part of TVEs poses a formidable challenge.

Entrepreneurship

Despite the struggles of many post-TVE line workers, a number of former TVE managers have started their own private enterprises, which is an important development for a transition economy. As TVEs served as a bridge mechanism between command and free market systems, its hybrid nature allowed TVE managers to acquire skills necessary to thrive in private enterprise. These managers often formed companies in sectors like manufacturing and mining, often consolidating with the operations of an ex-TVE in neighboring regions. It has been argued that TVEs were the “beginnings of modern Chinese entrepreneurship” (Liao 2001, pg. 27) as they critically learned to “react to prices and costs in pursuit of profits (Liao 2001, pg. 27). The TVE manager was thus better prepared for the transition to a private economy than his counterpart at a SOE. Again, ex-workers from both models did not fare as well unless they were picked up by the new businesses. The TVE managers running new businesses focused on efficiency and technology to drive productivity, hiring fewer workers compared to when they operated as a collective unit with township support.

[4] The Michigan team’s visit to Renmin University did not necessarily back up this demographic claim as many university

Competition in the FDI Era

Nonetheless, with the enormous growth in FDI after 2000[5], foreign born entrepreneurs, working with savvy multinationals, possess strong global business acumen that will continue to pressure managers and workers once part of the vast TVE network. The economies of Beijing and Shanghai are currently driven by world class multinational businesses (primarily in manufacturing) with a vast array of Chinese suppliers. These coastal businesses maintain world class efficiency and productivity, and will be difficult competitors for the new businesses to challenge. Given the Michigan team's visit to Xian, a developing city in central China, ex-TVE managers may find their best opportunities through growing inland Chinese businesses that are less saturated than the FDI-driven development on the coast.

APPLYING TVE SUCCESS TO OTHER DEVELOPING NATIONS

TVEs have played a unique role in China's development, yet little research has been done on whether the TVE model can serve other developing countries as well. Though certainly not identical, many traits of early reforming China are also found in the contemporary developing countries of Latin America, Africa, Asia, and Eastern Europe. There is good reason to believe that lessons can be learned from the TVE model.

The TVE model is particularly apt because of how much recent emphasis international aid organizations and development economists are giving to entrepreneurship and small business development. Homegrown businesses are attractive models of sustainable development because they use locally available resources. Many of these businesses utilize local resources. By purchasing inputs, small businesses strengthen the community and other companies. Also, new

students expressed apprehension at their ability to find quality employment despite their education

[5] According to the US-China Business Council, FDI inflows into China have doubled between 2000 and 2005

wealth is created for consumers as they are empowered with new types of goods and services at their disposal.

Role of in Suppressing Growth of Small Businesses

Despite their importance, there are a number of reasons that explain why small businesses have trouble growing in developing countries. Corruption and bribes are one major challenge. As businesses strive to grow, giving any extra "payments" can turn small profit margins into negative ones. In many developing countries, corruption is an ingrained way of doing business. For example, in Russia, entrepreneurs who fail to meet payments commonly face unjust takeovers by corrupt local governments. In many cases, officials use the police to physically seize assets. In other countries with high levels of organized crime, as in the Caucusus or parts of Eastern Europe, small businesses are constantly threatened. Substantial percentages of their profits are handed over to intimidating gangs.

Even if an entrepreneur in a developing country is not completely bankrupted by the corruption, their profits are decreased, their competitiveness is weakened, and their motivation is undermined. Corruption discourages entrepreneurs from taking off and, even when they do start, their growth becomes limited.

The TVE model could effectively assist developing countries in reducing corruption. Government officials would be wrongheaded to bribe the town's TVE, which is the primary source of revenue for government salaries and activities. In addition, mafias would be unlikely to approach a government-run business for a bribe.   .

Defending property rights is another essential component to long-term success of a business environment. In western developed nations, property rights are usually protected on a fundamental and even ideological level. Businesses are able to grow without worry that an authority or more powerful party will illegally seize their assets. Unfortunately, this is not the case in many developing countries, especially in countries reforming a command economy. In Russia, for example, small (and large) business often face encroachment. The Yukos Oil takeover is a good example. In this case, the Russian government jailed Mikhail Khodorkovsky, the former CEO of the largest oil company in Russia, because of “unpaid taxes” and other supposed offences that took place during a mismanaged and complex privatization process. It was probably not a coincidence that Khodorkovsky supported an opposition political party. Subsequently, the enormous assets of the Yukos company was sold off. Not only did this event devastate Yukos, but it also undermined foreign investors’ confidence in Russia.

The TVE model addresses many problems that plague businesses in developing countries. The vested interest of local governments insures a certain amount of security. Of course, each country has its own unique challenges. So, the TVE model would have to be adapted to meet the needs of different societies in order to be applicable. The challenges of anti-capitalist discrimination in socialist China are drastically different than the challenges of insecure property rights in Russia, but the solution may be similar.

Financial Inputs

The ability to procure production inputs, such as capital, is another advantage that was instrumental for TVE’s success in China. Raising private capital for starting and expanding a business is an essential aspect for any business environment. Raising capital is a key challenge of international development. Some theorists argue that lack of access to capital is the primary reason that developing countries remain poor. The microfinance revolution has taken stabs at this problem, and for that reason is considered a valuable way of attacking poverty. As demonstrated by China, the TVE model is another interesting strategy for distributing capital to poorer regions.

Knowing that a local government is willing to support a business, a bank will have significantly more confidence in that business's loan application. Moreover, if the local government serves as a guarantor, then the bank would have trouble finding any reasons to reject the proposal. Not only does the government's support reduce the bank's risk of not being able to collect, but it also increases the bank's confidence that default will not take place. Government involvement helps the probability that the business will be a success and, thus, capable of repayment.

CONCLUSION

There is no doubt that TVEs contributed to the success of transitioning China from a controlled economy to a market-based economy. It is also evident that TVEs encouraged modern day entrepreneurs in China. By blurring the line of public and private business TVEs addressed obstacles that many small businesses face in developing countries including access to capital and new markets and protection from corruption. While the structure of TVEs contributed significantly to their success, the economic and social climate and factors such as high rates unemployment also encouraged the success of TVEs. TVEs provide valuable lessons for other developing countries but, the chances of the model being replicated in another country are not strong unless their economic and social environment is similar. There are however valuable lessons that other countries can apply from the TVE model. The most important lesson is that public-private partnerships work and provide a good model for protecting infant businesses and encouraging entrepreneurial spirit. A combination of these two outcomes will help an economy grow.

Works Cited

Chen, Hongyi and Ashgate. 2000. The Institutional Transition of China's Township and Village Enterprise, Studies on the Economic Reform of China.

Ding, Daniel. 2004. Evolution of Organizational Governance and Human Resource Management in China's Township and Village Enterprises International Journal of Human Resource Management 15:4 June/15:5 August.

Garnaut, Ross, et.al. 2005. "China's Ownership Transformation." *International Finance Corporation.*

Hills, G.E. 1994. Market and Entrepreneurship: Research Ideas and Opportunities. Greenwood Press.

Hongyi Chen. 2000. The Institutional Transition of China's Township and Village Enterprises. Ashgate, Sydney.

Liao, Debbie. 2001. "The Development of Modern Entrepreneurship in China." *Stanford Journal of East Asian Affairs.*

Liu , Deqiang and Otsuka , Keijiro. 2004. A Comparison of Management Incentives, Abilities, and Efficiency between SOEs and TVEs: The Case of the Iron and Steel Industry in China. Economic Development and Cultural Change Chicago. Vol. 52, Iss. 4, p. 759-780 July, 22.

Nee, V. 1992. Organizational dynamics of market transition: hybrid forms, property rights, and mixed economy in China. *Administrative Science Quarterly.* 37: 1-27.

Pingyao, Lin. 2003. China's Economic Growth: New Trends and Implications. *China and World Economy*, Number 1, 9-15**.**

Perotti, et al. 1999. State-Owned Versus Township and Village Enterprises in China. Comparative Economic Studies, XLI, 151-179.

Roman, Z. 1986. Competition and industrial organization in the centrally planned economies.

Shiraishi, Maho. 2004. *Efficiency of Chinese Township and Village Enterprises and Property Rights in the1990s: Case Study of Wuxi* Go Yano. Comparative Economic Studies New Brunswick. Vol. 46, Issue. 2, 311-340.

Slowing growth of rural enterprises in China. 1998 Oxford Analytica Ltd. 1998.

Tan, J. and Litshcert, R.J. 1994. Environment-strategy relationship and its performance implications: an empirical study of Chinese electronics industry. *Strategic Management Journal*. 15: 1-20.

Tan, J. 1996. Characteristics of regulatory environment and impact on entrepreneurial strategic orientations: An empirical study of Chinese private entrepreneurs. *Academy of Management Best Papers Proceedings*. 106-110.

Taube, Markus. 2002. Stability in Instability. China's TVEs and the Evolution of Property Rights. *ASIEN*. July.

Weitzman, M. and Xu, C. 1993. Chinese township village enterprises as vaguely defined cooperatives. Unpublished paper. Harvard University, April.

World Development Report.1996. From Plan to Market. Oxford University Press.

Yadong Luo, J. Justin Tan, and Oded Shenkar. 1998. Strategic responses to competitive pressure: The case of township and village enterprises in China. *Asia Pacific Journal of Management.* Vol. 15, 33-50.

Zhang, Yi. 1990c. China Township and Village Enterprises: Historical Inevitability). Beijin: Falu chubanshe.

Zhang, Zhihong. 1999. Rural industrialization in China: From backyard furnaces to township and village enterprises. *East Asia: An International Quarterly Brunswick. Vol. 17,* Iss. 3, 61-87.