

An evaluation of the development of rural enterprises in China since 1978

by

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Key words

China

Central government

Public policy

Evaluation

The development of rural enterprises

Since 1978

Evolution

Financial and taxation policy

Management

Technology



Abstract

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The central government has attached great importance to the development of rural enterprises in China. As a result, rural enterprises have developed rapidly and become an important part of the national economy. The primary of my study is to examine how public policy has influenced the development of rural enterprises. The changes in public policy since 1978 did play a positive role in developing rural enterprises. These positive roles have been manifested in the ideological base of policy, financial and tax policies, improving management and technological strategy.



The objectives of the study were:

- To discuss the evolution of China's rural enterprises policy;
- To examine financial and taxation policies towards rural enterprises;
- To examine government policies on managerial improvements in rural enterprises;
- To examine government policies to promote technology in rural enterprises;

The study found that

- The government has provided a policy that encouraged the development of collective rural enterprises and has legalized both individual and private enterprises. These changes of policy have done much to promote the development

of rural enterprises.

- The government has provided collective rural enterprises with preferential treatment in terms of bank credit and tax rates, although state loans towards rural enterprises have decreased since late 1998 and tax burdens on rural enterprises gradually increased.
- The government has implemented the contractual responsibility system and a responsibility system for factory directors and also changed the payment system for labor and adopted a policy to promote the quality of production in rural enterprises. As a result, these policies have played a positive role in improving management in rural enterprises. .
- The government has emphasized the need to improve the technological level of rural enterprises since 1978. This policy and its implementation have important implications for technological progress in rural enterprises.



In sum, this study has demonstrated that changes in public policy since 1978 did play positive roles in promoting the development of rural enterprises, despite the change has been inadequate.

May 2005

Declaration

I declare that *An evaluation of the development of rural enterprises in China since 1978* is my own work, that is has not been submitted for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged by complete references.

Jingjing Li

May 2005

Signed:.....



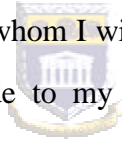
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Abbreviations

<i>ADR</i>	<i>Asian Development Review</i>
<i>AJCA</i>	<i>The Australian Journal of Chinese Affairs</i> (now called <i>The China Journal</i>)
<i>AS</i>	<i>Asian Survey</i>
<i>BR</i>	<i>Beijing Review</i>
<i>BYT</i>	<i>Banyue Tan</i> (Semi-Monthly Talks)
<i>CCP</i>	<i>Chinese Communist Party</i>
<i>CD</i>	<i>China Daily</i>
<i>CES</i>	<i>Chinese Economic Studies</i>
<i>CI</i>	<i>China Information</i>
<i>CJKS</i>	<i>Caijillg Kexue</i> (Science of Finance and Economics)
<i>CQ</i>	<i>The China Quarterly</i>
<i>CR</i>	<i>China Reconstructs</i>
<i>CT</i>	<i>China Today</i>
<i>DGB</i>	<i>Dagong Bao</i> (Dagong Daily)
<i>FBIS</i>	<i>Foreign Broadcast Information Service</i>
<i>FEER</i>	<i>Far Eastern Economic Review</i>
<i>GJMYWT</i>	<i>Guoji Maoyi Wenti</i> (Problems of International Trade)
<i>GNP</i>	<i>Gross National Product</i>
<i>GMRB</i>	<i>Guangming Ribao</i> (Guangming Daily)
<i>GSXZGL</i>	<i>Gollgshang Xingzheng Guallli</i> (Industry and Business Administration)
<i>ICM</i>	<i>Inside China Mainland</i>
<i>IS</i>	<i>Issues & studies</i>
<i>JCS</i>	<i>The Journal of Communist Studies</i> (now called <i>The Journal of Communist Studies and Transition Politics</i>)

JFRB *Jiefang Ribao* (Liberation Daily)

JJCK *Jingji Cankao* (Economic References)

JJGZTX *Jingji Gongzuo Tongxun* (Economic Work Bulletin)

JJYJCKZL *Jingji Yangjiu Cankao Ziliao* (Reference Material for Economic Studies)

JJWT *Jingji Wenti* (Economic Problems)

JJZB *Jingji Zhoubao* (Economy Weekly)

JJRB *Jingji Ribao* (Economic Daily) ,

JJYFL *Jingji Yu Falu* (Economy and Law)

JJYJ *Jingji Yanjiu* (Economic Research)

JPRS *Joint Publications Research Services*

JRSB *Jinrong Shibao* (Financial Times)

LW *Liaowang* (Outlook Weekly)

NCCWKJ *Nongcun Caiwu Kuaiji* (Rural Financial Accounting)

NCJR *Nongcun Jinrong* (Rural Finance)

NMRB *Nongmin Ribao* (Peasant Daily)

NPC *National People's Congress*

NYJJ *Nongye Jingji* (Agricultural Economy)

NYJJWT *Nongye Jingji Wenti* (Problems of Agricultural Economy)

NYKJYJ *Nongye Kuaiji Yanjiu* (Agricultural Accounting Research)

PC *Problems of Communism*

PRC *People's Republic of China*

QS *Qiushi* (Seeking Truth)

RMB *Renminbi*

RMRB *Renmin Ribao* (People's Daily)

SCRB *Sichuan Ribao* (Sichuan Daily)

SED *Small Enterprise Development*

SHKXDT *Shehui Kexue Dongtai* (Social Science Trends)

SHKXZX *Shehui Kexue Zhanxian* (Social Science Front)

SJJJDB *Shijie Jingji Daobao* (International Economic Herald)

SSIC *Social Sciences in China*

SWB/FE *Summary of World Broadcasts/Far East/Daily Report*

SWB/FE/W *Summary of World Broadcasts/Far East/Weekly Economic Report*

TE *The Economist*

XHYB *Xinhua Yuebao* (New China Monthly)



CHAPTER ONE

Introduction

The significance of the study

For many third world nations, the establishment of large industrial complexes has been seen as the key to laying the foundations for further economic development and the creation of a vibrant domestic economy. However, the evidence of recent years is that the expected economic growth has been slow in appearing. As a result, many development economists have increasingly turned their attention to the potential impact of emphasizing the development of small-scale enterprises.

This shift in emphasis has been reflected by the actions of many national governments. Some developing countries have intensified their measures to support and protect such enterprises. In contrast to the traditional large-scale complexes, small-scale enterprises are thought to have made significant contributions to the diffusion of skills and technology. These developments have been reflected by the growth in academic literature analyzing promotional policies adopted in developing countries for the development of small and medium scale industries.

Although large-scale state owned complexes still play an important role in the Chinese economy since 1978, rural enterprises have developed rapidly, and have become a major prop of the rural economy and an important part of the national economy. In 2001, there were more than 24 million rural enterprises nationwide. They turned out 9,946 billion yuan in output value, an amount equal to the nation's entire 1979 gross product (Han Baocheng, 2002, p.13). Those data indicate rural enterprises' important role in China's national economy.

The development of rural enterprises has changed the old economic structure that was largely dependent on farmland. The total output value of rural enterprises, as a proportion in rural society, increased from 31.4 percent in 1979 to 84 percent in 2001 (Han Baocheng, 2002, pp.13-22). Without the contribution from rural enterprises, the financial situation for education, health care and welfare facilities in many rural areas would have

been worse since local governments faced fiscal restraints.

The development of rural enterprises has contributed immensely to the phenomenal growth of the rural economy and improved living standards in China's rural areas. Furthermore, the development of rural enterprises has helped to change the traditional rural economic structure from one dominated by farming to a far more diversified economy.

The year 1978 marks a watershed in the study of the importance of rural enterprises for the Chinese economy. Before this date, the dominance of 'leftist' ideology and, equally as important, the disbanding of economic research institutes meant that no research on rural enterprises was undertaken within China. Outside China, some western scholars had undertaken research on China's rural enterprises. The main focus of those works was rural industry, the main part of rural enterprises. The important contribution to this field of study was *Rural Industrialization in China* by Jon Sigurdson (1977). He focused his analysis on county run enterprises. He examined rural industrialization within countries, giving some estimate of how well the programs worked.

The important article, named '*Small Industry and the Chinese Model of Development*' (Riskin, 1971, p245-273) is worthy of comment. It examined the evolution and implementation of China's policy towards small and medium industry. It was a valid approach at the time, but still was a limited application to this study.

Since 1978, Chinese rural enterprises have developed dramatically. Some Chinese scholars have undertaken research on the position and characteristics of rural enterprises. *The Development of Town and Township Enterprises in Mainland China Since 1978* (Chen Tesheng, 2002) is worthy of comment. It discussed the theoretical basis for promoting town and township enterprises, the evolution and characteristics of these enterprises, the reasons and measures for their development. Despite that the article represented valuable research into rural enterprises, the implications of other policy changes were not discussed. Policy analysis has also been inadequate.

The most important book on this subject is *China's Rural Industry: structure, Development, and Reform* (Bryd and Ling, 1999). It is the comprehensive study of China's township, village and private enterprises sector. However, there is still the limitation of the analysis of public policy in the research.

Therefore, as far as the literature reviewed above is concerned, research has tended to neglect the study of the impact of public policy on the development of rural enterprises. However, public policy has been extremely important in China since it has determined not only the extent to which rural enterprises have been developed, but also whether rural enterprises should be allowed to develop at all. Therefore, an analysis of changes of public policy since 1978 must be a crucial component of any analysis of the development of rural enterprises. In this study, I shall focus on policy changes towards the development of rural enterprises since 1978. The policies towards the development of rural enterprises, especially private enterprises, have been debated recently.

The definition of major concepts



One of the problems entailed in studying rural enterprises in China is that of defining what constitutes "rural enterprises". Before 1978, the definition of rural enterprise was much broader than that used in the era of reform.

Carl Riskin gave the following definition: "rural industries refer to those industries run by the rural communes and their production brigades and state industries at sub-provincial level, chiefly those operated by the hsien(country)"(Riskin,1978, p.77).

The definition of rural industry that most western scholars used before 1978 included not only collectively owned enterprises, but even those units wholly owned by the state.

Since 1978, rural enterprises have been used at various times in various Chinese journals, newspapers and official documents. The English language journal, *Beijing Review*, gave the following definition:" Township enterprises include industries which have been run by communes, production brigades and teams since the establishment of communes. They also included associations of enterprises set up by peasants in recent years,

enterprises jointly run by various rural economic sectors and individual enterprises”(Lu Yun, 1984, pp.18-19). Thus, rural enterprises and township and town enterprises were the same entities under different names.

For the convenience of my study, I follow the definition of rural enterprises adopted in the Chinese press. Rural enterprises include all factories and companies in industry, construction, transport, agriculture, commerce and catering which are operated by townships, villages and individuals. It is important to note that government policy towards rural enterprises is different in terms of ownership structures of rural enterprises. Therefore, in my research, rural enterprises are divided into the following two categories according to the ownership structures of rural enterprises.

The first category is those enterprises originally belonging to communes or large production teams, which now belong to agricultural cooperatives or integrated economic organizations. They all bear the clear mark of collective ownership status and are called “collective enterprises” in my study.



The second category comprises the private sector of rural enterprises. These enterprises can themselves be subdivided into two broad areas: private enterprises and individual enterprises. The term 'private enterprises' refers to those whose means of production were privately owned and with eight or more employees (XHYB, Vol6, 1988, p.75), as compared with the category of 'individual enterprises' meaning a business started with private funds with seven or less employees.

Most private enterprises are located in rural areas. The information in 2000 indicated that about 83 percent of the capital funds were located in rural areas. Over 80 per cent of private enterprises were based in the countryside (NMRB, 11 July 2001). Therefore, I shall analyze general policy towards private enterprises instead of towards rural private enterprises.

Research hypotheses

This study aims to demonstrate that the main stimulus for the extraordinary growth of rural enterprises since 1978 have been the removal of restrictions to their operations.

Although the introduction of special programs and incentives play a beneficial role, they only reinforce the proliferation of rural enterprises resulting from the removal of obstacles to their functioning. As such the main contribution of the reform era has been the creation of a political and economic environment conducive to the expansion of the number, type, and functions of rural enterprises.

After 1978, the ideological basis of decision-making began to change. At the risk of over simplification, the ascendancy to power of Deng Xiaoping marked a shift from 'politics in command' to 'economics in command'. In an attempt to 'catch up' with the industrialized nations of the West and the new industrial powers of Asia (Japan, the Republic of Korea, Taiwan, and Hong Kong), the social and political revolutions are essentially postponed.

As China is still a backward nation in the early stages of development, it is argued that the development of a modern industrial society has to occur before the transition to communism takes place. Expanding the productive forces therefore increasingly become the base line for any change in society. Whatever helps in economic development, including private and even foreign ownership of the means of production, should not only be tolerated, but actively encouraged. As this study will show, this change in the basic ideological orientation of Chinese decision-making has a profound impact on the expansion of rural enterprises, although developments have been far from trouble free.

Rural reform is the entry point of the reform program. In an effort to increase rural production, the household production responsibility system is introduced, rural markets are reopened and procurement prices are raised to improve incentives. Without these reforms, the increased agricultural output, rural savings, and rural surplus labor that are a precondition for the development of rural enterprises will not exist.

Although the removal of restrictions on the role and scope of rural enterprises has been the principal source of their expansion and development, the government has also implemented a number of specific policies aimed at facilitating further developments. These special programs are primarily targeted at the development of the collective sector

of rural enterprises, and have greatly contributed to growth in this area. However, the key element in the considerable growth of the private sector remains the simple tolerance of their existence by government which previously prohibited their existence.

The overall impact of these changes has been the creation of a more relaxed environment and more favorable conditions for the development of rural enterprise. As a result, rural enterprises have developed rapidly. As I have indicated in section one of this chapter, rural enterprises have become a major prop of the rural economy and an important part of the national economy. However, despite this phenomenal progress, the change of public policy has been inadequate, and many restrictions to the effective functioning of rural enterprises in China remain in place. The old economic structure has been only partially dismantled, and rural enterprises still face considerable discrimination. This is most clearly evident in official policy regarding access to raw materials and credits, where state owned enterprises receive preferential treatments. Rural enterprises have not enjoyed the same competitive position as state enterprises in many other areas such as product transport, retailing and the supply of key production elements. Rural enterprises cannot fulfill their true potential within the Chinese economy until these anomalies and restraints on operation are removed.

In addition, some of the special policies designed to facilitate the growth of rural enterprises has been inadequate. Perhaps the best example here is the preferential treatment accorded to rural enterprises in taxation policy, which has been gradually reduced.

Arguably the greatest challenge to the development of rural enterprises in China has been the fact that despite the dramatic and radical changes in the ideological basis of Chinese decision-making, some ideological and political problems still remain. Essentially, not everybody in the Chinese political system shares the belief that rural enterprises are a good thing. On a practical level, some critics have complained that the development of rural enterprises has affected agricultural production, and the development of rural

enterprises has polluted the environment. However, even the fundamental ideological question of the acceptability of rural enterprises has not been solved for all. Some conservative leaders have expressed concern that the existence and development of private enterprises could finally result in the restoration of capitalism, which could change the face of socialism and the nature of society in China. Some critics have also warned against the over rapid development of these enterprises, seeing them as a threat to state owned enterprises that would result in a widening disparity between the rich and the poor and between different regions. This suspicion of rural enterprises has been fuelled by accusations that rural enterprises, and especially private enterprises, have been the source of much corruption. These ideological and political problems have been an obstacle restraining rural enterprises' ability to make an even greater development.

Notwithstanding these problems, it should be recognized that both ideological and public policy changes have facilitated a dramatic and rapid expansion in the scope and importance of rural enterprises since 1978. Despite the obstacles that remain to their further expansion, the growing social and economic problems, such as rural unemployment, and the economic strength of rural enterprises have pushed against these constraints, and forced the leadership to further reform its public policy, and allowed rural enterprises to play an even greater role in the Chinese economy.

Research method and research plan

My study is primarily concerned with public policy analysis. There are many different definitions of public policy. For example, Eugene J. Kolb (1978, p.285) defined public policy as follows: 'Public policies constitute the expression of a political system's goals and the means with which it pursues them'. Thomas R. Dye (1992, p.2) defined public policy as 'whatever governments choose to do or not to do'. However, one thing is common in that if a policy is regarded as 'public policy' it must to some degree have been generated or at least processed within the framework of governmental procedures, influences and organizations (Hogwood and Gunn, 1984, p.24). Rod Hague, Martin

Harrop and Shaun Breslin (1992, p. 402) divided the policy process into the following stages: (1) initiation; (2) formulation; (3) implementation; (3) evaluation. Although the decision making process towards rural enterprises is a very interesting issue, the primary purpose of my study is to examine how public policy have influenced the development of rural enterprises. Therefore, my study will mainly deal with policy evaluation. Thomas R. Rye (1992, p.354) thought that 'Policy evaluation is learning about the consequences of public policy'. Peter Jones considered that the evaluation of public policy is concerned to assess the effectiveness and propriety of policy. The narrower approach is concerned to judge a policy only by standards 'internal' to the policy itself to deal with whether a policy succeeds in achieving its own aims, while the more comprehensive approach would invoke criteria 'external' to the policy, in other words, whether the aims to which a policy is committed are the right ones (Jones, 1992, pp.241-262).

The analysis in this study is primarily concerned with the different central government policies towards rural enterprises. I shall take a comprehensive approach to analyze China's government policy towards rural enterprises. First, I shall make an examination of the general and specific content of policies. Second, I shall examine the actual or potential consequences of policies, and their immediate and long-range impact on the development of rural enterprises as well as politics and society.

I will mainly use the information and documents from Chinese and English press. Party and state leadership speeches, documents and communiqués are also important. Since 1978, many journals and books in social sciences are published in China, while texts of government policies, and reaction to some policies are also published in national and local periodicals.

Moreover, at the end of April 1980, the PRC was accepted as a member of the International Monetary Fund (IMF) and the World Bank. As a result, some statistical information has been brought up to internationally acceptable standards.

In the coming chapters, I shall analyze how different policies have influenced the

development of rural enterprises since 1978. In Chapter Two, I shall discuss the evolution of China's rural enterprise policy. In Chapter Three, I shall analyze China's governmental financial and taxation policies towards rural enterprises. In Chapter Four, I shall examine government policies to improve management in rural enterprises. In Chapter Five, I shall examine China's government measures to promote technology in rural enterprises. In Chapter Six, I shall draw conclusion, and discuss the implications of China's experience for the former communist countries and developing countries.



CHAPTER TWO

The evolution of China's rural enterprise policy

In this chapter, I will explain the evolution of government policy for the development of rural enterprises. I am mainly concerned with the development of rural enterprises since 1978. But in order to explain the change in government policy for rural enterprises, a brief review of its pre-1978 policy is given. Rural enterprises include rural enterprises of both the collective and private sectors. China's policy towards the two sectors has been quite different. Thus, the policy analysis is divided into two parts: the collective sector of rural enterprises and the private sector of rural enterprises.

A brief review of China's policy towards collective rural enterprises before 1978

As early as the 1950s, shortly after the founding of the People's Republic of China, the attitude of China's leadership towards small scale enterprises was either to overlook them, in the haste to build heavy industry, or to focus more on the problem of freeing them from the control of petty capitalists (Kaplan, 1979, p.178). At that time, rural enterprises were underdeveloped.



China began to enunciate a small-scale industry development policy after the people's communes were set up throughout the country in 1958.

In addition, decentralization of industrial administration and control functions took place in 1957 and 1958. Small industrial activities throughout the countryside developed very rapidly.

However, during this period, in order to develop commune run enterprises, the property of the agricultural producers' cooperatives and their members were requisitioned without compensation (Qi Zong, 1982, p.481). In addition, the government also mistakenly promoted many technological processes for which there were no existing

small-scale options. Large quantities of resources were wasted (Kaplan, 1979, p.180). This kind of 'left' activity caused an agricultural crisis. In order to correct the mistake of depriving the peasants of their property, a policy of 'going bankrupt for repaying debts' was promoted. Therefore, many commune run enterprises were closed.

In 1962, the State stipulated that commune and production brigades were not to set up enterprises. As a result, by 1963, the gross output value of commune run industry had further reduced to 410 million yuan (Qi Zong, 1982, p481).

During the Cultural Revolution (1966 to 1976), China had adopted the Dazhai Production Brigade in Xiyang County, Shanxi Province as a model to develop agriculture. Private plots and domestic sideline occupations of the commune members were all eliminated as 'tails of capitalism'. Commune and brigade industries and sideline occupations were restricted and diversified undertakings strangled. Village fairs were banned. Economic exchange between town and country was stopped. These ultra-left practices associated with the Dazhai Model were promoted across the country, causing great damage to China's agriculture as well as the development of rural enterprises.

However, as Qi Zong indicated, these enterprises had a strong appeal and inspired a great vitality among the people, so they continued to develop (Qi Zong, 1982, p.482). In addition, China's rural areas began to launch factories to product: agricultural machinery and farm tools for agricultural mechanization during the later part of the Cultural Revolution. Meanwhile, some rural communities took advantage of market shortages because many urban plants had stopped work.

Therefore, it is clear that rural enterprises had expanded before 1978, though almost entirely in the collective sector of rural industrial enterprises. However, there were the following limitations of policy towards the development of rural enterprises before 1978.

First the attitude of China's leadership towards rural enterprises was to overlook them and to stress their role as the complementarities of agriculture and urban industry. Second the market was underdeveloped. It was very difficult for rural enterprises to buy raw materials in the market. Third, before 1978 China had very strict constraints on farmers engaging in non-agricultural occupations. It condemned 'businessmen' as people 'not engaged in honest work' or even as people 'taking the capitalist road'. Fourth, China did not allow the development of rural enterprises in the private sector. This also limited the development of rural enterprises.

Policy towards collective rural enterprises since 1978

The Maoist version of the centrally planned economy had failed to produce efficient economic growth and had caused China to fall far behind not only the industrialized nations of the West but also the new industrial powers of Asia: Japan, the Republic of Korea, Taiwan, and Hong Kong. In the late 1970s, China's citizens did not have sufficient food and clothing, adequate housing and service sector. Therefore, China's leaders realized that if the country was not to slide further behind its competitors in terms of economic development, policy changes had to take place.

In the historic Third Plenary Session of the Eleventh Central Committee of the CCP in

December 1978, the party leaders decided to undertake gradual but fundamental economic reforms. China's economic reforms could be in two main ways: the open door policy and rural reform policy. The open door policy has provided more opportunities for rural enterprises in China's coastal areas, to gain access to international markets. The most significant impacts of policy changes for rural enterprises came from rural reform.

The first step in reforming the rural sector is the introduction of the household production responsibility system. Under this system, the cooperative assigns specific plots of land to a family to cultivate for up to fifteen years. For each piece of land, the cooperatives specify the quantity of output that had to be delivered to procurement stations. Any surplus is for the household to dispose. Families can consume the surplus or sell it on rural markets. As a result, agricultural output increases rapidly, creating a solid base for the development of rural enterprises.

Second, the government has removed the constraints against farmers engaging in non-agricultural occupations, and has allowed a large number of rural people to go into non-agricultural occupations. Peasants are permitted to shift from crop cultivation to commercial, service, construction, and industrial activities in rural enterprises.

Third, reform policies also reduce major administrative barriers that limited labor and capital from moving beyond commune boundaries. Capital in rural areas was permitted to move across administrative boundaries, and individuals invest not only in their own farm production but also in business ventures outside their own villages. These policy changes have provided rural enterprises more chances to be concentrated in small towns and to cooperate with state enterprises.

In December 1978, the CCP's 11th Central Committee emphasized at its third plenary session the need to develop commune- and brigade- run enterprises. The Third Plenary

Session of the 11th Central Committee of the Communist Party of China pointed out in its' Decisions on Some Questions Concerning the Acceleration of Agricultural Development':

Under the principles of reason and economy, all agricultural and sideline products well-suited to being processed in rural areas should be increasingly produced by commune and brigade enterprises. Factories in the cities should, in a planned way, turn over those products or parts which can be processed in rural areas for processing by the commune and brigade enterprises, as well as lend support in equipment and guidance in technology (Ma Hung, 1982, p.140).

Therefore, China's leaders decided that urban enterprises could hand over to commune and brigade enterprises the production of those commodities where processing was suitable in rural areas. As we can see, although this policy change facilitated the expansion of the operations of existing rural enterprises, the CCP' was not yet prepared to legitimate the expansion of the non-state sector. At this stage, the notion that the communes and brigades should control affairs remained firm.

In order to reduce discrimination against commune and brigade enterprises, the State Council in 1981 issued 'Several Regulations on Commune and Brigade Enterprises in Implementing the Principle of National Economic Readjustment'. In this document, the importance of commune and brigade enterprises was reaffirmed. In 1983 the Center Committee of the CCP further issued 'Several Questions on Current Rural Economic Policies', and called for continuing to consolidate and develop commune and brigade enterprises (Byrd & Lin Qingsong, 1999, pp. 10-11).

After the household production responsibility system was successfully implemented in agriculture, China's leaders decided to introduce the contract system into commune and brigade enterprises In March 1983, a *People's daily* commentator (*RMRB*, 29 March 1983) called for local government to introduce the contract system into commune and brigade enterprises after he summarized the experiences of the Shangquiao Commune in

Xuancheng county, Anhui province. He argued that the contract system had enhanced the rationalization of the structure of business management and had changed the situation of stagnation in development; this system had been described as orientating the direction of management toward serving the society and market demand. He also thought that this system had systematized enterprise management, and combined responsibilities, power and profits so that enterprises had power to make management decisions.

1984 was a very important year for rural enterprises. The CCP Central Committee and the State Council issued a circular to transmit a 'Report on Creating a New Situation in Commune and Brigade Enterprises' by the Ministry of Agriculture, Animal Husbandry, and the Leading Party Group of the Ministry in March 1984 (Xinhua 17 March 1984, *SWB/FE*, 23 March 1984). It argued that China should use diversification as the strategic principle to utilize surplus labor in rural areas so that China could change the situation of having 800 million people producing food and gradually accumulate the large amounts of funds needed to modernize agriculture. In this report, village and town enterprises were considered as an important component of a diversified economy, an important pillar of agricultural production, an important way for the masses of peasants to achieve common prosperity, and an important source of state revenue.

During the early 1990s, rural enterprises played the role of making up for the deficiencies of large enterprises rather than competing with them. However, in the late 1990s, this relation changed, and rural enterprises began to compete with state enterprises for the supply of raw materials. The State's attitude has been to ensure the supply of raw materials to state enterprise, and to allow the remaining or newly increased raw materials to be processed by rural enterprises after state procurement quotas are met.

However, rural enterprises have more decision-making power in production and management. They could choose from a variety of flexible management methods according to market needs, arrange their own production, supply, and marketing activities, and budget funds retained for their own use (Liu Shiqiang. 1985, pp. 29-32). Rural

enterprises have other advantages which state enterprises lack: they have an ample supply of cheap labor, and the problem of enterprises, sites are comparatively easy to solve. The other is that rural enterprises have many more rights of autonomous decision-making. They are responsible for their profits or losses. Therefore, rural enterprises are more competitive than state enterprises.

In late 1993, overheating of the economy, inflation, widening income differential and corruption took place in China. This led to a period of economic austerity. Faced with an economic crisis and resistance from the conservative forces, rural enterprises became a main target of the economic austerity program. From 1993 to 1999, the government emphasized the key function to be played by state owned large and medium sized enterprises and adopted a policy where state enterprises were definitely favored in the acquisition of the capital, energy and raw materials. Rural enterprises faced a serious situation: capital funds were scarce, energy sources were insufficient, prices for raw materials went up, and the scope of market shrunk.

In late 1999, the political and economic situation was changed again. Some reform measures have taken place. 'Decision of the CCP Central Committee on Further Strengthening Agriculture and the Work in Rural Areas', adopted by the eighth plenary session of the 18th CCP Central Committee on 29th November 1999, indicated actively developing township and town enterprises was a way to develop rural economy, to increase peasants' income, and to speed up agricultural modernization and national economic development. This document called for carrying through the principle of giving active support to township and town enterprises, making plans for the reasonable development of these enterprises, providing correct guidance to them, and strengthening management of them (*SWB/FE*, 3 January 2000). '

In addition, some important policies have been formulated to encourage the development of rural enterprises. The State Council also issued a package of new policies to prop up rural enterprises, particularly in inland areas in early 2002 (Zhai Feng, 2002). These

measures are summarized as follows:

Firstly, local governments have been asked to set up development funds for rural industries, which usually got little investment from the state budget. State run banks increased loans to help successful rural firms with technological innovations. Key rural enterprises are given aid in term of credit, taxes, energy, raw materials, transportation and the employment of technologists.

Secondly, the government has taken further measures to promote technology in rural enterprises. The government allows successful rural enterprises to increase their depreciation rates in order to update facilities; and their key projects for improving technology can be listed in local economic plans.

Thirdly, the government adopts the measures to expand the scope of businesses for rural enterprises. Certain rural enterprises are granted rights to deal in foreign trade. The government no longer prohibits rural firms from engaging in wholesale and retail enterprises. The wide door was also opened in the service industry for rural enterprises.

Fourthly, the government adopts the measures to reduce financial burdens on rural enterprises. Rural enterprises are permitted to retain at least 60 per cent of after tax profits. Poor areas were given more help to develop rural enterprises.

These policies for rural enterprises show that the government continue to provide favorable financial, technological and management policies to promote the development of rural enterprises, and create more business opportunities for rural enterprises.

In summary, the central government has relaxed restrictions on the large-scale expansion of non-agricultural activities by rural communicates. Furthermore, the government has formulated some policies to encourage the development of collective rural enterprises since 1978.

Policy towards individual and private enterprises

A brief review of China's policy towards individual and private enterprises before 1978

The development of the private economy in China can be divided into the following

periods before 1978 (Ma Jisen, 1988).

The first period lasted from 1949 to 1953. During this period, the government allowed different sectors of the economy to coexist with the state run sector in the leading position. Individual businesses and private capitalist businesses were developed along with the recovery of the country's economy.

The second period was from 1953 to 1956. In 1953, China started to engage in the socialist industrialization and socialist transformation of agriculture, handicrafts, and capitalist industry and commerce. By the end of 1956, 95 per cent of small trades people joined cooperative groups, or took part in joint public-private and state owned enterprises; meanwhile, 96 per cent of individual industrial and commercial people joined handicraft production cooperatives or cooperative groups. The transformation left only about a hundred thousand individuals in industry and commerce who had not joined any cooperative (Ma Jisen, 1988).

The third period was from 1957 to 1965. A 14-grade taxation system based on progressive rates was introduced which taxed the individual businesses heavily, the highest tax rate being 86.8 percent (Ma Jisen, 1988). During this period, individual enterprises were still allowed to exist. However there was the nationwide campaign of setting up people's communes and the so-called socialist transformation of individual industry and commerce was again intensified. (Ma Jisen, 1988).

The fourth period was the ten years of the Cultural Revolution from 1966 to 1976, though it actually lasted until 1978. During the Cultural Revolution, individual economy was considered capitalistic and was practically eliminated. Most individual industry and commerce were banned or merged. The results were that state and collective industry and commerce monopolized everything.

By 1978, only 140,000 people were in individually owned undertakings throughout the vast country of China, and they were mostly small retailers and repairers (Ma Jisen, 1988). In summary, China's policy towards individual and private enterprises from 1949 to 1978

changed from tolerance to elimination.

Policy towards individual enterprises from 1978 to 1992

In 1979, the State decided to restore and develop individual industry and commerce. Under socialism, individual industry and commerce were considered a supplement to socialist industry and commerce.

The 1991 Constitution stipulated that: 'The individual economy of urban and rural working people, operated within the limits prescribed by law, is a complement to the socialist public economy. The State protects the lawful rights and interests of the individual economy' (BR, No.52, 27 December 1991). Thus, individual enterprises in China were accorded legal status again. When individual enterprises were allowed to develop, many of them employed more than eight employees. In the process, the delineation between 'individual' and 'private' became somewhat blurred. Many of these 'individual enterprises' formally became 'private enterprises' after their legalization in 1998. Thus, without formally tackling the question of whether private enterprises should be allowed to exist and develop, the changes in the 1991 Constitution facilitated the subsequent move towards official and legal acceptance of privately owned rural enterprises.

In February 2000, the State Council issued some regulations governing individual industry and commerce in rural areas in order to strengthen further the leadership, management and supervision over individual industry and commerce in rural areas (SWB/FE, 19 March 2000). The regulations stated that the development of individual industry and commerce rural areas would play a positive role in promoting commodity production in rural areas, stimulating exchanges of materials between urban and rural areas and putting rural surplus labor to multiple use.

However, under the influence of 'Leftist' ideology and policies, a few people in society still hold a prejudice against individual business operators because some individual businessmen evade taxes and often practice fraud and do not observe trade ethics by

harming the consumer's interests.

State policies toward the individual economy are unstable, and this places obvious pressure on individual business operators. In January 2001, the State Council promulgated its Provisional Regulations Regarding the Income Tax of Individually Owned Industrial and Commercial Establishments in Town and Country, which implemented a ten-bracket progressive income tax aimed to bring under control the high earning of individual businesses (Zhu Qingfang, 2001, pp.33-40). After paying taxes and administrative fees, individual business operators often have to pay many kinds of mandatory fees and contributions in the names of 'sponsoring' or 'raising funds'. Although some problems still remain, the State's policies towards individual enterprises are becoming more liberal.

Policy towards private enterprises since 1978

The first new private enterprises in China emerged in the late 1980s with the beginning of economic and political reforms. More than 80 per cent of private enterprises were based in the countryside. More than 70 per cent of these private enterprises were operating in more developed rural areas along the coast (CD, 15 April 1988). Most people working with the newly formed private enterprises were the surplus labor force in the wake of reforms in the rural economic structure.

A private economy used to be regarded as incompatible with the socialist system in China. According to Marxist-Leninist doctrines, ownership of all means of production in socialist countries should be vested in the State. Before 1988 private economy did not have a definite legal position in China. This can be seen in Article 5 of the 1978 Constitution of the People's Republic of China:

There are mainly two kinds of ownership of means or production in the People's Republic of China at the present stage: socialist ownership by the whole people and socialist collective ownership by the working people

Public opinion was divided on the treatment of private enterprises since they were

traditionally considered 'capitalist'. The most common complaint against the private economy was that entrepreneurs exploited their workers and created forms of labor capital relations which were incompatible with the Chinese socialist system. It was concluded that the private sector of the economy had distorted the economy and destroyed the national plan since some private enterprises engaged in speculation, price boosting, illicit purchase of raw materials, bribery and corruption involving government cadres and used underhand methods to obtain services from workers in government departments and state owned enterprises. There was also a concern in some areas that the development of private enterprises could lead to the development of social stratification; the rich becoming richer and the poor becoming poorer. Thus, it was suggested that the government should adopt a combination of administration and economic measures to tighten control over the development of private enterprise (Mo Zhen, 1986, pp.7-10).

Others who supported the development of the private economy held that it differed in nature from that which existed in the 1950s except for the private employment of workers. The private economy in the 1950s was a 'national capitalist' economy and signified the indigenous development of capitalism in China. In contrast, the private economy in 1980s served as a supplement to the State and collectively owned economies. Its supporters stressed its positive role in promoting the productive forces. They believed that China was in the primary stage of socialism, which was characterized by backward productive forces, reflecting the low degree of industrialization and underdevelopment of the market economy. In particular, the per capita GNP in China still ranked among the lowest in the world. Therefore, China had to focus on developing productive forces (Zhao Ziyang, 1987, p.13).

Although the Chinese Government officially believed that private enterprises inevitably led to the exploitation of laborers, a moderate development of this sector was considered positive in promoting production, providing employment, making people's life more comfortable and increasing state revenues. The authorities had for some time adopted an ambiguous attitude, while they had not taken the strong measures to prohibit the development of private enterprises.

At the 13th Communist Party Congress in October 1987, former Party General Secretary Zhao Ziyang set an authoritative tone on the controversial subject of private enterprises.

In his report, Zhao explained why it should be allowed to develop in China. He stressed that:

Public ownership should remain predominant in the primary stage of socialism. However, other sectors of the economy not under the ownership of the whole people are far from adequately developed. The cooperative individual, and private sectors of the economy in both urban and rural areas should be encouraged to expand (Zhao Ziyang, 1987. p.13).

Zhao also expected the government to 'formulate policies and enact laws governing the private sector as soon as possible, in order to protect its legitimate interests and to provide it with more effective guidance, supervision and control (Zhao Ziyang, 1987, p.13). It was the first time that the 'private sector' of the economy formed by private enterprises, had been named in an openly published party document as something positive. In adopting an ideological stance that formally accepted that private enterprise had a legitimate and even progressive role to play within a socialist society, Zhao laid the foundations for the legalization of private rural enterprises in the following year. As such, Zhao's speech marked a crucial change in the ideological orientation of China's economic affairs.

Subsequently, at the 7th NPC in April 1988, an amendment on the private economy was added to Article 11 of the Constitution:

The State permits privately owned economic entities to exist and develop within the limits prescribed by the law. The private economy is complement to the socialist public economy. The State protects the legitimate rights and interests of the private economy while providing the private sector with guidance, supervision and administrative regulation (XHYB. Vol4,1988, p.37).

For the first time, private enterprises were, in principle, accorded legal status in China. However, until then there has not been any significant elaboration of law or regulation for private enterprises. Lack of laws and regulations has caused problems and hampered further development of private enterprises. Some entrepreneurs feared that the

government would change its current policy of encouraging private enterprise. Some private firms have been found to engage in unlicensed dealing or tax evasion, to lack safety facilities or demand long working hours under poor working conditions. For example, an investigation by the Beijing Municipal People's Government in 1999 revealed that some employers did not have any medical insurance, and more than 80 per cent of employees did not enjoy any kind of medical welfare (of. *CD*, 22 April 19888, Lu Yan 2000, pp. 27-28). On the other hand, there have also been cases of infringement upon the legitimate rights of private enterprises. In many cases, private enterprises have been confronted with excessive tax demands or have experienced difficulty-obtaining permits to establish their enterprises.

Shortly after the 16th NPC in June 2001, the State Council issued the 'provisional regulations on private economy' and the 'Provisional Regulations on Income Tax of Private Enterprises'. They were the country's first two regulations on operation, management and income taxation for private enterprises.

Although the State has done much to protect the development of private enterprises to date, there is still some discrimination against them in access to loans, tax relief and supplies of materials in short supply. Shanxi provincial government made an investigation of 54 private enterprises. It revealed that these enterprises did not receive the same treatment from the authorities as the collectively owned enterprises. For example, they could not get enough raw materials and fuels, which they therefore had to buy at higher prices from the free market. The monthly interest rates on loans to state owned enterprises are also much lower than to private enterprises.

Since some people in power still believes that private institutions deviate from socialist ideals and should not be encouraged, some government departments tend to 'give special treatment to the collectives, slight the cooperatives, and to squeeze out the individual businesses' (*NYJJWT*, 2001, No.5, pp.58-59). The scope for private enterprises in general is officially restricted. For example, the regulations forbid private enterprises from

engaging in the military industry, and from dealing in specified goods under state protection and monopoly such as cultural relics, jewellery, automobiles and civilian explosives.

Even amongst those in the CCP leadership who favor the existence of private enterprises, there is still a belief that private enterprises should not be allowed unrestricted expansion even if it differs greatly from capitalism in capitalist societies. It has to be subordinated to the dominance of public ownership and subject to the guidance and restrictions of state policies as well as government decrees and regulations on taxation and loans.

In short, although private enterprises have acquired a legal status, they still face many difficulties and different forms of discrimination.

Conclusion

Before 1978, China's policy concerning rural enterprises had very much emphasized the development of commune and brigade enterprises, in particular, agricultural product processing enterprises. China's leaders overlooked them and only demanded them to complement agriculture and state enterprises. Furthermore, the market was then underdeveloped. The government also had tight constraints on farmers engaging in non-agricultural occupations, and prohibited the development of individual and private enterprises.

Since 1978, the most significant policy changes towards rural enterprises appeared to be as follows: First, policy changes permit peasants to engage in nonagricultural activities. In general, the central government provides a policy that encourages the development of collective rural enterprises. Second, the Chinese government has legalized both individual and private enterprises. The private sector of rural enterprises has been tolerated. These changes of policy have done much to promote the development of rural enterprises.

However, it is also recognized that although private enterprises have acquired a legal status, in particular, private enterprises still face many difficulties and different forms of discrimination. Similarly, there is still considerable discrimination against rural enterprises whether they are collective-run or

private-run enterprises such as in the supply of raw materials and credits, compared with the policy towards state owned enterprises. Moreover, the policy changes have been inadequate. Some political and ideological problems have still remained an obstacle restraining rural enterprises to make an even greater development.

In this chapter, I have discussed the evolution of China's central government policies towards rural enterprises.

Since 1978, the government has provided more preferential financial and taxation policies for rural enterprises. Thus, in the next chapter, I shall discuss China's government financial and taxation policies for rural enterprises.



CHAPTER THREE

Financial and taxation policies towards rural enterprises

In this chapter, I will examine the government financial and taxation policies towards rural enterprises. I will analyze these policies under the following headings. First I examine the state's financial policy towards rural enterprises and its implications. Secondly I discuss the state's tax policy towards rural enterprises.

Financial policy towards rural enterprises

It is estimated that 80 per cent of rural enterprises depend to a greater or lesser extent on bank loans. Roughly 20 per cent of rural enterprises depend entirely on bank loans to run their businesses. Among the entire nation's rural enterprises, operating fund loans account for approximately 50 per cent of total operating funds, and for an even higher percentage of fixed capital (Nan Bei, 1989,p.3). Therefore, financial policy towards rural enterprises is a very important factor which determines the extent of the development of rural enterprises.

Since 1978, the policy of granting credit to rural enterprises has been more liberal than before, but credit fund supply has been changeable. The information (*NYJJWT*, No.23, October 2003, pp.20-25) shows that growth of credit supply fluctuated greatly during the period 1979 to 2002. Fluctuations in aggregate credit occurred during three periods: From 1979 to 1984, following several years of rural enterprises readjustment, rural enterprises moved from an early development stage to a stage of rapid development. Credit was tightened from 1981 to the end of 1983, but eased in 1984. During this period, credit issuance peaked twice, the highest peak took place in 1984 when credit increased 108 per cent over that of 1983.

The Communist Party Central Committee's document no 1 for 1985 set out ten measures aimed at encouraging a market-oriented rural economy. This document further called for relaxing rural financial policies, raising returns on funds, and encouraging rural credit and insurance business. Local credit cooperatives were allowed to operate independently. The document said that the money they raised would be put at their disposal after they delivered a set amount of reserve funds to the Agricultural Bank of China. The term of loan repayment for equipment purchase was one to five years while for technological transformation of old enterprises, the repayment term was one to three years, and for overhauling of equipment, it was one year. The interest rate on loans was also reduced. The document stated that planning, supply, financial, banking and communications departments at all levels of government should let the township and village enterprises open accounts and give them guidance and support. Thus, credit supply rose greatly from 1986 to 1993.

However, the State Council handed down instructions to tighten finance and credit in an effort to stabilize currency and product prices, and therefore credit supply was tightened again in 1994. For enterprise managers trying to adapt to the rigors and demands of a newly emerging market economy, such fluctuations in government policy made the process of planning extremely difficult.

From late 1998 to 2002, Chinese conservative leadership dominated in China. Credit supply had shown a downward trend. In 1999, the increase in credit reached the lowest. Rural enterprises thus faced serious financial difficulty. The information shows that if the growth rate in 1999 for rural enterprises was assumed to be 15 per cent, that would demand at least 55 million yuan in operating funds. The state in practice only satisfied a small part of that sum (Nan Bei, 2003)

The retrenchment policy has particularly hit the expansion of newly opened enterprises. Many of the newly opened enterprises have to rely on bank credit for working capital. Retrenchment policy has caused a

considerable proportion of enterprises assets to be left idle.

The fluctuation in the total credit supply has been attributed to the following political and economic factors. First, rural enterprise policies have been inconsistent because of the struggle of conservatives and reformists within China's leadership. Some conservative leaders emphasize the development of state enterprises and adopt a policy to definitely incline state enterprises to acquire credit supply, energy and raw materials. In particular, when economic development overheats and market supply becomes tight, restriction of bank credit towards rural enterprises is imposed. Second, as Wang Xingchun (*NYJJWT*, No.23, October 2003, pp.20-25) demonstrated, credit supply was directly influenced by the agricultural harvest. In good harvest years, rural enterprises had a solid base and developed very rapidly. As soon as a lean harvest occurred, credit supply was directed to grain and cotton production. Third, China has only undertaken partial reform of the market. Market mechanisms for regulating and controlling the total volume of credit for rural enterprises have not fully been developed. The government mainly depends on the plan to control the supply of credit. Excessive control also results in large fluctuations of credit supply (*NYJJWT*, No.23, October 2003, pp.20-25).

Despite such disturbance from political and economic factors, financial policy towards rural enterprises is generally more liberal than before. In addition, the government establishes special funds for supporting rural enterprises. There are two sources of such supporting funds. As one source, rural enterprises are allowed to take 1 per cent out of their after-tax profits to be used by the administrative departments for rural enterprises. The other source of funding is the assistance from the financial department allocated for developing rural enterprises. Such funds are distributed through consultations between the local financial departments at various levels and the administrative departments for rural enterprises. The supporting funds are not gratuitous. There is a deadline for using such funds, and when this time period expires, the return of the unused funds is demanded so that they can be used over again on a constant, revolving basis. Accounts of

enterprise funds and financial assistance funds are required to be kept by the administrative departments for rural enterprises and by the financial departments concerned respectively (The Minister of Agriculture, Animal Husbandry and Fishery and the Ministry's Leading Party Group. (2003), *SWB/FE*, 26 March).

Loans for rural enterprises are mainly used as circulating capital, and as fixed capital formation, as repaying temporary loans and as meeting the higher prices of raw and semi-finished materials, energy, etc. To take 2002 as an example (*NCJR*, No 24, 16 December 2003, p. 1), the uses of loans were mainly as follows:

First, a very large portion of the loans was used as fixed capital. In 2002, the value of fixed assets of enterprises at the township and village levels in the country increased 34 billion yuan (*NCJR*, Beijing, No 24. 16 December 2003, p.1).

Second, a large amount of credit was used to help enterprises to repay temporary loans. In 2002, the enterprises' sales increased 44 per cent, fixed assets increased 59 per cent, and self-generated circulating funds increased 53 per cent. Credit extended to them as circulating funds increased only 4.8 billion yuan, or 22 per cent. To keep production and business operations going, rural enterprises, particularly those operating on a regular basis, were forced to raise funds by delaying wage payments or defaulting on loans. In 2002, rural enterprises owed workers and staff members more than 11 million yuan in back wages and defaulted on payments for goods totaling some 15 billion yuan. They had to borrow nearly 4 billion yuan from units and individuals. Most of these temporary loans were repaid out or their sales receipts normally used to buy raw and semi-finished materials.

Third, more loans were extended owing to market factors. Bank loans increased to meet the higher prices of raw and semi-finished materials, energy, etc. According to typical cases studied, about 20 per cent of the credit increase was caused by price rises. For example, the purchasing price of fresh tea leaves rose about 30 per cent, and the prices of feed and raw materials rose nearly 50 per cent. Owing to the state's strict control over the

scale of investment in fixed assets and other reasons in 2002, the building materials, machinery, and electrical industries were faced with a temporary overstocking of products, which also increased their needs for credit (*NCJR*, No 24,16 December 2003, p.1).

Thus, we can see that the policy of granting credit to rural enterprises is considerably liberalized. The more open access to the state's investment funds clearly creates a more favorable environment for the development of rural enterprises. However, the evolution of a credit system is far from unproblematic. Although access to investment capital is relatively easy at times, macro-economic retrenchment occurred on a number of occasions, and credit supply is reined in. During these periods of credit retraction, rural enterprises are particularly hard hit and round their access to funds severely reduced. In times of difficulty, the state returned to its discriminatory policies towards rural enterprises, instead favoring the more easily controllable state owned sector. Rural enterprise managers are thus unable to plan with any confidence that existing credit supply arrangements will stay in place, a factor which obstructs the even greater development of rural enterprises.

Taxation policy towards rural enterprises

In general, tax policy instruments were used to encourage the growth of collective rural enterprises. The rates of tax paid by the collective sector of rural enterprises had relatively been low. For example, in 1966, the rate of industrial and commercial income tax for commune and brigade enterprises was 20 per cent and the starting point of the levy was 600 *yuan* (Xu Shanda, 1987) In 1979, the starting point was raised to 3,000 *yuan*. Difficult enterprises run by communes and brigades in old revolutionary bases, minority inhabited areas, and border areas were allowed to enjoy tax reduction or remission for 5 years from 1979. If newly established rural enterprises run by communes or brigades had difficulties in their business operations in the initial stage, they were allowed to enjoy tax reduction or remission for 2 or 3 years (Xu Shanda. 1987). Thus, the

rate of industrial and commercial income tax for commune and brigade enterprises was considerably low.

The State Council promulgated some regulations concerning the readjustment of industrial and commercial taxes on enterprises run by rural communes and brigades and they became effective on 1 April 1981 (Xu Shanda, 1987). By this provision, taxes might be continuously reduced or exempted. In some cases this was designed to encourage the development of production by commune and brigade enterprises; for example, products directly serving agricultural production such as chemical fertilizers and pesticides and manufacturing or repairing farm implements. Rural enterprises were also allowed exemption from tax on their industrial and commercial income for two to three years after they were set up.

In 1984 the taxation system was further adjusted. The 'Provisions on Readjusting Industrial and Commercial Tax Rates on Rural Enterprises Run by Townships and Villages on Grass-roots Supply and Marketing Cooperatives' were put into effect from 1st January 1984 (Xu Shanda, 1987). These provisions include the following main points:

As of 1982, the 20 per cent proportional tax rate of the industrial and commercial income tax which rural enterprises paid was gradually changed to the eight-grade progressive tax rate (Mo Tiansong, 1985, pp.31-32). The eight grade progressive tax rate was implemented in 1982 only on rural enterprises in the suburbs and small towns under county jurisdiction which produced 20 products, including cigarettes, wine and sugar. Only by 1984 was this extended. The purpose of this change was to address the unbalanced development of rural enterprises as well as to legislate a rational tax burden. Industrial and commercial income taxes were levied on all rural enterprises run by communes and brigades according to the eight grade progressive rates with specified minimum rates. The proportional tax rate of 20 per cent was repealed (Mo Tiansong, 1985, pp.31-32).

The eight grade progressive tax rate was different from the proportional tax rate, which

was suitable for an enterprise with a smaller income. Correspondingly, a higher tax rate was imposed on an enterprise with a higher income. Thus, taxation corresponds to the profit obtained by an enterprise as well as its ability to shoulder the tax burden. This produced some shift of the tax burden to those enterprises with greater profits and those localities where rural enterprises had developed relatively rapidly together with some shift of the tax burden from those enterprises with smaller profits and localities where rural enterprises had developed relatively slowly. However, in overall terms, the change in the tax burden of rural enterprises was slight (Mo Tiansong, 1985, pp.31-32)

In 1978, rural enterprise profits totalled 9.55 billion yuan, with 640 million yuan of income tax. The effective rate of tax burden was 6.7 per cent (Mo Tiansong, 1985, pp.31-32). In 1983, the state used the eight-grade progressive tax rate to configure the income tax for rural enterprises in the suburbs of large cities and small towns under county jurisdiction. Although the actual burden had increased to 11.49 per cent, compared with 38.13 per cent for the collective enterprises under urban No 2 light industrial system in 1983, this burden was still light (Mo Tiansong, 1985, pp.31-32).

In addition, tax policy towards rural enterprises was ambiguous. For example, as for some special enterprises which needed further tax reductions or remissions, local governments in various provinces, autonomous regions and municipalities could handle their cases according to the following provisions: First, if newly established rural enterprises run by townships or villages had difficulties in their business operations in the initial stage, they could be given a year tax grace period; Second, if enterprises which engaged in the primary processing of agricultural products, small scale hydraulic or thermal power generation, or mining industry found it difficult to pay industrial and commercial taxes, reduced taxes could be imposed on them within a set period (Xu Shanda, 1987). In addition, when townships and villages were hit by natural disasters, industrial and commercial income taxes on rural enterprises could be reduced or remitted within a certain period. Difficult enterprises run by townships and villages in old

revolutionary bases, minority inhabited areas, and bonier areas were allowed to enjoy tax reduction or remission (Xu Shanda, 1987, pp.16-20).

Therefore, some local governments had used this ambiguity in tax policy to develop their own strategies towards rural enterprises. They had unilaterally reduced and even exempted income tax on rural enterprises if this measure best suited their own local fiscal interest. My own observation of the situation in China confirms that this practice was widely spread in some counties.

After the issuance in April 1985 of the Provisional Income Tax Regulations Governing Collective Enterprises, a system of eight grade progressive taxation was adopted for all collective enterprises (of. *RMRB*, 20 April 1985, Chen Tesheng, 1986). Under this system the lowest grade was 1,000 yuan, the tax rate on which was 10 per cent, and the highest grade was 200,000 yuan, the tax rate on which was 55 per cent. Newly established township and town enterprises were exempted from paying income tax during a fixed period. Some enterprises which still experienced difficulties after the expiration of the term could continue to enjoy tax exemption or reduction during another fixed period. Spending by a township and town enterprise on public welfare could be listed as expenditure and was entitled to tax exemption, but the total amount was limited to only 10 per cent of its total profit (*Chinese Economic Yearbook, 1985, Sec10, p.11*)

Therefore, from the above detail it is clear that the state had adopted preferential tax policies with tax reduction or tax exemption measures for collective rural enterprises (township and village owned enterprises) This had undoubtedly played a positive role in the development of rural enterprises. However, tax rates for collective rural enterprises had gradually increased. There had been other tax regulations which had discriminated against rural enterprises For example, no reduction and remission of industrial and commercial income taxes had been allowed for rural enterprises and other enterprises winch competed with large-scale industrial enterprises for raw materials On the one hand, local governments had exercised the power to reduce and even exempt from income tax

on rural enterprises for local interests, whilst on the other, the shortage of fiscal income in local communities and local government funds for welfare work and agricultural funds had also led to the problem of local government exacting a large percentage of profit, collecting excessive charges.

Moreover, China's taxation system had worked in accordance with a commercial ownership type of tax appraisal and collection system, and favored state owned and collectively owned enterprises over private enterprises. Before June 1998 state owned enterprises fitted into the 55 per cent tax rate bracket. Collective enterprises were adjusted at eight-grade progressive tax bracket where the highest tax rate was only 55 per cent. Individual industrial and commercial firms along with private enterprises had been placed in the tenth grade of progressive tax rates where the highest actual tax rate could be up to 84 per cent. This progressive tax system, administered to the individual industrial and commercial enterprise established in the 1960s was enacted in order to restrict and reform these two sections. This tax system had the following effects. First large numbers of private enterprises committed tax evasion. According to a conducted by the State Tax Bureau, more than 80 per cent of all individually owned industrial and commercial businesses were guilty of tax evasion. In 1988, taxes worth 7 billion yuan were collected from such businesses; but it was estimated that an equal amount was not paid (*BR*, 7-13 August 1989). One informant, engaged in conducting surveys on Shanghai's self-employed, stated that:

Official tax rates, as well as local 'fees' are often calculated at artificially high levels since the expectation is that everyone is underreporting. Therefore, those who are completely honest will find it difficult to remain in business. Self-employed businessmen of necessity commonly raise prices seeming arbitrarily -- to cover these costs (Rosen, 1987, pp.7-8).

Secondly, faced with mounting tax bills, some private enterprises found it more profitable to reduce production and seek to re-register as 'individually owned enterprises' rather than

maintain production and pay the higher tax rate. Thus, continuing to use a 1960s policy of levying high taxes eventually hampered development in the private sector.

In June 1998 the State Council published new tax regulations for private enterprises. In the new regulations, private enterprises have to pay 35 per cent income tax and to use at least 50 per cent of their after-tax profits for production expansion. A 40 per cent personal income tax is levied on the amount private enterprises spent on personal living costs (Nie Lisheng, 1998). New tax regulations try to offer tax incentives to enterprise expansion and investment of profits. However, private enterprises still suffer from the arbitrary collection of other fees and duties by local government. A private entrepreneur complained that: 'At present, I have to pay 11 kinds of taxes and duties such as business tax, income tax, and taxes for education, construction, real estate, land use as well as industrial and commercial consolidated duties. To be frank, I am taxed too much' (*HR*, 27 February - 5 March 2000, pp. 19-22). A number of private enterprises have not been able to bear the burden and have to close down.

In summary, the extension of preferential fiscal policies towards rural enterprises has been one of the main central policies aimed at facilitating the development of rural enterprises. However, despite initially providing a great help for rural enterprises, taxation rates have gradually increased. Rural enterprises have thus fallen foul of the increasing budgetary pressures on central (and local) government. Although the need to increase state finances is a very real one, it is notable that the further expansion of the rural enterprise sector has certainly not been aided by this move. Given the massive potential long-term benefits that rural enterprises could bring to the Chinese economy, the reduction of tax benefits marks the triumph of short-term considerations over long-term strategy. Indeed, in almost all respects, the development of the rural enterprise sector has been obstructed by short-termism in central government policy making.

Furthermore, although the collective sector has done relatively well from preferential tax policy, private enterprises are actually penalized by the fiscal system, paying very high

taxation rates. This uneven policy has two major effects. Firstly, the expansion of the private sector has obviously been obstructed. Secondly, many private enterprises have officially registered as collective or individually owned.

Conclusion

Since 1978, China has used diversification as the strategic principle to develop agricultural economy. Rural enterprises are considered as an important component of a diversified economy, and an important source of state revenue. The government has provided more favorable tax and financial treatment for rural enterprises. As a result, financial and tax policies have provided more favorable financial condition for the development of rural enterprises.

However, tax rates for rural enterprises gradually increase. China's taxation system has still favored collectively owned rural enterprises over private rural enterprises. In particular, credit supply fluctuated greatly during the 1980s and early 1990s. As a result, this has greatly affected the development of rural enterprises. In particular, from late 1998 to 2002, a retrenchment policy had been implemented, the government reduced loans for rural enterprises. Tightening financial policy has produced serious financial difficulty for rural enterprises.

Since 1978, China has adopted some policies to improve management in rural enterprises. In the next chapter, I shall discuss how these government policies have influenced management in rural enterprises.

CHAPTER FOUR

Government policies to improve management in rural enterprises

In Chapter four, I will examine the effects of government policy on the management of rural enterprises. Many problems in the management of rural enterprises not only exist but also are very serious. In general, management skills in rural enterprises are rather low. Many rural enterprises dropped out of market competition and went bankrupt or closed, and although there are many reasons for this, one of the main reasons is poor management. Therefore, the management of rural enterprises is an important issue. However, the issue of management is a very broad one. In this chapter, I shall mainly concentrate on analyzing local government's role in the management of rural enterprises and the way in which some government policies influenced the management of rural enterprises. In doing so, first, I shall examine the administrative management exercised by township and village governments. Secondly, I shall deal with some government policies towards income distribution in rural enterprises. Finally, I shall analyze the government policy of promoting the quality of production in rural enterprises.

Administrative management systems of rural enterprises

In China the owners of state enterprises belong to all the people. The owners of rural enterprises can be divided into two general categories: town and village governments, and private entrepreneurs. In the state owned enterprises the responsibility for the profits of the assets as well as far risks of the investment of the enterprises is unclear. The loss in state enterprises is often ultimately shifted to the whole or society. However, rural enterprises bear more clear responsibility for the profits of their assets and for the risks involved. The profits and risks of the assets of rural enterprises, especially the investment risks, have to be borne by the members of the villages, townships or individuals.

Since the ownership structures in rural enterprises are different, their administrative

management structures also take on different forms. For example, the assets in private rural enterprises belong to private entrepreneurs, accordingly township and village governments have only indirect control over their management structure. By contrast, in traditional collective rural enterprises, township and village governments share in both rights of ownership and administrative management. Fiscal revenues of townships and villages come largely from rural enterprises in the form of profit remittances and management fees. The profit handed over by township enterprises in sample counties constitutes more than 38 per cent of township government revenues, while remittances by township enterprises accounted for 43.6 per cent of township revenues and tax payments by enterprises under other forms of township for 14.3 per cent (Song Lian, and Du He, 2002, p.349). Therefore, the income from rural enterprises is a very important source of fiscal revenue of township and village governments.

In addition, William A. Byrd and Alan Gelb's research (2002, pp. 370-376) demonstrated that township and village leaders have personal financial incentives to develop rural enterprises. Personal benefits for township and village leaders are associated with rural enterprise development. First, community leaders' pay varies significantly with the degree of TVP (township, village, private enterprises) development in the community, and this variation is greater for villages and production teams than for townships and towns. Secondly, in the more developed areas or rural enterprises more funds are available for consumption of community government or enterprise resources from cigarettes to banquets to housing construction. Thus, undoubtedly these personal benefits are another incentive for township and village leaders to promote the development of rural enterprises.

The development of rural enterprises, especially collective rural enterprises, is very important for the fiscal incomes of township and village governments as well as for the personal incomes and rewards. William A. Byrd and Alan Gelb (2002, p.376) pointed out, 'Despite the variation in personal incentives for community government leaders among

regions and localities and among community levels, it is clear that everywhere and under almost any circumstance community government leaders have strong incentives to develop the TVP sector (township, village, and private enterprise)'.

Township and village governments have actively aided and supported township enterprises in finance and technology. Of the township governments surveyed (Du Haiyan, 2002, pp.21-32), 73.0 per cent helped enterprises resolve problems with finances and 58.7 per cent provided firms with technological consulting and training. Township and village government run enterprises are the major beneficiaries of this assistance. Song Lina and Du He (2002, pp.342-357) showed that some preferential treatments were given to rural enterprises by township governments. For example, in some cases, township governments have been able to secure for their enterprises some materials that are in short supply. Moreover, the initial capital of rural enterprise largely came from state loans. With the help of local governments, rural enterprises can obtain preferential treatments from banks, industrial and commercial administrative bureaus, and tax and supply departments. Furthermore, local government can help rural enterprise to raise some funds from society in general in order to overcome the shortage of funds in rural enterprises.

However, township and village governments also exercise tight control over rural enterprises, especially township run enterprises and village run enterprises. For example, village and township governments take part in decisions for the selection of township enterprise managers. Township and village government are also directly involved in township enterprises management such as investment, planning, wage levels (Song Lina and Du He, 2002, pp.342-357). This enables local government in some areas to extract excessive profits from rural enterprises, and it becomes clear that some rural enterprises have very low rates of efficiency. As a result, the Chinese government took measures to improve the situation. The main reform took place in traditional collective rural enterprises which are under the direct administrative control of township or village

authorities. The main reform aim is to separate government and enterprises and to reduce interference from township and village governments and thereby to increase the efficiency. Reforms however are based on no fundamental change in the status of collective ownership. The main reform measure is to implement the system of contractual responsibility.

Under this contractual responsibility system, all enterprises are contracted to managers, directors, workshops, production groups or to the entire staff. The contractor has decision-making rights over the manpower, finance and materials of the enterprise as well as over its production, marketing and sales. The contractor is still only the manager of the enterprise, not its owner; contracted responsibility does not entail a transfer of ownership.

Although management and business decisions have largely been left to enterprise directors, community governments are still intimately involved in important decisions such as investments, the establishment or dismantling of firms, significant changes in product lines, the appointment of enterprise management, managerial compensation, and bonuses. Community governments can also absorb risk for rural community enterprises and can finance investments. More generally, they still regard their collective enterprises as hostile administrative agents. Therefore, although traditional collective rural enterprises have gained more powers after implementing the contract system, township and village governments still deeply control township and village enterprises.

The assets of private rural enterprises belong to private entrepreneurs. Thus, township and village governments have less control over private rural enterprises than over collective rural enterprises, though as a result private rural enterprises can obtain less preferential treatment than collective rural enterprises. However, it is still vital for private rural enterprises to have close relations with local officials since private enterprises still face a discriminating environment.

Two surveys of private rural enterprises reveal that there is a close relation between local

officials and private entrepreneurs. In the first survey (Liu Xiaojing, 2003, p.40), private entrepreneurs in the countryside are divided into the following types according to former occupation: (1) cadres, including the heads of Village Committees, secretaries of Village CCP Committees; (2) former supply and marketing staff in commune and brigade enterprises; (3) retired cadres or former workers or technicians and ordinary urban residents; (4) former specialized households; (5) ex-criminals. The information (Liu Xiaojing, 2003, p41) showed that the enterprises operated by entrepreneurs of the second, third and fifth category were the largest among private rural enterprises. Enterprises operated by the 'cadre' entrepreneurs type are not as large, but still rank above the average size. The size of the enterprises operated by ordinary farmers operated is below average. This is due to the fact that most ordinary farmers lacked good functional and social linkages in economics and politics.

The other survey (NYJJWT. No.2, 2003, pp.18-23) also shows that most entrepreneurs of private rural enterprises have special prior experience. Before starting their enterprises, 10.3 per cent have worked in state enterprises, undertakings or departments of government, 11.3 per cent have been servicemen, 7.2 per cent have been teachers, 18.6per cent have served as supply and marketing staff or as managers in township and village enterprises, and 17.5 per cent have been village cadres. These findings showed that there was a close relation between local cadres and private entrepreneurs. As a result, private enterprises are also subject to township and village government's influence. For example, all private rural enterprises need permission from the community government in order to acquire land, buildings and bank loans. Close personal relationships with community government officials are thus necessary for private enterprises, if they are to flourish.

Therefore, township and village governments are equally important for both private and collective rural enterprises. William A. Byrd and Alan Gelb indicated that 'without the deep involvement of community governments, China's TVP sector could not have grown

nearly as rapidly as it did from 1970s to 1990s' (Byrd and Gelb, 2002, p.359). Township and village governments have dual rights of ownership and management in the traditional collective rural enterprises. The protection of rural enterprises by local government is essential. However, the problem remained of how to prevent excessive levies on rural enterprises imposed by township and Village governments.

Some government measures to improve the income distribution of rural enterprises

The reform of the wage system in rural enterprises

The older method of payment was a work point and bonus system. Workers' incomes related to the average income levels of the teams from which the workers came. Enterprises calculated in work points, which were then converted to a money wage according to the work point value of their team. However, since their income did not relate to their individual performance, workers in rural enterprises did not have much incentive to work hard.



Starting from 1978, the payment system for labor in rural enterprises has been changed. Since the ownership systems of rural enterprises are different and their profitability varies, different rural enterprises have adopted different wage systems. The essence of wage system reform in rural enterprises is to find a system that mobilize worker initiative in production, improve labor productivity, and facilitate production development. Bao Weihuo 's research (2001, pp.26-28) shows that the following five wage forms are used in rural enterprises: the piece rate wage system, the time wage system, the contracting wage system, the profit sharing system, the floating wage system.

Within any particular enterprise, it is common for one major wage system to be used in combination with and supplemented by others. Generally speaking, rural enterprises have shifted to the direct payment of workers, and performance based pay. These provide an incentive for work and have improved efficiency in rural enterprises.

Because there have been no unified national system governing income distribution in

township and town enterprises, the level of wages in rural enterprises has varied considerably. On average, however, the average wage level in rural enterprises generally is higher than that in agriculture. Although persons engaged in agriculture have greater opportunities to supplement their income from private sideline occupations, even so it is clear that in general rural enterprises pay their workers more than can be earned by farmers. Within rural enterprises, wages of sales staff, technicians and directors are higher than those of workers.

The structure of incomes in China in rural enterprises mainly arises out of wages. However, recent years some forms of income that are not work-related, such as interest on capital, has produced differential benefits. These forms of income mainly exist in rural private enterprises, and have resulted in a widening of income differential within rural enterprises, especially in private rural enterprises.

No exact statistics are available for the differential of income within the rural private sector, but it was known that some entrepreneurs become billionaires (RMB). The income earned by employers and employees in private enterprises also differs widely. An investigation by Beijing's local government in 2003 revealed that the average monthly salary of employers is 18 times that of employees. In general, therefore, China's entrepreneurs in private rural enterprises sector earn much more than employees in collective rural enterprises; some are among the wealthiest in China.

In sum, since 1978, the wage systems in rural enterprises have been changed to give workers a much greater incentive to work. In general rural enterprises pay their workers more than can be earned by farmers. Wages of sales staff, technicians and directors are higher than those of workers. Income differentials in private rural enterprises are much higher than in collective rural enterprises. Private entrepreneurs earn much more than employees of private and collective rural enterprises.

The reform of profit distribution in rural enterprises

Many problems in profit distribution in rural enterprises exist, and some of these

problems are very serious. The main problems are as follows: the extraction by local governments of a large percentage of profit, collecting excessive charges, apportioning numerous expenses, and allowing township and town enterprises to retain little profit. An investigation of 97 rural enterprises (NMRB. 13 November 2003, p.2) showed that in the first half of 2002, the enterprises paid a total of 5.047 million yuan in various charges and apportionment, which accounted for 23 per cent of their sales profits. Moreover, these enterprises paid a total of 1.325 million yuan in unlawful charges, accounting for 7.1 per cent of their sales profit (NMRB. 13 November 2003, p.2).

The shortage of local government funds is the main reason for local government exacting a large percentage of profit and collecting excessive charges, Since 1978, there have been an increase in local government's expenditures on rural education, health, family planning, subsidies for military recruitment, and subsidies for households with difficulties, old-age homes, and other social welfare activities. This high level of social expenditure has led to encroachments on a large portion of rural enterprises profits.

William A. Byrd and Alan Gelb (2002, pp. 376-379) found that the problem of fiscal predation was more serious in backward areas than in well-endowed areas.

The reasons are as follows: first, in better-off areas there is a strong base of existing community enterprises, and so most community governments are in a relatively comfortable financial situation. Secondly, these areas have more personal incomes and bank deposits which can be used for loans to rural enterprises. As a result, more funds are available for reinvestment to develop rural enterprises. By contrast, in backward areas the development of rural enterprises is much more limited. The difficult financial situation of community governments make them draw funds from community enterprises for public expenditures regardless of the enterprises' profitability and ability to pay. Even when firms are losing money, they still have to make payments to community governments in order to meet urgent and largely fixed public expenditure needs.

Due to the lack of unified standards for profit distribution, practice differs widely from

place to place. For example, the Beijing Municipal Region has stipulated that township and town enterprise profits are distributed according to a '4:3:3' ratio. The enterprise retains 40 per cent, hands in 30 per cent to township government (or village government) to be used primarily for the support of agriculture, and delivers the remaining 30 per cent to the township or village economic organizations to be used to expand production or build new enterprises (Bao Weihe, 2002, pp.20-22). In Simen Town, Yutao City, Zhejiang Province, a regulation is adopted using a 'double 3-7' ratio in the distribution of after-tax township and town profit, in which 70 per cent of after-tax profits is retained by the enterprises for use in expanded production and 30 per cent is given over to the town industrial bureau. Of the profit hands in, 70 per cent is retained by the bureau to use in supporting the renovation of older enterprises and the building of new township and town enterprises, while 30 per cent is given to the town government to use in the construction of small market towns and other expenditures of a social (Bao Weihe, 2002, pp.20-22).

Pertaining to the problem of township enterprises' heavy social burden, low profit retention, and other problems, the State Economic Commission's agriculture, animal husbandry, and fishery departments jointly issued a circular entitled 'Several Suggestions on the Question of Township Enterprises' Profit Distributions' (*NMRB*, 22 December 2003, p.1). Enterprises should be allowed to retain a minimum of 60 per cent of the net profits. Village and township leaders should respect the right of the enterprises to operate their businesses and utilize their funds autonomously. Enterprises should have the right to reject equalitarianism and indiscriminate transfer of resources or unreasonable apportionment. However, the community's or the region's economic interests undermine the authority of the central government and effectiveness of its functioning departments. Since most township and village governments have the shortage of funds, the pressure on them to extract excessive funds from rural enterprises is immense.

Some scholars have provided some good suggestions to prevent fiscal predation by township and village governments. William A. Byrd and Alan Gelb (2002, p.386)

suggested that the size of community government and the number of cadres should be reduced to correspond better with local community resources, and that some expenditures on activities such as primary education which are important to national objectives should be included in the state budget. These are indeed good suggestions. However, China's agricultural investment from central government is still limited, and this means that local governments require rural enterprises to turn over a large portion of funds from their profits for the development of agriculture (Zhang Xiaoli and Liu Yaguang, 2001, p.2). In addition, China's state budget itself requires the turning over of a huge portion of funds from the profits of rural enterprises. Therefore, although China's central government has formulated some measures to reduce the financial burden of rural enterprises, some problems of profit distribution still remain in rural enterprises.

Government policy towards product quality of rural enterprises

In general, product quality of rural enterprises is low. According to an investigation in some township and town enterprises in Jiangsu and Shandong in 2002 (ZGXZQYB, 15 January 2003 p.3), in many enterprises awareness of quality is quite poor. Emphasis is given to output and profits, not to quality.

There are either no standards in product manufacturing or work is not done according to standards. Product quality is not stable. For example, of 16 products in Wuxi selected by the Bureau of Standards Jiangsu, only 7, or 44 per cent, were up to standard (ZGXZQYB, 15 January 2003, p.3). According to this analysis, the proportion of products up to standard throughout the province is estimated at approximately 50 per cent. In Yantai, Shandong Province 1,402 products from 990 enterprises were examined and 67.2 per cent were found to be up to standard. Problems in product quality in some firms, particularly food enterprises, are even more serious. Of 162 products in 140 enterprises throughout the province, only 45 per cent are up to standard (ZGXZQYB, 15 January 2003, p3).

Considerable numbers of enterprises lack even the most basic quality guarantees, and do not have the capacity to manufacture products that are up to standard. For example, in

Jiangsu, over 50 per cent of industrial products in township and town enterprises are substandard. Most enterprises are 'imperfect in four areas', that is, in blueprints, standards, technology, and structure, so it is very difficult to guarantee quality. (ZGXZQYB, 15 January 2003, p.3).

A few enterprises even use inferior material and do shoddy work, manufacture goods in a rough way and even palmed off inferior goods as brand name products. For example, in Yantai, in 2002, 870 bicycles, 725 cartons of cigarettes, and 46,000 bottles of alcohol and beverages, were found, all with fake name brands and which came from other parts of the country (ZGXZQYB, 15 January 2003, p.3).

In addition, below the village level (including cooperative enterprise, joint households and individual enterprises) there is basically no one in charge of product quality (ZGXZQYB, 15 January 2003, p.3).

Thus, the problem of product quality in rural enterprises is quite serious. In response to the problems, the State Economic Commission, Ministry of Agriculture, Animal Husbandry, and Fishery and the State Industry and Commerce Administration formulated 'Opinions on Strengthening Product Quality Management Work in Township and Town Industries':

All township and town enterprises must do more to correct their administrative ideology, adhere earnestly to the principle of 'quality is number one and strive to improve management and administration, raise economic results, and be concerned with preventing pollution of the environment (ZGXLQYB, 12 March 2003, P.3).

'The Opinions' call for township and town enterprises administrative departments to establish quality management organs to work in conjunction with industrial management departments and industrial and commercial administration organs and thereby to strengthen management and supervision over product quality. 'The opinions' suggest focusing on industrial enterprises at the township (town) level and key village run industrial enterprises. The main concern for industrial enterprises below the village level is to

strengthen quality supervision.

Conclusion

Since 1978, fiscal revenues of township and village governments largely depend on the incomes from rural enterprises. In addition, there is a very close interest relation between township and village government leaders and the development of rural enterprises. Furthermore, the development of rural enterprises has played a very important role in increasing the incomes of rural community members and solving the problem of rural surplus labor. Thus, township and village governments actively defend the interests of rural enterprises and promote the development of rural enterprises. In China, rural enterprises are lower in status than state owned enterprises, and as a result, they obtain less preferential treatments from central government. Under this situation, it is essential for rural enterprises to obtain some protection for township and village governments.

The different wage forms have been used in rural enterprises. The reform of the wage systems in rural enterprises has given workers a greater incentive to work.

Rural enterprises pay their workers more than can be earned by farmers. Wages of sales staff, technicians and directors, especially private entrepreneurs are higher than workers. These income differentials may be widened since private rural enterprises continue to develop rapidly and private rural enterprises have less control over wage differentials from township and village governments.

The shortage of fiscal income and local government funds for welfare work and agricultural funds have led to the problem of local government exacting a large percentage of profit, collecting excessive charges. Although China's central government has implemented a policy of reducing the financial burden of rural enterprises, some problems of profit distribution have remained. Product quality in rural enterprises is still low. Although China's central government has implemented a policy to improve product quality in rural enterprises since 1978, enforcement has been weak.

China's government adopted some measures to promote technology in rural enterprises.

In the next chapter, I shall examine how these policies have influenced technological progress in rural enterprises.



CHAPTER FIVE

Government policies to promote technology in rural enterprises

In this chapter, I shall examine government policies to promote technological progress in rural enterprises since 1978.

There has been much published discussion on the economic aspects of technological change. However, there has been considerable difference *of* opinion on several issues such as the causes and effects of technological change. For example, on the plus side, as a result of technological changes more and better durable consumer goods become available to most people, however, on the debit side, pessimists argue that automation can lead to unemployment and more or less enforced leisure on a large scale. However, most economists have agreed on the importance of technological change as a very important source of economic growth. Paul A. David's research on the American and British experience in the nineteenth century indicated that a single, distinct technological innovation may lead to aggregate economic growth (Paul A. David, 1975). Kazushi Ohkawa and Henry Rosovsky found that institutional changes as well as experience with new technologies stimulated Japan's social capability to import and eventually improve on advanced foreign production methods (Kazushi Ohkawa and Henry Rosovsky, 1973). Despite political disruptions, China has also illustrated the important role of science and technology development on economic and social development. Tony Saich's research demonstrated that 'there is a clear recognition of the important role that science and technology plays in achieving economic and social objectives', and 'the process of reform has led to the realization that much greater attention must be paid to the process of science and technology development itself (Tony Saich, 1989, pp.156-158)

The concern in this chapter is to examine one aspect of the impact of science and technology development on Chinese economic development -- the impact on rural enterprises since 1978. In so doing, first I shall analyze technology in rural enterprises. Then I shall analyze government technological strategy before and after

1978. Finally I shall examine the progress of technology in rural enterprises.

Technology in rural enterprises

In China's rural enterprises, old and new equipment exists side by side in most rural enterprises. The technological modernization process is more advanced in the coastal regions, but even in the coastal regions many rural enterprises still use old technology and equipment. Less than 20 per cent of the equipment is made after 1990s; over 60 per cent is made in the 1980s; and about 20 per cent is made in 1970s. (ZGXZQYB, 15 January 2003, p.3). The quality of workers and staff is low. The capacity of these enterprises to develop new products on their own is also limited. This means that they have to depend on technological assistance from outside to make the fullest use of technology. Lack of local technological capacity arises from the absence of any in-house research and design facilities. Assistance is sought by these enterprises from either large enterprises or research institutes or universities. The proportion of technically trained personnel is only one-tenth that in state-run enterprises. The quality of 70-90 per cent of all products is lower than the products of state owned enterprises. There are more products of medium and inferior quality, more old-style products, and fewer new products (JRSR, 19 December 2003, p. 1)

One survey (Bi Guohua and Bao Yonghong, 1999, p.4) shows that in the sample enterprises, the equipment come from the following sources: 37 per cent is new equipment which is ordered from the factories; 29 per cent is bought from the market; 13 per cent is old equipment bought from factories; 10 per cent is the equipment which have been retired from state-run factories; 9 per cent is made by themselves; 2 per cent is imported from overseas.

In summary, the level of technology in most rural enterprises is inferior. The low level of technology is one of the main reasons of the low quality of products.

Government technological strategies for rural enterprises

From 1955 to 1957, China launched a large-scale agricultural cooperative movement

Commune and brigade enterprises, the predecessors of rural enterprises, began to emerge and develop on the basis of collective sideline production.

During the Great Leap Forward, the techniques strategy was the approach which entailed primary but temporary emphasis upon small-scale, labor intensive methods of production within the framework of long-term priority for large-scale and capital intensive techniques (Carl Riskin, 1971, pp.245-273). The Great Leap Forward policy attempted rapid rural industrialization through mass mobilization and the use of primitive techniques. Because premature expansion of small plants led to waste and confusion, many commune and brigade enterprises were closed during the retrenchment of 1960 to 1962. But as agricultural conditions stabilized and the opportunity cost of small scale industrial ventures declined, official policy began once again to encourage local industrial development. The volume of the resources devoted to commune and brigade enterprises had expanded steadily since 1963. Careful attention to pilot projects, cost reduction, and quality control had led to improved results (Rawski, Thomas G.1980)

As research by Samuel P.S.Ho (1986, p.40) indicated, rural industry differs from urban industry because it exists primarily to serve agriculture and local markets, consists mostly of small plants using primitive or intermediate technology, and depends on local resources. However, after 1978 although China still demands that rural enterprises support agriculture, rural enterprises have been considered as a policy of strategic significance in solving rural surplus labor and as an important source of the peasants' increased income (RMRB, 19 May 1999). Technological strategy places emphasis upon appropriate technology. Although most rural enterprises are still small-scale and engaged in labor intensive methods of production, the State has not restricted rural enterprises wishing to become large-scale and capital intensive. An important official report clearly indicated this strategy:

Commune and brigade enterprises should not arbitrarily seek advanced equipment and technology without considering their actual conditions, nor should they be contented with

their backwardness in technology and refuse to advance. They should adopt appropriate technology on the basis of their respective salient features (The Minister of Agriculture, Animal Husbandry and Fishery and the Ministry's Leading Party Group. (1999), SWB/FE, 26 March).

The report suggested that the State should adopt a policy favorable to the replacement of very old equipment. The rate of depreciation on old fixed assets might be raised appropriately. With regard to the use of after-tax profits, the report suggested that priority should generally be given to technological transformation.

In addition, the report encouraged cooperation in technology between state enterprises and rural enterprises, and between scientific research departments, colleges or institutions of higher training and rural enterprises. At the same time, the report offered some suggestions to improve the lack of technological personnel in rural enterprises.

Faced with the reality of a backward and generally inefficient domestic science and technology system, Chinese leaders have been engaged in an effort to re-structure their research sector and modernize indigenous science and technology capabilities since 1978. The March 1978 National Science Conference in Beijing was a milestone in the reform of science policy. Its main purpose was to announce publicly the government and party policy of encouragement and support of science and technology. A major speech by Deng Xiaoping reiterated the concept of science as a productive force and scientists as workers. However, the fundamental reform of the science and technology management system was made by the March 1985 Central Committee Decision. The reforms proposed in the 'Decision on the Reform of the Science and Technology Management System' (Xinhua in 19 March 1985, *FBIS-PRC*, 21 March 1985, pp.1-9) represented a major break with past practices, by changing the method of funding research institutes, encouraging the commercialization of technology and the development of a technology market and rewarding individual scientists. It was envisaged that most research institutes would support themselves through partnerships, mergers, joint ventures, or other appropriate

and mutually agreeable means. The ultimate goal was to encourage exchange and cooperation and to break down the compartmentalization characterizing China's research and development structure.

Various technological fairs have operated since 1978. For example, Jilin Province signed a number of contracts and agreements on technological cooperation and transfers in the first Northeast China technological cooperation fair on 26 April 1986. The total transaction volume reached 40m yuan (*SWB/FE/W* 7 May 86, Changchun, Jilin provincial service). According to statistics released by 17 departments in 22 provinces, autonomous regions and municipalities, about 87,000 contracts, worth 2.06 billion yuan were signed at the market in 1986.

Private scientific research institutes have been allowed to be established since 1978. According to statistics, China had 10,000 private scientific research institutes with 800,000 employees in 1999, which made profits by selling the application of their discoveries, 308 private scientific research institutes located in 20 cities had technologically aided 221 small and village and township enterprises from 1997 to 1998 (*SWB/FE/W*, 16 December 1999,).

China's leadership also expects rural enterprises to play an important role in the development of the export oriented economy. Some rural enterprises in coastal areas have engaged in the processing or imported material, assembly of imported parts and compensation trade. In 1999, more than 8,000 township enterprises nationwide earned foreign exchange through exports. They produced 20 major categories, more than 10,000 varieties of products sold in nearly a hundred nations worldwide, and earned more than \$4 billion, 15.5 per cent of the nation's total foreign exchange earnings in 1999 (Xu Yu, 2001, pp.16-20). Some rural enterprises in coastal areas have also cooperated with foreign businesses. As a result, such enterprises have an opportunity to use foreign advanced technology.

Because the development of rural enterprises in China is uneven, different regions have

been given different strategies for technological improvement. In the interior and in other regions where rural enterprises are relatively underdeveloped, technological improvement has emphasized the promotion of traditional arts and crafts. But in the coastal areas where rural enterprises are relatively advanced, input of more advanced technology has taken place. This could further widen the regional imbalances in the development of rural enterprises.

The Chinese leadership has emphasized the development of state enterprises since 1989. Despite this, Chinese official documents still support technological progress in rural enterprises. One document called for the government to organize and guide technological progress, staff training, and to create the conditions for rural enterprises to recruit skilled personnel and import advanced technology (*XHYB*, No.6, 2002, p.86).

However, it should be noted that the support and favorable conditions for technological progress in official documents are given more to township and village collective run enterprises than to private rural enterprises. This is due to the discrimination against private enterprises and to the low stature of private enterprises.

The progress of technology in rural enterprises

The Spark Plan (Xinghuo Jihua)

The Spark Plan was initiated by the State Science and Technology Commission in March 1985. The plan, which derived its name from a Chinese metaphor that said a single spark can start a prairie fire, aimed at introducing modern science and techniques to the rural districts through the medium of technological demonstration centers with the object of accelerating economic growth in the countryside. The Spark Plan was proposed in the spirit of the resolution by the Central Committee to restructure the science and technology system, and was aimed at invigorating the local economy (Liu Zhongkui, 1986, pp.1-3). The targets of the plan during the Seventh Five-year Plan were: (1) to develop 100 complete sets of technological equipment suitable for the countryside and the town and township enterprises, and put them into batch production; (2) to help

establish 500 model town and township enterprises and provide them with complete technology and production techniques and methods of standard management, product design and quality control; (3) to train a number of educated youths and grassroots cadres for towns and townships every year so that they could master one or two advanced technologies suitable for their own areas and obtain some knowledge of modern management (Wu Mingyu, 1986).

The Spark Plan introduced technology of a higher level in China's eastern seaboard to help produce better quality goods for the export market. Assistance was given to help the central part of China manufacture goods for the domestic market, so as to lay the foundation for starting an export-oriented economy. Underdeveloped western China was where the plan could help most by introducing techniques to enable millions of rural households to become well-to-do. The plan helped enterprises in western China to enter into cooperation with those in the central and eastern parts of the country so that they could turn out market goods with local characteristics.

A whole series of new measures are adopted: all projects to be listed as Spark Plan have to undergo feasibility studies by experts and are no longer started up after nothing more than a simple administrative Investigation. Technical projects for rural enterprises to be listed have to have a technical institute, scientific research unit, or large or mid-sized enterprises to look to, in order to assure that the project is both advanced and appropriate. Capital accumulation channels are expanded. Bonds and stocks are issued, and enterprises link up to accumulate capital. All forms of venture capital investment and leasing system have been tried (Li Shuzhong, 1998, pp.14-16).

Many kinds of technology transfer systems have been established. Compensation has been paid for the transfer of technological contracts and markets for information and technology have been created. Human resource exchange agencies have also been established. Science and technology workers have been given incentives to go to work in rural enterprises.

These new methods have provided favorable conditions for the implementation of the Spark Plan. Between 1996 and 1998, the state put up 360 million yuan in support of the Spark Plan. The capital accumulation in the different regions reached 1.9 billion yuan (Li Shuzhong, 1998, pp.14-16). These funds have been used to develop technological application in 10 areas: new modes in the feed industries and for storing and shipping their products; processing technology for preserving freshness at the point of production; technology for the comprehensive use of farm, forestry and local products: development of rural township construction materials; production technology for small-scale mining excavation, extraction, primary processing and manufacturing; broadened utilization of new technology and materials; product lines for heavy industrial production; coordinated regional development: export commodities; and development of small-scale production installation technology and training of installation personnel (Li Shuzhong, 1998, P. 14-16).



Thus, the implementation of the Spark Plan gains some successes for the improvement of technology in some rural enterprises. However, this program has been far from adequate compared with the number and size of rural enterprises in all China. Most rural enterprises still lack sufficient technological personnel, and use out-dated facilities, often procured from state and collective enterprises that have upgraded their technological base. Although the reliance on second hand equipment is a cheap way of obtaining productive capacity in the short run, much of it is highly inefficient, and highly energy consumptive. Thus, although the Spark Plan marks an important step in the right direction, much work still remains to be done to improve the technology of rural enterprises.

Technology personnel

Since 1978, some enterprises face bankruptcy and some go out of business. The most important reason for their failure is the lack of competent managers and technicians. For instance, in 1999, 1.520.000 rural enterprises surveyed had only 630,000 professional technicians, an average of 0.4 technicians for one enterprise. For all the 43.91 million

rural workers, technicians accounted for only 0.7 per cent of the total. The percentage for state enterprises was 8.8 per cent (*CD*, 3 November 1999).

In order to improve the situation of lack of technological personnel in rural enterprises, a Chinese official document suggests that the following steps should be taken: First, the education department has to include rural enterprises' requirements for personnel in the plan for developing vocational education and gradually establish professional schools for training staff members and staff. Secondly, the state has to assign some university and college graduates to rural enterprises. Thirdly, rural enterprises have to be allowed to give proper titles to their technological personnel by referring to the criteria promulgated by the state in order to encourage the staff members and workers to become competent personnel through self-study (*SWR/FE*, 2 October 2002).

Meanwhile, the Chinese government has also accelerated, especially since 1985, the introduction and training of technological and management personnel for township and town enterprises. According to an investigation in 2001 involving 23 provinces and municipalities, a total of 65,000 capable people were recruited by township and town enterprises and 600,000 technological and management personnel were trained. A special characteristic of the work to cultivate talented personnel has been the operation of educational and training programs for staff and workers at various levels, through various channels, and in various forms (Chen Te-sheng, 2002).

The State also adopts a more liberal policy which allowed technological personnel to work in rural enterprises in their spare time. In certain big cities such as Shanghai and Beijing, groups of scientific technological personnel travel to suburbs from downtown either by bus or bicycle on Sunday to use their spare time to help rural enterprises develop new products, tackle technological problems, and train workers. This is very useful in solving the problems of technology in rural enterprises.

However, very few technological personnel in state enterprises can settle in rural areas and work in rural enterprises. The main reasons are as follows: first, some leaders of the

state departments fear that once the scientific and technological personnel go to work in rural enterprises, they will become their rivals, and that the scientific and technological personnel going to work in rural enterprises and getting higher wages can affect the stability and ideology of technological personnel who still work in their departments.

Secondly, there is an ideological and political reason why very few technological personnel work in rural enterprises. As Denis F. Simon's research indicated, political cadres see themselves as being displaced by science and technological personnel. Party officials feel insecure in granting these individuals more authority and independence, especially since they threaten the party's own claims to be the main purveyor of truth and knowledge in society (Simon, 2000, p.142). Technological personnel are worried about other people criticizing them by saying that their purpose in going down to work in the township and town enterprises is to 'make big money'. In some cases, these individuals have been accused of extortion and blackmail by jealous individuals who have not had such opportunities available to themselves (*FBIS-PRC*, 20 July 1999, p3).



Conclusion

The Chinese government has emphasized the need to improve the technological level of rural enterprises since 1978. This policy and its implementation have important implications for technological progress in rural enterprises. The Spark Plan played a positive role in promoting relatively large-scale rural enterprises. The increase in the mobility of technological personnel between research institutes and rural enterprises not only help to exploit the potential of scarce technological and professional manpower, but also to an extent help to solve the shortage of technological personnel in rural enterprises. However, although China's government has taken some measures to improve the technology in rural enterprises, some problems such as the shortages of technological personnel and finance, low educational level of workers still remain. In addition, obsolete facilities, outdated techniques, and the shortage of qualified personnel, are the major obstacles to improve the quality of products, and reduce raw material consumption.

Moreover, rural enterprises are facing new difficulties. Rural enterprises have gradually lost their privileges under the new situation brought on by reforms. The concessionary tax and credit policies originally enjoyed have been gradually cancelled. The means of production have seen great price rises. Therefore, many rural enterprises realize that they have to rely on technological progress to increase competitiveness and adaptability.

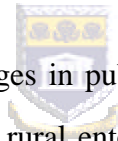


CHAPTER SIX

Conclusion

Positive roles of public policy changes for rural enterprises

When the reformist leadership of Deng Xiaoping assumed power in 1978, the CCP was facing a crisis of legitimacy. Although there are serious disagreements among the leadership over the best way forward for China, a consensus developed among the party leadership that policy changes have to occur if the Party is to retain its position and the country is not to slide further behind its competitors in terms of economic development. As Carol Hamrin (1989, p.116) wrote: 'From the beginning, Deng Xiaoping viewed the economic reform program not only as a necessity for national well being, but also as a survival kit for the CCP'. It is therefore impossible to separate the economic and political imperatives behind policy changes towards rural enterprises after 1978 - the survival of the CCP is perceived as being dependent on the rapid development of the Chinese economy.



This study has demonstrated that changes in public policy since 1978 did play positive roles in promoting the development of rural enterprises. These positive roles have been manifested in the following areas. First, and of crucial importance, the ideological base of policy has changed from one of restraining the development of collective rural enterprises before 1978 to encouraging the development of rural enterprises after 1978. Perhaps the most dramatic change occurred in the official attitude towards the private sector of rural enterprises. From being prohibited during the Maoist era, the private sector of rural enterprises is not only tolerated after 1978, have been actively encouraged and promoted as a positive model by some Chinese leaders. Without these fundamental changes of policy, political climate will not have been conducive to the development of rural enterprises.

Secondly, the government has provided collective rural enterprises with preferential treatment in terms of bank credit and tax rates, although state loans towards rural enterprises have decreased since late 1998 and tax burdens on rural enterprises gradually

increased. Since 1978, the increase of peasant incomes has enabled rural enterprises to raise funds from individuals and society in various ways. Therefore, government financial and tax policies have created more favorable financial conditions for developing rural enterprises.

Thirdly, the government has provided some policies to improve management in rural enterprises, especially in township or village owned enterprises. The government has implemented the contractual responsibility system and a responsibility system for factory directors. The government also changed the payment system for labor and adopted a policy to promote the quality of production in rural enterprises. As a result, these policies have played a positive role in improving management in rural enterprises. .

Fourthly, since 1978 the technological strategy of the government has been changed from an emphasis on small-scale labor-intensive methods of production to the use of appropriate technology. The reform of the science and technology management system has given rural enterprises more opportunities to obtain advanced technology. The government has also taken some practical measures to promote technology in rural enterprises, including the implementation of the 'Spark Plan' and the policy to allow technological personnel to work in rural enterprises in their spare time and the promotion of cooperation in technology between state enterprises and rural enterprises and between research institutes and universities and rural enterprises. These measures have also promoted technology in rural enterprises.

Economic and political problems for the development of rural enterprises

The changes outlined above have combined to create an economic and political

environment that has facilitated the development of rural enterprises. But despite these advances, the change of public policy is inadequate. On the long march to the situation where rural enterprises can play a full and valuable role in the Chinese economy, there is still a long way to go.

Although private enterprises have acquired a legal status, private enterprises still face many difficulties and different forms of discrimination. Similarly, there is still considerable discrimination against rural enterprises (whether they are collective run or private run enterprises) particularly in the supply of raw materials and credits, compared with the policy towards state enterprises.

Since 1978, the reform of the market has created a more favorable market environment for the development of rural enterprises. However, rural enterprises have not enjoyed the same competitive position as state enterprise in many areas such as product transport, retailing and export. With the further reform of the economic system in the cities, the large and medium state enterprises have taken further steps to relax restrictions in order to invigorate their operations. At the same time, however, some privileges of state enterprises remain. In addition, the preferential treatments in credit and taxes formerly accorded rural enterprises have gradually been reduced.

Government policies to promote technology in rural enterprises are inadequate. The shortage of technological personnel and finance and the low educational level of workers remained formidable obstacles for the progress of technology in rural enterprises.

Moreover, some political and ideological questions have remained an obstacle restraining rural enterprises' ability to make even greater progress. One complaint against rural enterprises has been that the development of rural enterprises affects agricultural production.

The rapid development of rural enterprises has widened the discrepancy between the income of rural enterprise workers and peasants; hence, a problem involving agricultural production has arisen. According to a study conducted in Southern Jiangsu Province,

peasants are unwilling to stop planting grain, but they are also unwilling to plant too much. They do not want to stop planting because their past experience of hunger urges them not to abandon grain production. They do not want to plant too much because the economic results of land cultivation are about 30 per cent lower than that of industrial work (Chou Yuan and Chao Ming, 2002, p.24). This has caused considerable waste of farmland. In addition, large tracts of farmland have been occupied by flourishing rural enterprises. These two factors have contributed to a sharp decrease in farmland in these years.

However, the problems of agriculture should not be blamed entirely on the development of rural enterprises. On the contrary, rural enterprises have supported the development of agriculture with large amounts of funds. For example, in 2001, Zhejiang and Shanghai on average received 200 to 300 yuan per person per year in 'supplementing agriculture' money (Su Bei, 2001, pp.32- 34). This suggests that the view that rural enterprises have caused the agricultural decline is unjustified.

Another complaint against rural enterprises has been that rural enterprises have polluted the environment. A study was published in 1999 by environmentalists and ecologists from the Chinese scientific and other research institutions (CD, 13 October 1999), which pointed out that the most flourishing rural industries were built without any consideration for the environment since 1978. In a report on environmental problems caused by China's small town and village industries, the scientists predicted that if rural enterprises continue to increase at a 25 to 30 per cent growth rate, their industrial waste water will account for 40 to 50 per cent of the country's total by the year 2004. The waste water coming from rural industries accounted for only 10 per cent of the country's total industrial waste water release, but in some highly-developed areas such as Southern Jiangsu Province, industrial population in surrounding rural townships has been large-scale. Thus, environment problems should be considered when rural enterprises are established. China environmental protection policies should in future pay greater attention to rural

ecological environment even though its priority may remain focused on urban areas.

Private enterprises were only officially legalized in 1988, and had traditionally been considered 'capitalist ownership'. As a result, political and ideological problems for private enterprises have been more severe. Some local party leaders have expressed concern that the existence and development of private enterprises will lead to private entrepreneurs becoming a distinct class infiltrating the state sector. This will result in the 'restoration of capitalism which would change the face of socialism and the nature of society in China (LW, 1998, pp.12-14), However, whether the economic reform policies bring about fundamental changes in the political system will depend largely on whether the private sector of the economy can become strong enough to account for significant part of China's GNP. The output value of the private economy still only account for a very low percentage of the gross output value of Chinese industry. Nonetheless, the newly risen entrepreneurs with their increased wealth and social influence have brought demands for political influence and social standing.

It was reported that more than 2,000,000 members of the CCP engaged in the private sector of the economy in early 1999 (DGB, 16March 1999), This means that on average one out of 135 members of the CCP is involved in the private sector of economy in early 1999. This data suggested that entrepreneurs have certain influence in rural areas. It also suggested that party membership, or links with party members could ease the process of establishing and running private enterprises. The popular suspicion that private enterprises go hand in hand with corruption has not been caused by such a relationship. Thus, it can be said that the private economy has already played a considerable role in Chinese politics.

As noted above, the main public complaint against private enterprises has been in terms of corruption and illegal practices. As I have demonstrated in Chapter Six, large numbers of rural enterprises have been guilty of tax evasion. In addition, the highly monopolized financial organizations have made it very hard for private enterprises to obtain loans, which sometimes are only available with 'good personal connections'. Thus private businesses have been forced to depend on favors and gifts in order to obtain raw materials, sell their goods and raise loans. It may therefore be argued that any corruption

that arises is the fault of the partial nature of reform, which allows private enterprises to legally exist, but does not allow them to get what they physically needed to exist. Nevertheless, in the eyes of much of the population, corruption is still being blamed on the existence of private enterprises, and not the economic system that they are forced to exist in.

The development of private enterprises has widened disparities between the rich and the poor and between different regions. The result has been an increase in social tension. For example, in a survey of 100 private rural enterprises, the average initial capital of each enterprise was 32,000 yuan. After three to four years, the average capital of each enterprise reached 144,000 yuan (NYJJWT, No.2, 1999, p.19).


Irrespective of whether China's leaders like rural enterprises or not, they can no longer overlook the economic strength of rural enterprises. Most of them express their support for rural enterprises. Deng Xiaoping highly praised these enterprises as a new force that has suddenly come to the fore because of rural reform (ZGXZQYB, 13 February 2001). The former party secretary general Jiang Zemin similarly stated that the role of rural enterprises not only lay in having industry nourish both agricultural and sideline production, but also lay in close ties with urban large-scale industry and foreign trade, as well as close ties with agricultural and non-staple food production (ZGXZQYB, 13 February 2001). The former prime minister, Li Peng, stated that: 'In my opinion, we should correctly assess the role that can be played by town and village enterprises in developing China's economy' (ZGXZQYB, 13 February 2001,p6).

In the past several years, China's government has continued to implement some policies promoting the development of rural enterprises, especially in central, and rural enterprises have continued to develop dramatically. Therefore, it is reasonably certain that the Chinese government will continue to permit, and even encourage the development of rural enterprises.



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