UNORTHODOX OWNERSHIP AND GOVERNANCE STRUCTURES IN EAST ASIA

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by Laixiang Sun

Introduction

This study examines the nature of the unorthodox ownership and governance structures which are emerging among firms and the way these structures are supporting the remarkable economic growth in the transition economies of East Asia, as represented in particular by China and Vietnam. These economies are embarked on a distinctive process of property rights reform that resists widespread privatization in favour of evolutionary transformation.

Following a brief description of the 'ownership puzzle' in transition economies, the study provides a general framework for understanding property rights reform in the transition economies of East Asia. This covers issues such as the evolutionary perspective of organizations and property rights as a bundle of rights. Section 3 examines the reform of property rights in the state-owned enterprise (SOE) sector in China, Vietnam and Laos and evaluates the impact of the reform on the performance of SOEs. Section 4 describes the features of the ownership and governance structures of township and village enterprises (TVEs) in China and analyses the importance of these features for liability and incentives. Section 5 examines the ambiguities of property rights arrangements among private enterprises in these economies and outlines the comparative benefits and costs. Section 6 presents a summary of the features of heterodox ownership and governance structures and then explores the distinction between 'ownership of the asset' and 'ownership of the firm' and the perspective of thinking the latter as 'state-contingent ownership'.

1. Ownership puzzle in the transition economies

1.1 *The puzzle of post-privatization ownership structure*

The privatization approach was one of the earliest consensus views on the post-communist transition and has been a central feature of the transition in Eastern Europe and the former Soviet Union. This common sense view is believed in theoretical terms to possess the self-evidence that comes from orthodox property rights theory. The existence of well-defined private property rights is a basic precondition for the proper functioning of a market economy. As a corollary, the creation of clear and legally enforceable private property rights for firms is seen as the only way to remedy the problems associated with the soft-budget constraint and bureaucratic bargaining prevailing in the state-owned sector. The most compelling

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practical reason for the privatization of SOEs is the long-lasting inefficiency of SOEs as a whole. By creating property owners, privatization is thus perceived as the most direct avenue for unlocking gains in economic efficiency by the placement of property under the exclusive control of private owners who are seen to be liable for the consequences of bad decisions, but entitled to the rewards of goods ones and willing to offer greater motivation for both managers and workers.

After seven years of great sacrifice along with the transition, it is now widely acknowledged that the privatization process has turned out to be much more difficult and costly than expected. Furthermore, the key outcome, the post-privatization ownership structure, has also become quite complicated and is far from having developed clear and legally enforceable private property rights. On the one hand, the privatization of former SOEs has led to a complex ownership structure involving banks, investment funds, other enterprises, state asset management agencies, and local governments in a network of cross-ownership. The resultant governance structure is characterized by insider control, representing a general strengthening of the managerial classes in nearly all these post-communist countries. On the other hand, many of the emerging private firms are turning to the state for all kinds of financial 'rents'. Subsidies, tariff protection, legal monopolies, and redistributional regulations are still prevailing even where direct state ownership has become rare (cf., e.g. Brada 1996, Frydman et al. 1996, Stark 1996). Together, these indicate that the way to engineer post-privatization ownership and governance structures and the way to modify incentives so as to make corporate actors look to the benefits of enhanced economic efficiency rather than to the rent they can extract from the state remain a great challenge during the transition in these post-communist countries.

1.2 *Induced property rights reform in East Asia*

Property rights reform in East Asia contrasts markedly with the privatization approach widespread in Eastern Europe and Russia. Although it has been officially stated that the industrial reform in East Asia involves management reform but not reform in ownership, there is much evidence demonstrating that the clarification and reassignment of various property rights among different levels of governments, between government and enterprise, and among parties within the enterprises have progressed in a piecemeal, incremental and induced fashion.

While reformers at the national level have established the broad parameters of enterprise reform, the actual outcomes have to a great extent been determined by the competition specific to localities and enterprises. Within an increasingly competitive environment, poor performance gives rise to pressure for reform and reform improves performance. Low or declining profits lead directly to low or declining bonuses and welfare incomes, poor reputations, and so forth and thus motivate enterprise managers and employees to seek more autonomy and greater control over profits. Among local governments, particularly those at lower levels with fewer enterprises under their jurisdiction, the erosion of enterprise profits, the major source of local revenues, results in immediate fiscal distress. This distress not only destabilizes the distribution of fiscal revenues among regions and administrative levels, but also reduces the bonuses and benefits and hurts the reputations of local officials and thus supplies a strong incentive for local governments to push enterprise reform beyond even the limits set by the central government. An additional contribution of competition - one which has not been well recognized - is the fact that competition has been gradually exhausting the monopoly profits of most state-owned industries, the traditional, primary source of fiscal revenues, and has thus been forcing both central and local governments to reform SOEs, support the development of TVEs and encourage the establishment of other types of enterprises so as to generate more revenue and create more employment.

In contrast to the unprecedented fall in output, employment and incomes following the transition in Eastern Europe and Russia, the SOE sector in the East Asian transition economies has done well relative to international standards, although it is still suffering financial troubles. In China, the real output of industrial SOEs grew by 7.8 per cent per year from 1978 to 1995 despite increasing competition (SSB 1996, p. 403). The share of medium and large SOEs (over 500 employees) in total industrial output remained approximately constant (about 41 per cent) between 1978 and 1994, accompanying with an annual growth rate of overall industrial output of 14 per cent (Naughton 1995, pp. 164-67 and 330-31, SSB 1995, p. 377).[1] Although the financial situation of the SOE sector seems worsening along with the growth (Bai, et al. 1997).

In the case of Vietnam, SOEs in the industrial sector maintained their dominant role, and their GDP share climbed from 33 per cent in 1989 to 37 per cent in 1994 and 39 per cent in 1996 (Dodsworth et al. 1996, Table A9, Mallon and Irvin 1997, Table 2),[2] although several thousand loss-making SOEs were liquidated, government subsidies were eliminated, implicit subsidies through the banking system were substantially reduced, and the principle of equal taxation among state and private firms was instituted. Given the average GDP growth rate of 7 per cent over this period, these aggregate data may be indicative of a remarkable surge in the performance of SOEs.

SOE reform in Laos involved the granting of managerial autonomy to SOEs during 1988-90 and the prevalence of fixed-term leasing after 1990. During the first period, fiscal subsidies and capital transfers to SOEs were successfully discontinued, but the overdue debts accumulated by SOEs to the banking system were substantial. Fixed-term leasing, although it did not change the structure of ownership, seemed the most practical way to change the governance structure over the medium-term and effectively hardened SOE budget constraints and provided much greater incentives to SOE management to improve performance (cf. Otani and Pham 1996, World Bank 1994a).

1.3 *TVE miracle and TVE paradox*

The greatest achievement of the Chinese reform may be the emergence of the township and village enterprises. Between 1978 and 1995, the TVEs realized a real average output growth of 21 per cent per annum. In 1993, the TVE sector exceeded the state sector in terms of industrial production and employment generation. It produced 44.5 per cent of total industrial output and provided employment to 123 million people, whereas the state sector yielded 43 per cent of total industrial output and employed 109 million people (SSB 1996, pp. 87, 388-89 and 403). The emergence of rural entrepreneurs and enterprises has not been experienced in any other country on such a large scale and at such a rapid rate. Understanding the driving forces behind this spectacular growth is of great importance to international companies and investors seeking to do business with China.

The TVEs seem to possess features that are unparalleled in any organizations in the West or in other socialist economies. The residual benefit rights of TVEs are mainly enjoyed by local residents via their township or village governments. The residual control rights, including the right to appoint and remove managers, are typically possessed by community governments. TVEs do not face a soft-budget constraint, but the financial liability for each individual TVE in the case of insolvency is not clearly defined. Very often, the community governments play a decisive role in initiating liquidation and reorganization. This role is similar to the main bank's role in a Japanese *Keiretsu*, but the underlying ownership-control structures are quite different. It seems that, as economic entities, the townships and villages, rather than individual TVEs, have almost unlimited liability.

The conceptualization of the nature and experience of TVEs has received much attention (cf. Chang and Wang 1994, Lin 1995, Nee 1992, Oi 1992, 1996, Pei 1996, Weitzman and Xu 1994). While introducing specific insights to the analysis of the issue, each of these alternative perspectives seems still to get bogged down in paradoxes.[3] This indicates that there is an urgent need to build up a consistent and comprehensive theoretical framework which captures the links between the unique ownership and governance structures of the TVEs and their goals, strategies and managerial behaviour in an increasingly competitive and internationally oriented environment.

1.4 *Ambiguous property rights in the private sector*

The overwhelming majority of private-owned enterprises in China and Vietnam are the small individual or family type enterprises. Instead of directly participating in markets on their own, most of these operate in tandem with community authorities, such as village governments, which contract with larger corporate organizations to produce certain items.

Enterprises that expand beyond the family also tend to need support from community authorities. This support comes weighted with reciprocal sharing in both residual benefit rights and residual control rights. As a result, such firms are far from representative of private-ownership as this is commonly understood. Instead, they exhibit an ambiguous property rights arrangement that involves sharing between private entrepreneurs and community authorities (Li 1996). Although such an arrangement relies on the existence of a particular community spirit and a set of ambiguous and personalized relationships that may undermine the long-term development of these enterprises, it has certainly been mutually beneficial during the transition. It permits smooth business transactions among relatively independent operators and supplies the sense of security needed for long-term development. It creates additional sources of revenue for communities and administrative units and greatly facilitates the necessary administrative supervision and tax collection.

1.5 *Adaptive recombination versus immediate replacement*

The above comparison between privatization in Eastern Europe and property rights reform in East Asia suggests that, instead of thinking about institutional and organizational innovation as immediate replacements for the old ownership regimes, a more instructive perspective is to see it as a dynamic transformation process involving the disassembly and reassembly of existing institutional configurations. Using the concept of Schumpeter, organizational innovation should be thought of as the adaptive 'recombination' rendered necessary because of the urgency of finding solutions to immediate practical dilemmas (Schumpeter 1934, Nelson and Winter 1982, Stark 1994, 1996). Thus, our emphasis should lie on transformational processes rather than on fixed outcomes. Our attention should focus on the emergence of new elements in combination with competitive and co-operative adaptations and rearrangements of existing organizational structures. The old institutional forms may be inefficient. However, through innovative recombination and the addition of some new elements, they can become productive assets, resources, and the basis for credible commitments and co-ordinated actions (Williamson 1991, 1994).

Reflecting upon the transition experience, our thinking about property rights needs to depart from the Marxist practice of assuming that an 'owner' is an individual or a homogeneous monolithic group (e.g. capitalist-minded shareholders). The evolutionary experience of the developed market economies suggests that property rights are a bundle of rights which are neither indivisible nor unrestricted and that 'property can be productively disintegrated in ways such that different actors can legitimately claim rights to different aspects and capacities of the same thing' (Stark, 1996, p. 126; Grey, 1980). Based on such a perspective, it becomes easier to understand why the transformation of property rights is typically a process of renegotiations among a wide array of actors who are seeking to resolve their claims over a certain set of property rights.

2. Innovative transformation and property rights reform: theoretical issues

2.1 *Market transition as a process of innovative adaptation*

In his book *What Should Economists Do?* James Buchanan (1979, p. 29) emphasizes that 'a market is not competitive by assumption or by construction,' but 'becomes competitive, and competitive rules come to be established as institutions emerge' to shape behaviour. Such a 'process of becoming' is bound to go far beyond any kind of rationalist design or central planning, because the process evolves from sequences of economizing behaviour, market-learning institutional evolution, technical innovation, and, particularly, a multitude of cumulative and mutually reinforcing choices by numerous actors who have diverse interests and constantly evaluate alternatives and reconsider their previous views.

The market economy in the West did not originate by blueprint. Its development is characterized by decentralized evolution. The concrete institutions operating in the West are rooted in capitalist structures and grow through adaptive evolution. They cannot be directly replicated in the East. A key lesson from the failure of centrally planned economies - that one cannot organize all economic processes into a grand design - may indicate that the attempt to replicate market institutions by following a rationalist design is doomed to failure as well.

The market transition in both Eastern Europe and East Asia is bound to be path dependent. The transition is not a simple passage between two equilibrium social orders. In Eastern Europe and Russia, the collapse of the communist regime did not result in an institutional vacuum. Most of the previously existing organizational forms and social ties have persisted. For a decade before 1989, market-like transactions and reciprocal relations were also widespread inside the socialist sector and in the 'second economy' (Kornai 1980, Laky 1979, Sabel and Stark 1982). In the transition, the existing informal structures and networks have played an important role in the struggle of enterprises for survival. The interaction of market-oriented structures and the earlier types of organization has favoured and will continue to favour the emergence of hybrid forms of organization.

According to Williamson (1991), between the polar modes of the market and hierarchy, hybrid governance structures generally possess their own institutional advantages. In transition economies the hybrid mode of governance structures may have greater significance, because hybrid forms 'use resources and/or governance structures from more than one existing organization' (Borys and Jemison 1989, p. 235) and thus are capable of reducing uncertainty in interorganizational relationships involving bilateral or multilateral dependence and of supplying an elastic contract mechanism to facilitate continuity and efficient adaptation. In comparison with hybrids in advanced capitalist economies, hybrids in transition economies lack a well-specified structure of property rights. Therefore, they also lack sufficient autonomy and are faced with rapid changes and institutional uncertainty. For this reason, transitional hybrids of superior adaptive capacity are bound to be more flexible, informal and open to entrepreneurship. They must rely more on such social capital as personal ties and localism rather than on legal contracts to provide assurances that the terms of a transaction will be met by both parties (Nee 1992, Carroll, et al. 1988).

2.2. *Ownership as a bundle of rights*

Property rights are sanctioned relationships among people or organizations that arise from the existence of scarce goods, pertain to their use and are sanctioned by norms, customs and laws. An owner of property rights holds the consent of others to act in particular ways without interference by the community, provided that these actions are not prohibited in the specifications of the rights. This definition of property rights is consistent with Roman law, common law, Karl Marx's writings, and the new institutional economics (Demsetz 1967, Pejovich 1990, Chap. 4). Within the general concept of property rights, the ownership right is the most well-known category consisting of a bundle of rights. The core bundle of these rights includes the following three elements.

(i) The right to utilize an asset. This right is also distinguished as the 'utilization right' or the 'control right'. It is also a collection of numerous specific rights, including management, decision-making and the supervision of utilization. There is a widespread division between ownership and control in modern corporations and in SOEs. That is, the daily control of the asset is delegated by the owners to their agents or professional managers. For this reason, a residual control right, usually involving the right to appoint and remove managers and other rights beyond the content of contracts, is assumed to be the crucial dimension of ownership. Nonetheless, the separation of ownership from control is definitely a delegation of selected property rights to management. It requires the owner to create a variety of incentive schemes to assure that the management team satisfactorily performs the control functions.

(ii) The right to capture benefits from the utilization specified under (i) and the responsibility for negative outcomes such as debts and damages. This right is typically identified as the 'return right', involving the right to establish rules concerning the distribution of earnings. As an alternative to the notion that residual control rights should be treated as the crucial dimension of ownership, the right to collect residual returns is proposed as the key feature of ownership by Milgrom and Robert (1990) and others (e.g. Zou 1992). Because of the fact that state socialist economies are commonly recognized as 'redistributive', distribution rights may be more relevant to property rights reform in the transition economies.

In order to clarify further the significance of the right to residual returns in the process of property rights reform in East Asia, let us consider the position of the insider entity of an SOE under the 'contract responsibility system' accepted by the entity (*quanyuan chengbao*). Taking the simplest case, the entity pays a fixed amount of taxes and profits to the government in exchange for the use of government-owned assets, and keeps the residual. Thus, all the employees of the SOE, rather than the principal government, possess the right to the residual returns.

(iii) The right to change the form or substance of the asset and the right to transfer all or some of the rights specified above to others at a mutually agreed price or as a gift. This aspect of ownership is usually referred to as the 'alienation right'. It involves the decision to buy or sell the asset and defines the owner's right to effect changes in the value of the specified asset.

Theoretically, it is evident that an infinite number of configurations of property rights are possible. The historical configurations of property rights are, nonetheless, created by social actors, shaped by struggles among various interests, and subject to changes over time and within different institutional environments. In recent years, the problems encountered in the enforcement of property rights are central in the literature of contracts, industrial organization and bureaucracies in the West, because the 'attenuation' of property rights has become increasingly significant. An attenuation of property rights is usually induced by the restrictions imposed by government regulations on asset use, on the income flows from the asset and on the freedom of an owner to transfer some portion of property rights to others (Campbell and Linberg 1990, Walder 1994).

In contrast to the trend whereby many of the restrictions established by the state through legal provisions are attenuating property rights in the West, the process of economic reform in the transition economies of East Asia is characterized by the downward devolution of property rights in political and administrative hierarchies or the reassignment and clarification of property rights among institutions, communities and households. Economic reform in East Asia has been dominated by the devolution of selected property rights over assets – particularly a large share of utilization rights and residual claim rights – from higher to lower levels of government administration or from government authorities to enterprises, households and individuals. These specific reassignments have significantly altered the incentives for economic behaviour, the distributional pattern of subsequent income flows, the structure of political power and interests, and thus the ownership and governance structures of SOEs (cf. e.g., Lin, et al. 1996, Naughton 1995, Walder 1994, 1995).

3. Property rights reform in the SOE sector: processes and consequences

3.1 *Understanding local government property rights over SOEs in East Asia*

Because the existence of local government property rights over SOEs and the substantial downward devolution of financial power over residual revenues have played a leading role in the initiation and development of the programmes of property rights reform, it would help to introduce the features and functions of local government property rights for our understanding of the process of the reassignment of selected property rights between SOEs and their supervisory government bodies.

As argued in Granick (1990, pp. 39-44), the property rights of regional governments over SOEs in China have existed at least since the early 1970s. However, before reform, monetary income was of lesser importance and thus the financial interests of local governments were weak. The ownership rights of local governments over their SOEs were exercised through the control over the distribution of marginal output at the regional level, the management of SOE operations, the material allocation within the constraint of delivery quotas for the central government, and the use of depreciation funds.

The fiscal reform in the 1980s fundamentally altered the situation through the devolution of financial property rights from higher to lower levels of government and from supervisory government bodies to enterprises. First, instead of governments appropriating all profits from their own SOEs automatically, the SOEs were to be taxed according to fixed rates. The residual income left to the SOEs served to supply spontaneous incentives to managers and workers. Second, from the tax revenue collected from their own enterprises, each level of government turned over a contractually specified amount to the next higher level of government, while retaining the residual.

This system has given local governments the incentive to exercise financial property rights more effectively over the assets they administer. The better the financial performance of the local enterprises and the more rapid the economic growth of the region, the greater the annual increase in the revenues available to government control (cf. Wong 1992, World Bank 1994b, Walder 1995). Such direct causality has pushed local governments to initiate experimental reform programmes far ahead of the central government (Zhang and Yi 1995).

The greater control over residual revenues has been accompanied by more expenditure responsibility. Local governments must strain to meet the expenditure obligations imposed by the policies of higher level governments. They must take direct responsibility for the solution of the large range of social problems arising from unemployment, housing shortages, infrastructure deficiencies, growing dissatisfaction in the consumption sector, and so on. They must also promote more rapid local economic growth so as to enhance their own negotiating position within the hierarchy.

Because they have the smallest revenue base and are confronted with the strongest pressure from rising living standards and growing competition, township and village governments have shown the most motivation to develop TVEs and private enterprises (Oi 1996). In turn, as the relevant political restrictions set by the central government have become more flexible, county and prefectural governments have been the most interested in the restructuring of their own most inefficient small-scale SOEs through a great diversity of bold methods, including the establishment of joint ventures with foreign investors, the introduction of employee stock ownership plans, the sale or lease of SOE assets to management and employees, the sale of SOEs to outside investors, liquidation, and equitization (*Chinese Youth* 1996, pp. 14-20, Gu 1996).

In the case of Vietnam, provincial and local governments historically enjoyed considerable economic autonomy from the central government. In pre-colonial days, the village was the basic unit of government. Even afterwards, in pre-communist days, villages sought to adapt national decrees to their particular needs (Probert and Young 1995). Under the Democratic Republic of Vietnam, from 1954 to 1975, the efforts to strengthen central control were in fact reversed because of the war in the south. Most of the SOEs already established in urban areas were forced to move into the mountainous regions. Local self-sufficiency in supply was clearly a critical factor for survival. This primacy of self-sufficiency led in turn to the establishment of more locally run SOEs.

The record of economic changes in Vietnam since unification has shown a cyclical pattern. The cycle begins with the efforts of the central government to impose central planning. An economic crisis follows. Meanwhile, local governments and their SOEs start to resist the central planning by 'fence breaking' and expanding market-oriented activities. These activities are tolerated by the central government to a certain extent, and, as a result, the crisis is overcome. Ironically, the economic recovery may lead to new support for the central planning model, as occurred in 1982-83. The readopting of this model induces a new economic crisis and, as a consequence, a new round of reform (Fforde and Vylder 1996, Probert and Young 1995).

In the Lao People's Democratic Republic, 'the local level is a constant objective structure of the Lao society' (Kaysone Phomvihane, the secretary-general of the Lao Communist Party, cited in Evans 1988, pp.31-32). Laos does not possess a unified national economy. Rather, it has a combination of a central economy and local economies. In most cases, the governments at each level are organized like sovereign governments, since there is no telecommunications between the capital and most provincial centres and more than half the road network is impassable in the rainy season. The local administration is under the sole authority of the president of the local administrative committee. The modern sector, which plays only a marginal role in the economy, is likewise extremely fragmented. Each sectoral administration at each level of government supervises those SOEs located on its territory and in its sector. As a consequence, the Lao experience indicates that there no scope for building socialism in a subsistence economy, and this has finally been admitted by the party (cf. Bourdet 1995, Evans 1988, Funck 1993).

3.2 *The reassignment of property rights in the SOE sector*

3.2.1 *The case of China*

Prior to the reform, the ownership rights of different levels of government over their SOEs were far more extensive than those exercised by the owner of a firm in a market economy. The governments exerted direct control over all factors of production within the SOE sector. Customers, suppliers, managers, technicians, and workers all had only very limited freedom to exercise autonomous choice, because of the absence of product and factor markets and legal guarantees. The absence of choice in fact precluded the right of production factors to enter into voluntary contracts that specified rewards and obligations. If one views this causality from the opposite perspective, it can be seen that this absolute ownership implies that the creation of product and factor markets and the choice enjoyed by market participants would undermine government control and coercion. Markets disperse effective ownership and favour voluntary contracts to specify rewards and obligations. This means that in the transition economies competitive markets have an additional function: to induce and promote property rights reform (Jefferson et al. 1995).

Three sets of SOE property rights reforms have been successively implemented along with 'stop-go' cycles in China. The first two have been characterized by the reassignment of selected control rights and claim rights to residual returns, whereas the third one has involved the reassignment of alienation rights as well.

The first reform effort, undertaken between 1979 and 1983, consisted of tentative steps towards an expansion of the role of financial incentives through a moderate margin of profit retention and towards improved performance through greater enterprise autonomy. The SOEs selected for the reform experiments had the right to retain a share of profits, enjoyed a relatively higher depreciation rate, and had the right to sell any above-plan output. Although the programme as initially proposed was only for a small number of SOEs, officials at various levels of government quickly saw the benefits of profit retention by their own SOEs. As a result, the programme became overextended nationwide (Lin et al. 1996, pp. 138-40, Naughton 1995, pp. 99-100).

The second round of SOE property rights reforms was implemented between 1984 and 1988 and remained in force between 1989 and 1992. It centred on two innovations: a dual-track pricing system and the enterprise contract responsibility system. The dual-track pricing system effectively partitioned SOE inputs and outputs into planned and marketed components. Actively responding to this system, most

SOEs steadily boosted their marginal sales and purchases on the markets so as to catch the benefits arising from market transactions. Under the contract responsibility system, SOE managers and employees agreed to fulfil specific obligations. These typically involved targets for profits and productivity, as well as other profit-sharing rules. The targets were negotiated individually for each enterprise. In return, the SOEs obtained greater control over business operations, such as the drafting of output plans and prices, the choice of customers and suppliers, the fixing of wage and bonus differentials, and decisions on the use and allocation of retained profits and depreciation funds (Jefferson et al. 1995).

The contract responsibility system and dual-track price system had greatly enhanced entrepreneurial responses to market-determined supply and demand signals. However, because of the rapidly changing environment, profit targets had to be renegotiated annually. As a consequence, managers had to be concerned with 'ratchet' effects, that is, an increase in the coming year's profit targets imposed on successful performers. Government entities continued to be involved in the determination of every aspect of a firm's compensation schedule. More negatively, in order to assure growth in wages and bonuses, SOE managers would boost profits in the short-term by cutting depreciation allowances, underreporting operation costs, postponing necessary investment, and neglecting asset maintenance (Sun 1992).

The third round of property rights reform was initiated in 1992, following the decisive push for renewed reform by Deng Xiaoping. Since then, the international media have paid a great deal of attention to the two new stock exchanges in Shanghai and Shenzhen. The establishment of stock exchanges in a socialist country like China does indicate a fundamental change. In terms of property rights reform, however, the change is more ideological than practical. The stock exchanges are still considered a government experiment. Substantial limitations have been imposed on their development. The number of companies listed on the stock markets is tightly controlled, and there is no guarantee that all firms satisfying the strict requirements can be listed (Sun 1997).

The most radical reform was once again initiated by local governments. Faced with the renewed impulse for reform, local governments obtained a more flexible commitment from the centre to allow experimentation with local firms. Seeing an advantage, a number of cities and provinces took the bold, radical step of reassigning ownership rights over SOEs selectively or fully. The most impressive reform was implemented by cities, particularly county- and prefectural-level cities. County and prefectural SOEs have typically been the most inefficient ones. These SOEs are often too small to apply economies of scale, but too bureaucratic to be able to exploit their small size as TVEs usually can. Finding a way to compensate for the rising losses of local SOEs has been the number one headache for most county and prefectural governments. The reform measures adopted by local governments have included the sale of SOEs to insiders and outside investors, the lease of SOE assets to management and employees, and permission to foreign companies and other non-state institutions to take over local SOEs (for details, see Sun 1997). All these measures are still being hotly debated among central government officials and the ideological authorities of the party.

It can be anticipated that the final outcome of the debate will not be determined by ideology, but by the efficiency and welfare consequences of the reforms. Moreover, in contrast to the political environment during the initial stage of the implementation of the household responsibility system, which had to be secretly undertaken by peasants in Anhui Province in 1978, the majority of the reactions during this phase of the reforms have been quite positive. This round of reform has shown remarkable efficiency benefits and, at the same time, has not generated any substantial social costs such as notable unemployment or temporary cuts in production. This is mainly because the local governments have promoted local revenue creation, assured social stability and been able to play the leading role in the design and implementation of the reform process. The significant efficiency benefits and very limited social costs of these reforms mean that property rights reform will become widespread in the near future (Sun 1997).

It should be pointed out that the third set of property rights reforms has been initiated in only a relatively small number of cities which are located in coastal areas. The great majority of SOEs still suffer from the unresolved problems accompanying the second round of reform. Particularly due to the less favourable structural conditions and the greater fiscal dependence on the central government, the pace of reform in the vast interior regions has lagged far behind that along the coast (Raiser 1996). The SOE sector is still characterized by over-heated capital construction, excessive production capacity, the insufficient use of facilities, redundant workers, outdated technologies, low energy efficiency, high production costs, and poor competitiveness. The reform of SOEs in the structurally weaker interior regions of the country will continue to be a major dilemma for economic policy makers (cf. *People's Daily*, 2-10 March 1997).

3.2.2 *The case of Vietnam*

Similar to the reform process in China, three sets of SOE property rights reforms can be identified in Vietnam. The first set of reform was undertaken between 1979 and 1982 and, in a somewhat altered fashion, between 1982 and 1985. It was characterized by spontaneous 'fence breaking' at the grassroots level.

By the end of the 1970s material shortages, the threat of widespread famine and the near isolation of Vietnam from the outside world had essentially broken down the system of state allocations for subsidized inputs and of state procurement of consumer goods for rationing. SOEs had to establish horizontal contacts with each other and, more importantly, to participate in free market activities in order to solve the most acute shortages of food, inputs and spare parts. Consequently, SOEs began to swap or sell their products on the free market to earn cash so that they could fulfil their needs, likewise on the free market.

These spontaneous steps to maintain and stimulate production received some political support during the VI Party Plenum in August 1979. A government decree (No. 25-CP) recognized the fence breaking activities and announced the launch of a 'three-plan' system. SOEs under Plan A were to use the subsidized inputs supplied by the state to reach output quotas which were set by the state. The output was also to be procured by the state. In return, Plan-A SOEs were permitted to keep 50 per cent of their profits. Under Plan B, which could only be initiated if additional inputs were required for the production of 'list' goods subject to the state monopoly, permitted SOEs to acquire materials from non-state sources. In this case, the share of the profits that could be retained by an SOE increased to 60 per cent. Under Plan C, SOEs were permitted to produce items not in the state plan, sell them freely at negotiated prices and keep 90 per cent of the profit.

It is widely accepted that the three-plan system contributed to the recovery in state industrial output in the early 1980s. Annual industrial growth rate averaged about 9 per cent during those years. Nevertheless, the recovery was most clearly marked in areas sensitive to market demand and in which domestic raw materials were readily available (cf. Fforde and Vylder 1996, pp. 138-39, McCarty 1993, Probert and Young 1995).

The second round of reform, undertaken during 1986-1989, focused initially on macroeconomic issues such as further price liberalization, the elimination of local trade barriers, and the shift away from the heavy-industry-oriented development strategy. It was a bold response to the spiralling inflation and other compelling economic problems caused by the reassertion of the command-economy model and rural collectivization during 1982-85. SOE reform was renewed through two principal pieces of legislation issued in 1988. SOEs that were officially included in a 'new statute' could make a 'single contribution to the state budget' that took the form of taxes rather than planned output quotas. These SOEs were also given greater autonomy and were encouraged to establish market-like linkages with other enterprises and among different sectors. However, most large SOEs were excluded from the reform (Fforde and Vylder 1996, Probert and Young 1995).

Along with the substantial marketization, structural readjustment and increasing openness to the world market, the market share of SOEs was reduced by a large amount, even as government orders continued to fall significantly. The result was a two-fold growth in inventories by 1990. At the end of 1989, fully 40 per cent of all SOEs were recording heavy losses and only about 20 per cent seemed to be operating at a profit (Thanh 1995, Probert and Young 1995). Moreover, the urgency of the SOE reform was sharpened by a new external shock, the withdrawal of Soviet aid, which in various forms had accounted for about 40 per cent of the government budget.

Under such conditions, budgetary considerations alone could force the government to cut its fiscal subsidies to the SOEs and to seek to eliminate loss-making SOEs. Thus, the third set of SOE reforms, initiated in 1989, consisted of cuts in budget subsidies for SOEs, the establishment of positive real interest rates, the shutdown of hopelessly loss-making SOEs, and the transfer of management and financial responsibilities for the SOEs to SOE managers, including full autonomy in the setting of prices, the formulation of production plans, and investment decisions.

This round of reforms led to substantial changes in the SOE sector. Over 2,800 SOEs were liquidated, and another 3,000 were merged with viable SOEs, so that by early 1994, only about 6,500 to 7,000 SOEs remained registered with the State Planning Commission. The 800,000 layoffs that resulted were mainly absorbed by the rapidly developing non-state sector. The economic benefits of these reforms were also significant. Budget deficits were substantially reduced. The SOE sector showed a strong growth trend and maintained its GDP share despite the remarkable GDP growth rates. The profitability of SOEs was improved as well, although soft bank credit and protective entry barriers were introduced once again for some SOEs in essential industries, and there is still a considerable degree of management weakness in the SOEs (cf. Dollar 1994, Irvin 1995, Probert and Young 1995).

Since the second round of reform, SOEs in Vietnam have benefited greatly from foreign investment in the form of joint ventures. Between 1988 and 1994, foreign investment may have accounted for a combined total of approximately 10 percentage points (one-fifth) of accumulated economic growth. Foreign investment has also played an important role in the transfer of technology and in the introduction of modern organization and management forms. Owing to their established links with policymakers, their preferential access to quotas, land and bank credits, and their relatively larger size, SOEs have been a more attractive domestic partner in joint ventures (Dodsworth 1996, Mallon and Irvin 1997). Because official statistics record the output of these joint ventures as SOE output, the development of SOE joint ventures partly explains the relatively strong performance of the SOE sector.

3.2.3 *The case of Laos*

By the end of the 1980s, the SOE sector in Laos comprised about 640 enterprises and accounted for virtually all of the modern industrial sector. SOEs employed about 16,000 workers, or around 10 per cent of the non-agricultural labour force. Roughly one-third of the SOEs in the modern industrial sector were centrally managed, while the rest, which were usually smaller, were managed by provincial and district governments. Three-quarters of the SOEs were engaged in manufacturing, and the others in construction, electricity and mining (Otani and Pham 1996).

Before 1990, the SOE reforms in Laos appeared no different than those in Vietnam (Rana 1995, Table 2). The emphasis was on the granting of greater managerial autonomy to SOEs. By March 1988, almost full operating autonomy had been delegated to SOE management. SOEs were free to determine their production mix and production totals, wages and prices, and investment plans. In the meantime, subsidies and capital transfers to SOEs had been terminated. Responding to the changes, some SOEs strategically transformed their financial obligations into overdue debts to the banking system and used their autonomy to raise the cash wages of their employees.

In response to such strategic behaviour and the weak performance of SOEs, a privatization programme was implemented in March 1991. By December 1994, 64 of the 200 or so centrally managed SOEs existing in 1989 had been privatized. Data available on 58 of these privatizations show that 78 per cent of the relevant SOEs were leased for fixed terms, 19 per cent were sold outright, and 3 per cent were hire-purchased (that is, payment in instalments). The average value of the SOEs which were leased (about $40,000) was higher than that of the SOEs which were sold (around $23,000) or that of the SOEs which were hire-purchased (about $3,000). At the provincial level, the sale of SOEs, rather than leasing, seemed to play a more important role. Between 1988 and mid 1993, more than 52 provincially managed SOEs were sold, and more than 29 were leased.

Why did leasing for fixed terms become prevalent in the privatization programme? The answer certainly cannot be limited to the government's reluctance to do more. Several reasons are listed by Otani and Pham (1996, p. 47). Leasing may be more politically acceptable than outright sales because of a concern among the public that the nation's property might be entirely sold off. Because of uncertainty about the value of SOEs and about the effectiveness of the economic reforms, the private sector may prefer the less risky option of leasing. When alternative modes of privatization are too costly, contracting out or leasing to employee collectives becomes practical. If SOEs are relatively large or require technology that is more sophisticated than the technology domestic sources are able to provide, joint ventures become more attractive.

Although fixed-term leasing has benefits over the medium run, it can cause problems in the long run. Leasing does not involve the transfer of residual control rights, and management structures are shifted only for a limited period. These two characteristics represent disincentives for long-term investment and even encourage decapitalization because, with an average lease period of 15 years, leaseholders may have a limited horizon. From the government perspective, monitoring the leased SOEs is difficult and costly. Therefore, refinements in the leases, such as offering to lessees who have performed well the priority during future lease negotiations or competitions and other more radical reforms will be required.

4. Ownership and governance structures of TVEs in China

In official statistics in China, 'township and village enterprise' (TVE) covers a wide range of ownership categories, including collective ownership by township and village communities, private ownership by households and groups of households, joint ownership by domestic and foreign investors, and joint ownership by domestic shareholders (Table 2). The sector does not include SOEs and enterprises owned by urban collectives, although it does include enterprises owned jointly by urban and rural enterprises.

Table 1 - THE OUTPUT, EMPLOYMENT AND NUMBER OF RURAL ENTERPRISES IN CHINA (1994)

		Total	Township	Village	Joint[1]	Household[1]
Output	Value (billions yuan)	4,258.85	1504.09	1382.51	111.38	476.93
	Share (%)	100.00	35.32	32.46	6.31	27.00
Employment	Number (millions)	120.18	29.61	29.38	7.71	46.78
	Share (%)	100.00	24.64	24.45	7.30	44.00
Number	Number (thousands)	24,945	423	1,228	901.8	18,487.2
	Share (%)	100.00	1.70	4.92	4.31	88.39

Sources: SSB (1995), pp. 363-5, Yearbook of China's Township and Village Enterprises (1993).
Notes: [1] 1992 figures. Because of the slight decline of the shares of household and jointly owned firms from 1992 to 1994, the sum of the shares of each component is slightly greater than 100.

In 1994, enterprises owned by townships and villages account for 49.1 per cent of employment in the TVE sector and produce the dominant portion (67.8 per cent) of total output. The individual household-run enterprises account for 44 per cent of employment and 27 per cent of output. The shares of jointly owned private enterprises in both employment and output are quite small. In the discussion that follows, 'TVEs' are understood in the narrower sense of collective ownership only. The ownership characteristics of household-run enterprises and other private enterprises, as well as the close links between them and TVEs will be analysed in the next section.

The range of activities undertaken by TVEs is much broader than their name implies. These activities include all 40 industrial categories appearing in Chinese statistics, as well as agriculture, construction, transportation and communications, and commerce and services. Some TVEs have reached beyond China to set up joint ventures in Eastern Europe, Russia, Southeast Asia, and the US (Wong et al. 1995). The shares of one TVE are traded on the Hong Kong Stock Exchange (*People's*

Daily, overseas edition, 16 July 1996, page 5). The annual growth rate of the exports of TVEs has been above 30 per cent since the mid 1980s. Since 1992, TVE exports have accounted for over 42 per cent of the national total. TVE exports include textiles, garments, arts and crafts, chemicals, machinery, and electronics and communications equipment (*The Economist*, 28 November 1992, *Yearbook of China's TVEs*, various years). TVEs also vary in size. For example, in Jiangsu Province in May 1996 there were 1,172 TVEs with close to or more than 1,000 employees each. The 329 large TVE groups officially registered by the Ministry of Agriculture average 183 million yuan ($22 million) each in total assets, 300 million yuan ($36 million) each in annual sales and 32.5 million yuan ($3.9 million) in profits before taxes (*Hsingtao* 1996, page A8).

There is an obvious contradiction between the outstanding performance of TVEs and the outcome predicted by traditional property rights theory. As pointed out by Weitzman and Xu (1994), first, a typical TVE has no owner in the sense of traditional property rights theory. Nominally, TVEs are collectively owned by all the members of a community, but these collective owners usually do not have clearly defined shares. Second, there are no residual control rights in the traditional sense. 'Owners' must wait passively to enjoy the ownership benefits, which mainly take the form of communal social investments. The 'owners' of a TVE do not have full rights to use the after-tax income, a majority of which, by law, must be used for reinvestment or for social purposes. Third, until recently at least, and in most cases, the 'owners' could not sell, inherit or otherwise transfer TVE assets. According to traditional property rights theory, TVEs should therefore be relatively inefficient, and they should be privatized.

However, in reality, not only has the growth rate of TVE output been impressive in both absolute and relative terms, but the productivity of TVEs has also been extraordinary. Although capital-labour ratios among TVEs are only about 25 per cent of those in the SOE sector, output-labour ratios among TVEs are about 80 per cent of those in the state sector (*People's Daily* 19 Feb. 1997). Various estimates place the annual growth rate of the total factor productivity of TVEs at between 5 per cent and 12 per cent over more than a decade. This is outstanding relative to world standards (cf. World Bank 1996, p. 51, Weitzman and Xu 1994, Jefferson and Rawski 1994, p. 56, Woo et al. 1994). Likewise, TVEs have exhibited comparative advantages over private firms in China, and their average performance seems to be at least as effective as that of private enterprises (Nee 1992, Svejnar 1990, Dong and Putterman 1997).

Why is this so? First, community members do possess the right to derive significant short-run and long-run benefits from TVE ownership, if, rather than merely short-run financial advantages such as dividends, 'benefits' are understood in the larger sense of job opportunities, job security, pension funds, and communal welfare programmes in housing, health care, irrigation, road construction, and other infrastructure.[4]

Second, although the residual control rights exercised by a community government may imply a certain amount of risk of bureaucratization, the control by government over the implementation and co-ordination of internal reorganization or over the takeover process does sidestep the social and economic costs of bankruptcy through court action or of takeover by outsiders. This control is quite similar to that exercised by the main bank in a Japanese *Keiretsu*.

Third, because it is a fixed economic entity, the community, unlike a specific TVE, can shoulder an almost unlimited liability. Under the pressure of intense competition, this ability can facilitate a consensus among community members, the community government and TVE management and workers to maximize profits even by means of the sacrifice of all or part of wage income. Moreover, because a community is diversified in an economic sense, it can diversify the business risk. A township or village can rather easily create several small-scale TVEs in manufacturing, agriculture, commerce, construction, and transportation and then expand the size of these TVEs.

Fourth, because the community is a small society, the citizenry can fully or partially vote by hands in the semi-competitive elections for community officials in wealthier villages and in those with large TVE economy (O'Brien 1994, pp. 47 and 51; *The Economist*, 2 November 1996, pp. 81-83). The citizens can also participate quite directly in discussions with community leaders. These two avenues clearly contribute to the solution of the problem of monitoring the monitors and help reduce the cost of organization.

Finally, because the community is the corporation, the responsibility contract and subcontract system can be easily arranged between the community representative assemblies and the community government, between the government and the TVEs, and within the TVEs. These contracts and subcontracts have facilitated the solution of monitoring problems within the community and within the TVEs (Lin 1995; O'Brien 1994, p. 45; Wong et al. 1995).

The advantages of the TVE ownership and governance structure are only relative. Many serious problems exist that may be linked to this structure. Among them, two are often pointed out. First, because township and village governments seem to be shifting the responsibility for the overall development of rural communities onto TVEs and to exercise unfavourable interference into TVE management, many TVEs are now also experiencing redundant employment and increasingly heavy social burdens (*China Information Daily*, 2 August 1993, p. 2). Second, because TVE development has been so closely tied to local initiative, rural industrialization has not yet been accompanied by urbanization. As a result, many TVEs have already been restricted by the lack of infrastructure, market information and social services and by poor transportation and communication networks. The existence of such problems means that there is a need for further reform in the TVE sector. The reform would be more than further clarification in TVE property rights.

5. Property rights and private enterprises in East Asia

The private and household enterprise sector has experienced very dramatic growth during the reform years in China and Vietnam. For example, in industry in Vietnam the share of private and household enterprises in the total rose from 14.5 per cent in 1987 to 23.3 per cent in 1990 and 26.1 per cent in 1993, while in China the corresponding share climbed from 1.8 per cent in 1985 to 5.4 per cent in 1990 and 12.9 per cent in 1995.

Three types of enterprise can be distinguished in the sector: household enterprises, rural private enterprises and urban private enterprises. Household enterprises make up over 95 per cent of the total. Most of these do piece work for SOEs, TVEs and other 'corporate' organizations. This integration of public enterprises (SOEs and TVEs) and household 'workshops' on the basis of strict contracts has benefited both sides.

Private enterprises that have grown beyond family-based entities nearly always require local government support in order to obtain raw materials, land, equipment, funds, contacts, and access to regional and national markets. This support is typically supplied partly in exchange for a share in both residual benefits rights and residual control rights. The difference between these private enterprises and the typical private enterprise in a capitalist economy was well understood by the Central Committee of the Communist Party of China in the early years of the reform (State Bureau of Industrial and Commercial Administration and Theoretical Department of *Beijing Daily* 1984).

Table 2 - PRIVATE AND HOUSEHOLD INDUSTRIAL ESTABLISHMENTS IN VIETNAM AND CHINA

	1985	1987	1989	1991	1993	1995
Vietnam						
-Number (units)						
-Private enterprises	–	490	1,284	959	3,322	25,000
-Household enterprises	–	–	333,337	446,771	452,866	
-Share in industrial output (%)	–	14.5	22.0	26.7	26.1	
China						
-Number (1,000s)	3,348	5,553	6,124	6,387	7,971	
-Share in industrial output (%)	1.8	3.6	4.8	6.0	8.4	12.9

Sources: Vietnam: Dodsworth et al. (1996, p. 45), General Statistics Office (1996); China: SSB (1991, p. 391; 1995, p. 375; 1996, p. 401).

The rural private enterprises appear more like the wider community enterprises in which township and village governments have established informal but effective proprietary interests (Young 1994). On the other hand, the ties between the urban entrepreneurs who operate private enterprises and the officials staffing state administrative, distributive and production entities appear more like patron-client relationships (Wank 1996). This arrangement raises two very attractive but quite general questions: how might one favour stable expectations for long-term investment and the development of private enterprises rather than the uncertainty which can arise from the haphazard enforcement of laws and regulations by agents of the state? How can social trust and morality be used to facilitate resource allocation, stable expectations and information flows? While a functioning market economy is popularly understood as a system of well-defined property rights and legal structures, an understanding of the ways in which social trust can institutionally undergird market activity would certainly generate new insights into institutional plurality in market economies.[5]

In China and Vietnam, the bureaucracy is the dominant integrative structure in the social order, the social trust embodied in a community or a patron-client relationship is not readily transferable by one actor to another community entity or relationship. This fact enhances the likelihood of ongoing future co-operation and an orientation towards mutual benefit. As a consequence, social trust in this form, like property rights, is productive. It enables actors to calculate risks and likely returns, encourages business activity by creating the reasonable expectation that others involved in the relationship will behave in a fairly predictable way, and tends to foster much more business activity than alternative forms, including the absence of this type of social trust.

This social trust links entrepreneurs with the overarching bureaucratic structure. The connection cannot be viewed simply as a localized exchange of commercial wealth for bureaucratic power. Its contribution to productivity and marketization may be much more significant. From the perspective of private entrepreneurs, the connection provides local stability in an environment characterized by central policy instabilities and ideological hostility. At the same time, it offers private entrepreneurs institutionalized access to crucial resources such as bank credits, land and key raw materials, many of which are directly or indirectly controlled by government. From the perspective of local governments and officials, the connection institutionalizes new sources of revenue to cope with the increasing expenditure and development pressure (Li 1996, Wank 1996, Wong 1995).

The major contribution of patron-client ties is stylized as the stimulation of competition, support for innovation, the reduction of uncertainty, and the facilitation of market linkages (Leff 1964, Wank 1996). This stylized contribution may be more suited for the ties between rural private enterprises and community governments.

Private entrepreneurs compete against each other for bureaucratic favours that are in short supply. The licences and dispensations are usually renewed on an annual basis, enabling annual cost adjustments. This assures that in the long run only the most productive entities can meet the payment requirements (including bribes). Competition takes place among bureaucratic actors because bureaucratic resources are generally abundant, inducing better service even reform from below. For example, according to the 'individual business family' policy implemented in China in the late 1970s, a private firm could not expand its business beyond seven employees and beyond the use of vehicle transport. Many local governments circumvented this policy by allowing private firms to register as collectives. Without such a practice, the significance of private business in job creation, the generation of fiscal revenue and the elimination of gaps in supply and demand might not have been recognized by the state and the public by 1984 (Liu 1992, Parris 1993, Wank 1996).

The ties between private entrepreneurs and local government entities and officials have reduced the political uncertainties that used to follow political and policy cycles. They have thereby encouraged investment and the diversification away from speculative trade and towards services and industrial production. Because private firms can use these ties to obtain the officially-mediated resources that enhance profits and security, they are motivated to develop these ties as new market channels. As a consequence, private firms have sometimes helped public units market their products, provided production inputs for them and infused capital through public-private partnerships. They have thus helped public enterprises 'grow out of the plan' (Naughton 1995, Probert and Young 1995, Wank 1996).

6. Concluding remarks

This study has illuminated the dynamic processes of SOE property rights reform in China, Vietnam and Laos, the comparative advantages of China's TVE ownership, governance and liability structures, and the way private enterprises in China and Vietnam expand business through social trust because of their participation in community enterprises or their patron-client ties with government entities and officials. Table 3 summarizes the approach of this study in three panels. Panel 1 outlines the ownership features of major types of firms in East Asia relative to the corresponding features of large Japanese firms (J-firms) and large American corporations (A-firms). Panel 2 compares the liability and governance features of these firms. Panel 3 presents a brief remark on the performance of these firms wherein performance is valued in relative terms only.

The ownership structure may shape fundamental features of the liability and governance structure of a firm. However, it cannot fully determine the liability and governance structure. For example, SOEs with management contracts and SOEs with leasing contracts show quite similar ownership structures, but the latter have a relatively hard budget constraint and a less serious agency problem than the former, and as a consequence the latter usually perform more effectively.

The relative efficiency of different type of firms seems to be more directly and closely linked with the liability and governance structures, in which the hardness of the budget constraint, the genuine fear of bankruptcy, the effective monitoring of the monitors, and the existence of compatible incentives for management to reduce agency problems are key dimensions. Within the same general type of state ownership, the management contract system resulted in a performance which was better than that of the SOEs directly controlled by government entities. Meanwhile, the leasing contract system and joint ventures, particularly with foreign investors, have exhibited improved performance. City-run SOEs transformed into full employee stock-ownership enterprises have had impressive success in China, and the approach may be implemented nationwide, especially among medium-size SOEs in the near future.

The excellent performance of TVEs may be attributed to such factors as the compatible interests and incentives among community members, township and village governments and TVE management, the almost unlimited liability borne by the community as a whole, the intense competitive pressure, and the fact that community governments are effectively monitored by community representative assemblies and by community members. These liability and governance features of TVEs are mainly due to the TVE ownership structure and the marketization of the economy. Private enterprises in East Asia show hybrid features of the TVE type and of classical private firms. The ownership features of TVEs appear to stand between the J-firms and the A-firms.

For a better understanding of the plurality of ownership arrangements in East Asia as well as in the West, one might distinguish between ownership of the firm and ownership of the asset. Ownership of the asset is equivalent to the classical concept of property rights, including the right to utilize a specified asset, the right to capture benefits from the asset, and the alienation right over the asset. Ownership of the firm refers to the claim right to residual returns and the residual control right. For example, when creditors and shareholders are both the owners of the financial capital of a firm, the creditor gets contract-specified benefits (interests) from his capital and usually has no residual control right or residual benefits right. Therefore, he cannot be identified as one of the owners of the firm. In contrast, a shareholder has a claim to residual benefits, possesses a right to residual control, must bear the risks entailed in the exercise of these rights, and is generally identified as one of the owners of the firm.

Thus, we can view the firm as a nexus of contracts among various asset owners. These asset owners include not only the shareholders and creditors who are owners of the financial capital and the workers and managers who are owners of their human capital, but also certain government agents who may own or have monopoly control over specific, non-marketable institutional and social capital. The actual allocation of residual control rights and rights to residual benefits among these asset owners is dependent or contingent on the state rather than unique or deterministic. For instance, in a typical capitalist economy, the concrete ownership arrangements for a firm may consist of a partnership whereby all the members of the firm share residual benefits and residual control rights; it may consist in the hiring of labour by capital whereby capitalists exercise the residual control rights and enjoy the residual benefits, or it may consist in the employment of capital by labour whereby workers enjoy the residual control rights and the residual benefits rights (Blair 1995, Hart 1995).

The basic logic behind this state-contingent ownership is the value-maximization principle of the firm, according to which the optimal ownership arrangement of the firm should match the right to residual benefits with the residual control rights. In other words, the risk-makers should be the risk-takers (Milgrom and Robert 1992, pp. 291-93). Taking into consideration the monitoring and agency problems which exist under conditions of asymmetric information, the allocation of partial or full ownership rights in a firm to the most important actors in the development of the firm can effectively reduce the cost of monitoring and the problem of moral hazard and thus maximize the match between the residual control rights and the right to the residual benefits.

One may conclude that the value-maximization principle will push SOEs with management contracts to seek an arrangement involving leasing, joint ventures, employee stock ownership, and other hybrid forms of the shareholding company. The evolution of TVE ownership and governance structures will continue and will be increasingly influenced by international competition. The TVE comparative advantages in terms of the match of residual control rights and the residual benefit rights will be strengthened in the evolution. The evolution of private enterprise in East Asia will also retain unique features and will continue to follow the path of mutual benefits, although private enterprises in East Asia may begin to resemble private firms in the West.

Table 3 - THE FEATURES OF HETERODOX OWNERSHIP AND GOVERNANCE STRUCTURES VERSUS THE J-FIRM AND THE A-FIRM*

	SOEs in the Reform							
	Management contract	Leasing contract	Employee stock ownership	Joint ventures	TVE's	Private firm in Asia	J-firm	A-firm
Nominal owner	All citizens	All citizens	All employees	Citizens & contract	Community members	Private owner(s)	Shareholders	Shareholders
Control right	Government	Government	Shareholder Assembly	Government & partners	TVG	Owners & local government	Workers & managers	Managers
Major beneficiaries	Government & citizens	Government & citizens	All employees	All the three parts	Citizens & TVG	Owners & community	Workers & managers	Shareholders
Alienation right	Government	Government	Employees & government	Government & partners	Citizen assembly & TVG	Owners & local government	All the three groups	Shareholders & managers
Budget constraint	Soft	Relatively hard	Hard	Relatively hard	Hard for whole community	Hard	Relatively hard	Relatively hard
Subject to bankruptcy	No	Yes	Yes	Not certain	Yes, but not by court	Yes	Yes	Yes
Who monitors the monitors	Nobody	Nobody	Shareholder Assembly	Not clear	Citizen rep. assembly	Owners	Shareholders	Shareholders
Agency problem	Most serious	Less serious	Moderate	Less serious	Moderate	Not present	Moderate	Less serious
Average performance (relative efficiency)	Poor	Good	Excellent	Very good	Excellent	Excellent	Very good	Very good

*TVG = township and village government.

Notes

[1] The GDP share of SOEs in China may be underestimated by a small margin, because official statistics count SOE joint ventures and shareholding companies as 'other ownership enterprises' even when most of the capital is invested by the SOEs. For example, according to the *1995 Industrial Census of China*, the output value of SOE share holding companies accounted for 8 percent of the total (*People's Daily*, 19 Feb. 1997).

[2] In contrast to the classification in official Chinese statistics, SOEs and foreign joint-venture enterprises in Vietnam are counted as part of the state sector even when most of the capital is provided by the private partner. As a result the GDP share of SOEs is certainly overstated by a significant margin in the official statistics. On the other hand, the distinction between the state and private sectors has become increasingly blurred. For instance, some 700 nominal 'private' enterprises, which account for about 60 per cent of all private enterprises, are reported to belong to ministries or party organizations (Irvin 1996, Probert and Young 1995, p. 515).

[3] For a detailed literature survey on this issue, see Sun (1997).

[4] For a detailed discussion about the characteristics of TVE ownership and governance structures based on a broader perspective than the notion of property rights, see, Sun (1997).

[5] The institutional plurality in market economies like Japan and the US has attracted the attention of social economists. For instance, because they are considered more easily adaptable to volatile markets, personal contracts are popularly employed in Japan, despite the availability of legal contracts and a legal system (Dore 1983). In the US, for the sake of saving time and costs, sales representatives often settle deals with a handshake rather than by contract (Macaulay 1963).

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