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## **How to Define Property Rights? A Social Documentation of the Privatization of Collective Ownership<sup>1</sup>**

*Abstract:* Since rural China began to implement economic structural reforms in the late 1970s, township and village collective enterprises (TVEs) have attained significant expansion for a long time. They have become not only sections with most rapid economic development, but also experimental sites for the rural reconstruction of “common prosperity.” However, since the mid-1990s, TVEs have been experiencing a property rights transformation of rapid privatization. One of the noteworthy social consequences of this transformation is how the redefinition of property rights may lead to new differentiation and distribution of wealth and resources, in whose hands will wealth concentrate, and whether the concentration process will lead to new inequalities. Exploring the social process of property rights definition can help our understanding and analysis of these questions. Moreover, empirical materials concerning this process are complete and abundant, furnishing the sufficient conditions for new examinations and summaries on their basis.

*Keywords:* privatization; collective ownership; distribution of wealth; property rights.

### **Introduction**

#### **Problems and Viewpoints**

Property rights are an institutional expression of society’s basic rights relationships. They are distinguished from legal rights in that, in practice, property rights are not a clause, statute or regulation, but an institutional arrangement subject to deconstruction and construction. Under such an understanding, definition of property rights is an inter-dynamic process that exists between the parties who establish or alter rights contracts.

In past research two dominant theoretical viewpoints have been noteworthy. The first is the dilemma under the explanatory logic of the economics of property rights,

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which holds that all enterprises experiencing institutional reforms, whether state-owned or collective, are currently facing the following dilemma: there is no real market without property rights (Zhang 1995, 1999), but property rights are difficult to define without a real market (Lin et al. 1997). The second theoretical viewpoint starts from the explanatory logics of the institutional school within organizational sociology, the “social networks” school and anthropology, and emphasizes the social relationship basis and importance of the “informal or spontaneous privatization” strategy (Nee & Su 1996), the contribution of family solidarity and trust to the implementation of informal property rights rules (Peng 2004), the significance of family networks to the permeation of collective property rights, the uncertainty of such social factors as political processes and cultural ideas and its influence on repeated definitions of property rights (Zhang 2003, Zhang 2004), membership rights as the basic principle for the definition of collective property rights (Shen, Wang 2005), the function of “relationship contracts” in enforcing ownership (Liu 1996), and the significance of the idea of “property rights as a bundle of relationships” (Zhou 2005).

This paper’s research on property rights definition is closer to the second line of thought, but we put greater emphasis on collective ownership’s social contractual nature and focus on the dynamic definitional social process characterized by establishment—dissolution—reestablishment. The significance of such research is that it reveals that the collective property rights are largely not market contractual rights, but social contractual rights. Such social contracts, based on legitimization mechanisms, are neither consciously designed institutions nor natural expressions of social relationships, but the product of the coordination of specific social interaction and reflect a harmonious social order. As market contracts are incomplete, such social contracts may informally and satisfactorily manage and resolve problems in intra-community cooperation and conflicts in property rights, thus defining and maintaining a community property rights order. However, when the institutional environment changes drastically, the function of such social contracts becomes very limited. As rural China currently relies on administrative power to promote property rights reform, there may be severe negative consequences to sustainable community development if institutional designs replace informal social contractual rules and insufficient consideration is given to the latter’s continuation or replacement. Elite privatization will become inevitable and aggravate social polarization on the basis of property rights.

Here it is necessary to reference Russia and Eastern European countries’ past experience in privatization. Although countries such as Russia and the Czech Republic, during the early stages of privatization, applied “mass privatization” to state-owned assets, allowing the employees to acquire 40–50% of their enterprises’ stocks at zero or discounted costs, they were actually letting political goals supersede economic goals as they treated privatization as an institutional arrangement that made reform irrevocable, and forced through large-scale privatization through administrative means or without compensation. As a consequence, the later stages witnessed “bureaucrats’ privatization,” “managers’ privatization” and “predatory privatization,” which produced severe polarization, and subsequent governments had to repeatedly adjust privati-

zation methods, eventually reorganizing property rights and enacting modernization reforms for already privatized enterprises (Xu 2003).

This paper's research is limited to an analysis of collective property rights in rural communities. The cases this paper relies on have a certain typical or regional representativeness and can help deepen our understanding of the following problems: How come anti-collectivity forces have arisen under the institutional framework and ideology of collective ownership? Why has collective ownership, when put in practice, not achieved equal ownership of collective property? How do wealth and ownership highly concentrate in the hands of the managers and what influence does this concentration have on social polarization?

### **Collective Property Rights in the Community: Social Contractual Rights**

For TVEs arising from their parent communities, this paper holds a different understanding than economics does. TVEs are not pure firms in the market, but also firms in the community. Not only are the enterprises' economic activities deeply embedded within the social relationship structure of the community, but informal contracts also perform especially important functions in resolving property rights problems. In our opinion, informal contracts are not only transactional contracts established on the basis of economic principles, but also social contracts established on the basis of social legitimacy and with reciprocal exchanges at their core. Such social contracts, widely acknowledged in the rural community, essentially stipulate rights relationships and, in particular, affirm the reciprocal rights relationship in people's possession and use of expected incomes and assets. These are their important functions in clarifying the actual property rights arrangements of the enterprises.

The above explanatory logic differs from that for property rights arising from market transactional contracts. It takes as the basis of social contract formation membership rights and concomitant social relationship networks. Such contracts are based on collective ownership of land and contain such social relationship components as "collective ownership by all members," "equal ownership" and "Human Rights". They therefore necessarily imply reciprocal trust and social expectations that suppress inequality and opportunistic actions. Social contracts are also based on the interpersonal relationships of "community of acquaintances," contain associational responsibility and trust, and have at their background such informal institutions as conventions and precedents. Since such contracts occur in such a "community of acquaintances" as the rural community and depend on long-term trust for its maintenance, their establishment does not occur during the event, but exists implicitly before the event. As a result, such contracts help form stable profit expectations. The central problem that the parties to the contracts have to resolve in practice is how to agree on a reasonable and generally acceptable mechanism for distributing rights and profits arising from collective ownership, while increasing total profits. Such contracts are conducive to the establishment of collective goals characterized by such ideas of equality as "common prosperity," to the community's collective survival, and to the prevention of inconveniences arising from disputes due to lack of clarity on the internal boundaries

of collective property rights. Such social contracts are formed between the leader of the collectivity and the members of the community.

Although contracts so formed differ from legal contracts in that they are implicit, not formal written rules, and cannot even be called oral agreements, they undoubtedly constitute practical contractual relationships. As the collectivity along with its leader and the community members agree on conditional promises and responsibilities dictated by the reciprocity principle (Michael Lessnoff 2004: 11–12), such contracts can form the basis for determining whether the distribution of property rights and resources is fair and reasonable. Such contracts possess ideological and moral force, for they are the product of the community members' reciprocal social interactions and not the result of conscious designs; but they also differ from cultural convictions, for they still rely on certain legal legitimizations, such as the support of the collectivity institution and policies concerning collective enterprises. We therefore may treat such contracts as an institutional mixture that stands in between the formal and the informal. However, although the social contracts' ideological and moral force can let them function as common law, they cannot absolutely restrain the actions of authoritative persons or villagers. In particular, as soon as externally promoted formal institutions or policies are strong enough to challenge conventions and become the legitimate bases for change, such contracts' restraining force will decline. As can be seen from the practical enforcement of collective enterprise reform, as soon as the social contracts are ignored or trampled upon, it becomes difficult to keep the distribution of community property rights and resources just and fair.

#### **The Basis of Property Rights Definition: Legitimization Mechanisms**

Legitimization is a complicated and multi-dimensional sociopolitical participatory process and cannot be simplified as the problem of legal legitimization. We especially cannot ignore the influence of such factors as social recognition and "community reason," for the resolution in practice of certain legitimization problems is based on them.

When village communities define property rights, they usually do not seek the support of higher-level governments or the recognition of policies or laws, but attend to local ideological inclinations, and even value the influence of and seek a certain balance in the community's ideas and morals and expectations. We call these "legitimization mechanisms," i.e., institutional and ideological forces that lead the inducers and coercers (organizations or individuals) to adopt organizational structures or actions that are socially recognized and morally justifiable (Zhou 2003: 75).

We treat legitimization mechanisms as a set of institutions whose components both possess individual significance and interact with each other. The set mainly contains legal legitimization, administrative legitimization, official ideological legitimization, and social reasonableness legitimization. Different mechanisms' definitional results may be compatible, or incompatible and conflicting but still capable of coexistence. Their difference may also form the condition for reaching a certain balance. No logic implicit in any one legitimization mechanism can be the only logic that integrates

the definitional process. Even the formal definitional process cannot always exclude informal processes and may even rely on them.

The social reasonableness legitimization mechanism is based on the following idea: A society's ideas and rules about expectations, once widely accepted, immediately become social facts that people are accustomed to and thus possess moral force and thereby regulate people's activities. Legitimacy crises will occur if such social facts are violated. We can therefore treat the social reasonableness legitimization mechanism more precisely as a set of socially recognized or reasonable logics (Zhou 2003: 74). This mechanism is very practical and has important uses in rights definition. The social facts it produces often become the reference for the legal, administrative and official ideological definitions and even the force promoting the flexibility or reform of such laws, precedents or ideologies. We should therefore see the social reasonableness legitimization mechanism as the definitional mechanism that is most practical and most in accordance with the ideas of justice.

Now let us explore the above problems through an actual case of the reform of a collectively-owned TVE.

### **A Case of Dynamic Definition**

Tang village, located on the plains along the Yangtze River Delta, is one of the villages that used to be highly industrialized and that ran enterprises through collective ownership. The village's dominant industry is shoemaking and its products have sold to Japan and other international markets for many years. The village was well known as a rich village and large taxpayer before the dissolution of collective ownership.

After the mid-1990s, the region began to re-think collective ownership and the curtain was thus formally raised for Tang village's three-act reform. Property rights problems for TVEs normally occur on three relationship levels: First at the external boundary of village collective organizations, i.e., between the village collectivity and the town and village governments; second at the external boundary of the TVEs, i.e., between the village political authorities and the TVEs; third among the "internal persons" of the TVEs, i.e., between the managers and the ordinary workers/villagers. Every problem concerns how to define property rights based on the above-mentioned relationships. Tang village's three-act reform has also developed along these three levels and every act has prepared for the ultimate concentration of property rights and wealth in the hands of the enterprise managers.

#### **Act I: "Transition"—Toward "Joint-Stock Ownership"**

During the mid-1990s, TVEs in the region had already passed the stage of rapid growth that usually occurs when the economy is just taking off, and most of them were facing declines in profits, shrinking market for products, increase of bad debt and heavy indebtedness. Confronted with such difficulties, people proposed adjustment and reform in industrial organization and began to notice the shortcomings of

collective ownership. Then came 1997. Around the time of the Fifteenth People's Congress, a series of policies and plans for property rights reform came out. Thus, with promotion by local policies, Tang village made the following "substitution" for its collective stock assets: Of the net assets (1997), collective assets constituted 93%. Of the collective assets, village's collective stocks constituted 46.8%, employees' individual stocks 20.1%, employees' shared stocks (or Shareholders of Unit) 20.1%, managers' individual stocks 14%. The remaining 7% of the net assets consisted of the capital of the social legal person.

Rights over collective property thus went through fundamental changes. Part was taken by joint private capitals, another part was distributed to individuals through stock distribution, and the remaining "collective stock" (property rights of the legal person) was severed, both in name and in actuality, from the employees (the investors). The employees' attention was on the distribution of individual stocks and shared stocks Shareholders of Unit. Collective stock was to them only of unclear significance and had been in actuality thoroughly transferred to the collectivity's representatives.

Another clear severance occurred at the external boundary of collective property rights. When Tang village accepted the transition, it, like the region's other villages that persisted in collective ownership for many years, did it out of practical considerations, i.e., it had repeatedly weighed the practical benefits to the village and expected the transition to change its economic relationship with the local government. Although the villagers understood that the changes were insufficient to restrain government actions, they at least considered them to provide justification bases. The transition, agreed to from such considerations, might provoke local authorities to more speedily or even entirely withdraw their already weak control over TVEs.

Then how to manage the relationship between the collective enterprises and the village administrative organizations? When Tang village made the enterprises transition toward joint-stock ownership, it targeted employees as the stock-owners and did not let all the village cadres become the natural stock-owners. Cadres not working for the enterprises, such as the village director and other cadres, did not have certificates of stock ownership. The enterprises said that "their benefits would be taken care of through other means," i.e., the enterprises would pay them salaries several times higher than those of the surrounding villages and also reimburse their administrative expenses. Such choices and designs of stock ownership clearly incorporated considerations for the community's rights structure and the property rights consciousness of the designer himself. They emphasized the economic elite's power to control enterprise assets, laying the groundwork for the next step of achieving internal village-enterprise severance.

## Act II. "Imitation"—"The Corporation System"

The second direct aim of Tang village's reform was to suppress the village's internal administrative system's pursuit of property rights and profits. Two years later in 1999, with the localities encouraging such policies as withdrawing collective stocks and

rewarding the management with stocks, Tang village began to divide up collective property rights.

i) Village-enterprise severance

By then the corporation proposed that “the corporation should create collective net assets” and for the first time made rigorous distinctions between “the corporation” and “the village,” excluding “the village collectivity” from “the corporation collectivity.”

Determination of the village administrative organizations’ share in the assets is a process worth ruminating over. During the actual division, no one probed or relied on questions such as what constituted “investment” or “initial investment” or claims such as “the shoe factory was run by the boss (the village secretary also serving as board chairman) and the village had not invested a cent.” Such claims would provide authoritative justifications for the corporation’s right to define property rights and were implicitly acknowledged by the village committee and the villagers. However, it was also an undisputable and politically legitimate fact that the enterprise was a collective factory. Thus what people cared most about was first to contemplate and agree on a distributional ratio. On the question of how to determine the village’s share, local policies did not furnish any reference. Upon close examination, the interviewers found out that its  $\frac{1}{4}$  share was reached quite dramatically, for it was completely accidentally decided when the village secretary communicated with another similar village. In other words, this ratio had been repeatedly referenced and agreed to by local villages and thus possessed regional legitimacy.

Since the village committee could not cite “the initial contract” as support, it made no objection to the distributional ratio proposed by the corporation, but only bargained somewhat on the details of asset division and insisted on having the town government serve as witness. The town government afterwards approved of the division with formal documents.

There were thus rigorous divisions between the property of the village collective organizations and that of the corporation. According to local policies, community public goods and property rights over welfare enterprises that enjoyed preferential treatment by policy should belong to village collective organizations. The villagers also considered such an arrangement to be reasonable. According to them, public facilities “performed significant and practical tasks for the common people” and it was natural that such fixed assets, which received no profit and were of the nature of public goods, should belong to the village. Thus it seemed that the true purpose of village-enterprise severance was to affirm the corporation’s right over “the corporation-created collective net assets,” i.e., the appreciating assets, and to thereby completely exclude from the corporation collectivity the village government and the village collective economic organizations.

ii) Severance between the managers and the corporation collectivity

Meanwhile, the corporation internally made clear divisions between the property rights of the managers and those of the employee stock-owning association. The

managers by this time already possessed 49% of the corporation's stocks, 14% derived from the "cash stocks" ratio affirmed during the previous transition, 25% were "rewarding stocks" from this second round of reform according to local policy.

The employee stock-owning association was a representative organization in charge of the employee's collective property rights. The stocks it was responsible for actually includes two parts: One part was the shared stocks distributed to employees during the previous transition; the other part was stocks newly allocated from the corporation's assets (i.e., the collective assets that remained after the managers' individual stocks were subtracted) to the employees collectively. Both parts were relatively independent from the enterprise managers. Although their owners had no power to freely control them, encroachment upon them was prevented by supervision. Thus "collective property rights" were no longer property rights under collective ownership, but began to have relatively clear boundaries and belonged to a particular group—the employee collectivity.

Although this reform of Tang village preserved employees' shared stocks and community cooperation, its design of the managerial structure imitated "the corporation system." Such an arrangement largely accomplished the transition of the corporation's managerial structure toward that of a joint-stock limited liability corporation. Internally, the corporation established the stock-owners' representatives congress and elected the board of directors and the board of supervisors. Within such a framework, the village collective organizations only possessed 50% of the stocks of a small welfare subsidiary of the corporation and thus largely withdrew from the corporation's stock ownership structure.

From Tang village's experiences we can see that the most essential result of the transition toward joint-stock ownership and the corporation system is the redistribution of property rights through the distribution of stock ownership. This result is brought about when, first, collective enterprise assets and control over them are concentrated in the corporation through the village-corporation severance, and then, corporation assets are further concentrated in the hands of the entrepreneurs through the manager-corporation collectivity severance, when finally, privatization is simply the exchange under market principles between the managers and other property owners. From this standpoint, achieving joint-stock ownership is the most important process in the redefinition of collective property rights and eventually privatization. Inequality in the distribution of wealth and property rights occurs mainly during this process.

### **Act III. "Reform"—Privatization**

Clearly the corporation arrangement was the most important step in Tang village's property rights reform, for it helped solve the difficult problems of the withdrawal of village collective assets and the managers' ownership of substantial stocks, and especially redefined new property owners. By then, Tang village corporation's property rights reform faced two possible prospects: Maintaining the status quo or further privatization. Foundation for the latter was already laid and could be achieved as soon as there was policy encouragement to increase the ratio of the managers' stock own-

ership to a sufficient amount. For the managers, choice between the two was simply a question of whether and how to exchange property rights among the corporation's "internal persons."

After 2000, two factors promoted Tang village's privatization process. The first factor some cadres who vehemently supported privatization represented the opinion of the new local reform party, which decided on large-scope reform and directly entered villages to find experimental sites. According to local policies concerning state-owned enterprise (SOE) reform, the key was to mobilize the village collectivity to withdraw entirely, have the board chairman buy up the enterprise, and coordinate the relevant departments, such as the city union, the bank, and the town government, to support Tang village's "privatization reform." The second factor was the initial public offering (IPO) that Tang village had planned for years. It was suggested by the partners that the joint-stock system was unqualified for an IPO. Thus privatization reform was formally pushed to the front stage.

Withdrawal of collective assets was one of the most important enterprise reform policies in the southern Jiangsu region. Tang village, after the last two rounds of reform, had to deal with two interested parties: One was the village collectivity represented by the village committee; the other was the employee collectivity represented by the employee stock-owning association. How to make them withdraw smoothly became the focal point of all operations. Eventually Tang village employed the following policies:

**Conversion to cash.** Sell to the corporation assets under the name of the village collectivity. The latter receives cash and acquires independent fiscal capability; the former receives the ultimate property rights.

**IPO.** Dissolve the employee stock-owning association and transfer all of its stocks to the village secretary also serving as board chairman. Compensated transfer of collective assets was no longer a novelty in the region and representatives of the employee stock-owning association made no objection to it.

What the representatives cared most about were two things: One was how to dispose of the transfer fee; the other was whether the corporation's policy toward the employees would change. On these the village secretary also serving as board chairman made two promises: First, gains from the transfer would be taken out of the corporation's total assets and set up as a fund for rewarding employees. The fund would have its own account and management and applications specific to itself. Annual rewards would be given to employees based on the magnitude of their contributions (this promise was made according to relevant local policies); employees having worked for more than three years would receive 1,000 *yuan*, an amount similar to past bonuses. Second, policy toward the employees would remain unchanged. Whether such promises were made in public or not, they all represented the employees' potential expectations for their transfer of stock ownership.

**Buy out.** Compared to ordinary employees, the managers were more sensitive about the transfer of stocks from the employee stock-owning association. They originally owned ten-odd times more stocks than ordinary workers. How to protect the interests of the workers was the key problem for completing the transfer smoothly.

The sophisticated but honest village secretary also serving as board chairman did the following: Change the “explicit” bonuses from the managers’ annual shared stocks to “implicit” bonuses of a similar amount and even with slight yearly increases.

Execution of the above strategies made Tang village’s reform proceed smoothly, as the villagers and employees accepted the reform peacefully. The post-reform property rights definition was as follows: Of the net assets (1999), 77% belonged to the corporation. Of these 77%, 55% belonged to the managers themselves and 45% belonged to their sons. The village collectivity’s share of the total assets, after the three rounds of reform, changed from the initial 93% to 23%. Such assets were termed “village-owned capital” and mainly included un-profitable public goods, not-so-profitable land rents and the one-time transfer fee from the welfare subsidiary. By this time, the Tang village shoemaking corporation had become a limited liability private corporation.

From Tang village’s entire property rights definitional process we can see that achieving the joint-stock system was the first and most important property rights definitional event since Tang village industries’ adoption of collective ownership. We take it to be the formal contractual arrangement, or “during-the-event” definition, upon which basis we identify “before-the-event” and “after-the-event” definitions. Let us further discuss the basic problems of wealth and property rights redefinition through an analysis of these three specific processes.

### **Before-the-Event Definition: Formation and Operation of Social Contracts**

#### **Whether there Was and what Was the “Initial Contract”**

As with most TVEs, Tang village, in its decision to give to the highest-level managers the property rights over most of the former collective assets, followed the corporation law principle of “those who invest and create should profit.” According to the above principle, determining the source of the initial investment is the most important basis for reform. Upon questioning further, however, we were often told that most enterprises were in the embarrassing situation of having no initial contract and the Tang village collective organizations were no exception. Thus, whether the village collectivity enjoyed ownership of the enterprise and how much of the assets it should possess both became questions continuously asked by all parties, including the collective organizations. Absence of an initial contract was often cited by the enterprise managers in bargaining with and suppressing the ownership share of the village collective organizations.

What is here referred to as the “initial contract” signifies the formal market contract at the founding of the enterprise and, following Ronald Coase understanding of enterprises, constitutes a type or set of market contractual rules. However, what the founding of the TVEs followed was not completely or even mainly the logic of market enterprise contracts. In this respect they were similar to publicly owned enterprises, which neither had initial contracts nor relied upon market contracts (see Zhou 1997,2000: 101 notes 4, 140, 150).

Tang village's enterprises were started like most other TVEs, i.e., under the direction of village political organizations, registered as collective enterprises by virtue of city processing projects, and eventually given birth through people capable of finding projects. The collectivity thus symbolically existed as an indispensable owner of enterprises properties. In the beginning, incomes of villagers who worked for the enterprise did not directly belong to the villagers, but were distributed first to the production brigades and then to the villagers, so that the incomes of the villagers who worked for the enterprises and of those who continued farming would be more leveled. There was clearly no need for and no formal contract between entities of the collective person. Internal rules maintained managerial order, lessened institutional friction and achieved fair distribution.

Without initial contracts, collective enterprises faced great difficulties in the subsequent quantification and definition of assets. As a result, some large- or mid-sized and well-running collective enterprises, in order to lessen the impact on enterprise management, did not voluntarily reform and even resisted reform, or, like Tang village, treated "investment" only as cash investment and made no account of investments in land, labor and intangible assets.

The catch is: Along this line of logic, since the collectivity's initial investment was zero, the appreciation during the development of the enterprise would have nothing to do with the collectivity. Further, Tang village enterprises would probably be similar to "enterprises with a red cap," which only needed local governments to "take off the cap." Then how come reform was promoted by the corporation, accepted by the village collectivity and assented to by the villagers in a village like Tang village? Many key problems in Tang village's reform thus remain difficult to explain. There must be implicit non-economic forces.

Under the initial arrangement of the village community's collective property rights, although it was difficult to establish a formal economic contract, there was established, upon the basis of community reason, an implicit or informal social contract. Most village enterprises were started under such implicit social contracts (Liu 1999, Chen 2000). The significance or purpose of the social contract was not just economic needs (e.g., minimizing transactional cost), but more deeply the need to maintain the survival of the community collectivity and thus the extension of the reciprocal community logic.

Undoubtedly local collective economic policies institutionally supported the existence of the social contract, providing the basis for its legal legitimacy as the initial contract. More importantly, this before-the-event implicit social contract could informally define collective property rights, or more precisely could become the legitimacy basis for not depriving the collectivity of its property rights. We can therefore treat it as an implicit informal initial contract. During Tang village's first and most important property rights definitional event—the transition toward the joint stock system, it was just this contract that provided the basis for defining 93% of the net assets as "collective capital." Moreover, from the repeated during-the-event and after-the-event redefinition of collective property rights, we can see that collective property rights defined formally by policies was only an institutional bottom line, above which there was

substantial institutional constructive space and whose maintenance was guaranteed by the informal social contract.

### **Basis for the Initial Contract's Social Legitimacy**

It is clear the initial definition of property rights mainly relied on the social legitimization mechanism. In Tang village's series of property rights arrangements, we can detect a phenomenon of seeming contradiction but long-term coexistence produced by this mechanism.

Determination of entitlement to the village enterprise and its profits did not actually entirely follow the logic of demands by nominal ownership, but was done according to the rule of reciprocity that was acknowledged throughout the village. During the early stages of industrialization, when "no worker was not rich," Tang village's collective organizations, despite having the intention and motivation for starting enterprises, could not find capital or good projects. Thus, the "old village cadres" invited a capable villager who had been an accountant before, i.e., the current village secretary also serving as board chairman, to start the enterprise. If, using policy language, the property rights expressed by "collective ownership" were ambiguous, then whether the actual rights over the enterprise belonged to the village or the enterprise was clear from the very beginning. Expressions such as "the enterprise was started by such and such" and "the enterprise of such and such" were employed throughout the village, not only when referring to the relatively large-scale shoe enterprise, but also to other smaller enterprises. The practical significance of such expressions was that the villagers conferred upon the enterprise managers an informal control over the enterprise. "Those who manage the enterprise have the last word;" other people, even village political organizations who represented the nominal owners could not interfere. Because such a rule existed, there could be people who willingly started the enterprise for the collectivity when there was little to start with and the future was uncertain. As seen from the village records, accomplishments in managing the shoe enterprise were recorded as political accomplishments for the old secretary, in accordance with the legal legitimacy of collective property rights. In reality, however, the village political leaders could not demand any practical power over the shoe enterprise and the villagers accorded the contribution of starting the enterprise and their gratitude for getting rich to the enterprise founder, so much so that, when the shoe enterprise later partnered with a Japanese business, it was named after the manager and the Japanese business. When the village's small enterprises reformed, it seemed entirely natural to the villagers to first sell the enterprises to their founders. This phenomenon also exists in other observed forms of collective economic management.

The above-mentioned phenomenon was actually a balancing strategy employed by the villagers to deal with contradictions: One part of the contradictory phenomenon was emphasized, and the other part was fictionalized or symbolized but still retained the power to reassert itself in the future. According to their conventional ways, the villagers on the one hand conferred the control over the enterprise to the managers, but on the other hand retained the nominal property rights for the village collectivity,

and both definitions were significant. When the villagers informally defined property rights, they bypassed determination of nominal ownership by suspending it but at the same time refusing to surrender it. Their emphasis upon the managers' practical property rights accorded with the reason of the small community, whereas their protection of the village collectivity's nominal property rights accorded with the policy and ideological demands of the larger society and also indicated the villagers' care for sharing. All these functioned to balance rights. Even the village political organizations, with the aim of centering on economic development, employed flexible strategies and understood that "If you want the enterprise to continue, you cannot always cite policies to pressure people." Definitions so made, upon becoming conventions, would possess social legitimacy and be voluntarily followed by both parties as their optimal responses in normal circumstances. We can term property rights so defined "conventional property rights." What they largely relied on were not the rules and logic of defining and enforcing ownership, but those of the community's internal self-organization and reciprocity (Qinmu 2001: 35–36).

In other words, only improvement of the community's total welfare could guarantee the individuals' private interests. If the community respected the managers' rights, the managers would likewise respect the community's interests. Both sides would form stable expectations of each other. Such stability derives from the villagers' long-term practical experience, from which they realized that following such a reason and logic could actually help with the community's collective survival and the prevention of inconveniences arising from disputes due to ambiguity in the internal boundaries of collective property rights.

#### **During-the-Event Definition: Establishment and Weakening of Social Contracts**

##### 1. Re-contracting and undisputed property rights

Victor Nee and Su Sijin, in their research on China's economic reforms from the perspective of market transition, suggest that China's economic growth should be attributed to the informal privatization of property rights. Informal property rights are embedded within a larger framework of norms and conventions. In most cases, the more stable the social network in which the informal property rights are embedded, the less disputed and more protected will be property rights. However, as uses of property become conventional and supported by social norms over time, informally established property rights will strengthen continuously. Eventually such informal property rights will acquire the basis for becoming formal property rights.

The insight from this research is that, since informal property rights are embedded within social networks, the stability provided by the networks may, through the working of conventions, make the property rights undisputed and thus transformed into formal rights. However, the research has not considered the mechanisms through which such transformation is accomplished. We have already explored how the managers acquire the informal control over the enterprises. What needs to be further clarified is that this control must go through re-contracting informally second relationship contracts (Liu 1999) to become undisputed and thus formal.

That the Tang village shoe corporation's external trade is conducted by receiving orders provides the opportunity for establishing a second relationship contract. Production by receiving orders mostly relies on the enterprise managers' establishment of and personal control over a network of connections. In this type of enterprises that we interviewed, the enterprise director possesses two powers: First the power to receive orders and next the power over finances. In fact, with these two powers in hand, the director already has substantial control over the enterprise's life and death.

With such cognition, the enterprise manager's pursuit for managerial profits and even ownership thus becomes another great motivating force for collective enterprise reform. Although reform policies are not yet clarified, in reality the enterprise manager already exclusively possesses, controls and manages the corporation assets. Whether the corporation assets would be lost or transferred depends entirely on such moral restraints as the manager's loyalty to the collectivity and his suppression of his private thoughts and desires. By this time legal property rights can no longer restrain the transfer of the corporation assets. A clear result of second contracts is to strengthen the actual undisputed property rights and eventually give them thorough formal legitimacy support through multiple informal affirmations of definitional rules and conventions.

Of course, for the manager, the temporary, limited and uncertain nature of such clandestine operations as asset transfer may give rise to anxiety and feelings of guilt. He therefore demands that compensation for personal property rights may be publicized and legalized. Such demands may lead to another type of second contracts, which are often established formally and help the rights game between the nominal owners and the actual possessors "go from dark to light."

Here re-contracting usually arises from power inequality and leads to the redefinition of property rights. In Tang village's three-act reform, the transition toward joint stock ownership, adoption of the corporation system and privatization all established second contracts. By this time, establishing the second contract became the nominal owners' last resort for protecting their own rights.

## 2. "Corporation-run village" and withdrawal of village political organizations

The re-contracting process strengthened the corporation and the power balance tipped toward it. The "village-enterprise union" under collective ownership had thus smoothly transitioned from the "village-run enterprise" at the enterprise's founding to the "corporation-run village." Here the term "village-run enterprise" not only indicates to whom enterprise property rights belong, but also that the enterprise is run like a village. Conversely, the term "corporation-run village"<sup>2</sup> signifies not only

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<sup>2</sup> The "corporation-run village" is very common in local villages such as Tang village. In some villages, the corporation unified party, political and enterprise powers. The village committee usually became a subsidiary organization in the corporation, in charge of agriculture and village political affairs. Village treasury also became a secondary accounting unit in the corporation treasury. All expenses in village political affairs were presently reimbursed in cash by the enterprise. In some villages, the agricultural sector simply became an enterprise workshop or farm, whose production and management all followed enterprise management. In this sense, the village is an enterprise and exists in the form of the enterprise or the corporation.

that the village is run like a corporation, but also that enterprise property rights have been transferred to the corporation.

Within this model, achieving control by the corporation was the key step in changes and definitions of collective property rights. First, before the formal reform, through an unbalanced profit distribution between the employee stock-owners in the corporation and the nominal collective owner—the village collectivity, the employee stock-owners in the corporation had already acquired most of the profits. Second, through informal and actual possession and control, the corporation and its leaders acquired the power to define property rights during the formal reform.

These results actually testified to the village secretary also serving as board chairman's power over the village managerial structure. As the corporation economy became the life blood of the village economy, setting up the village secretary also serving as board chairman not only unified village and enterprise power, but also announced the corporation's acquisition of the village political organizations. The village collectivity had thereby lost its status and power as the overseer of collective assets and appeared weak.

We can see that the corporation's "Maidan, paying the bill" had two impacts on village governance. First, the village, as a lower-level institution, enjoyed a position similar to a corporation subsidiary, accepted the corporation's unified leadership, and thus lost its control over the corporation and thereby its ability to bargain with the corporation. Second, the corporation running the village was a welfare managerial strategy, whose main function was to decide between economic development for the corporation or welfare improvement for the community. It was also responsible for providing social welfare, but drawing from the welfare fund was not stipulated by contract or entitled to sharing in the surplus on the basis of the extent of property rights. In this process, the corporation's power over village affairs increased along with the increase in its welfare provision, whereas the village committee gradually evolved into the corporation collectivity's welfare execution organization. The faster the corporation economy grew, the more welfare resources the village committee could control. Within such an arrangement, new game strategies developed between the village committee and the corporation: As long as the corporation did not object to paying the expenses for "performing important tasks for the villagers," the village committee would not object to the corporation's acquisition of village governance and could even devise welfare strategies to avail as much of the corporation's profits as possible for distribution and sharing within the village. In other words, the lowest cost of "absentee village governance" exchanged for the greatest profit of "welfare improvement."

### **After-the-Event Definition: Squaring Up and Expression of Social Contracts**

#### **Contract's "Backward Calculation" Implication**

In defining village collective assets, Tang village employed "governance by the corporation" to first ensure itself a fixed  $\frac{1}{4}$  share in the total assets. When we expressed

doubt about this ratio, the corporation made clear that “this ratio was not picked randomly,” and the village government said that “they felt bad to ask more of the corporation.” Then each party used the same logic to calculate for us the reasonableness of the ratio.

The calculation started from the welfare needs of the village government and the community and thereby inferred the approximate amount of collective assets. It can be represented by the following formula:

$$\text{expenditure on public facilities} + \text{daily operational expenditures of the village government} + \text{welfare expenditure on the villagers} = \text{village collective assets}$$

This “backward calculation” first obtained a base number from the expenses needed for the village’s expected “performance of great tasks,” i.e., inauguration of large-scale public facilities, and then added daily operational expenditures and welfare expenditures, thus forming the basic structure for village assets. The bottom line in this calculation was to maintain and improve on the welfare level enjoyed by the villagers during the past 20 years of collective industrialization, which was the same as the bottom line for the social contract. It also represented the implicit conditions for the village committee and the villagers’ willing acceptance of the arrangement, which were the same the implicit content of the social contract.

Property rights defined through “backward calculation” clearly did not quite conform to the property rights arrangement logic as understood in economics. They did not define assets according to the ratio of profit enjoyment derived from ownership or rights over things, but calculated the asset’s amount and ownership based on the extent to which public welfare needs would be satisfied, and were thus conventional “welfare property rights.” The asset quantity under welfare property rights was actually related to the expectation for public welfare given by community reasonableness legitimacy and the villagers’ cognition of their share in enterprise profits. Industrial departments differed from the agricultural departments familiar to farmers, for they, while improving the villagers’ profits, also deprived them of the right to be informed about industrial activities. For the villagers, enterprise profits were an uncontrollable variable. The villagers therefore did not care about the upper limit that their profits could reach, but did have certain expectations of the bottom line, i.e., as long as enterprise management did not experience great difficulties, their welfare should be maintained at the historically optimal level and also experience yearly increases. Such expectations also referenced the optimal level in the region. Put another way, the conventional “welfare property rights” were the “ultimate contract” based on the community’s principle and logic of sharing and reciprocity.

This ultimate contract was clearly a social contract. Using the expressions of the contracting parties, it was a “debt-paying” historical contract and a “sentiment-paying” social contract. Afterwards the village secretary also serving as board chairman said, “This way I have not let down the village.” Here “debt” vaguely referred to “the village’s support in the past,” which should include letting him take advantage of the collectivity’s favorable treatment, acquire at no compensation the profits from land capital transfer, use low-cost labor, and possess not-yet-paid social security funds. Paying the historical debt through investment in public goods is currently

a common device in the village collective enterprise reforms of the southern Jiangsu region. Although the debt was not clearly calculated, this device both acknowledges the reasonableness of taking into account collective un-tangible assets during the reform and can prevent difficulties and embarrassments arising from possible suspension of the assets due to difficulties in accurate calculation. It therefore received the local government's support and the village cadres and villagers' approval. The above-mentioned arrangement could also be seen as a form of compensation for the villagers upon dissolution of collective ownership of industries. By establishing for the villagers a fiscal structure that could maintain and improve their welfare, the device was a relatively wise one that allowed the villagers to directly and permanently benefit.

**Institutional Entrepreneurs' Holding of Large amounts of Stocks  
and the Administrative Hierarchy based on Property Rights**

When Tang village transitioned toward the corporation system, it presented the following bottom line request—"the corporation should create collective net assets," a claim that can be seen as the manifesto of the corporation's control. Making clear that collective assets were to be created by the corporation was important for property rights definition, for it could serve as the basis for the corporation's claim to most assets and the power to draw up plans.

However, in the multiple definitions of property rights, the person actually wielding the definitional power was the leader of the corporation—the village secretary also serving as board chairman. A clear instance of "Power Defines Rights." His power derived from his characteristics, identity and capability as an institutional entrepreneur (Zhou 1997, 2002: 104). Here institutional entrepreneurs refer to entrepreneurs who have the double identity of being both a community political leader and an enterprise manager. Compared to ordinary entrepreneurs, they on the one hand have more convenient access to intra-institutional resources and on the other need to directly shoulder greater duties and responsibilities for the community (Zhe, Chen 2004).

In the village-run enterprises in such regions as southern Jiangsu, institutional entrepreneurs arise in two ways: First, "old village cadres" may directly start enterprises and serve in them. We thus have "party secretary also serving as board chairman" or "village head also serving as director." Second, village political organizations may take in experienced or otherwise successful village enterprise managers to enter village governance by giving them such positions as village secretary. Usually the village does not send additional village cadres into the enterprises. The purpose of such an arrangement is to give the enterprise managers a certain managerial autonomy and to cement a greater connection between the enterprises and community welfare, so that the community and the village government may benefit from the enterprises' success. Tang village employed the latter way.

The reason for institutional entrepreneurs' power in property rights arrangements is related to the administrative hierarchy contained within collective ownership. The power structure under collective ownership has as its basis power derived from administrative positions. In particular, the highest power within it combines administrative

and corporation positions. This means that property rights contain and are dependent on administrative power; power and wealth are closely related. This way, control over the corporation must be defined through administrative positions, i.e., political power. There are several implications: First, An individual can only qualify as a corporation legal person (or corporate) by occupying an administrative position as a representative of the collectivity. Second, control over the collective enterprises does not naturally belong to any member of the collectivity. Even capable managers or powerful persons can only obtain and exercise control over the enterprises or corporations by obtaining relevant positions within them. Third, within this institutional framework of property rights derived from administrative positions, the so-called property rights allocation does not base itself upon quantity of assets owned or managerial capability, but rather upon the magnitude of the administrative positional power. A hierarchical structure is thus formed. Moreover, privileges accompanying administrative positions, such as opportunities, income, benefits, housing, and others that can't be numbered, are naturally also allocated according to positions (Lin 1999). The institutional entrepreneurs' positional property rights stand at the very top of the hierarchy. Such is the institutional basis for collective property rights' eventual concentration in positions such as "party secretary also serving as board chairman."

If collective property rights may be allocated based on the hierarchical order of positions, they may also, when policy allows, be revoked through the same channel. Tang village relied on just this logic when, after "the withdrawal of village collective assets" and "the managers' holding of large amounts of stocks" had largely been accomplished, it decided to give 77% of its net assets to the corporation and, after repeated definitions, eventually transferred all of them to the highest-level manager and his children, thus achieving elite privatization. Here elite privatization refers to the privatization process that, through administrative definition and policy promotion, allocates the initial collective property rights on the basis of the magnitude of administrative positional power, forms the structure in which the managers hold large amounts of stocks, and eventually, by revoking scattered stock ownership, concentrates property rights in the hands of the power wielder and his family.

### Conclusion

Through our case study of a process in which collective property rights have experienced repeated definitions, we have suggested that collective property rights are actually social contracts established on the basis of social legitimacy. We have also explored such contracts' limited influence on defining property rights relationships. We have derived the following preliminary conclusions:

Reform clarifies property rights through privatization. To the question of whether such clarification is the key to enterprise reform, academia has already had the "property rights and market: which is more important?" debate. However, all parties to the debate first assume that both internal property rights clarification and external full market competition are the necessary conditions for enterprise reform, and only

differ on where to lay their emphasis. None of them has touched on the question of the ownership unit's internal capability to solve the question, e.g., whether the community's reciprocal principle, balancing mechanism and cooperative capability may also provide incentive or efficiency or even the keys to conflict resolution. In fact, a "reciprocal chain" formed from the principle and logic of reciprocity practically maintains the property rights order within the community. Before policies promoted reform, property rights were not the central or key community problem for villages, such as Tang village, which had highly developed collective ownership. In other words, the community may, through conventions and precedents, yield relatively satisfactory solutions to its property rights problem. On the other hand, if external forces seek to enforce from top down a uniform property rights solution, the balance may be broken and property rights problems may truly appear.

A social contract reflects a harmonious social order, but it is neither a consciously designed institution nor a natural expression of social relationships, but rather the product of the coordination of particular social interactions. As an informal institution and process, it exists symbiotically with such formal institutions as the "collective economy" policy and the "common prosperity" ideology. The relationship between the informal and formal institutions is close to the coexistence described by Scott (see Scott 2004/1998: 425): Policies and ideological language by themselves cannot establish a normally operating social order, for they are to a great extent dependent and even parasitic on informal social contracts. At the same time, without support from policies and the institutional environment, social contracts can hardly be created or maintained. Therefore, when the institutional environment changes drastically, social contracts' influence on property rights definition becomes very limited.

When market contracts are incomplete, social contracts may provide relatively satisfactory solutions to problems in internal cooperation and conflicts in property rights. They can also help maintain the bottom line for collective property rights, as can be seen from Tang village's reform experience. If, when promoting reform through administrative forces, one simply replaces the informal rule and logic of reciprocity with institutional designs, without giving sufficient consideration to the continuation or replacement of social contracts, one may bring severe problems to the sustainable development of the community. However, since these promises are embedded in the personified social relationship network between him and the community, as soon as such relationships are dissolved or interrupted, the continued restraining force of such character promises, which have no institutional guarantee, is quite questionable. By then, opportunist actions induced by the reform will inevitably occur. They constitute potential crises for Tang village and many other reformed villages and are one of the causes of recent years' increase in litigations over firing of employees and severe dystrophy of primary government finances. They are a serious social problem faced by the reform designers—local governments.

Given the social contractual nature of community collective ownership, its concomitant property rights are not market contractual in nature, but contain such social relationship components as "collective ownership by all members", "equal ownership" and "human rights." We therefore cannot treat collective property rights simply as an

economic problem. When dealing with collective property rights, one cannot just follow the logic of economic rights, but also the logic of social relationships. Otherwise, not only will it be impossible to truly resolve the shortcomings of collective ownership, but it will also be difficult to find a substitute plan that solves public problems and maintains community survival. Privatization is a process that forcefully excludes community members. After affirmation that collective property rights belong to the enterprise managers privately, if the problem of how to exclude the rights of the original property owners, i.e., all the villagers, is not fairly dealt with, the community will lose the capability for public accumulation and finance, a new public space will not be able to be constructed, members' public demands will not be able to be met, and, on the whole, the property rights arrangement and the social relationship network in which it is embedded will become disjointed, creating high costs for trying to recover old debts. As soon as public problems occur, community members' consensus about public property rights will change and pursuit and squaring up of the original public property rights will become a new difficulty.

When social contracts exist and function, a great many unreasonable actions within the village community may exist and be reasonably maintained, for property rights problems are adjusted and suppressed by the social contracts. For example, during the reform, the villagers' attention to protection of his employment rights far exceeded his care for whether and how many stocks he would own. Since the villagers considered themselves to possess the name of the collectivity, the questions they pursued were not how many profits the enterprises had made or whether their own portion had been reasonable, but whether their personal incomes and benefits had increased yearly and reached a relatively high level in the region. In property rights adjustments, what they cared about was not whether they themselves had any share in the enterprise assets, but whether they had received the incomes and benefits promised according to social rules. The villagers used the following logic to calculate their interests: They wanted to exchange land for non-agricultural opportunities, which could only be obtained through employment at the enterprise; thus, as long as their employment rights were protected, they would not oppose the reform. Their non-agricultural incomes could only be continuously obtained when the enterprise was guaranteed to profit; thus, as long as the enterprise profited and shared part of its profits in the form of welfare, they would not oppose the enterprise managers' private ownership of the enterprise. It was only when these two rights were threatened that they would again pursue and square up their rights as members of the collectivity and property rights problems would truly appear and intensify.

What remains worth mentioning is that, when social contracts are severely neglected, elite privatization will necessarily result. Some regions' reform policies designs employ the principle of rewarding enterprise managers with stocks. Approximately 20% of the employee reward fund may be given as a one-time reward in the form of stocks to managers who have made special contributions to enterprise development, but there is no effective device for protecting the property rights of most ordinary employees. The portion awarded to entrepreneurs by some local governments tends to expand beyond 25%, making it convenient for the managers to buy up

large- or medium-scale enterprises with good management records. Correspondingly, some entrepreneurs are constantly waiting for the opportunity to buy up the enterprise at the lowest price. Furthermore, since property rights can be allocated through the reform movement according to the administrative hierarchy, they may also be revoked from ordinary stock-owning employees and eventually concentrated in the power wielder and his family through the same channel according to policy. This way, while the enterprise owner is re-accumulating great wealth, ordinary villagers' relative and even absolute poverty will be difficult to prevent. Thus, polarization on the basis of property rights will become the important phenomenon in the stratification of Chinese society.

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