

China's Rural Industry: Developments after 1978

by

Bing He

056506

Major paper presented to the
Department of Economics of the University of Ottawa
in partial fulfillment of the requirements of the M.A. Degree

Supervisor: Professor Michel Chossudovsky

ECO 7997

Ottawa, Ontario

December, 1994

Table of Contents:

Glossary	i
Abbreviations	ii
A Map of China	iv
1. Introduction	1
2. Background Review	5
2.1. Socialist Transportation and the First Five Year Plan	5
2.2. The Great Leap Forward and Subsequent Readjustment	9
2.3. The Cultural Revolution	12
3. Rural Industry post 1978	13
3.1. Policy Cycles	16
3.2. Policy Content Changes	21
3.2.1. From Equalitarianism to the Household Responsibility System	21
3.2.2. From 'self-reliance' to the 'open door'	24
3.3. Patterns and Characteristics of Rural Enterprises after 1978	27
3.3.1. Characteristic 1: Diversified Ownership	28
The Wenzhou Pattern	31
The Wuxi Pattern	34
Inland Rural Enterprises	36
3.3.2. Characteristic 2: Export-Oriented Enterprises	39
The Nanhai Pattern	42
3.3.3. Characteristic 3: New Rural-Urban Relations	43
3.4. Sigurdson's Model and Chinese Rural industry	47
4. Conclusion	52
4.1. Policy Evaluation and Recommendations	52
4.2. Future Trends	58
References	61

Glossary:

Advanced Agricultural Producers' Co-operative (1955-1958): The third step of land reform. Every member collectively owns land.

Commune and Brigade Enterprises (CBS): Enterprises owned by a commune or a brigade. The name of CBS changed to the township and village enterprises in 1982.

Elementary Agricultural Producers' Co-operative (1952-1957): The second step of land reform. This type of co-operative merged farmers' land, capital goods and labour. Income distribution was based on each household's share of the land, capital goods and labour contribution.

Household Responsibility System (HRS): also called production responsibility system. Land was allocated to each household in accordance with the active number of workers per household. The contract signed between production team and peasants specified quantities of output to be handed to the production team. After selling the quotas to the government, peasants can sell extra products to free markets or to the government at a negotiable price.

Mutual Aid Group (1950-1955): It was the first step of the land reform launched in the 1950s. Households merged their capital goods for mutual assistance, but the ownership and management of each farm remained in the hands of the individual household.

People's Commune: The commune took over the administrative functions of the villages, collected taxes and operated schools and medical facilities. The commune was responsible for agricultural procurement, fulfilling state quotas and assigning work and production quotas. The People's Commune Movement started in 1958.

Production Team: Purely a community structure, having lost most of its administrative functions as a result of the implementation of the production responsibility system.

Sideline: production of pig, poultry (ducks, geese, chickens) and small-scale handicrafts.

Three Freedoms and One Responsibility: The policy adopted by Liu Shaoqi (the Chairman of China from 1960 until he died in 1969). The 'three freedoms' were the freedom to develop a free market, the freedom to develop small enterprises and the freedom to increase the size of private household plots. The 'one responsibility' was the fulfilment of output quotas by the collective.

Township (formerly the *commune*): It is the lowest level in China's government hierarchy. It has an articulated government structure. The typical township has a population of 15,000-30,000.

Township and Village Community Enterprises (TVCEs): The community enterprises owned by townships and villages are referred to as TVCEs. These exclude enterprises run by production teams.

Township, Village and Private Enterprises (TVPs): The rural non-state enterprises, including production team enterprises.

Village (formerly the *brigade*): It is not a separate level of government but has governmental functions and a community structure. Villages generally have a population of 1,000-2,000.

Abbreviations:

CBE: Commune, Brigade Enterprise

GVIO: Gross Value of Industrial Output

HRS: Household Responsibility System

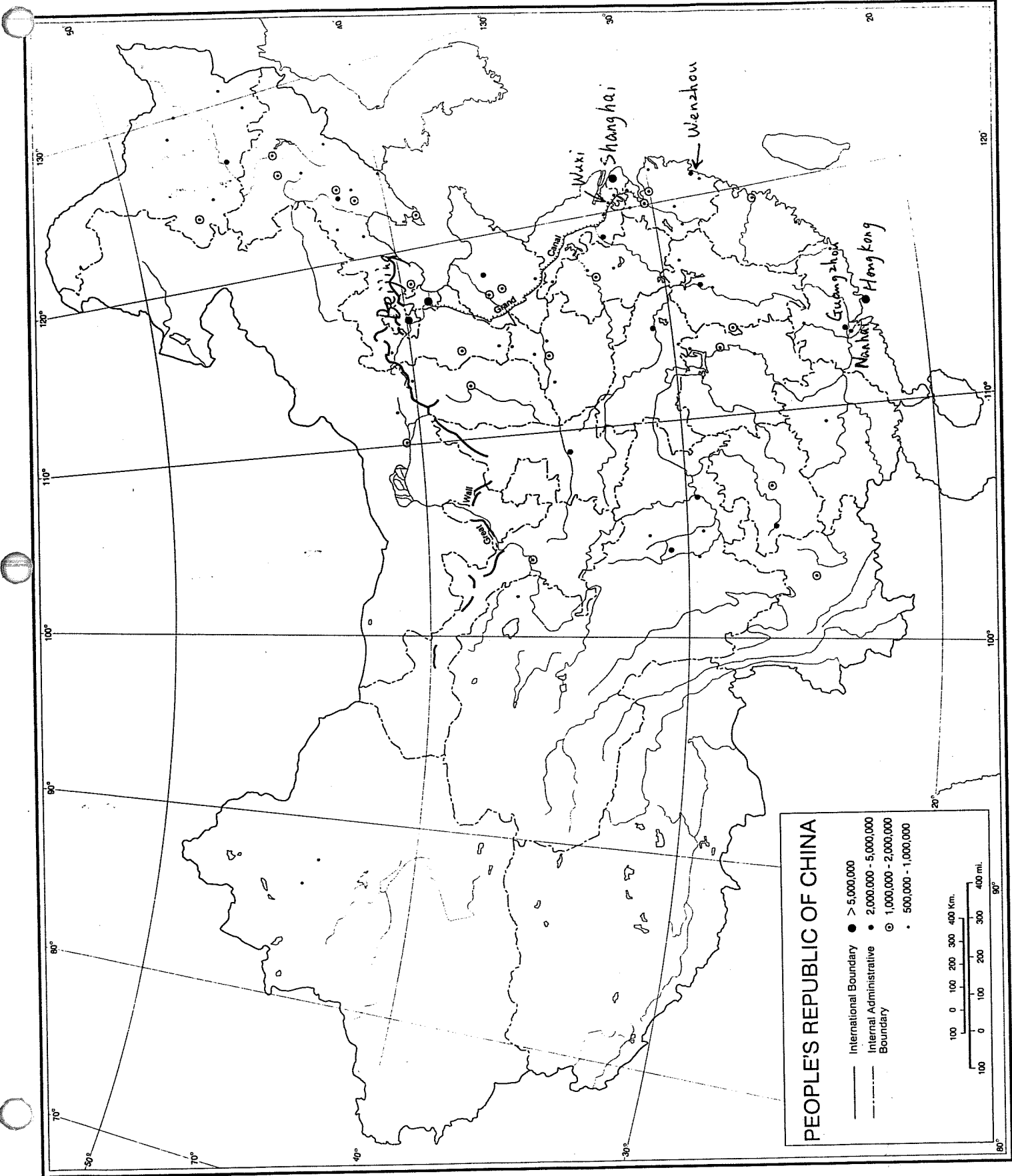
MOFERT: Ministry of Foreign Economic Relations and Trade

RE: Rural Enterprise

SOE: State-Owned Enterprise

TVCE: Township and Village Community Enterprise

TVE: Township, Village and Private Enterprise



PEOPLES REPUBLIC OF CHINA

- International Boundary
- Internal Administrative Boundary
- > 5,000,000
- 2,000,000 - 5,000,000
- ⊙ 1,000,000 - 2,000,000
- 500,000 - 1,000,000

100 0 100 200 300 400 Km.
100 0 100 200 300 400 mi.

1. INTRODUCTION

China is a large country, its regions vary greatly in geography and in endowments of natural resources, human resources and material capital. Moreover, regional differences in economic history have created big gaps in current levels of development, specifically in rural areas. Before the People's Republic of China was established in 1949, over 70 percent of the industrial assets and output were concentrated in the coastal areas while the rest of the country shared the remainder.¹ Within the coastal region, modern industrial production was heavily concentrated in a few cities; the gross value of output of eight cities (Beijing, Shanghai, Shenyang, Anshan, Benxi, Dalian, Fushun) accounted for 55 percent of the total for the coastal region.² Most of the rural areas had a considerable number of workshops and handicraft industries but very few large factories.

After 1949, China launched a large scale agricultural cooperative movement. Farmers working part-time in the handicraft industry were organized into specialized sideline production teams. Commune and brigade enterprises, the predecessors of TVPs (Township, Village and Private Enterprises), subsequently began to emerge and develop on the basis of collective sideline production. The first wave of rural industrialization came in 1958. The Great Leap Forward led to the creation of numerous small-scale rural industrial firms in order to develop industry but

¹State Statistical Bureau, *Thirty-Five Glorious Years: 1949-1984* (Beijing: *Zhongguo Tongji Chubanshe*, 1984), p. 64.

²Charles Roll and Kung-Chia Yeh, "Imbalance in Coastal and Inland Industrial Development" in *China: A Reassessment of the Economy*, A Compendium of Papers submitted to the Joint Economic Committee, United States Congress (Washington, D.C.: Government Printing Office, 1975), p. 82.

these, for the most part, turned out to be unsustainable for a variety of reasons including low levels of technology and inadequate scales. During this period, grain production declined from 200 million tons in 1958 to 165 million in 1959 and to 160 million in 1960. The Gross National Product (GNP) dropped from US\$95 billion in 1958 to \$92 billion in 1959, to \$89 billion in 1960 and to \$72 billion in 1961.³ The Great Leap Forward not only dampened farmers' enthusiasm for production but also precipitated a crisis for the national economy. In 1960 the Central Committee of the Communist Party called for readjustment of the national economy and began to check the communization campaign.⁴ As a result, the number of rural firms shrank drastically in the early 1960s. But later as economic conditions improved, the role of rural firms expanded again in the late 1960s.

The second wave of rural industrialization began in 1970, based on the government's desire to promote production of key inputs for the mechanization of agriculture. Rural factories began to produce agricultural machinery and farm tools. The third wave came after 1978, when the Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party was held and the Household Responsibility System was adopted, accompanied with the open door policy. The Household Responsibility System allocated land to peasants which increases their incentives to produce which in turn led to large increase of surplus labour. In order to solve this problem, the government encouraged the development of rural enterprises to absorb the labour. This wave was

³Immanuel C. Y. Hsu, *The Rise of Modern China* (Oxford: Oxford University Press, 1990), p. 691.

⁴William Byrd and Lin Qingsong (ed.), *China's Rural Industry: Structure, Development, and Reform* (Oxford: Oxford University Press, 1990), p. 10.

characterized by the rapid growth of rural TVPs, the appearance of export-oriented rural enterprises, a diversified ownership of rural industry and a growing role of TVPs in China's economy.

The share of rural enterprises in the total national Gross Value of Industrial Output (GVIO) rose sharply from only 3 percent in 1971 to 9 percent in 1978, to 12 percent in 1983, and to more than 21 percent in 1986.⁵ The rapid growth of rural industry was the result of reform policies. The agricultural reforms created an available surplus for investment and released a pool of labour to engage in rural industries. Also, the initial industrial condition which had neglected the light industry created major opportunities for the entry of small firms into this sector. The rural industry now became increasingly significant in generating fiscal revenues⁶ and in providing a growing proportion of the personal income of rural inhabitants.⁷ After the reform, TVPs played an important role in Chinese industry as a whole, both in meeting rising demands for industrial goods and as a competitor and partner of the state industry.

We cannot, however, simply say that the rural industry developed at the same speed in different parts of China. The different regional conditions created different patterns. The Wenzhou region,

⁵*Ibid*, p. 16.

⁶Between 1981 and 1986, the share of TVCEs' pre-tax profits rose from 23.3 percent to 46.0 percent. In 1988, it reached 47.7 percent, comparable to the 49.7 percent paid by state enterprises. Between 1986 and 1988, TVCE taxes rose in total by 72.2 percent in nominal terms. See Anthony Ody, *Rural Enterprise Development in China, 1986-90* (Washington: World Bank, 1992), pp. 14-15.

⁷The per capita net income of peasants increased at an average rate of 13.1 percent in real terms, compared to the increase of the average net income of farmers by only one yuan a year between 1965 and 1977. See Du Runsheng, "Advancing amidst Reform" in Longworth (ed.), *China's Rural Development Miracle* (Queensland: University of Queensland, 1989), pp. 7-9.

situated in south-eastern Zhejiang Province, developed a pattern of rural industrialization characterized by its lively private and individual economy. Its rural individual industrial and commercial firms made up 81 percent of the total number of licensed firms in 1984. Since then, the production value of private enterprises has accounted for nearly 60 percent of the net industrial output.⁸ Compared to the Wenzhou Pattern, the Wuxi region located near Shanghai in the most industrialized rural county in China is famous for its dominant commune-owned enterprises. The collectively-owned enterprises dominate 95 percent of the total enterprises in Wuxi,⁹ and are tightly controlled under the supervision of township governments. Private enterprises are severely hampered by administrative restrictions, and sizable ones have not emerged. By contrast, Nanhai County in Guangdong Province is an example of the involvement of its enterprises in business relationships with the outside world. Since it is near Hong Kong, foreign investment plays a more important role in Nanhai's economy. It is also highly industrialized and more urbanized than Wuxi with highly diversified ownership of its enterprises. The commune-owned enterprises are important but not dominant. However, most inland rural enterprises perform poorly, many of the inland enterprises developing at less than the average national rate of development of rural industry.¹⁰ Through the different case studies which to be presented later, we can better understand the various facts in the rural industrial system in China.

The purpose of this paper is to show how the reform policies on agriculture brought about the

⁸Liu Yialing, "The Private Economy and Local Politics in the Rural Industrialization of Wenzhou", *China Quarterly*, June 1992, p. 300.

⁹ Ody, *op.cit.*, p. 3.

¹⁰Byrd and Lin (ed.), *op.cit.*, p. 13.

development of the rural industry and further stimulated the urbanization. Through comparisons of the present situation of TVPs and a historical review, the paper shows the influence of policies on the development of rural industries and how reform led to the three main characteristics of TVPs after 1978. The case studies will be used and Sigurdson's model will be examined in order to find out successful methods for the development of rural industries. Finally, the future trends of TVPs will be estimated.

2. Background Review

2.1 Socialist Transformation and the First-Five Year Plan

With the inauguration of the People's Republic of China in 1949, the problems facing the Chinese government were formidable. National administrative control had to be established. After three years of rehabilitation, China launched the movement of socialist transformation. Private industry and trade were restricted, brought under state control and gradually nationalized and cooperatized. The individual economy and the private capitalist economy were transferred to state economy or cooperative economy. Thus over time the diversified economy disappeared and only the public sector prevailed in China. There were two forms of public sectors, i.e. the state economy and collective economy. The state economy was the sector under "ownership by the whole people" while the collective economy was a "lower form of socialist public ownership, under which the means of production belongs to people in one economic collectivity".¹¹

Meanwhile, China's leaders found it important to develop industry, especially heavy industry.

¹¹Xue Muqiao, *China's Socialist Economy* (Beijing: Foreign Languages Press, 1981), pp. 45-46.

During the first five-year plan (1953-1957), almost two-thirds of the major projects, including 156 major construction projects with Soviet aid were located in the interior.¹² Mao Zedong, in his 1956 speech "On the Ten Great Relationships", said that more than 90 percent of all heavy industry projects were to be built in the interior.¹³

The industrial system taken over by the Chinese Communist leadership in 1949 was extremely unbalanced. In the early 1950s, when the Chinese leadership started their efforts at industrialization, they regarded the huge coast-interior imbalance as irrational for three main reasons. First, the coast areas of industrial production were usually too far away from energy and raw materials supply areas and the interior market. Second, the rich resources in the inland areas could not be properly exploited. Thirdly, since the coast was easily exposed to foreign military power, the heavy concentration of industry there represented a national security risk.

Those important enterprises aided by Soviet Union were in sectors such as iron and steel, metallurgy, chemicals, electric power generation, coal mining and textiles. Of the total outlay of capital, 58.2 percent was for industrial construction, 19.2 percent for transport, postal services, and telecommunications.¹⁴ Hence, the proportion of industrial output contributed by heavy industry grew from 8 percent in 1949 to 14.8 percent in 1952. Steel production reached 5.2 million tons, iron 5.8 million tons, electric power 19,030 million kwh in 1952-each representing a 25 percent rise above the

¹²*Ibid*, p. 84.

¹³Mao Zedong, *Selected Works of Mao Zedong* (Beijing: Foreign Languages Press, 1977), p. 284.

¹⁴Hsu, *op.cit.*, p. 654.

original targets.¹⁵

In agriculture, the land reform occurred between 1949 and 1952. Because 70-80 percent of the land was owned by 10 percent of the farm population (i.e., the landlords and rich peasants), the government promulgated the Agrarian Reform Law. It stated that "the land ownership system of feudal exploitation by the landlord class shall be abolished and the system of peasant land ownership shall be introduced"¹⁶. By 1952, 700 million mu¹⁷ of land had been redistributed to 300 million peasants.¹⁸ Mao emphasized the link between industrialization and agricultural co-operative transformation: "socialist industrialization cannot be carried out in isolation from the co-operative transformation of agriculture. ...If our agriculture cannot make a leap from small-scale farming with animal-drawn implements to large-scale mechanized farming, ... than we shall fail to resolve the contradiction between the ever-increasing need for commodity grain and industrial raw materials and the present generally low output of staple crops"¹⁹. Then, in order to raise production and achieve greater agricultural specialization, the second phase of agricultural reform began. There were three steps of co-operation. The first step was "Mutual Aid Groups", which appeared from 1950 to 1955. These groups were established by the voluntary participation of several households, which merged their capital goods for mutual assistance. "Elementary Agricultural Producers' Co-operatives", the

¹⁵Zong Huaiwen, *Years of Trial, Turmoil and Triumph--China from 1949 to 1988* (Beijing: Foreign Languages Press, 1989), p. 84.

¹⁶Carl Riskin, *China's Political Economy: the Quest for Development since 1949* (Oxford: Oxford University Press, 1987), p. 48.

¹⁷1 hectare = 15 mu.

¹⁸Hsu, *op.cit.*, p. 477.

¹⁹Mao, *op.cit.*, pp. 196-197.

second step, began to develop (1952-57). In this phase, the members merged their labour, capital and land. Income distribution was based on each household's share of the land, capital goods and labour contribution. Then, "Advanced Agricultural Producers' Co-operatives" evolved from 1955 to 1958, in which all members collectively owned the land. Along with the drive for industrialization, the government took a further step toward socialist transformation by announcing the creation of People's Communes. By the end of 1958, all farmers became members of a commune.²⁰ Under the commune system, there was a three level rural management system: the commune, the brigade and the production team. The production team, composed of 30 to 40 households, was the basic production unit of the commune responsible for specialised agricultural work. The brigade level was responsible for irrigation, water conservancy and farm machinery. The average size of a commune was about 4,000 households.²¹

The victory of the Communist Party was based on the struggle of the poor and landless peasants against the exploitation of landlords. Hence, the central government allocated land to the peasants immediately after the People's Republic of China was established. But the individual farming was the lowest form of rural production. Mao wanted large-scale mechanized farming to support industrialization. Meanwhile, Mao was afraid that the skilled peasants could become richer and the poor peasants would eventually lose their land. Thus, the People's Commune Movement occurred in 1958. However, 20 years of a commune system did not suit all Chinese rural areas. The traditional attachment to land was very strong. The rapid collectivization caused loss of material incentive, such

²⁰Xue Muqiao, *op.cit.*, pp. 32-37.

²¹Luo Xiaopeng, "Ownership and Status Stratification" in Byrd and Lin (eds.), *China's Rural Industry, op.cit.*, p. 134.

as the slaughter of pigs, the sale of draught animals and a decline in subsidiary production. In reality, some poor areas had no capacity to work in the commune system. Also, because of the peculiar nature of the conditions under which peasants work, it was impossible for the people's commune leadership to make a fair estimate or calculation of the quality and quantity of the labour contributed to the commune.

In industry, according to Mao's thought, the government should control big industry and the middle and small capitalists could co-exist with the state-owned enterprises. Actually the private-owned enterprises vanished after the socialist transformation. The Communist Party needed help from the national patriotic bourgeoisie to establish the industry system in the beginning. After the task was finished, the Communist Party could not allow existence of private-owned enterprises. The rapid growth of industry after 1949 was based on high investment and high accumulation. Light industry and agriculture were sacrificed to support heavy industry.

2.2 The Great Leap Forward and Subsequent Readjustment

Encouraged by the achievement in the first five year plan, the government drove to accelerate the expansion of the already overheated economy. In 1958, the National People's Congress announced a "Great Leap Forward" Movement, calling for a 19 percent increase in steel production, 18 percent in electricity and 17 percent in coal output for 1958. To achieve this record, everyone was urged to participate in industrial production. By the fall of 1958, 600,000 backyard furnaces had appeared all over the country.²²

The promotion of rural industry began during the Great Leap Forward, when large numbers of small iron and steel works were established in the countryside as a part of the "walking-on-two-legs"

²²Hsu, *op.cit.*, p. 655.

strategy. The main concept of walking-on-two-legs is: agriculture must develop rapidly to meet the requirements for food, clothing and industrial production. Meanwhile, agricultural development depended on the support of industry to provide agricultural inputs.²³ Hence, the purpose of creating "five small industries"--namely the iron and steel, fertilizer, cement, coal and hydroelectric power, and machine building--was to provide agriculture with needed modern inputs. There are several reasons for the use of rural industries to support agriculture. China's inadequate transport system transporting goods from urban to rural locations is very expensive and the rural small-scale industries are close to their market. Hence, they can better understand and meet the needs of the customers. Also, the local resources which could not be exploited by large-scale enterprises could be exploited by local small enterprises. By the end of 1958, the commune and brigade enterprises in China employed 18 million peasants. This compares to the early 1950s when 10 million peasants worked in sidelines and 2 million were rural workers involved in full-time, small-scale industrial production.²⁴ Millions of "backyard furnaces" were erected to produce native pig iron to feed into modern steel mills. Unfortunately, under the generally chaotic and frenzied atmosphere during the Great Leap Forward, little attention was paid to the suitability of production processes for small-scale labour-intensive operations. The bulk of these small plants were set up without prior investigation of raw material availabilities. In some cases, no market could be found for products from the newly-promoted industries, resulting in wasted capacity. The clearest case of failure in the development of small plants was the iron and steel industry. In August 1959, 3 million of the 11 million tons of steel produced in

²³Jon Sigurdson, *Rural Industrialization in China* (Cambridge, Mass: Harvard University Press, 1977), p. 8.

²⁴Samuel Ho, *The Asian Experience in Rural Nonagricultural Development and Its Relevance for China* (Washington, D.C.: World Bank, 1986), p. 43.

1958 was pronounced unfit for industrial use because backyard furnaces did not perform the same function as the giant steel mill. Subsequent retrenchment closed down or suspended more than 300 of the existing 500 small plants.²⁵ Many of the enterprises in the five small industries may not have been economically viable and probably should never have been established. In the 12 years between 1968 and 1979, local small and medium iron and steel works lost a total of 6 billion yuan.²⁶

The disastrous failure of the Great Leap Forward made Mao give up his position as the Head of State to Liu Shaoqi in 1960. Liu and Deng Xiaopeng controlled the Central Committee so they began to fulfil the policy of 'three freedoms and one responsibility'. The main content of this policy was decentralization which gave the peasants more freedom, such as the freedom to develop a free market, to develop small enterprises, and to increase the size of private household plots. And the peasants had responsibility to fulfil the output quotas.²⁷ However, this policy was fulfilled only from 1960 to 1963. Mao later began the Cultural Revolution to gain back his position and dismissed Liu.

2.3 The Cultural Revolution

During the Cultural Revolution, rural industry developed very fast. In 1970, the State Council at the North China Agriculture Conference called for effort to speed up agricultural mechanization. Between 1965 and 1969 the production capacity of small nitrogenous fertilizer plants grew five times, and their share of national fertilizer output increased from 12 percent in 1965 to 60 percent in 1971.

²⁵Christine Wong, "Rural Industrialization in the People's Republic of China: Lesson from the Culture Revolution Decade" in *China under Four Modernizations*, Joint Economic Committee, United States Congress (Washington, D.C.: Government Printing Office, 1982), pp. 401-402.

²⁶*Jingji Diaocha*, Series 2, 1983, p. 18.

²⁷Michel Chossudovsky, *Towards Capitalist Restoration? Chinese Socialism after Mao* (London: Macmillan, 1986), p. 37.

The number of cement plants increased tenfold between 1965 and 1973, and came to produce almost half of China's cement. Similar growth occurred in pig iron production, small-scale power generators and farm equipment.²⁸ In 1978, there were 600,000 enterprises in the 'five small industries'.²⁹ In 1979, there were reportedly nearly 1.5 million enterprises run by rural communes and brigades. They produced a gross income of 48,080 million yuan or over 30% of the total income for the three-level rural collective economy of communes, brigades and production teams. Commune and Brigade enterprises employed 28 million workers, nearly 10% of the rural labour force.³⁰ Of these enterprises, 21 percent were commune-operated and the rest brigade-operated. The average size of the commune enterprises is some 40 workers, which is three times that of brigade enterprises.³¹ However, even though these enterprises are often called 'industrial' in the Chinese press, they also include enterprises engaged in nonindustrial, subsidiary agricultural activities such as poultry, fish-raising, orchards, mulberry and tea plantations.

3. Rural Industry in China after 1978

The Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party in 1978 was a major landmark in the political and economic life of the post-Mao era. It adopted the drastic decision of using greater material incentives and loosening the control mechanisms that used to constrain growth in the rural sector. The two major documents in this meeting were "Some Questions Concerning the Acceleration of Agricultural Development" and "Regulation on the Work

²⁸Riskin, *op.cit.*, pp. 214-215.

²⁹Wong, *op.cit.*, p. 398.

³⁰*Beijing Review*, No.5, 4 February 1980, pp. 7-8.

³¹Ho, *op. cit.*, p. 43.

in Rural People's Communes". Three decisions were made to permit more diversified agriculture, to allow the individual economy greater flexibility to develop in rural areas and to promote the vigorous and systematic development of Commune and Brigade Enterprises (CBEs).³² The Household Responsibility System was adopted. Under this system, land remained public, but each household received a plot for cultivation and negotiated a contract with the Commune's production team. The contract specified quantities of output to be handed to the production team as payment for the use of the land. Each household had full control of its labour resources and could either keep or sell in the free market the product that exceeded the contracted quota. Also, draught animals, tools, and equipment were divided among households. In 1979, the price for grain increased 22 percent, cooking oil 26 percent, cotton 28 percent, compared to prices in 1977.³³ All these policies increased peasants' incentives. The growth rate of agricultural output was 8 percent during 1979-1984, compared to only 2.6 percent between 1957 and 1978. Per capita net income of peasants increased at an average rate of 13.1 percent a year between 1979 and 1987, compared to only 3 percent a year in the period 1954-1978.³⁴

However, allocation land to peasants was another form of egalitarianism. The land was allocated on the number of able farm workers, not on the peasants ability to work. The huge amount of population and limited arable land made the land allocated to each household very small. Some households could not get enough to support themselves from the small plot land. Others who were

³²*Ibid*, p. 49.

³³Terry Sicular, "China's Agriculture Policy during the Reform Period", Harvard Institute of Economic Research, Discussion Paper No. 1522, November, 1990, p. 9.

³⁴*Ibid*, p. 7.

good at farming could not find enough land to till. Some peasants who had skills in fisheries or forestry wanted to put all their energy on sideline activities instead of farming. Gradually, "specialized households" emerged, which defined as family businesses based on individual households where the labour force and most of its funds are invested in one specialized undertaking. These households engaged not only in agricultural production, but also in service industries, such as transport and commerce. Many peasants have become prosperous because of their expanded activities as "specialized households".³⁵ The types of peasants involved in the specialized households were: production and team leader with managerial skills, demobilized soldiers, peasants with skills in specific grain or cash crop cultivation (such as silk, tobacco, livestock, poultry breeding, fishery cultivation or forestry), and individual providing services.³⁶ Such specialized activities offer opportunities to earn higher incomes than contract farming, and the state hoped that many households would find it advantageous to give up their contracted land and devote themselves fully to the more lucrative activity.

The introduction of specialized households in rural China has provided a distinct shift in China's agriculture from basically farming, that is from providing enough grain to feed the families to commercial commodity production. Peasants entered into service trades, commodity production, manufacturing, and transportation of locally produced goods to distant locations. The development of specialized households has enabled peasants to diversify. Under this arrangement, peasants grow any type of high-yield commercial commodity crop suitable to the land and which can be produced profitably. The need to encourage peasants to specialize and diversify led to another important change

³⁵*Beijing Review*, February 27, 1984, p. 18.

³⁶*Ibid*, p. 18.

in rural China: in 1984, the individual household was allowed to transfer the contracted land to another household with approval of the local cooperative unit. Specialized households were also allowed to form partnerships and companies, either by themselves or in joint venture with the township. They could even hire workers as helpers under the labour exchange. By October 1984, 24 million households, or 13 percent of total rural households, were "specialized households".³⁷

As specialized households mushroomed and agricultural production became more efficient, there arose a problem of rural surplus labour. In 1985, the Xinhua News Agency reported that as many as one-third of China's total rural labour force had been idled, or "freed" from farming.³⁸ One expert on rural China has reported that 30 to 40 percent of China's rural labour force, about 370 million of surplus labour, could create "a class of landless landlords" in the future.³⁹ Instead of allowing the surplus peasants to move into the already overpopulated cities, the Chinese government permitted them to engage in non-agriculture activities in small towns. The Central Committee Circular in 1984 stated that in addition to supporting the development of commune and brigade enterprises, governments at all levels should encourage peasants to invest in or buy shares of all types of enterprises.⁴⁰

In 1987, the Thirteenth Party Congress further liberalized the sale of right to land utilization by one household to another.⁴¹ The grain specialized households could farm larger pieces of land. The

³⁷Hsu, *op. cit.*, 1990, p. 845.

³⁸*Xinhua News Release*, January 8, 1985, p. 1.

³⁹*Beijing Review*, April 30, 1984, p. 18.

⁴⁰Byrd and Lin (ed.), *op cit.*, p. 11.

⁴¹Hsu, *op. cit.*, p. 845.

surplus labour either went to the rural enterprises, or went to the cities, or got hired by rich farmers in farming the land. The large amount of cheap labour made the rapid development of rural industries possible. But the large number of peasants entered the cities and made the bottleneck transportation worse and brought the serious social problems to the cities. Also, the gap between rich farmers and poor hired peasant widened.

3.1 Policy Cycles

The development of China's rural industry has not been smooth and uncontested. On the contrary, the policies governing rural industries have kept moving between extremes of encouragement and official discouragement in response to the shifting political views of the central government. China's rural industry experienced three ups and three downs. It received its first big boost during the Great Leap Forward of 1958-60. At least 7.5 million new factories and workshops, with the majority processing agricultural produce, were set up in the first nine months of 1958.⁴² The Leap emphasized the iron and steel industry, leaning heavily on mass mobilization to speed up industrial development. In the economic crisis of the early 1960s, most of the firms established during the Great Leap Forward were shut down because the communization campaign not only dampened farmers' enthusiasm for production but also precipitated a crisis in the national economy. But as economic conditions improved after, the role of rural firms expanded again in the late 1960s, particularly in industries closely related to agriculture. From the mid-1960s through the early 1970s, rural enterprises developed further for two reasons. Responding to the US escalation of the Vietnam War in the fall of 1964, China moved one-third of its industrial base to the hinterlands. Second, the State Council at the North China Agriculture Conference called for efforts to speed up agricultural

⁴²*Ibid*, pp. 125-126.

mechanization in 1970.³⁹ After 1978, some rethinking of rural industry's role in China's development had taken place. Enterprises in the five small industries accounted for 53 percent of the total losses sustained by all state industrial enterprises in 1978.⁴⁰ Grossly inefficient enterprises in the five small industries were to 'close down, suspend operation, merge, or shift to other work'. The number of CBEs decreased from over 1.5 million in 1978 to about 1.3 million in 1981. But the gross revenue earned by CBEs increased by 78 percent from 1978 to 1982.⁴¹ In 1984, commune and brigade enterprises were renamed as TVPs, since the People's Communes had been abolished and a large number of partnerships and individual enterprises had come into being.⁴² In the early reform years, rural enterprises benefitted from a variety of tax exemptions, but such exemptions were progressively phased out.⁴³ In 1982, China's constitution recognized the individual economy as a complement to the public economy and offered state protection to its lawful rights and interests, but individual firms remained officially subject to employment ceiling of eight employees.⁴⁴ In 1986, there were 6.35 million rural industrial enterprises, and they employed about 47.6 million people. The value of rural industrial output in that year reached 241 billion yuan and accounted for 32.5 percent of the total

³⁹Byrd and Lin, *op.cit.*, p. 10.

⁴⁰Wong, *op.cit.*, p. 398.

⁴¹Ho, *op.cit.*, pp. 51-56.

⁴²*Ibid*, p. 55.

⁴³Ody, *op.cit.*, p. 14.

⁴⁴*Ibid*, p. 22.

value of rural social output and 23 percent of the total national value of industrial output.⁴⁵

After the June 4, 1989 Movement in Tiananmen Square, conservative leaders in charge of the economy retrenched rural enterprises to restrengthen the state sector and state-owned industries. The "decision on improving the economic order", put forward at the 5th plenum in November 1989, stated that TVEs which consume a considerable amount of energy, produce shoddy goods, pollute, or compete in a major way with state enterprises for material should be closed down, suspended, merged or forced to shift to other production lines.⁴⁶ As a result of these measures, almost two million firms closed or were taken over by other firms, and almost three million workers lost their jobs. However, the recent survey indicated that rural firms accounted for only 10.7 percent of waste water discharges, 9.4 percent of air emissions and 11 percent of solid wastes, comparing to rural industries' 25 percent share of industrial output.⁴⁷ The State-Owned Enterprises have enjoyed more favourable access to budgetary finance, bank loans, long-distance transport, energy supplies and trained personnel. On the other hand, state-owned enterprises' output prices have also been held down by administrative controls. The higher market prices obtained by rural enterprises for their output have permitted them to outbid state-owned enterprises for less effectively controlled raw materials inputs. Competition between rural enterprises and state-owned enterprises has been certainly unequal.

By Spring 1990, the policy towards rural enterprises was forced to respond to popular anxiety and economic reality. China's state budget faced an increasing deficit, and rural industries have supplied

⁴⁵Du Haiyan, "Causes of Rapid Rural Industrial Development" in Byrd and Lin (eds.), *China's Rural Industry*, *op.cit.*, p. 47.

⁴⁶*Renmin Ribao*, 20 March 1990.

⁴⁷Ody, *op.cit.*, p. 20.

over 50 percent of new state taxes since 1980. With almost 100 million rural inhabitants employed in rural enterprises, nationwide plant closing and massive unemployment would lead to further rural-to-urban migration, and both urban and rural unrest. The speeches, national conferences, exhibitions, and press reports supporting rural industry forced Premier Li Peng to visit Jiangsu Province in February 1990, where he admitted that 'insufficient stress has been laid' on rural industry, and that its significance must be again recognized.⁴⁸

As we can see, whenever China's economy has met difficulties, the rural industry has been attacked first. The excuses of three retrenchments were all the same, which were pollution, lacking of efficiency and the competition with the state-owned enterprises. The ways to attack rural enterprises were the same also: "close down, suspend operation, merge, or shift to other work". However, the rural enterprises have developed without central government's direct financial help. The development of rural industry means there is need for their products. The central government could not simply close rural enterprises when the state-owned enterprises got into difficulties. The experience proved that the state-owned enterprises did not have better performance after the rural enterprises had been closed.⁴⁹ The nation relies more and more on the taxes collected from rural enterprises. The ups and downs of the policy have made peasants doubt the stability of government policies and hesitate to invest in the enterprises.

By 1990, the number of rural enterprises increased thirteen fold to 18.5 million and provided

⁴⁸*Nongmin Ribao*, 15 March 1990.

⁴⁹State factories depended on subsidies which equalled to about on-half billion dollar a month in the first half of 1990. See James Stepanek, "China's Enduring State Factories: Why Ten Years of Reform Has Left China's Big State Factories Unchanged" in *China's Economic Dilemmas in the 1990s* (New York: M. E. Sharpe, 1992), pp. 440-454.

employment to over 90 million people, which was 17 percent of the national labour force.⁵⁰ In the period 1979-92 the number of workers employed in TVEs rose from 28.26 million to 105.8 million.⁵¹ Township Village Community Enterprises (TVCEs) accounted for 20 percent of the enterprises, 60 percent of employment and 80 percent of gross output.⁵² The average township collective firms would indeed be considered as medium rather than small scale (i.e., employment of 50-99 persons), and many exceed even this limit.

At the opposite extreme, the typical individually owned Chinese enterprises are very small firms with less than 10 workers. Actually, the average size of TVPs in 1992 is smaller than that of CBEs before 1978. In 1978, the average size of rural enterprises were 12 persons, but it declined to 7 persons in 1992, which means there is a larger number of household yet these enterprises are of a smaller scale. But the average size of TVP in China could not explain everything. The average size of all TVCE in Wuxi is much higher than the national average size. Whileas the size in backward areas is much lower. The rural enterprises could include the bicycle repair shop which has one worker, and the private enterprise in Wenzhou which has 1,500 employees.

3.2 Policy Content Changes

Although the development of rural enterprises experienced three waves as the result of government policies, the policies' content in the third wave changed significantly. Before 1978, the policies were characterized by equalitarianism and self-reliance. After 1978, the policies became characterized by

⁵⁰Ody, *op. cit.*, p. xi.

⁵¹*Zhongguo Jingji Tongji Nianjian 1992* (1992 Economic Statistical Yearbook of China) (Beijing: Zhongguo Tongji Chubanshe, 1992), p. 23.

⁵²Ody, *op. cit.*, p. xi.

the Household Responsibility System and the 'open door' policy.

3.2.1 From Egalitarianism to the Household Responsibility System

Before 1978, workers in commune enterprises generally were paid in working points allocated through their production team. The work-point system was the basis of income distribution. Anybody who worked was given the same amount of points, and at the end of the year the remuneration was based on the amount of points accumulated. Though workers in rural enterprises might earn rather more than ordinary peasants, there was no relationship between their enterprise's performance and their income.

The Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party in late 1978 was a turning point. The outcome of this meeting was that all economic organizations must carry out the principles of 'from each according to his ability', 'to each according to his work'. The Household Responsibility System was established. Land was allocated to each household in accordance with the active number of workers per households. The public ownership of the means of production was not changed. The peasants only had the right to use land. But they did not have the right to buy, sell or transfer the land. Farmers signed contracts with a brigade, agreeing to sell a certain quota of production to the brigade. After selling this quota to the brigade, they could either sell the extra production to the government at a negotiated price or sell it at the free markets. This system spread rapidly. By 1982, 90 percent of production teams had adopted the Household Responsibility System.⁵³

The Household Responsibility System has many similarities to the "three freedoms and one responsibility" policy that was implemented by Liu Shaoqi. However, it was impossible for Liu to be

⁵³Chossudovsky, *op. cit.*, p. 45.

openly against Mao's People's Commune Movement and allocate land to peasants. The only thing Liu could do was to adjust Mao's policy and give peasants limited freedom. It was only after Mao's death and Deng's reinstatement as leader that Deng could continue Liu's unfinished policy. In the Sixth Plenary Session of the 11th Central Committee of the Communist Party of China, Deng claimed that Mao was chiefly responsible for the disaster that happened in the Great Leap Forward. The Cultural Revolution initiated and led by Mao was entirely wrong and Mao made serious errors in his later years.⁵⁴ The open and complete criticism towards Mao enabled Deng to implement the Household Responsibility System and to go further in opening the door of China to the world.

After the Household Responsibility System was adopted, peasants were 'no longer eating from the same pot'. Also, their incentives increased when the price of grain rose 20 percent in 1979. Hence, agricultural output value increased at an average annual rate of 9 percent, per capita grain production grew from 319 kg to 395 kg and the supply of farm products rose by 24.2 percent from 1979 to 1984.⁵⁵

The Commune and Brigade System was no longer suitable for the new situation. In 1982, China's Constitution replaced the People's Communes by old township governments.⁵⁶ For most rural enterprises, they used 'job responsibility system' which is basic rates and bonuses related to work. This system ties rewards more closely to productivity. Hence, workers' efforts increased sharply: the

⁵⁴"Revolution on Certain Questions in the History of Our Party since the Founding of the People's Republic of China" in *Almanac of China's Economy 1981* (Hong Kong: Modern Cultural Company Limited, 1982), pp. 84-94.

⁵⁵The annual growth rate of total agricultural product in the period between 1953 and 1978 was 3.2 percent. Du, *op.cit.*, p. 5, and Lu Wen "Development Strategy in Rural China" in *China's Rural Development Miracle*, p. 164.

⁵⁶Riskin, *op.cit.*, p. 299.

prospect of extra income for workers whose living standard was low and had been unchanged for many years led them to accept greatly increased labour input for a relatively small increase in personal income.

China's rural communities were profoundly affected by the production responsibility system. A major consequence was to make apparent the extent of surplus labour and so to generate pressures to address the employment problem. With continuing controls on mobility, job creation in rural areas was needed not only for social stability but also for the potential productivity gains of the production responsibility system to be fully realized. At the same time, increased rural incomes boosted the demand for consumer goods, creating the markets for products suitable for production by smaller firms, while rural savings offered growing resources of capital to finance industrial investment.

Also, the initial industrial conditions had, by having neglected the light industrial sector, created major opportunities for entry of small firms into this sector, where rapid and very high profits could be made. Hence, the rural industries mushroomed in China's rural areas. The external setting of the former commune enterprises altered sharply. Under the former system most material inputs were provided by the state at the state-fixed prices. Relaxation of state controls in these areas began to take effect much earlier in the collective than in state enterprises. Compared to pre-1978, the mid-1980s collective enterprises had greatly increased their freedom and to negotiate supply sources, prices, and outlets. In the early and mid-1980s not only were rural non-farm enterprises given greatly increased freedom to purchase inputs, but also they had much greater freedom than state enterprises to fix prices.

3.2.2 From 'Self-Reliance' to 'Open Door' Policy

During the Culture Revolution, 'self-reliance' was emphasized. The principle characteristics of self-

reliance at the national level were: full utilization of domestic resources, including labour and techniques; rejection of indiscriminate imitation of foreign methods in favour of accumulating indigenous experience suited to Chinese conditions; reliance upon domestic saving to finance capital accumulation.⁵⁷ The idea of self-reliance at the local level was to let each locality, region or enterprise rely insofar as possible on its own resources. Hence, plants were built according to the principle of "three locals", in which local, small plants were to make use of local resources to produce for a local market.⁵⁸

In the 1980s, the government reversed its self-reliance policy, and adopted the open door policy. The open door policy has four major components: the creation of special economic zones, the attraction and efficient investment of foreign capital, the increase of foreign trade, and the import of modern technology and management techniques.⁵⁹ In 1979, four Special Economic Zones in Shenzhen, Zhuhai, Shantou and Xiamen were established. In 1984, 14 coastal cities were declared open cities for foreign investment. In 1988, Hainan Island became a province and in effect China's largest Special Economic Zone to date. Since then, numerous areas in the coastal region have been designated "economic open areas" that enjoy special policy advantages in attracting foreign investment. The privilege included certain tax exemptions to encourage foreign investment, more decision-making power over foreign investment projects, a large amount of foreign exchange and bank loans from central government, preferential treatment to joint ventures. Hence, many export-

⁵⁷Riskin, *op. cit.*, p. 205.

⁵⁸Wong, *op. cit.*, p. 396.

⁵⁹He Chunlin, "Eight Years of the Open Policy", *China Reconstruct*, November 1987, p. 12.

oriented firms were established. Total trade more than tripled from 1980 to 1990 to over \$110 billion, equivalent to 41 percent of China's GDP--up from just 12 percent in 1980.⁶⁰ In June 1992, China announced the extension of its open door policies to 28 cities along the Yangzi River and to 13 border cities in the northeast, southwest and northwest regions.⁶¹ New sectors such as transport, retail and real estate were open to foreign investors. In addition, 11 tourist locations were approved for development by foreign investors. As a result, direct foreign investment flows reached a record of US\$9 billion, an increase of more than 200 percent over 1991. By the end of 1992, there were over 84,000 approved foreign funded enterprises in China.⁶²

TVEs today play a decisive role in the national economy. From 1979 to 1992, their total output value increased from 54.84 to 846.16 billion yuan in nominal terms and the rate of growth of the output value of the TVEs far surpassed that of the total national economy. Between 1978 and 1990, the output value of the TVEs grew from 7.2% to 25% of the nation's gross social product, and their industrial output value increased from 9.5% to one-third of the gross national industrial output value, and a quarter of all foreign exchange earnings. By 1990, 34 percent of the country's coal, 63 percent of its nylon, 60 percent its garments, 80 percent of its farm machinery and equipment, and more than 90 percent of its bricks were produced by rural enterprises.⁶³

The above indexes combined with the Table 3.1 allow us to see the difference between rural

⁶⁰Erin Endean, "China's Foreign Commercial Relations" in *China's Economic Dilemmas in the 1990s*, p. 743.

⁶¹Peter Harrold and Rajiv Lall, *China: Reform and Development in 1992-93* (Washington, D.C.: World Bank, 1993), p. 13.

⁶²*Ibid*, p. 14.

⁶³World Bank, *China: Strategies for Reducing Poverty in the 1990s*, *op.cit.*, p. 61.

industries' production pre-1978 and that of post-1978. Before 1978, the main role of rural industries was to serve agriculture. Hence, the main products were bricks, machinery, cement and fertilizer. In the 1980s and the 1990s, the products mentioned above had been the important part of their production. However, they now produce garments, foods and crafts which are more closely related to the people's daily necessities. This means that they play an important role not only in serving agriculture but also in other sectors.

Table 3.1 Composition by Sector Industrial Shares of TVEs, 1986(percent)

Sector	Township Enterprises (%)	Village Enterprises (%)	Total Percentage in China
Building Materials	25	22	47
Metal products	19	7	26
Arts and Crafts	18	16	34
Furniture	18	15	33
Textiles	10	15	25
Machine Building	10	11	21
Food	9	8	17

Source: Statistical Yearbook of China, China statistical press, 1987.

3.3

Patterns and Characteristics of Rural Enterprises after 1978

The rural enterprises in China fall into four categories. Those in the first category depend largely on subcontracting relations with large state-run enterprises. In both the Shanghai and the Tianjin suburban areas, more than 50 percent of small-scale output consists of subcontracting. One of the best example is Wuxi County, which is located near Shanghai and has become the most developed area in China. A second related category consists of firms which produce primarily on contract for foreign producers. They are concentrated in Guangdong Province and engage in cooperative

production with Hong Kong firms. In contrast to linkages with state firms in the previous category, which tend to be long-term and may involve substantial technical cooperation with state firms, these relationships are usually short-term, contractual and processing agreements. Nanhai County in Guangdong Province can be the example of export-oriented pattern of this category. The third category consists of firms producing light consumer goods. Marketing for such enterprises is often carried out by specialized enterprises that may send marketing representatives throughout the country. A clear example would be the private producers of buttons, ribbons and small plastic items around Wenzhou in Zhejiang Province. In this case, the easy portability of the items produced makes a distribution network founded on personal travel by sales representatives feasible. Finally, a fourth category is in the production of building materials and food processing. The local producers survive because the prices of products from other provinces are too high as a result of China's inadequate transportation system. The local producers mainly serve the local market. This kind of rural enterprise is mainly located in inland.

3.3.1 Characteristic One: Diversified Ownership

One main characteristic of rural industry after 1978 is the diversification of ownerships across China. After 1949, China carried out the socialist transformation by putting the means of production into socialist public ownership. As required by the Party for the period of transition from new-democracy to socialism, the task of a socialist transformation consisted of: (1) changing the economy of the peasants and crafts person by changing it from an individual ownership into a cooperative economy; and (2) changing the capitalist economy of the bourgeoisie into a component part of the socialist economy. Hence, the two major ownerships replaced the diversified ownerships of Chinese enterprises. The two major forms of ownerships in China are state owned enterprises and collective

enterprises. The state owned enterprises are owned by the whole people in the state economy. It is "a higher form of socialist public ownership under which the means of production belong to all the working people."⁶⁴ Production of state owned enterprises is carried out by a plan and is aimed at fulfilling the rising material and cultural requirements of society as a whole. The products of an enterprise belong to the state. The enterprise turns over most of its profits to the state and retains the rest as its own fund. The other is collective enterprises, which is "a lower form of socialist public ownership, under which the means of production belong to people in one economic collective or another." The economic sector under collective ownership differs from the one under ownership by the whole people in that each economic collective is an independent owner.⁶⁵ State enterprises and their employees enjoy the most privileges. They have preference in the allocation of material inputs and bank loans at low interest rates, lifetime employment and so on.

Under Mao, it was impossible for an individual or a group of co-operators to set up an independent enterprise. Indeed, anyone leaving agriculture to work in outside activity was liable to be seriously criticized. In the early 1980s such prohibitions were removed completely. The Central Committee Circular on Agricultural Work of January 1, 1984, stated that government at all levels should encourage peasants to invest in all types of enterprises and set up various kinds of enterprises.⁶⁶ Peasants were strongly encouraged to seek non-farm employment in the villages or small towns, so as to absorb some of the agricultural labour surplus, and leave the farming to 'farming experts' who had higher productivity. Rural non-farm enterprises with a multiplicity of ownership and operating

⁶⁴Xue Muqiao, *op.cit.*, pp. 45-46.

⁶⁵*Ibid*, p. 46.

⁶⁶Byrd and Lin (ed.), *op.cit.*, p. 11.

structures mushroomed. These included township owned enterprises, village owned enterprises and private enterprises. By 1985, the diverse forms of non-farm, non-collective enterprises accounted for two-fifths of total employment and 27 percent of the gross value of output in township enterprises.⁶⁷ The growing share of industrial output contributed by collectives and TVEs implies a change in the ownership and management of industrial enterprises as shown in Table 3.2.

Table 3.2 Percentage of Industrial Output by Category of Ownership

Enterprise Ownership	1978	1983	1984	1986	1988
State (%)	81.4	77.0	73.6	68.7	57.0
Collective (%)	18.6	22.0	25.0	29.2	36.0
of Which TVEs (%)	5.2	6.7	7.7	10.5	19.0
Other	0.0	1.0	1.4	2.1	7.0
GVIO in 1980 Yuan (Billion)	421	616.4	703.0	902.8	1,283.4

Sources: Statistical data on China's Industrial Economy, 1949-84; Statistical yearbook of China, various issues

The regional pattern in terms of the relative importance of the collective and non-collective sectors in the non-farm rural economy in the mid-1980s was striking. The collectively-owned sector generally was strong in areas where the rural non-farm economy was most advanced, especially those in close proximity to large urban centres such as Southern Jiangsu. Indeed, by 1986-1987 this was referred to as the Sunnan (Southern Jiangsu) pattern. The less well-located areas had less opportunities to

⁶⁷*Zhongguo Jingji Nianjian 1986* (1986 Chinese Statistical Year Book) (Beijing: *Zhongguo Tongji Chubanshe*, 1986), p. 42.

undertake subcontracting from large factories. There, as technical skills were weaker and brigade and commune enterprises were weakly developed before 1978, the private sector was relatively much more important in the non-farm sector. In some areas, such as Wenzhou in Southern Zhejiang Province, the individual non-farm rural economy expanded very rapidly indeed in the mid-1980s. This alternative path of development was, by 1986-87, being referred to as the Wenzhou pattern, and was becoming the characteristic form in poorer parts of the Chinese countryside.

The Wenzhou Pattern

Wenzhou is located in the south-east corner of the coastal Zhejiang Province. The mountains comprise 76 percent of its total area and plains only 17.5 percent. There is little arable land relative to the large size of the labour force. Only 2 percent of total areas is used for farming. The arable land per capita was only 0.45 mu in mid-1980s, much lower than the national average of 1.4 mu. Wenzhou municipality covers 11,800 square kilometres, including two municipal districts, one inland city, and eight rural counties. Among its 6.3 million residents, 520,000 reside in the municipal districts and 5.78 million in rural areas.⁶⁸ Its traffic routes inland are restricted to several rough roads through mountains, and its contact with other coastal cities relies upon underdeveloped maritime shipment. Many Chinese scholars regarded this geographic isolation as the most important factor in explaining the rise of the private economy in Wenzhou. On the one hand, isolation reduced central intervention. On the other, it prevented Wenzhou from getting the benefits of large industrial cities, such as capital investment, technical support and market demand. This is in contrast to areas like southern Jiangsu

⁶⁸ Chris Bramall, "The Wenzhou 'Miracle': an Assessment" in Peter Nolan and Dong Furen (eds.), *Market Forces in China, Competition and Small Business: the Wenzhou Debate* (London: Zed, 1990), p. 12.

which has received long-term capital and technical support from the metropolitan area of Shanghai. Accordingly, while southern Jiangsu is subjected to rigid state control and its economy is dominated by collective industry, Wenzhou is relatively free from state intervention and its economy is more privately oriented. Since 1984, the production value of private enterprises has accounted for nearly 60 percent of the net industry output in Wenzhou. In 1978, average rural income in Wenzhou was 56 yuan, below national average of 77 yuan. In 1985, peasants' average income reached 417 yuan, 17 percent higher than the national average income of the peasants. Meanwhile, the percentage of individual under the poverty line dropped significantly.⁶⁹

According to Yialing Liu's analysis⁷⁰, the Wenzhou cadres' resistance to the collectivization imposed by the state and the protection to the local private economic activities were the keys to the speedy development of the private sector. Many of Wenzhou's economic practices, such as business affiliation, land transmission and the floating interest rate, were all prohibited by the state in the beginning. However, the coincidence of interest between the local cadres and peasants led the Wenzhou cadres take local interests' concerns into account. Even though they did not overtly support deviant practices, they did not take any serious action against them, and this made the private economy possible. In the local capital market, 95 percent of the total capital needed by the local private sector has been supplied by 'underground' private financial organizations, such as money clubs, specialized financial households and money shops that have set their own interest rates since the very beginning. As early as 1980, in order to compete with these private financial organizations, a local collective credit union abandoned for the first time the fixed interest rate and adopted a

⁶⁹ *Ibid*, p. 48.

⁷⁰Liu, *op.cit.*, pp. 300-309.

floating interest rate before the central state officially ratified it in 1984.⁷¹

Very few private factory enterprises in Wenzhou were willing to be identified as private enterprises. They like to be called either "local collective enterprises" or "partnership enterprises". There appears to be greater psychological security in joint ventures because the collectively-owned enterprises have no restriction on the number of employees. Meanwhile, the local authorities and cadres benefit significantly from the rapid growth. For example, the local government has received many "voluntary donations" each year.⁷² It imposed fees from private enterprises for public utility and infrastructure construction, such as roads and bridges. Also, many large private partnership enterprises gave free shares to powerful cadres in exchange for political protection and favours, since political backing is one of the most important conditions for a private enterprise to survive and succeed in China. The coincidence of interest between the local cadres and peasants in the private sector inclines the cadres to tolerate local deviant practices and bypass state policies, and to allow private industry in Wenzhou to take the lead in local development. The conflict between the state's interest on the one hand and peasants' interest in the private economy on the other not only provides local cadres opportunities for illegal gains in law and policy enforcement, but also forces them to stand with peasants in resisting state policies that might harm the local economy.⁷³

However, conflicts of interest between the local authorities and the state have actually been a serious problem across China since 1949, and localism based on the coincidence of interest between local cadres and peasants is a common occurrence everywhere in rural China.⁷⁴ Since cadres at team,

⁷¹Liu, *op.cit.*, p. 300.

⁷²*Ibid*, p. 305.

⁷³*Ibid*, p. 298.

brigade and even commune levels are recruited primarily from the grass roots, their interests are tightly interwind with those of local peasants.

The Wuxi Pattern

Wuxi County is located in southern Jiangsu Province in the hinterland of Shanghai and it is in the Yangzi River delta. The area has been highly developed since the Song Dynasty (960-1279). There are 1.02 million people occupying 960 square kilometres. In Wuxi, the widespread implementation of the Product Responsibility System began only in 1982, after the system was officially endorsed by the central government. Township Village Community Enterprises are predominant in Wuxi: they constituted 36 percent of the total number of industrial TVPs and contributed almost 96 percent of GVIO in 1985.⁷⁵ And the farmers' average per capita income rose from 124.4 yuan in 1978 to 412.7 yuan in 1983, an increase of 232 percent in real terms.⁷⁶ In Wuxi, arable land per person declined from 2.52 mu to 1.27 mu from 1955 to 1977. Like Wenzhou, the limited agriculture resources were the initial force behind the development of rural industries. Industry in Wuxi is highly efficient by Chinese standards. The TVCEs are relatively large and many of them use relatively advanced technology.

With the permission of private industry by the central government, Wuxi's private firms have grown rapidly in 1983 and 1984. They challenged the supremacy of TVCEs, competed in hiring technical

⁷⁴Michel Oksenberg, "Local Leaders in Rural China, 1962-65: Individual Attributes, Bureaucratic Positions, and Political Recruitment" in *Chinese Communist Policies in Action* (Seattle: University of Washington Press, 1969), p. 48.

⁷⁵Jan Svejnar and Josephine Woo, "Development Patterns in Four Counties" in Byrd and Lin (eds.), *op. cit.*, pp. 67-69.

⁷⁶Du Haiyan, *op. cit.*, p. 51.

and marketing personnel, and their higher remuneration for workers broke the old balance of income in the county and caused wider gaps in personal incomes. Besides, the private firms enjoyed tax exemptions without contributing any savings to the collective. In 1985, Wuxi authorities took steps to reestablish order and consolidate the position of TVCEs. The principal measures included: (1). penalties were implemented to skilled persons who left TVCEs for higher income. The most effective penalty was that members of the person's family were permanently barred from jobs in TVCEs. (2). Private enterprises were constrained by limits on loans, restricted access to inputs, and environmental and other regulations. They are not allowed to take on public construction projects. Only one or two helpers and three to five apprentices are allowed to be hired in private households. (3). Wuxi government restored the control over TVCE wage levels.⁷⁷ Average rates were not allowed to diverge too much among firms. Enterprises managers' pay was linked to the average wage in their factories; twice the average wage was normal, and three times was the maximum. In the first half of 1986, 2,120 business licenses were issued to private industrial and commercial households, but during the same period 1,485 households stopped business operations.⁷⁸

Township governments now possess a greater proportion of assets than all other sectors, and their control over other economic entities is even greater than in the past. They have supplied initial funds, shared the risk, served as a supervisory body, appointed managers and allocated workers. Partly because of the favourable conditions, such as proximity to Shanghai, the presence of skilled labour, industrial tradition, the Wuxi system worked well. Actually, Wuxi's economy worked so well that it has had to hire 10,000 workers from outside the county. Also, the good performance of TVCEs in

⁷⁷ Luo , *op.cit.*, p. 150.

⁷⁸ *Ibid*, p. 58.

Wuxi offered the opportunities for higher returns to capital, they brought in 40 million yuan in loans from banks in 1984.⁷⁹ In Wuxi total export procurement from TVPs in 1985 was about 60 billion yuan, or less than 2 percent of their GVIO.⁸⁰

Inland Rural Enterprises

The development of China's rural enterprises, like the development of the national economy as a whole, is characterised by great regional imbalances. Natural resources are mainly located in the West and North, whereas its agriculture resources and population are mainly located in the coastal areas of the South and East. Moreover, regional differences in economic history have created disparities and influenced the current levels of rural enterprises. The level of TVPs development falls down progressively from East to West, that is, from the economically developed coastal areas to the hinterland and western frontier.

The development of rural industries during the 1980s, and the strong performance of rural enterprises in the poor provinces of northwestern, northern and southwestern China, hid tremendous variations. In Gangxi Province, 11 percent of all 1988 rural enterprises income was generated in just two of the province's 105 counties. Similarly, Kunming City accounted for 29 percent of 1990 Yunnan Province's rural enterprises income.⁸¹ The development of rural industries in the more remote and poorer counties has been quite limited.

Rural community governments-townships, villages, and to a lesser extent production teams have had

⁷⁹William Byrd and A. Gelb, *Township, Village, and Private Industry in China's Economic Reform*, PRE Working Paper, (Washington: World Bank, 1990), p. 78.

⁸⁰Jan Svejnar and Josephine Woo, *op. cit.*, p. 71.

⁸¹World Bank, *China: Strategies for Reducing Poverty in the 1990s*, *op. cit.*, p. 65.

a profound impact on the nature, speed, direction, and accomplishments of rural industry. In addition to limited resource endowments and disadvantageous location, local government policies have contributed to the failure of rural enterprise development in many poor countries, townships and villages. Most importantly, the struggle to mobilize revenue forces local governments in the poor areas to extract excessive funds from local enterprises, regardless of their financial performance. Byrd and Gelb document⁸² an extreme example of such "financial predation" in a very poor township in Shangrao County in Jiangxi Province in 1986, in which payments to local government actually forced township enterprises to suffer net losses in that year. It is also likely that, in poor counties and townships, local government policies favoured collective-owned enterprises over small-scale private enterprises despite the probability that the latter could more efficiently exploit poorly developed local markets.⁸³ Local governments found small-scale enterprises more difficult to tax and, because they could often compete effectively with larger-scale collective-owned enterprises, might actually consider such enterprises to be a threat to a proven and vital source of revenue. Unfortunately, local government often responds to the challenge of small-scale private enterprises by attempting to restrict them.

In 1983 the government made a rule that each owner of a private enterprise in rural areas could employ one or two hands, and a person with special skills could take on no more than five apprentices. But the government adopted a "wait and see" policy; it gave no encouragement or publicity to violations of the rules but did not immediately stop or punish them either. This policy left room for the development private enterprises. But the resulting uncertainty also had negative effects

⁸²Byrd and Gelb, *op.cit.*, pp. 10-15.

⁸³*Ibid*, pp. 65-66.

on the private sector's development.

First, uncertainty about policy blunts private enterprises' desire to reinvest and makes them extremely shortsighted in their operations. In their early stages, most private enterprises had strong motives to reinvest because they had not reached the limit of number of employees. Then increasing concern about political risks dampened entrepreneurs' interest in growth and shortened their horizons in operations and management. They took every opportunity to profiteer by legal and illegal means and to take advantage of loopholes in the state's regulatory system, and they were ready to quit business at any time. They were unwilling to undertake projects that require long-term investments and especially to expand employment, preferring to spend their earnings on building and repairing houses and purchasing other living facilities. Because of such shortsightedness, most private enterprises continue to operate on an extremely small-scale year after year. Also, the policy uncertainty confused the property relationships of private enterprises and caused retrogression in their development. Moreover, it led to all sorts of leeway for corruption in the relationships between these enterprises and community government officials.

Hence, the state policy regarding private enterprise should be further relaxed, so that it will not only continue to encourage and support the development of private enterprise in general but will also allow the existence and growth of private enterprises with large numbers of employees. The state should publicly acknowledge these enterprises's legal status through legislation and permit them to make the most of their potential by supporting their legitimate operations and protecting their lawful rights.

3.3.2. Characteristic Two: Export-Oriented Enterprises

If the diversified ownership is the main characteristic across China, then the export-oriented enterprises is the phenomenon mainly for the coastal region, especially southern coastal region. The

first step towards internationalizing the rural economy in the post-Mao era was made in 1978 in Guangdong, when officials began to redirect Guangdong's rural production towards serving Hong Kong's market. The "grain first" policy of the pre-1978 was replaced by expanding fruit, fish, poultry and pig production geared to the tastes and living standards in Hong Kong. Soon compensation trade agreements were signed with Hong Kong businessmen who supplied equipment to TVEs in return for the factory's output.

Then, the nation-wide effort to link the rural economy with the export sector occurred in 1984 when Premier Zhao Ziyang visited Guangdong and raised the slogan of "trade-industry-agriculture" instead of "agriculture-industry-trade".⁸⁴ The rural enterprises have a strong sense of competition and survival. They are flexibly managed and able to adapt themselves to market changes.

The late 1980s confirmed the potential of China's rural enterprise sector to penetrate export markets on a major scale. As shown in Table 3.3, the dollar value of estimated TVE exports increased tenfold over 1985-90, and the sector's share in total exports rose from 4.4 percent to an estimated 21.0 percent. Although special export promotion schemes for rural enterprises were announced at the end of 1988, it seems that the overall process of decentralization of trade responsibility, together with improved firm-level incentives, had played a more important part in stimulating growth.

Another major readjustment was the decision to decentralize control over foreign trade and foreign exchange earnings. The decision-making authority on what goods to produce, which foreign firms to link up with and how to spend foreign exchange was shifted from the Ministry of Foreign Economic Relations and Trade (MOFERT) in Beijing and the provincial foreign trade corporations to the county levels. Units which gained authority could claim a bigger share of the domestic, as well

⁸⁴*Renmin Ribao*, 26 December, 1984.

as international market. Yet introducing quotas for total value of exports, foreign exchange earnings and the amount of Chinese currency spent to earn the foreign exchange gave cadres new responsibilities and new indicators of success or failure. The most important foreign trade reform was the "contract managerial responsibility system" adopted in 1987-88⁸⁵.

Pre-reform foreign trade was monopolized by the Ministry of Foreign Trade. It controlled foreign trade through 16 corporations that specialized in trade in defined product areas. The Ministry of Foreign Trade (MFT) purchased resources or finished products for export through centralized foreign trade corporations organized along product lines. MFT had divisions under its direct control at the provincial, municipal and country level. Control over foreign exchange was in the hands of the Foreign Exchange Management Bureau with branch offices at the city and provincial level.

Under the new system, the Ministry of Foreign Economic Relations and Trade (MOFERT) contracted with the State Council to fulfil State Council assigned targets involving export earnings in foreign exchange, export costs, and control over total financial losses. Each province signed an annual contract with MOFERT specifying the amount of foreign exchange they will turn over to the state. Then the province passed quotas to county level. Firms might establish contracts with different foreign trade companies and some were even able to make direct ties with foreign firms. The number of foreign trade corporations increased from 16 to 800 by the mid-1980s and soared to 5,000 in 1990.⁸⁶ Rural firms and local governments now had greater incentives to increase their foreign exchange earnings, as they had the right to use their foreign exchange earnings. The surplus could

⁸⁵David Zweig, "The Political Economy of Export from Rural Industry", *China Quarterly*, December 1991, p. 725.

⁸⁶Nicholas Lardy, *Foreign Trade and Economic Reform in China, 1978-1990* (Cambridge: Cambridge University Press, 1992), p. 39.

be sold to the governments, factories, or firms with export licences through foreign exchange redistribution centres which were established in many cities and provinces in 1988.

Rural enterprises' exports appear to originate primarily from a fairly small number of firms; the export-oriented enterprises shown in Table 3.3 increased from 0.5 percent of all TVCEs in 1985 to 3.5 percent in 1990. The seventh five-year plan embodies the official promotion of regional differentiation, and this was reflected in the pattern of China's trade during the 1980s. In 1987, the predominantly coastal region provided 83 percent of the reported total, central region 14.6 percent and interior region 2.4 percent. Sectoral analysis indicates that rural enterprise exports still originate primarily from relatively labour-intensive manufacturing activities, and secondarily from processing materials.⁸⁷

Table 4.3.2.1 TOWNSHIP AND VILLAGE ENTERPRISE EXPORTS

	Exports (\$ Billion)	As Share of Total (%)	Export-oriented Enterprises (Number)
1985	1.20	4.4	8,500
1986	2.67	8.6	9,000-11,000
1987	4.35	11.0	18,000-20,000
1988	8.03	16.9	n.a.
1989	10.00	19.1	n.a.
1990	13.00(EST)	21.0	56,000

SOURCE: for export 1986-88: Township And Village Enterprise Yearbook, 1989;
Cited in Ody, *Rural Enterprise Development in China, 1986-90, op.cit.*, p. 9.

Table

3.3 shows the rapid expansion of TVE exports and its importance to China's foreign trade. In 1985,

⁸⁷Ody, *op.cit.*, p. 10.

TVEs earned only 4.4 percent of total export earnings, while productions for 1990 reached 13 percent of total export earnings. Moreover, Chinese analysts argue that if one includes industries owned and administered by the country government, and the work done by TVEs on goods that are eventually exported by state enterprises, the rural industrial sector's contribution to China's export earnings exceeds 25 percent of the total.⁸⁸

The Nanhai Pattern

A good example of export-oriented rural enterprises is Nanhai. Nanhai County is located in a highly developed and urbanized area about 20 kilometres from Guangzhou. The county has several well-developed towns. The area's agriculture produces enough to support its own population and to export a substantial quantity of products to Hong Kong. TVPs in Nanhai tend to be on a smaller scale. The country enterprise sector is weaker and the private sector is stronger than in Wuxi. More than 60 percent of the rural labour force in Nanhai now works in industry. It has 40,000 hired workers from outside. In Nanhai, where the government encourages the development of TVPs at all level, TVCEs are much less predominant. When macroeconomic control over domestic credit was imposed in 1985, the government encouraged production team firms and even private enterprises to seek financial resources through foreign channels. These measures boosted the development of lower-level TVPs.

89

Because of Nanhai's proximity to Hong Kong, the foreign sector has a much more important role. In 1980-86 foreign investment in the county totalled US\$92 million, of which US\$27 million went into joint ventures and US\$64 million was for processing arrangements. Total processing income

⁸⁸Zweig, *op.cit.*, p. 717.

⁸⁹Byrd, *op.cit.*, pp. 47-187.

increased from US\$10.6 million in 1985 to US\$42 million in 1986. Many TVPs, including some production team firms, partnerships, and individual enterprises, established direct foreign contacts through relatives or other social connections. In Nanhai, the export market is relatively more important; 1986 export procurement from TVPs totalled 247 million, or about 11 percent of their total gross income.⁹⁰

3.3.3. Characteristic Three: New Rural-Urban Relationship

Rural-urban relations are very important in China. The success of the Communist Party's control over China came from the support of the peasants in the rural areas. In China before 1949, urban per capita income substantially exceeded rural per capita income. The income distribution varied sizeably in different regions. After 1949, the general medium to long-term targets of Chinese rural development was the elimination of all rural-urban differentials, such as the difference of incomes, living standards and productivity. However, the three great differences--those between 'city and countryside', between 'workers and peasants' and between 'mental and manual labour'--did not vanish after Mao's endeavour. Actually, the central government withdrew resources from agriculture to support its industrialization drive. The state set up the registration system in the mid-1950s. The system was based on a rigid division of the population into two basic categories: either agricultural or non-agricultural households. People with an urban registration were entitled to ration books for key goods (mainly grain, cooking oil and cotton products), were allocated jobs through the state employment bureau, and were granted access to schooling and health services either through their employer's own facilities or those of the urban authorities. This combination of registration and the

⁹⁰Byrd, *op. cit.*, pp. 50-113.

lack of access to basic goods without the ration coupons effectively prevented movements into or even between urban areas.

The system weakened in the 1978-1989 policy era. Even without proper entitlement, more people moved into cities. The number of rationed goods declined. Access to housing today is not as tight as in the past. Many construction projects need labourers for jobs that urbanites are unwilling to do. Peasants took these jobs. They entered the city to open small stores and sell many rural goods. As a result, the central government adopted temporary residence measures to allow villagers to gain temporary registration in cities even while they gained no access to the state-subsidized supplies that fully entitled urban residents enjoyed.

Post-1979 agricultural reform not only brought unprecedented agricultural production but set a stage for rapid development of nonfarm activities and revival of rural market towns. During the five-year period 1980-1985, the annual growth rate of non-farm enterprises averaged more than 20 percent. In 1986, more than 70 million people in rural China were engaged in various nonfarm activities, accounting for 19 percent of total rural employment. The total value of nonfarm enterprises in rural China reached 330 billion yuan.⁹¹

China's rural reform can be attributed more to local institutional transformation of agricultural production systems, diversification of rural economic activities, improvement of production efficiency, and maximum utilization of natural and human resources with little financial aid from the central government. Near larger Chinese cities, such as in southern Jiangsu, rural enterprises can negotiate contracts with state enterprises to produce parts or process raw materials and thus gain valuable technical and financial help. For much of China, the process of rural development not only

⁹¹*China Daily*, 31 July 1986.

relies on local resources for development but also generates income to replace state investment in public facilities. Only about 5 percent of the production value of rural industries was directly included in national plans. In Wenzhou, 81 percent of infrastructure and utility construction expenses in market towns were contributed by individual households.⁹²

Rural industrialization has transformed the function of many market towns. Traditional market towns were essential trading centres for the surrounding countryside, and they were held only periodically. In contrast, industrialization has converted many rural towns into processing and manufacturing centres with employment for many part-time farmers. Large rural enterprises in southern Jiangsu often have three shifts, with some workers preferring to work at night so that they can take care of their farms by day.⁹³ Rapid development of rural enterprises in well-developed areas such as southern Jiangsu and the Pearl River Delta has caused farm labour shortages. As a consequence, there has been limited but steady rural-to-rural labour migration from northern Jiangsu to southern Jiangsu and from northern Guangdong and Hunan to southern Guangdong. This limited interregional flow of rural labourers has benefited places of both origin and destination. The shift to commodity production has accelerated the growth of nonfarm activities. Through diversification, rural surplus labour is moving to the nonfarm sector. Out-migration of rural labour toward small towns is taking place with generally positive effects. The rural enterprises in southern Jiangsu provide a successful example not only of transferring about 50 percent of the agricultural labourers to industrial production.

⁹²Pei, *op. cit.*, p. 156.

⁹³Sidney Goldstein and Alice Goldstein, "Town and City: New Directions in Chinese Urbanization" in Yeh and Xue (ed.), *Chinese Urban Reform: What Model Now*, *op. cit.*, p. 37.

They show a special path toward urbanization and establish a new model of rural-urban relationships. In southern Jiangsu, apart from medium-sized cities such as Suzhou, Wuxi, Changzhou, and Zhenjiang, there are three levels of small towns:

1. County seats (*xian chengzhen*). There are 10 county towns, which are the political, economic, and cultural centres of a county and have double administrative offices for the county level and town level.
2. Designated towns (*jianzhi zhen*). There are total of 24 second-level towns. These towns serve both administrative and retailing functions. The town government is separated.
3. Rural towns (*xiang zhen*). There are 30 rural towns. Though these towns have no government of their own, they serve as administrative centres for the surrounding countryside, while also typically hosting privacy markets.⁹⁴

From the above study, it is clear that the urbanization could not be so fast without the rapid development of rural industries. The policies before 1978 put all rural-urban product exchange under the control of the government. The peasants were led to concentrate on grain production and they were kept out of the manufacturing and service sectors. The resident registration system was used to prevent peasants entering into cities, but could not solve the problem of employment in rural areas. Modern developed China needs developed agriculture. Those policies before 1978 separated the rural and urban sectors, intensified the contradiction between the two, and impeded the industrialization of rural areas and the urbanization of China, since towns could no longer act as the link between cities and villages.

The rapid development of small towns did solve part of employment problem in rural areas. Since

⁹⁴*Ibid*, p. 173.

there is such a large labour force, the small towns and rural industries could not absorb all the surplus labourers. The flush of peasants into big cities created a lot of social problems. The villages were left to women, children and the old people, which created problems in rural areas too. The policy of "limited development in all large metropolitan areas, the selective development of only a few medium-sized cities, more development in small cities, but most development in rural towns and villages" need to be fulfilled. There is still a long way to go to solve the problem of surplus labour.

3.4 Sigurdson's Model and Chinese Rural Industry

Through the above study, we can see that the development of Chinese rural industry received a lot of help from agriculture and modern industry. According to Hirschman,⁹⁵ the linkage effect was a characteristic compelling a sequence of investment decisions occurring in the process of economic development. The establishment of one industry may lead, through linkage effects, to the establishment of additional industries. Hirschman criticized the Harrod-Domar growth model in which growth depends only on the capital-output ratio and on the availability of capital. Actually, natural resources, factors of production and entrepreneurship need to be efficiently allocated to various activities in order to get better results. Then we meet the development alternatives: whether to invest in agriculture or in industry, in export promotion or in import substitution, in heavy industry or in light industry.

There are two kinds of linkages, "backward linkage" and "forward linkage". Backward linkage means: the setting up of one industry will lead to the setting up of relative industries producing the inputs. The forward linkage is: the existence of a given product line A, which is a final demand good

⁹⁵Albert Hirschman, *The Strategy of Economic Development*, (New Haven: Yale University Press. 1966), pp. 98-116.

or is used as an input line B, this acts as stimulant to the establishment of another line C which can also use A as an input. The relationship between agriculture and some rural industries is the backward linkage, since the establishment of rural enterprises increases the input demand from agriculture, such as the food processing industry. The rural industries which tend to locate near modern industries, can be regarded either as the forward linkage or backward linkage. In the case of cement, for example, the manufacture of multi-wall bags for packing purposes represents a backward linkage while the establishment of a cement block industry represents a forward linkage.

The rapid development of rural industry in China can be analysed in relation to the linkage effects. The products of rural industries provide inputs for modern industries, such as Wuxi produces inputs for industries in Shanghai and the rural industries in Nanhai produce inputs for Hongkong and Guangzhou, which can be seen as backward linkage. Also, because of the development of modern industry, there is demand for the new products and the market is increasing. The "forward linkage" investment comes primarily from the efforts of enterprises to increase and diversify the market for their products. Wuxi County, for instance, depends on the modern industry in Shanghai. The input demand of modern industries in Shanghai encouraged the rural enterprises in Wuxi to develop rapidly. The new products and new technology increased the market demand and allowed more new factories to be established in Wuxi.

We can also use Myrdal's spread effect theory to explain the Wuxi Model. "Spread Effects" were defined as beneficial effects of the growth of a regional economy on the economies of other regions. These effects result in the creation of expanding markets for the products of the other regions and the diffusion of technical progress from the leading region.⁹⁶ The spread effects from Shanghai to

Wuxi operate through increased demands for their products. The development of Shanghai leads Wuxi to develop through the spread effects. Wuxi gets a lot of benefits from the development of Shanghai.

The linkage effects are mainly in industry. Agriculture itself is scarce of linkage effects. But Jon Sigurdson has a three-stage model which links agriculture, rural industry and modern industry together and explains some facts of the development of Chinese rural industry⁹⁷. According to Sigurdson, development of rural industry interacts with agriculture and modern industry, since agriculture provides manpower, raw materials and capital to rural industry, while modern industry supplies the rural industry with the technologies and provides markets for ancillary industries at a later stage of development. Modern technology is defined as a relatively high degree of mechanization and a relatively small employment.

At stage 1, rural industry is introduced as an intermedia. It is developed from many of the repair and maintenance facilities needed for tools and machinery which are used in agriculture. Rural industry produces industrial inputs for agriculture and gets manpower from agriculture. The relationship between rural industry and agriculture is mutual, while the linkage between modern industry and rural industry is mainly one-way relationship which means rural industry is given the required technology by modern technology. When agriculture develops, more raw materials, manpower and local capital can be provided for the further development of rural industry.

⁹⁶Gunnar Myrdal, *Economic Theory and Under-developed Regions*, (London: Gerald Duckworth & Co. Ltd, 1957), pp. 31-33.

⁹⁷Sigurdson, *op. cit.*, pp. 98-116.

At stage 2, rural industry and agriculture become partly integrated. Agriculture increases the supply of raw materials for industrial products and rural industry increases processing of farm products. Rural industry at this stage reaches a certain degree of sophistication and differentiation. Now, rural industry can supply modern industry with certain amounts of products, and the linkage between the two sectors develops into a mutual relationship. Labour absorption, unlike in stage 1, will take place not only in agriculture but also in the related activities and limited amount by rural industry. Hence, the urbanization is still very slow.

At the last stage 3, rural industry and modern industry become integrated. Some lines of production can be shifted from modern industry to rural industry. Rural enterprises become the subcontractors of modern enterprises. The quality standard in rural industry reaches the a level which stimulates the development of export. Differences in enterprise size and quality standards between rural industry and modern industry disappear. Since agriculture is mechanized, a large amount of labour can be transferred to the rural industry accompanied by a relatively rapid urbanization. Sigurdson indicated that the market demand and ancillary technology are the promoting drive for rural industry developed from stage 1 to 2 and from stage 2 to 3.

Using Sigurdson's model, we can clearly track the development of Wuxi and Nanhai's rural industries. When the command economy was replaced by the market economy after 1978, Wuxi began to develop its economy from stage 2. Since Wuxi is near Shanghai, it can obtain technological improvements from modern industry since it linked up with major plants with Shanghai. The enterprises in Wuxi could produce higher quality products and absorb modern technology. The quality of its products meet export standards. Although the share of the export in GVIO in 1985 was only 2 percent, it will increase dramatically with the development of the Special Economic Zone in

Shanghai. After several years of endeavour, Wuxi has entered stage 3. Actually there is not much rural-urban difference in Wuxi. The rapid appearance of small towns not only prevented the migration to Shanghai but also attracted workers from outside.

The same development pattern as in Nanhai occurred, the only difference is that Nanhai serves foreign markets because of its geographic location. The labour migration from outside, the rapid urbanization and the relatively high technologies shows that Nanhai's rural industries have developed into the higher level. Industry in Wuxi and Nanhai have to subsidize agriculture. This is totally different from the policy in the 50s and 60s when the central government withdrew resources from agriculture to support industry. The machinery subsector in Wuxi and Nanhai occupies a very high percentage which proves the achievement of its rural industry's development.

But if we compare the inland rural enterprises, they are still in stage 1. Their industrial base is weak, the main TVP activities are brick production, traditional handicraft and simple food processing, almost have no manufacturing industry. Their locations are far from modern technology, the active at brigade level consists only of using a few pieces of relatively simple machinery. Those enterprises are the majority of Chinese rural industry. Sigurdson did not show how they could develop under the situation of lacking modern technology. China has to solve this problem because it cannot become the developed country by neglecting the existence of the backwards inland economy.

Sigurdson's model could not explain the Wenzhou phenomenon. In Wenzhou, the surplus labour was not caused by the development of agriculture. There was not enough land for the large labour force. The low incomes of the peasants in Wenzhou could not produce enough demand for industrial products, and the poor farming sector could not provide the finance for investment in rural industries. Also, the geographic situation of Wenzhou prevents it from getting benefits from large industrial

cities, such as capital investment, technological support and market demand. The main products of rural enterprises in Wenzhou are buttons, shoes, elastic cords, plastic woven bags and plastic flowers, which can neither be catalogued as modern technology, nor relate to the production of agriculture. Hence, the Sigurdson's model of rural industry, agriculture and modern industry does not work for Wenzhou at all. The development of rural industry did not get help from agriculture and there are no modern technology resources nearby. The employment problem of surplus labour was the main drive for the development of rural industry in Wenzhou. Wenzhou solved the problem of market demand by sending 100,000 private marketing agents outside and attracted buyers and sellers from all over the country despite Wenzhou's remote geographic situation. Those marketing agents also brought back information, technologies and goods. In 1990, Wenzhou provided 80 percent of China's buttons. Wenzhou has become an industrial and commercial place, the proportion of agriculture in gross production output has dropped from 63.4 percent to 29.8 percent. The increasing purchasing power further promoted urbanization. The small town construction was financed by the local peasants.

The size, structure and performance of rural industries in different counties depended greatly on geographic and historic factors. The availability and types of local resources, the quality and size of local labour forces and the access to technology are also important. The policies pursued by the central government, especially by the local government played a key role. From the above study, we shall see that no unique model is suitable for all counties in China. Local government should use its own policy to develop its local economy.

4. Conclusion

4.1 Policy Evaluation and Recommendations

As we can see, policy has played a very important role in the Chinese economy. The development strategy of the pre 1978 period reflected Mao's determination to provide a minimum standard of living and economic security for everyone and to ensure that social inequalities did not become too wide. These objectives were achieved at the cost of a slow rise in consumption and a low productivity of investment. Hence, when the new reforms after 1978 shifted the emphasis from accumulation to higher consumption and from heavy industry to agriculture and light industry, the Chinese economy showed its vitality. The Household Responsibility System, as part of the new reform policies, gave peasants better treatment. It permitted peasants to have the right of using land. After selling the quotas to the government, they could sell extra production in free markets. Peasants had the opportunity to be better off because their income depended upon their own efforts. The great increase of farm products and of peasants' income proved the success of the Household Responsibility System.⁹⁸ The policy of the Household Responsibility System on agriculture had the positive effects on the rural industry. The more efficient productivity created a huge amount of surplus labourers. Limited land resources stimulated the movement of rural agricultural labour into industrial activity. At the same time, the central government realized the employment problem and encouraged the development of rural industries. The policy regarding rural industries included: tax exemption and tax reduction for the new established rural enterprises, legalization of the private enterprises, promotion of the free flow of peasant investment into various kinds of private and co-operative enterprises. In addition, the central government encouraged concentration of land in the hands of more efficient

⁹⁸From 1979 to 1984, grain production in China increased by one-third, per capita net income increased at an average rate of 13.1 percent which compared to the average net income of peasants increased by only one yuan a year between 1965 and 1977. See Longworth (ed.), *China's Rural Development Miracle*, *op.cit.*, p. xvii, p. 4.

producers by permitting lease-like arrangements between households so that households would find it advantageous to give up their contracted land and devote themselves fully to other activities. By that time, the Household Responsibility system did not exist anymore. From the development of TVEs, we can see how the Household Responsibility System changed peasants' life and subsequent policies made TVEs develop quickly.

The open door policy gave the second push to the development of rural industries. The open door policy made the rural enterprises not only play an important role in China's industrial field but also be an unavoidable contributor to China's foreign trade. The decentralization of foreign trade made rural enterprises easier to respond the changes of the world market. Rural firms and local governments had greater incentives to increase their exports since they now had the right to use the foreign exchange earnings. The export-oriented enterprises are very important for China's foreign trade. The exports of rural industries reached 21 percent of total exports in 1990 while they started from a zero base before 1978.⁹⁹

However, the Household Responsibility System, mainly concerning agriculture, is by no means perfect. The abruptly weakened agricultural performance in 1985 and the stagnation thereafter¹⁰⁰ showed the Household Responsibility System's shortcomings. The separation of the right of using land and the public ownership of land dampened peasants' enthusiasm. They were unwilling to invest in the land. Even the production contract period was extended to 15 years for annual crops, 50 years for tree crops and land transmission was permitted in 1988.¹⁰¹ Since the Household Responsibility

⁹⁹See Table 3.3.

¹⁰⁰During 1985-1988, the growth rate of agriculture output declined to about 3 percent, compared to 9 percent between 1979-1984. See Terry Sicular, *op. cit.*, p. 1.

System did not solve this basic problem of land ownership and the past experience of unstable policies is still fresh in peasants' mind, they are afraid that their contract land will be taken away after the investment.

Also, the policy on rural industries needs to be improved. The limit on the number of employees on private enterprises should be removed. The current policy only made the local cadres use their right to receive bribe. This blunts private enterprises to reinvest and will dampen the development of national economy finally. Hence, the state should publicly legalize the private enterprises' status and permit them to make the most of their potential by supporting their legitimate operation and protecting their lawful rights.

The twenty five years of reform made the immigration from rural to urban unavoidable. The registration household system cannot work in the new situation since the reform policies loosened the control of immigration from rural to urban. More and more peasants entered into the cities. The housing shortage, the bottleneck of transport system, poorer living conditions and worse social environment are becoming serious problem in large overcrowded cities. The policy of "limited development in all large metropolitan areas, the selective development of only a few medium-sized cities, more development in small cities" is good. But it is long way since the burden of large amount population is a problem that is hard to solve.

The three patterns show that the macroeconomic policies together with locally formulated government policies have had a significant impact on the growth of rural enterprises as well as the local government policies. The rural township governments have played an even more important role

¹⁰¹John Mcmillan, John Whalley and Zhu Lijing, "The Impact of China's Economic Reforms on Agriculture Productivity Growth", *Journal of Political Economy*, August 1989, p. 790.

on the nature, speed, direction, and accomplishments of rural industrialization in China. The collective economy in Wuxi is due to the local government's effort to develop the collective economy and restrict the private enterprises. The private enterprises in Wenzhou is the result of the local cadres' support. Also, the Nanhai government encouraged foreign investment, then the export-oriented economy played a key role in its development. The local policy should depend on its own situation. The policies contributed to Wuxi's development does not mean it can work in Wenzhou. The three patterns of ownerships stand for extraordinary cases in China.

Through the three patterns' research, we can find that many factors account for the diversity of TVP development and performance in the three counties. The initial conditions, such as geographic location and natural resources, are clearly important and account for much of the observed difference between the three counties. Without the advantage of short distance to Shanghai, Wuxi could not have developed as rapidly. Also, the Nanhai Pattern shows that Nanhai benefits from the geographic situation near Hong Kong and Guangzhou. But the initial factors mentioned above are beyond anyone's control, initial conditions are also significantly affected by local government policy. The Wenzhou Pattern showed people's factor played a more important role. The rapid development of Wenzhou depended on the local cadres' willingness to take risk. The governors in poor areas should learn the experience from Wenzhou and learn how to develop the local economy. TVPs have demonstrated their ability to grow rapidly under different patterns of local government intervention.

We can conclude that there were three distinct trends after 1978. The first was within the agricultural sector, where there had been a move from farming to nonfarming activities, the "grain first" policy was replaced by diversified activities, such as animal husbandry, forestry and fishery. This shift led to the emergence of "specialized households". The second shift was from agriculture to rural

industries. In developed areas, the share of agriculture in the gross value of agricultural and industrial output dropped significantly and the rural industry had to compensate agriculture. The third was that employment shifted from rural to urban areas. More peasants entered into small towns or big cities. Hence, we can say that the agriculture reforms have brought the development of rural industries and that in return, have brought the explosive growth in small towns and the subsequent urbanization of the country side. Without the Household Responsibility System, there would not be the development of rural industry. Without the successful performance of rural industries, the construction of small towns would not be so fast.

Another conclusion, is that no particular development model is clearly superior. The Wuxi case, based on the collective economy, is impressive. However, the extraordinary growth record of Wenzhou, is also remarkable. The Nanhai approach of export-orientation is also successful. Sigurdson's model, the interaction among agriculture, rural industry and modern industry, shows the development pattern for relative backward rural areas with close connection with modern technology and market. The Wenzhou model shows the other way to development for the backward areas far away from modern industries. Since China is such a big country, its geographic situation and historic background are so diverse. There is no unique blueprint for all areas. Different areas should learn how to use their own specific endowments. The way that can make the peasants rich and local area developed constitutes the right way.

The three characteristics that emerged after reform are due to the reform policies. The diversified ownership could only appear after the central government abandoned the policy of public ownership exist. The emergence of export-oriented enterprises and the rapid growth of foreign trade after 1978 were the results of the open door policy. It was a complete reversal of the Maoist policy of seclusion

in relation to the world market that had been in force for 20 years (1958-1978). The new rural-urban relations are due to the loosened control on immigration from rural to urban areas. One characteristic, like export-oriented enterprises, shows the open door policy is definitely right. The other, such as diversified ownership, indicates that the policy still needs to improve on the issue of private enterprises. And the new rural-urban relation tells us the serious problem of surplus labour. It is hard to find a policy to solve it but the central government must do something.

Hence, from above study, we are in a position to make some recommendations regarding the policies of rural industries. First, the central government should adopt a private enterprise law designed to encourage and guide private firms' development, ensure their equal status and treatment with regard to tax and credit, and promote fair competition between firms of different ownership types. Second, upgrade rural enterprises' level of technology and improve the management methods.

The low technology of rural enterprises will prevent them from developing rapidly. The employees in rural enterprises need to be trained in order to increase the quality of the products. Finally, programs to facilitate rural enterprises' exports need to be used. Some enterprises in Jiangsu still complained about the monopsonistic pricing practices by local Foreign Trade Corporations, and few rural enterprises could expect to reach the export volume needed to qualify for direct export rights.

4.2 Future Trend

Regarding the future trend of development of rural industries, it still needs further studies and research. First, the basic elements which stimulated the rapid growth of China's TVP industry after 1978 does not exist any more. In the late 1970s and early 1980s, imbalances in both the economic and industrial sectors led to a shortage of commodity goods. The demand for ordinary consumer

goods led to the formation and development of TVEs. However, great changes have taken place in the Chinese economy and TVEs face new challenges in the 1990s. Since the introduction of reforms, the previous shortage of both consumer and industrial goods no longer exists, and in some areas supply now exceeds demand. For the long-term perspective, TVP industry will face the difficulty in the future: the government's support to the growth of TVPs is disappearing. During the 1970s and 1980s, the government had adopted preferential policies towards TVPs, such as exemption from production and sales tax for one year and exemption from industrial and commercial taxes for two or three years after their establishment. However, during the 1990s this tax exemption will come to end for many TVPs. Also, the overall standard of TVPs is comparatively low. The technology in backward areas is old and outdated, their equipment is crude and simple, and the educational level of both staff members and workers is low. They must raise their quality and economic efficiency in order to increase their competitiveness.

Second, worsened market conditions as a result of increased competition will slow the speed of the development of rural enterprises. The rapid growth of TVP industry after 1978 depended partly on state enterprises lack of vitality. But reforms in state enterprises will change their organizational form and property relations so as to build up their competitive strength. TVPs will then no longer be the sole beneficiaries of the expansion of the market mechanism, and their favourable market opportunities will gradually diminish. The 14th Party Congress legitimized privatization by endorsing the sale and lease of small state owned enterprises to private enterprise and collectives.¹⁰² The reform of state owned enterprises will make the TVPs develop more difficult.

However, the rural industry in inland areas will survive for a certain period of time because of the

¹⁰²Harrold, *op. cit.*, 1993, p. 45.

backward transport system. And the rural industries in the developed areas have absorbed the modern technologies and gained enough strength to face the challenge of the state owned enterprises. Rural industries further development will have profound influence over the social and economic life of the nation. The factors which influenced the rapid development of TVPs in the 1980s have now changed and TVPs today face new challenges and opportunities.

References

Byrd, William, and A. Gelb. *Township, Village, and Private Industry in China's Economic Reform*. PRE Working Paper, Washington: World Bank, 1990.

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

Chang, Sendou, and R. Yin-Wang Kwok. "The Urbanization of Rural China." In Yeh and Xue eds., *Chinese Urban Reform, What Model Now?* New York: M.E. Sharpe, 1990.

Chossudovsky, Michel. *Towards Capitalist Restoration? Chinese Socialism after Mao*. London: Macmillan, 1986.

Du Haiyan. "Causes of Rapid Rural Industrial Development" in Byrd and Lin, eds., *China's Rural Industry*. Oxford: Oxford University Press, 1990.

Du Runsheng. "Advancing Amidst Reform." In Longworth, eds., *China's Rural Development Miracle*. Queensland: University of Queensland Press, 1987.

Endean, Erin. "China's Foreign Commercial Relations." In *China's Economic Dilemmas in the 1990s*.

Goldstein, Sidney, and Alice Goldstein. "Town and City: New Directions in Chinese Urbanization" in Yeh and Xue, eds., *Chinese Urban Reform: What Model Now?* New York: M.E. Sharpe, 1990.

Shen Guanbao. "Rural Enterprises and Urbanization: the Sunnan Region." In Yeh and Xue, eds., *Chinese Urban Reform: What Model Now?* New York: M.E. Sharpe, 1990.

Harrold, Peter. *China's Reform Experience to Date*. Washington, D.C.: World Bank, 1992.

Harrold, Peter and R. Lall. *China: Reform and Development in 1992-93*. Washington, D.C.: World Bank, 1993.

He Chunlin. "Eight Years of the Open Policy", *China Reconstructs*, November 1987, pp.

Hirschman, Albert. *The Strategy of Economic Development*. New Haven: Yale University Press, 1966.

Ho, Samuel. *The Asian Experience in Rural Nonagricultural Development and Its Relevance for China*. Washington, D.C.: World Bank, 1986.

Hsu, Immanuel C.Y.. *The Rise of Modern China*. Oxford: Oxford University Press, 1975.

Kamm, John. "Foreign Trade." In Ezra Vogel, eds., *One Step Ahead in China*. Cambridge, Mass: Harvard University Press, 1989.

Lardy, Nicholas. *Foreign Trade and Economic Reform in China, 1978-1990*. Cambridge: Cambridge University Press, 1992.

Liu Guoguang. *Zhongguo Jingji Fazhan Zhanlue Wenti Yanjiu* (A Study of the Question of China's Economics Development Strategy). Shanghai: Shanghai Renmen Chubanshe, 1984.

Liu Yialing. "The Private Economy and Local Politics in the Rural Industrialization of Wenzhou." *China Quarterly*, June 1992, pp. 293-316.

Luo Xiaopeng. "Ownership and Status Stratification." In Byrd and Lin, eds., *China's rural Industry: Structure, Development, and Reform*. Oxford: Oxford University Press, 1990.

Lu Wen. "Development Strategy in Rural China." In Longworth, eds., *China's Rural Development Miracle*. Queensland: University of Queensland press, 1987.

Mao Zedong. *Selected Works of Mao Zedong*. Beijing: Foreign Language Press, 1977.

Mcmillan, John, John Whalley, and Zhu Lijing. "The Impact of China's Economic Reforms on Agriculture Productivity Growth." *Journal of Political Economy*, August 1989.

Myrdal, Gunnar. *Economic Theory and under-developed Regions*. London: Gerald Duckworth & Co. Ltd, 1957.

Nolan, Peter, and Dong Fureng. *Market Forces in China, Competition and Small Business: the Wenzhou Debate*. London: Zed, 1990.

Ody, Anthony. *Rural Enterprise Development in China, 1986-90*. Washington, D.C.: World Bank Press, 1992.

Oksenberg, Michel. "Local Leaders in Rural China, 1962-65: Individual Attributes, Bureaucratic Positions, and Political Recruitment." In *Chinese Communist Policies in Action*. Seattle: University of Washington Press, 1969.

Parris, Kristen. "Local Initiative and National Reform: the Wenzhou Model of Development", *China Quarterly*, January 1993, pp. 242-263.

Pei Xiaoge. "Small Town Construction: an Alternative Path." In Nolan and Dong, eds., *Market Forces in China, Competition and Small Business: the Wenzhou Debate*. London: Zed, 1990.

"Revolution on Certain Questions in the History of Our Party since the Founding of the People's

Republic of China." In *Almanac of China's Economy 1981*. Hong Kong: Modern Cultural Company Limited, 1982.

Riskin, Carl. *China's Political Economy: the Quest for Development since 1949*. Oxford: Oxford University Press, 1987.

Roll, Charles, and Kung-Chia Yeh. "Imbalance in Coastal and Inland Industrial Development." In *China: A Reassessment of the Economy*. A Compendium of Papers submitted to the Joint Economic Committee, United States Congress, Washington, D.C.: Government Printing Office, 1975.

Sicular, Terry. *China's Agriculture Policy during the Reform Period*. Harvard Institute of Economic Research, Discussion Paper No.1522, November, 1990.

Sigurdson, Jon. *Rural Industrialization in China*. Cambridge, Mass: Harvard University Press, 1977.

State Statistical Bureau. *Thirty-Five Glorious Years: 1949-1984*. Beijing: *Zhongguo tongji Chubanshe*, 1984.

Stepanek, James. "China's Enduring State Factories: Why Ten Years of Reform Has Left China's Big State Factories Unchanged." In *China's Economic Dilemmas in the 1990s*. New York: M.E.Sharpe, 1992.

Svejnar, Jan and J. Woo. "Development Patterns in Four Counties." In Byrd and Lin, eds., *China's Rural Industry*. Oxford: Oxford University Press, 1990.

Wong, Christine. "Rural Industrialization in the People's Republic of China: Lessons from the Culture Revolution Decade." In *China under Four Modernizations*. Washington, D.C.: Government Printing Office, 1982.

World Bank. *China: Macroeconomic Stability and Industrial Growth under Decentralized Socialism*. Washington, D.C.: World Bank, 1992.

World Bank. *Strategies for Reducing Poverty in the 1990s*. Washington, D.C.: World Bank, 1992.

Xue Muqiao. *China's Socialist Economy*. Beijing: Foreign Languages Press, 1981.

Yeh, Anthony, and Xue Xueqiang. "Changes in City Size and Regional Distribution, 1953-1986." In Yeh and Xue, eds., *Chinese Urban Reform: What Model Now?* New York: M.E.Sharpe, 1990.

Zhongguo Jingji Nianjian 1986 (1986 Chinese Statistical Yearbook) (Beijing: *Zhongguo Tongji Chubanshe*, 1986).

Zhongguo Jingji Tongji Nianjian 1992. (1992 Economic Statistical Yearbook of China). Beijing: *Zhongguo Tongji Chubanshe*, 1992.

Zong Huaiwen. *Years of Trial, Turmoil and Triumph--China from 1949 to 1988*. Beijing: Foreign Languages Press, 1989.

Zweig, David. "The Political Economy of Exports from Rural Industry." *China Quarterly*, December 1991, pp. 716-741.