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TEEMU RUSKOLA*

People, Inc.? Law, Economic Enterprise, and the
Development of Inequality in China†

This Article tells the story of two Chinas and of different forms of public enterprise associated with each: state-owned enterprises (SOEs) in urban China and township-and-village enterprises (TVEs) in rural China. Historically SOEs have constituted the dominant form of socialist enterprise in China. However, China's unprecedented economic growth began with the rise of rural industry in the 1980s, and the bulk of rural growth was generated by a new type of entity known as TVEs. While legal scholars have mostly ignored TVEs, economists have devoted a great deal of theoretical attention to them: How were TVEs able to succeed in the absence of legally protected property rights, in defiance of standard economic theory? Remarkably, they operated without a formal legal basis. This Article argues that long before the enactment of the PRC's first Company Law in 1993, in TVEs local government law performed the core functions of corporation law—a phenomenon this Article characterizes as "Village, Inc." It was this law of local governance, and the formal and informal institutions supporting it, that propelled China's phenomenal growth for nearly two decades while helping close the historic welfare gap between city and country.

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The Article next compares TVEs' record of success with that of SOEs. The Company Law promulgated in 1993 marked a reorientation from rural reforms to restructuring urban SOEs. Despite its apparent novelty, in many respects the Company Law simply codified institutional arrangements pioneered by TVEs. Even after SOEs were "corporatized" in order to attract outside capital, the state remained a controlling shareholder—a configuration this Article describes as "People, Inc." However, despite the benefit of a formally promulgated corporate statute, as a group corporatized SOEs have not been able to replicate TVEs' extraordinary success. Beyond the Company Law's formal structures, there has been no informal "local law" of SOEs to regulate them, equivalent to the relatively egalitarian village institutions that governed the operation of TVEs.

Significantly, however, the corporatization of SOEs has not only restructured the state's relationship to capital. The final part of the Article considers how it has also fundamentally altered the relationship between capital and labor. The enactment of the Company Law was accompanied by the promulgation of a new Labor Law in 1994, mandating that all employees be provided with employment contracts. Since then, the revolutionary political subject of Maoism—"the people"—has been atomized into independent economic subjects responsible for their own welfare outside of work. This, in turn, has resulted in tectonic shifts in the boundaries among the state, the market, and the family. Moreover, with the contractualization of all labor, even urban workers no longer enjoy a guaranteed share of the benefits of economic development. Today, an earlier state-enforced inequality between city and country is increasingly overwhelmed by a society-wide gulf between the rich and the poor, without a necessary geographical correlate.

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Shanghai looks like the future!¹

Paris Hilton

Contradiction is universal and absolute, it is present in the process of development of all things and permeates every process from beginning to end.²

Mao Zedong

INTRODUCTION

This is a tale of two Chinas, and of different forms of public enterprise associated with each. It is a well-known, though often already forgotten, fact that China's post-Mao economic transformation began in the countryside, with agricultural reforms followed by rural industrialization. It was the astonishing growth of rural enterprise from the 1980s through the mid-1990s that lifted millions of peasants out of poverty and drove China's unprecedented economic growth. In a dramatic reversal, in the past few decades China's countryside has stagnated while cities have far outpaced it, with gleaming megalopolises becoming the horizon of the new millennium. As the above epigraph suggests, even Paris Hilton couldn't help but notice the obvious, gushing upon her arrival in China, "Shanghai looks like the future!"

That much is uncontested—even an unlettered socialite like Paris Hilton knows it. What is highly controversial are the causes of the divergent fates of rural and urban China. For the first two decades into the post-1978 reform era, when observers referred to the Chinese economic miracle what they were really talking about was an industrial revolution taking place in the Chinese countryside, not the Chinese economy as a whole. One key aspect of that revolution that is neither widely known (except among experts) nor well understood (even by experts) is the unique form of enterprise that drove this revolution: so-called township-and-village enterprises (TVEs).

In the end, rural industry declined in the late 1990s for a host of reasons. Among other things, as it came to pose a threat to state-owned enterprises (SOEs) the historic backbone of Chinese industry, the state cracked down on TVEs' access to credit. Correspondingly, to facilitate SOEs' access to domestic as well as international capital, the state began "corporatizing" them under the People's Republic of China (PRC)'s first-ever Company Law enacted in 1993.³ Since then,

1. Associated Press, *Paris Hilton Visits Shanghai*, WASH. POST (Nov. 22, 2007), www.washingtonpost.com/wp-dyn/content/article/2007/11/22/AR2007112200464.html (quoting Paris Hilton).

2. Mao Tse-tung, *On Contradiction*, in 1 *SELECTED WORKS OF MAO TSE-TUNG* 311, 318 (Foreign Languages Press, Beijing 1975).

3. *Zhonghua Renmin Gongheguo Gongsifa* (中华人民共和国公司法) [Company Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective July 1, 1994), CLI.1.7672(EN) (Lawinfochina), (rev'd Oct. 27, 2005).

dazzling skylines have sprung up from what were once rice fields on urban outskirts—shining monuments to the corporatization of SOEs, the accelerating privatization of state industry, and a surging tide of global capital fueled by China's accession to the World Trade Organization in 2001.

Today the countryside has been left behind the future that Miss Hilton saw so vividly emerging from the horizon in Shanghai, and swelling numbers of rural poor have become an endless army of disposable workers to build more megacities and to furnish low-wage labor for their industrial enterprises. The widening gap between urban elites, on the one hand, and an impoverished rural population and an underclass of disenfranchised migrant laborers in the cities, on the other, has come to pose a potentially existential threat to a regime whose political legitimacy rests ultimately on its revolutionary claim to represent the Chinese peasantry.

The broad outlines of this story are well known, even if the crucial early role of rural reform is fading fast from popular memory. This Article examines this larger story critically through a comparative analysis of the operation of TVEs and SOEs, the two main forms of rural and urban industrial enterprise, respectively, in a crucial period of China's development. Although there exists a body of scholarship on each, the two forms are rarely analyzed together, and TVEs in particular have eluded a specifically legal analysis, for reasons I explain below.⁴ Equally importantly, while the subject matter may seem technical, a comparative study of TVEs and SOEs illuminates not only theoretical debates in corporate governance but also opens a window to core political and economic questions that face China today.

In the first place, this Article argues that TVEs are best understood as a form of specifically local state enterprise—a kind of “Village, Inc.” Although their very name suggests as much, the proper characterization of TVEs remains controversial. Most scholarship on TVEs has been produced by economists and political scientists who are focused almost exclusively on a single question: How were TVEs able to succeed in the absence of legally protected property rights, in defiance of standard economic theory? Remarkably, until 1997 TVEs operated without a formal legal basis. When national regulations were finally promulgated, their appearance coincided, paradoxically, with the beginning of TVEs' decline as an enterprise form. The fact that TVEs'

4. Notable exceptions to the tendency to analyze TVEs and SOEs in isolation include William H. Simon, *The Legal Structure of the Chinese “Socialist Market” Enterprise*, 21 J. CORP. L. 267 (1996); Deqiang Liu & Keijiro Otsuka, *A Comparison of Management Incentives, Abilities, and Efficiency Between SOEs and TVEs: The Case of the Iron and Steel Industry in China*, 54 ECON. DEV. & CULTURAL CHANGE 759 (2004); Yingyi Qian & Barry Weingast, *Institutions, State Activism, and Economic Development: A Comparison of State-Owned and Township-Village Enterprises in China*, in *THE ROLE OF GOVERNMENT IN EAST ASIAN DEVELOPMENT* 254 (Masahiko Aoki et al. eds., 1997); Enrico C. Perotti et al., *State-Owned Versus Township and Village Enterprises in China* (UN Univ. WIDER Working Papers No. 150, Sept. 1998).

success was an essentially extralegal phenomenon is not a reason for legal scholars to ignore them. On the contrary, it is a reason for us to be *especially* interested in understanding them.

Exemplifying a more general academic frustration at China's failure to respect distinctions between public and private ownership, some time ago the economist Douglass North summed up his complaint by concluding that the PRC "does not have well-specified property rights, [TVEs] hardly resemble the standard firm in economics, and [the country] remains to this day a communist dictatorship."⁵ Although North received a Nobel Prize for his contributions to institutional economics, he is not a China specialist and in the end he attributed TVEs' extraordinary success rather casually to China's "cultural heritage."⁶ In contrast, Joseph Stiglitz—another Nobel laureate as well as former head of the World Bank—has paid more sustained attention to TVEs, declaring them a "brilliantly successful institutional innovation."⁷ In Stiglitz's view, TVEs succeeded even in the absence of formal legal entitlements because village governments protected parties' legitimate expectations. Rather than perverse hybrids of the state and the market, TVEs worked precisely *because* they combined elements of both.⁸

Stiglitz's account is insightful yet inadequate. Property rights alone—or even their functional equivalent—do not a corporation make. An enterprise needs also a body of organizational law. A village government may well have been in a position to ensure that TVE managers did not loot the enterprises they ran for their community, but what restrained local officials from doing so on their *own* behalf? It is a key argument of this Article that long before the enactment of the PRC's first statutory law of corporations, there existed a *de facto* body of corporation law. That is, in rural TVEs *local government law* performed the core functions of corporation law. This Article maintains that it was this unique law of local government, together with

5. Douglass North, *The Chinese Menu (for Development)*, WALL ST. JOURNAL (Apr. 7, 2005), www.wsj.com/articles/SB111283514152300351.

6. Douglass North, *Gunnar Myrdal Lecture: The Role of Institutions in Economic Development* 11 (UN Econ. Comm'n for Europe, Occasional Paper No. 1, 2003).

7. Stiglitz makes this observation, with two coauthors, in Athar Hussain, Nicholas Stern & Joseph Stiglitz, *Chinese Reform from a Comparative Perspective*, in INCENTIVES, ORGANIZATION, AND PUBLIC ECONOMICS 243, 271 (Peter J. Hammond & Gareth D. Myles eds., 2000).

8. In addition to the essay cited above in note 7, Stiglitz analyzes TVEs in several single-authored and collaborative works. See, e.g., JOSEPH STIGLITZ, WHITHER SOCIALISM? 261–63 (1994); Joseph Stiglitz, *Creating the Institutional Foundations for a Market Economy*, in LAW AND ECONOMICS WITH CHINESE CHARACTERISTICS: INSTITUTIONS FOR PROMOTING DEVELOPMENT IN THE TWENTY-FIRST CENTURY 71, 80 (David Kennedy & Joseph Stiglitz eds., 2013); Joseph Stiglitz, *Quis Custodiet Ipsos Custodes?*, 42 CHALLENGE 26, 45 (1999) [hereinafter Stiglitz, *Quis Custodiet Ipsos Custodes?*]; Yingyi Qian & Joseph Stiglitz, *Institutional Innovation and the Role of Local Government in Transition Economies: The Case of Guangdong Province of China*, in REFORMING ASIAN SOCIALISM: THE GROWTH OF MARKET INSTITUTIONS 175, 184–85 (John McMillan & Barry Naughton eds., 1996).

the formal and informal institutions undergirding it, that guided China's phenomenal economic resurgence from the 1980s through the mid-1990s. Moreover, it provided for a relatively egalitarian allocation of its gains among rural citizens while also helping close a historic welfare gap between city and country.

Given the world-historic scale of China's rural growth during that period, an accurate understanding of TVEs' operation is important in its own right. Yet analyzing TVEs as a form of public enterprise regulated by local law has further implications. Perhaps most importantly, it challenges a dominant narrative that ascribes China's economic accomplishments simply to the rise of markets and a corresponding retreat by the state from the economy. At the same time, it revises the standard positivist account of PRC corporation law and its role in the Chinese economic transformation. Rather than beginning the story with the formal enactment of the Company Law in 1993, written for SOEs, we discover it emerging in the Chinese countryside more than a decade earlier.

Proceeding from this broader definition of corporation law, the second half of the Article turns to a comparative analysis of rural and urban regimes of enterprise governance and their distinctive roles in China's uneven economic development. At the time of its enactment, the main purpose of the Company Law was emphatically not to privatize the urban state sector outright but simply to transform the state's role from that of an administrator to an investor, from managing SOEs directly to holding shares in them—a reorganization I characterize as "People, Inc." Remarkably, however, despite enjoying the benefit of a formally enacted statute, corporatized SOEs have been less successful as a group than their politically disfavored rural cousins.

This Article's legal analysis of TVEs seeks to illuminate this seeming paradox. It is indeed vital to analyze both TVEs and corporatized SOEs as forms of public enterprise. At the same time, it is equally vital to recognize their association with *different parts* of the state. Despite the formally unitary political structure of the PRC, its actual contours cannot be gleaned from a diagram in a textbook on Chinese constitutional law. Apprehending the legal regulation of TVEs and SOEs demands ultimately a historical sociology of the state—a comparative analysis of urban and rural political institutions and the changing ways in which they have been articulated with economic as well as kinship structures.

When the Chinese government first embarked on reforms in 1978, many of its key institutions had yet to recover from the devastation of the Cultural Revolution, including the most critical function of any modern state: tax collection. In a major fiscal restructuring in 1980, the central government delegated tax collection to lower levels of government, permitting each level to keep any revenue that exceeded its assigned quota. This gave China's rural townships and villages

a notable degree of genuine fiscal autonomy and an incentive to encourage local production in their own account. As the first half of this Article elaborates, it was this economic autonomy together with a range of local institutions—what I call the law of village government, broadly construed—that provided the basis for the establishment and operation of TVEs.

In contrast, SOEs based in urban locations are creatures of the central state, ultimately subject to ministries in Beijing and other central agencies, even as their operational control is often delegated to provincial and municipal governments. At the same time, they have been the chief vehicle for delivering a privileged material existence to urban workers, providing them with lifetime job security as well as a cradle-to-grave system of welfare, including housing, childcare, schools, hospitals, and retirement benefits. Corporate governance reforms in the urban state sector originated in the 1980s as a push for greater “enterprise autonomy,” aimed at improving SOEs’ productivity and reducing the state’s increasingly burdensome welfare obligations to SOE workers. However, when SOE reform culminated in the enactment of the Company Law in 1993, because of the distinctive organization of the urban state, there was generally no informal “local law” of SOE governance to mediate among competing interests, equivalent to the village institutions that supported the emergence of TVEs.

Remarkably, a number of corporatized SOEs are among the most successful companies in the PRC today. Yet these so-called National Champions’ success is better explained by the unique conditions of Chinese state capitalism than by the legal structures that support them. Today, *all* successful large firms in China—private as well as state-controlled ones—rely on connections to state power. At the same time, while the corporatization of SOEs under the Company Law may have changed mostly the form in which the state exercises control over capital, it has been nothing short of a revolution—or, better still, a counterrevolution—for Chinese labor. As an integral part of the corporatization process, SOEs have withdrawn the social contract of lifetime employment and replaced it with individual employment contracts, subject to the vagaries of hiring and firing.

The coda to this Article sketches briefly some of the broader implications of this restructuring of the relationship between capital and labor—without a doubt the single most important consequence of the corporatization of SOEs. The construction of autonomous market actors, both at the level of the enterprise and the level of the individual, has resulted in tectonic shifts in the boundaries among the spheres of the state, the market, and the family, and indeed also between city and country, as a former political inequality between the two has been replaced with a general market inequality expanding throughout society.

In sum, this Article provides a new sociolegal interpretation of TVEs, seeking to illuminate China’s economic and legal reforms as

well as the theory of corporate governance more generally. At the same time, by connecting the rise and fall of TVEs in the countryside to SOE reforms in the cities, this Article highlights Chinese corporation law's linkages with administrative law, employment law, and even family law, among other areas of law. Finally, by placing legal reform in the context of China's political economy as a whole, this Article helps illuminate the inherently political nature of corporation law and its society-wide ramifications, in China as well as anywhere else. Determining SOEs' "proper" role is ultimately a political question, and the answers to it cannot be deduced from economic theories alone. There is not one, but many, ways to organize the relationship among the state, the market, and the family.

The remainder of this Article is structured as follows. Part I is a brief note on analytics and periodization. Part II tells the story of TVEs, while Part III focuses on the legal reforms of SOEs. Part IV points to the larger social consequences of enterprise restructuring. It is followed by a Conclusion.

I. ANALYTICS: REVOLUTION, REFORM, TRANSITION

This Article seeks not only to describe China's changing legal and political landscape but also to question some of the basic terms in which we have come to narrate China's political and economic development. In analyzing Chinese institutions—legal and otherwise—there is a nearly universal, perhaps inevitable, tendency to compare them to Euro-American ones. By definition, they are different. That difference in turn is almost invariably interpreted as a deficiency. One key example of this tendency is the ubiquitous discourse of China's "transition."⁹ Although the notion of transition may seem neutral enough, it relies on an unstated assumption that whatever distinctive forms Chinese institutions may have adopted for now, those forms are ultimately not authentic. Until it looks like the liberal West, China will remain in transit.¹⁰

"Reform" is an even more common term for characterizing the changes taking place in China. It is instructive that the so-called reform era, dating to 1978, has already lasted a decade longer than the PRC's entire pre-reform history. Evidently Chinese law and politics will continue to change, as everything does, but at this point characterizing the post-1978 changes as a provisional era of reform is neither descriptively adequate nor analytically useful. While the discourse of

9. As Wang Hui observes, "[t]ransition' is the crucial unspoken premise of the contemporary discourse on Chinese society—it presupposes a necessary connection between the process of current inequality and an ultimate ideal." WANG HUI, *CHINA'S NEW ORDER: SOCIETY, POLITICS, AND ECONOMY IN TRANSITION* 43 (2003).

10. For a critical analysis of "transitology," see John D. Haskell & Boris N. Mamlyuk, *Capitalism, Communism . . . and Colonialism? Revisiting "Transitology" as the Ideology of Informal Empire*, 9 *GLOBAL JURIST* 1 (2009).

transition is prone to making grand, unfounded assumptions about the direction of history, the language of reform—preferred especially by Chinese political actors—is unduly modest, minimizing the significance of what it describes. Despite their divergent political perspectives, both serve a similar ideological function of depoliticizing what is taking place: by suggesting either that China is simply following the laws of history (transition discourse) or else engaged only in technocratic fine-tuning (reform discourse), rather than making deeply consequential political decisions about its present and future.

Relatedly, just as there is no single telos toward which China is advancing, there is not even a single “China” with a single political economy for us to investigate: rural and urban China are distinctive. However, whether they employ the framework of reform or transition, most scholars—including legal scholars’—overwhelming analytic focus is on urban institutions, despite the fact that until very recently the population in the countryside outnumbered its urban counterpart. Correspondingly, even the minority of scholars who study rural institutions typically do so to the exclusion of cities, thereby reproducing the administrative rural–urban divide in the arena of scholarship as well.¹¹ Yet in the end rural China and urban China are inextricably interlinked, and it is not possible to understand the changing structures of inequality in today’s China without examining the dynamic relationship between the two.¹² This Article seeks to attend to China’s legal and economic development in rural and urban as well as national and international contexts.

What follows, then, is not a story of China’s transition to anything—whether ideal-typical capitalism or something else—but simply an account of its ongoing transformation, in cities as well as villages. As the legal scholar Deng Zhenglai notes, insofar as they still rely on Cold War notions of socialism and capitalism, even Chinese scholars remain trapped in exported frameworks that threaten to make them “incapable of interpreting China’s own experiences.”¹³ Along similar lines, the New Left critic Wang Hui decries what he calls the “detheorization”

11. This problem is by no means specific to Western legal scholarship. Zhu Suli (or Su Li, under his pen name) has been an ardent critic of the scholarly neglect of rural China. See, most notably, his sociological study of rural dispute resolution, SU LI (苏力), SONGFA XIAXIANG: ZHONGGUO JICENG SIFA ZHIDU YANJIU (送法下乡: 中国基层司法制度研究) [SENDING LAW TO THE COUNTRYSIDE: STUDY OF THE BASIC-LEVEL JUDICIAL SYSTEM IN CHINA] (2000). On his call for lawyers to attend to China “indigenous resources” more generally, see SU LI (苏力), FAZHI JI QI BENTU ZIYUAN (法治及其本土资源) [RULE OF LAW AND ITS INDIGENOUS RESOURCES] (1996). While TVEs figure incidentally in Zhu’s work (see, e.g., *id.* at 48), his general focus is on political and judicial institutions.

12. While acknowledging the value of Zhu Suli’s focus on rural dispute resolution, Deng Zhenglai insists emphatically on the importance of analyzing rural and urban questions together, in a single frame, while integrating a global perspective as well. See DENG ZHENGLAI (邓正来), *Zhongguo Faxue Yanjiu zhong “Zhongguo” de Quewei* (中国法学研究中“中国”的缺维) [*The Absence of “China” in Chinese Jurisprudence*], in ZHONGGUO FAXUE XIANG HECHU QU (中国法学向何处去) [WHITHER CHINESE JURISPRUDENCE] 115 (2000).

13. Deng Zhenglai, *Academic Inquiries into the “Chinese Success Story,”* in STATE AND CIVIL SOCIETY: THE CHINESE PERSPECTIVE 1, 11 (Deng Zhenglai ed., 2011).

of China's post-1978 development.¹⁴ To understand China's transformation on its own terms, rather than as a (temporary) deviation from Euro-American modernity, this Article considers the recent Chinese past not simply as a set of empirical data to test theories developed by scholars elsewhere—even Nobel laureates—but as a historical experience capable of producing theoretical insights in its own right.¹⁵

Let us turn to rural China to find out what TVEs can teach us.

II. VILLAGE, INC.: THE STORY OF THE RURAL STATE

Everyone loves the TVE as an organizational form. In the story of Chinese development, it is the little engine that could.¹⁶ In the span of a few years, it became the locomotive pulling the rest of the economy behind it, giving rise to world-historic levels of growth. Consider the following statistics. Between 1978 and 1995, TVEs' total output increased at an average of 21% per year.¹⁷ From 1980 to 1996 their total number leapt from 1.4 million to 23.4 million, and the number of people they employed grew from 30 million workers to a total of 135 million.¹⁸ Over the period from 1978 to 1996, TVEs' share in GDP grew from 6% to 26%, at a time when China's GDP itself was growing rapidly.¹⁹

Although there is a vast scholarly consensus on TVEs' crucial role in China's early economic success through the mid-1990s, there is a striking degree of disagreement about their organizational structure and whether they ought to be analyzed as a form of private or public enterprise. Below, I draw on an existing literature on "local state corporatism" to argue that TVEs are best understood as a form of local state enterprise—a kind of "Village, Inc."—in which the law of village governance functioned as a corporation law *avant la lettre*, or even *avant la loi*.

A. From Decollectivized Agriculture to Collectivized Industry

The story of China's post-1978 reforms begins in the countryside, as a response to rural poverty.²⁰ Although it may sound counterintuitive,

14. See WANG HUI, *THE END OF REVOLUTION: CHINA AND THE LIMITS OF MODERNITY* 7–8 (2009). For a broad-ranging theorization of China's ongoing transformation—decidedly not "transition"—see LIN CHUN, *THE TRANSFORMATION OF CHINESE SOCIALISM* (2006).

15. See TEEMU RUSKOLA, *LEGAL ORIENTALISM: CHINA, THE UNITED STATES, AND MODERN LAW* 221 (2013).

16. The most comprehensive overview of TVEs remains a World Bank study conducted in collaboration with the Chinese Academy of Social Sciences, entitled *CHINA'S RURAL INDUSTRY: STRUCTURE, DEVELOPMENT, AND REFORM* (William A. Byrd & Qingsong Lin eds., 1990).

17. Enrico Perotti et al., *State-Owned Versus Township and Village Enterprises in China*, 41 *COMP. ECON. STUD.* 151, 152 (1999) (citing the *China Statistical Yearbook*).

18. *Id.*

19. BARRY NAUGHTON, *THE CHINESE ECONOMY: TRANSITIONS AND GROWTH* 274–75 (2007).

20. The beginning of the reforms is usually dated from the Zhongguo Gongchandang di Shiyi jie Zhongyang Weiyuanhui di San ci Quanti Huiyi Gongbao (中国共产党第十一届中央委员会第三次全体会议公报) [Communiqué of the Third Plenary Session of the 11th Central Committee of the Communist Party of China], Dec. 22, 1978, translated in *PEKING REV.*, Dec. 29, 1978, at 6. This watershed document emphasized the need to address rural poverty and promote agricultural production.

it was the decollectivization of agriculture that led to the rise of collectivized rural industry.

Over the course of three decades after its founding in 1949, the PRC extracted resources ruthlessly from the countryside to build up its urban industrial base.²¹ Fueled by the closely linked imperatives of developmental state socialism and the Cold War, the PRC invested heavily in SOEs in major cities. The vaunted “iron rice bowl”—guaranteed lifetime employment with associated welfare benefits—was a privilege whose enjoyment was limited to the urban elite of SOE workers.²² Once the collectivization of agriculture was complete, rural communes were held largely responsible for the welfare of their members.²³ In extraordinary circumstances such as crop failure, this could mean even famine unless the central government intervened.

Such a disparity in the economic status of rural and urban populations could be maintained only by restricting internal mobility. This was accomplished by instituting a strict household registration (*hukou*) system in 1955—essentially a legally enforced caste system that tied a range of state-conferred benefits to residence, ranging from food rations to schooling to medical care.²⁴ Once established, one’s residence was virtually untransferable. To be categorized a “peasant” (*nongmin*), as opposed to a city-dwelling “worker” (*gongren*), was thus not only to carry a social label but to occupy a legally enforced administrative status as well.²⁵ Under this regime of internal colonialism, which of the two Chinas one was born into—rural or urban—had a decisive significance for the trajectory of a person’s life.

The gradual decolonization of the countryside began with the decollectivization of agriculture. Once a so-called household contract responsibility system (*jiating lianchan chengbao zhi*) was established in 1978, collectives were permitted officially to divide their agricultural

21. See generally JEREMY BROWN, *CITY VERSUS COUNTRYSIDE IN MAO’S CHINA: NEGOTIATING THE DIVIDE* (2012); Thomas P. Bernstein & Xiaobo Lu, *Extracting Funds from the Peasants*, in *TAXATION WITHOUT REPRESENTATION IN CONTEMPORARY RURAL CHINA* 48 (2008).

22. See generally ANDREW G. WALDER, *COMMUNIST NEO-TRADITIONALISM: WORK AND AUTHORITY IN CHINESE INDUSTRY* (1986).

23. After the enactment of the Land Reform Law in 1950, peasants were at first given full individual private ownership. Subsequently Mao turned to the Soviet model and began to collectivize rural land, with a shift again in 1962 to smaller village-based collectives rather than giant communes. See Roy Prosterman, *Rural Land Rights in China*, in *LAW AND ECONOMICS WITH CHINESE CHARACTERISTICS: INSTITUTIONS FOR PROMOTING DEVELOPMENT IN THE TWENTY-FIRST CENTURY*, *supra* note 8, at 214, 216. As a rule, rural agricultural collectives were held responsible for the provision of public goods locally, rather than being subsidized from the national budget. See LILY L. TSAI, *ACCOUNTABILITY WITHOUT DEMOCRACY: SOLIDARY GROUPS AND PUBLIC GOODS PROVISION IN RURAL CHINA* 31–32 (2007).

24. See generally MICHAEL DUTTON, *POLICING AND PUNISHMENT IN CHINA* 189–245 (1992); Tiejun Cheng & Mark Selden, *The Origins and Consequences of China’s Hukou System*, 1994 *CHINA Q.* 664.

25. See generally Myron Cohen, *Cultural and Political Inventions in Modern China: The Case of the Chinese “Peasant,”* 122 *DAEDALUS* 151 (1993).

land into plots which were leased to member households.²⁶ So long as each household remanded an agreed-upon quota to the collective, it was free to sell the remainder at market prices. This simple reform had the desired goal of increasing agricultural production. It also had the wholly unforeseen effect of leading to the rise of TVEs. Over time, the near-total restriction on geographic—and, by implication, social—mobility imposed by the household registration system had given rise to a large rural population surplus and overemployment in agricultural production. As households began to accrue savings under the contract responsibility system, the appearance of a new source of capital coincided with the release of surplus labor from agriculture.²⁷ The basic factors of production were thus in place for the formation of TVEs.

The one ingredient that was seemingly missing, however, was the most crucial of all: an institutional framework for organizing the factors of production. More complex than agriculture, industrial enterprise requires organized structures of authority that exceed the household. In the PRC of the late 1970s and early 1980s, the local state was the main, if not sole, integrative structure of authority that was left standing in the aftermath of the Cultural Revolution.²⁸ Largely by default, the local state came to provide the institutional template for emerging rural industry.

It is important to recognize that the course of rural reforms was not decreed from Beijing. “What took us by surprise completely was the development of township and village industries,” Deng Xiaoping admitted subsequently, adding, “[t]his was not something I had thought about.”²⁹ To be sure, TVEs were not wholly unprecedented. During the Maoist era a number of rural collectives had organized industrial production on a limited scale in the form of so-called commune and brigade enterprises, and some survived into the 1980s, thereby providing a politically correct prototype for TVEs.³⁰ However, earlier experiments in rural industry had been largely unsuccessful, and many

26. SUSAN L. SHIRK, *THE POLITICAL LOGIC OF ECONOMIC REFORM IN CHINA* 38–42 (1993). A number of scholars note that official experiments were preceded by unauthorized ones in Anhui, among other places. See QIANFAN ZHANG, *THE CONSTITUTION OF CHINA: A CONTEXTUAL ANALYSIS* 48 (2012). Lynn White observes that “responsibility fields” were introduced extensively as early as the 1960s and that they were maintained in secrecy through the Cultural Revolution until they were relegitimated in 1978. LYNN WHITE, *UNSTATELY POWER: LOCAL CAUSES OF CHINA’S ECONOMIC REFORMS* 87 (1998). David Faure cites late imperial precedents for similar contracting of agricultural production, identifying a “great contractual tradition that had fuelled economic success from the Ming to the Republic with all its flexibilities.” DAVID FAURE, *CHINA AND CAPITALISM: A HISTORY OF BUSINESS ENTERPRISE IN MODERN CHINA* 76 (2006).

27. As Yasheng Huang observes, “[a] little known fact about the 1980s is that significant and imaginative innovations occurred in rural finance.” YASHENG HUANG, *CAPITALISM WITH CHINESE CHARACTERISTICS: ENTREPRENEURSHIP AND THE STATE* 112 (2008).

28. DAVID WANK, *COMMODYING COMMUNISM: BUSINESS, TRUST, AND POLITICS IN A CHINESE CITY* 230 (2001).

29. WHITE, *supra* note 26, at 96 (quoting Deng Xiaoping).

30. In 1978, there were only 1.5 million commune and brigade enterprises, but by 1985, 12 million TVEs. HUANG, *supra* note 27, at 73.

notoriously so, associated with the Great Leap Forward.³¹ A key institutional reason why TVEs succeeded where their predecessors had failed lay in the transformation of the fiscal relationship between the rural state and the central government.

In terms of its constitutional architecture, the PRC has been a unitary state since its founding. For administrative purposes it is a pyramid-shaped entity subdivided into five levels of government, with each level reporting to the level immediately above and ultimately to the central government.³² Prior to fiscal reform, each level submitted the revenues it collected to the central state, which in turn redistributed them downward according to a central plan. In order to relieve itself of its financial liability for provincial and other lower level governments whose expenses continually exceeded their receipts, in 1980 the central government instituted a so-called tax responsibility system, analogous to the household contract responsibility in agriculture.³³ The system permitted each level of government to keep any revenue it collected in excess of a quota which it negotiated with the level of government immediately above. This reorganization, often referred to as “fiscal federalism,” provided the center with a guaranteed stream of income and made lower levels of government largely self-financing. Colloquially the new arrangement came to be referred to as “eating in separate kitchens” (*fen zao chi fan*), in contrast to the Maoist ideal of everyone “eating from one big pot” (*chi da guo fan*).³⁴

Although the revenue quotas were a matter of intense negotiation and not always met, the reform gave local governments for the first time a distinct economic identity, subjecting them in theory at least to “hard budget constraints.”³⁵ While the point was to redistribute economic burdens, as a corollary local governments were also allowed to keep any “extrabudgetary” revenue they were able to generate.³⁶ The ability to retain any residual income over their tax quotas provided a crucial motivation for rural local governments to establish firms of their own. Collectively these firms came to known as TVEs. As owners

31. NAUGHTON, *supra* note 19, at 272–73.

32. SUSAN H. WHITING, *POWER AND WEALTH IN RURAL CHINA: THE POLITICAL ECONOMY OF SOCIAL CHANGE* 75 (2000). The five “officially” integrated levels are central, provincial, prefectural, county, and township governments. In principle, villages are self-governing entities.

33. See SHIRK, *supra* note 26, at 149–96.

34. *Id.* at 162, 149.

35. Janos Kornai coined the distinction between “soft” and “hard” budget constraints to analyze enterprises in post-Cold War Hungary, but the terms are ubiquitous in the Chinese economic literature as well. See JANOS KORNAI, *THE SOCIALIST SYSTEM: THE POLITICAL ECONOMY OF COMMUNISM* (1992).

36. SHIRK, *supra* note 26, at 162–68.

of local public enterprise, townships and villages could increase their receipts directly by the proceeds of their TVEs.³⁷

Before proceeding, it is helpful to sketch briefly how local government is organized in the PRC. For some two millennia, the county (*xian*) represented the farthest reach of public administration. The very assertion of direct control by the PRC over political, economic, and intimate life below the county represented a revolutionary extension of state power. After 1958, the countryside was organized into communes (*gongshe*), representing a complete merger of economic and political functions.³⁸ Communes in turn consisted of brigades. In 1983, communes were converted into townships, while brigades were turned back into villages, followed by a separation of each unit's public administration from the economic management of its collective assets.³⁹

For the sake of simplicity and consistency, the remainder of this Article will focus on villages, except where otherwise indicated. Although the "difference between township and village is only in degree and not in kind," they differ in some regards in their administrative organization.⁴⁰ According to the PRC Constitution, villages are "mass organizations of self-government" at the local level.⁴¹ Unlike townships and other higher levels of government, villages are in some ways both inside and outside of the rest of the state apparatus. For example, the village head is not officially a member of the state bureaucracy, and his salary is ordinarily paid from village funds.⁴² Nevertheless, while villages may not be considered formally an arm of government, "they are in reality perceived, treated, and utilized as part of the state organ."⁴³

37. In a system of "level by level management," profits of centrally run enterprises went to the central government while the profits of locally operated enterprises went to local governments, reflecting what Shirks describes as "China's tradition of centralized formal authority with a significant degree of de facto decentralization to the provincial level and below." *Id.* at 155. Strictly speaking, villages were not part of the revenue contracting system, but after paying taxes on their enterprises to the township government, they were allowed to keep all of their residual income. See Andrew G. Walder, *Local Governments as Industrial Firms: An Organizational Analysis of China's Transitional Economy*, 101 *Am. J. Soc.* 263, 280 (1995).

38. See YANG ZHONG, *LOCAL GOVERNMENT AND POLITICS IN CHINA: CHALLENGES FROM BELOW* 43 (2003).

39. WHITING, *supra* note 32, at 76.

40. Xiaolin Pei, *Township-Village Enterprises, Local Governments, and Rural Communities: The Chinese Village as a Firm During Economic Transition*, 4 *ECON. TRANSITION* 43, 46 (1996). Despite occupying a lower administrative rank than townships, villages were responsible for roughly half of China's rural industry, both small and large scale. WHITE, *supra* note 26, at 131.

41. XIANFA art. 111 (1982). For example, village governance is outside the scope of the provision of *Zhonghua Renmin Gongheguo Difang Geji Renmin Daibiao Dahui he Difang Geji Renmin Zhengfu Zuzhi Fa* (中华人民共和国地方各级人民代表大会和地方各级人民政府组织法) [Organic Law of Local People's Congresses and Local People's Governments of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., July 4, 1979, effective Jan. 1, 1980), CLI.1.44365(EN) (Lawinfochina).

42. WHITING, *supra* note 32, at 107.

43. ZHONG, *supra* note 38, at 190.

It is important to understand the specific ways in which TVEs' operation was articulated with the multiple institutions of the local state. Typically villages hired private managers to operate their enterprises on behalf of the community as a whole, but rather than simply renting out its name to a private entrepreneur for a fee, the local government retained control over strategic decisions as well as profits generated by the enterprise.⁴⁴ Early on, political scientist Jean Oi characterized the phenomenon—essentially the establishment of a separation of ownership and control in the operation of local public enterprise—as a form of “local state corporatism.”⁴⁵ Although an individual villager did not have direct, formal ownership rights in them, collectively villagers were the ultimate owners of the community's enterprises, not unlike shareholders of a corporation.⁴⁶ The local government in turn performed a role equivalent to that of a board of directors, monitoring TVE managers on behalf of the village community as a whole.⁴⁷ In many townships and villages the arm of the local government responsible for overseeing its TVEs was organized as a separate entity known as the local “industrial corporation” (*gongye gongsi*).⁴⁸

Remarkably, not only did TVEs turn out to be phenomenally successful in industrial production—by 1987, industry exceeded agriculture as the chief source of rural income⁴⁹—but they also routinely engaged in what Oi calls “redistributive corporatism.”⁵⁰ Because of the diffuse nature of their public ownership, TVEs could not simply distribute their profits to individual owners. Instead, the bulk of them were reinvested in the enterprise while the rest were spent on the provision of public goods, such as community centers, educational subsidies, and even free water and electricity, in the case of the most prosperous villages.⁵¹ In addition, because of their relatively higher pay,

44. As Lynn White reports, “[t]own leaders only involve themselves with rural businesses indirectly and in economic terms.” WHITE, *supra* note 26, at 126–27. Jean Oi similarly states, “[k]ey decisions about personnel, investment and product line must be approved by the village. The [villager to whom management is contracted] is merely an employee of the collective—that is, the village.” JEAN C. OI, RURAL CHINA TAKES OFF: INSTITUTIONAL FOUNDATIONS OF ECONOMIC REFORM 24 (1999).

45. *See id.* at 95–138. Oi herself notes her idiosyncratic usage of the term “corporatism.” While it usually refers to a system that seeks to integrate the state as a whole vertically, her concern is specifically with the integration of the interests of the *local* state. *Id.* at 11–12.

46. Pei, *supra* note 40, at 49. This was evident in the practice of paying local employees more than migrant workers from outside, the higher pay effectively a way of distributing “profits” to owners. WHITE, *supra* note 26, at 140.

47. Andrew G. Walder, *The County Government as an Industrial Corporation, in* ZOUJING IN TRANSITION: THE PROCESS OF REFORM IN RURAL CHINA 62 (Andrew G. Walder ed., 1998).

48. WHITING, *supra* note 32, at 242.

49. Oi, *supra* note 44, at 1.

50. *Id.* at 79–80.

51. *See, e.g.,* Martin L. Weitzman & Chenggang Xu, *Chinese Township-Village Enterprises as Vaguely Defined Cooperatives*, 18 J. COMP. ECON. 121, 133 (1994); Chun Chang & Yijian Wang, *The Nature of Township-Village Enterprise*, 19 J. COMP. ECON. 434, 441 (1994).

TVE managers typically sought to ensure that at least one member in each local household was employed in a TVE.⁵²

Insofar as the firm boundaries of TVEs were drawn on the level of the local community as a whole, they can be usefully characterized by the shorthand term Village, Inc.⁵³

B. How Did TVEs Work? Beyond Property Rights

This account of TVEs as a form of local state enterprise—a local state corporatism—is not uncontested. Political scientist Yasheng Huang, perhaps most notably, disputes the premise that TVEs were a form of public enterprise at all. Rather, he insists that the development of TVEs followed “universal laws” of economic theory. By Huang’s definition, this means that they were private firms that were merely masquerading as arms of local government.⁵⁴ It is important to emphasize at the outset that TVEs were indeed a form of *local* enterprise, and by definition their organizational and operational characteristics varied from one local government to the next, and even more so across regions. At different times and in different places, TVEs combined public and private elements in distinctive ways and in varying degrees.

Without question, many TVEs were in fact essentially private enterprises, as Huang argues. In an era when collective ownership was the only legal form of enterprise recognized in the countryside, private entrepreneurs had overwhelming ideological and material incentives to cloak themselves in public nomenclature. The phenomenon of “fake collectives” is exemplified by so-called red hat (*hong mao*) entities, run by entrepreneurs who paid a “management fee” to the local government for the privilege of operating a privately owned but officially recognized enterprise.⁵⁵ Nevertheless, it is no less clear that many TVEs were in fact collectively owned local government enterprises, not simply fake collectives.⁵⁶ Moreover, it was the TVEs under the actual

52. Oi, *supra* note 44, at 77. Indeed, overemploying personnel was a response to the rural population surplus, and another key reason why local cadres were partial to TVEs over private enterprises, as contributors to social stability. Chiang Chi Heng, *Local Governments and the Development of Rural Enterprises: A Case Study of Zhongshan City, 1978–1990*, at 33–34 (June 1994) (unpublished M.Ph. thesis, Chinese University of Hong Kong, Department of Government and Public Administration) (on file with author).

53. I borrow the term “Village, Inc.” from Jean C. Oi, *The Chinese Village, Inc.*, in *CHINESE ECONOMIC POLICY: ECONOMIC REFORM AT MIDSTREAM 67* (Bruce Reynolds ed., 1988), and *VILLAGE INC.: CHINESE RURAL SOCIETY IN THE 1990s* (Flemming Christiansen & Zhang Junzuo eds., 1998).

54. HUANG, *supra* note 27, at 77–78.

55. See, e.g., VICTOR NEE & SONJA OPPER, *CAPITALISM FROM BELOW: MARKETS AND INSTITUTIONAL CHANGE IN CHINA* 111 (2012).

56. See, e.g., Oi, *supra* note 44, at 58 (“[C]ollectively owned enterprises dominated in most townships and villages in the 1980s.”); Perotti et al., *supra* note 4, at 2 (stating that “the core TVEs are collectively owned by the citizens in rural communities” and are therefore “public enterprises like SOEs”); Qian & Weingast, *supra* note 4, at 255 (debunking the “clearly false” view that TVEs are “actually private firms in disguise”); NAUGHTON, *supra* note 19, at 271 (“[M]ost TVEs were collectively owned.”).

control of rural governments that were responsible for the bulk of the growth generated by rural industry.⁵⁷ These bona fide public enterprises were both the vanguard and the mainstay of China's economic revolution in the countryside.

As noted in the Introduction, TVEs have been the object of singular fascination among economists as their very existence defies basic economy theory. Among theorists of the firm, it is an axiom that the separation of ownership and control in an enterprise is not feasible without well-defined property rights. Otherwise, investors could hardly be expected to invest. In the so-called Coasean world, postulated by Ronald Coase, the state's key task is to provide for the rights of property and contract. Once they are established, in the absence of transaction costs markets will allocate resources optimally.⁵⁸ TVEs evidently defied this postulate, having succeeded extraordinarily well without legally defined property rights.

This puzzle is especially acute for scholars such as Yasheng Huang who characterize TVEs as privately owned enterprises camouflaged nominally as village collectives. Huang's answer to this puzzle is remarkably weak. Admitting to the absence of "a genuine institutional guarantee of private property rights" in TVEs, he asserts that post-1978 reforms nonetheless tended to guarantee private entrepreneurs' *personal* security—in contrast to the Cultural Revolution, during which engaging in private enterprise could result in arrest, and worse. Insofar as "[t]he security of the proprietor is the necessary condition for the security of the property itself," this constitutes a major step toward securing private property rights, Huang asserts.⁵⁹ Surely the protection of an entrepreneur's physical freedom and bodily integrity is an improvement over subjecting him or her to overt political violence, but it falls categorically short of a guarantee of protection of his or her property.

Shortly before his death in 2013, Ronald Coase himself—yet another Nobel laureate—joined the seemingly endless debate on TVEs. In a coauthored book, Coase recognized the local state's extensive role in TVEs, yet in the end he too insisted, "[i]t is not the case that the

57. See Chang & Wang, *supra* note 51, at 448 ("[E]nterprises with a low capital requirement are more likely to be privately owned than those with a higher capital requirement."); Oi, *supra* note 44, at 62, 67 (observing that collective TVEs were predominant over private ones, with the latter concentrated in "small scale service trades, handicrafts, and small manufacturing"). The literature on Chinese rural industry often distinguishes between the so-called Sunan and Wenzhou models, referring to the predominance of collectively owned industry in Sunan, in Southern Jiangsu, and private industry in Wenzhou, in Zhejiang. Susan Whiting notes that in the beginning of the reform era, Wenzhou had relatively few commune and brigade enterprises on which to build and therefore had little choice but to encourage private development. Her analysis suggests that Wenzhou turned to private enterprise as a "second-best" option. WHITING, *supra* note 32, at 123, 133.

58. Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); RONALD H. COASE, *THE FIRM, THE MARKET AND THE LAW* (1988).

59. HUANG, *supra* note 27, at 94.

Chinese experience of market transformation challenges secure and well-defined property rights as a legal foundation in the working of a market economy.⁶⁰ While admitting that China's failure to provide TVEs with such rights was nevertheless "peculiar,"⁶¹ Coase and his co-author Ning Wang suggested that the true secret to TVEs' success lay in the relatively hard budget constraints under which they operated. Economists' exclusive focus on property rights in TVEs was therefore "misplaced," Coase and Wang concluded—essentially contradicting their own claims about their foundational role.⁶²

To date the best-known and most consistent economic analysis of TVEs remains that advanced by Joseph Stiglitz.⁶³ Heralding TVEs as "[t]he great innovation of China,"⁶⁴ Stiglitz accepts the reality that the bulk of them were a form of publicly owned enterprise. Accordingly, he analyzes them as an institutional adaptation to the lack of formally defined property rights at an early state of legal and economic reform. In this view, what made TVEs work was the willingness of local officials to protect their assets and revenue from illegitimate extractions. Stiglitz, however, does not elaborate just *how* officials were able to protect TVE assets. Property scholar Frank Upham offers a more nuanced understanding of the sociology of Chinese rural society, locating the source of TVEs' success in a range of inherited informal institutions protecting investors' expectations.⁶⁵ Indeed, in his extension of Stiglitz's argument Upham goes so far as to suggest that local communities' ownership in TVEs "may actually have been better protected through social and political means than are the much more clearly articulated ownership rights of shareholders in U.S. corporations."⁶⁶

This analysis makes sense as a matter of both economic theory and historical explanation. For institutional economists, a firm is a command hierarchy amidst otherwise horizontally structured markets,

60. RONALD COASE & NING WANG, *HOW CHINA BECAME CAPITALIST* 172–73 (2012).

61. *Id.* at 172.

62. *Id.*

63. See sources cited *supra* note 8. There are a number of versions of this argument by others as well. See, e.g., DANI RODRIK, *THE GLOBALIZATION PARADOX: DEMOCRACY AND THE FUTURE OF THE WORLD ECONOMY* 151 (2011); Jiahua Che & Yingyi Qian, *Insecure Property Rights and Government Ownership of Firms*, 113 Q.J. ECON. 467 (1998); Yingyi Qian, *How Reform Worked in China*, in *IN SEARCH OF PROSPERITY: ANALYTIC NARRATIVES ON ECONOMIC GROWTH* 297 (Dani Rodrik ed., 2003); WHITING, *supra* note 32, at 121–75.

64. Stiglitz, *Quis Custodiet Ipsos Custodes?*, *supra* note 8, at 45.

65. See generally Frank Upham, *What Are Property Rights Good For? Surprising Lessons from the Chinese Experience*, in *RETHINKING LAW AND DEVELOPMENT: THE CHINESE EXPERIENCE* 82 (Guanghua Yu ed., 2013) [hereinafter Upham, *What Are Property Rights Good For?*]; Frank Upham, *From Demsetz to Deng: Speculations on the Implications of Chinese Growth for Law and Development Theory*, 41 N.Y.U. J. INT'L L. & POL. 551 (2009); FRANK K. UPHAM, *THE GREAT PROPERTY FALLACY: THEORY, REALITY, AND GROWTH IN DEVELOPING COUNTRIES* 89–91 (2018). There is a growing literature on informal or functional property rights in contexts beyond TVEs. See, e.g., SHITONG QIAO, *CHINESE SMALL PROPERTY: THE CO-EVOLUTION OF LAW AND SOCIAL NORMS* (2018); Weitseng Chen, *Arbitrage for Property Rights: How Foreign Investors Create Substitutes for Property Institutions in China*, 24 WASH. INT'L L.J. 47 (2015).

66. Upham, *What Are Property Rights Good For?*, *supra* note 65, at 87.

one that arises when transaction costs for coordinating economic activity in the market are too high—which occurs routinely in the real (as opposed to the Coasean) world.⁶⁷ As we have seen, when the economic reforms began in 1978, the local state was among the few structures of authority in existence. To be sure, the state is a form of public authority while the firm as envisioned by institutional economists is a private one. Structurally, however, they are in key respects isomorphic hierarchical organizations: we can think of the firm as a kind of small-scale “planned economy” amid markets. It is thus hardly surprising that emerging rural enterprise combined elements of markets with elements of the local state. So long as the local government protected investors’ legitimate expectations—whether the invested assets were public or private—TVEs had the institutional support they needed.⁶⁸

Yet even the accounts by Stiglitz and Upham offer only a partial answer to what scholars of corporation law characterize as the agency problem resulting from a separation of ownership and control. In principle, managers are required to act as agents for shareholders, their principals, rather than in their own interest. In the classical expression of the fundamental question of corporation law, *quis custodiet ipsos custodes*—who will guard the guardians?⁶⁹ In this formulation, the chief task of corporate governance is to provide a mechanism for allowing shareholders to maintain effective oversight over managers. Combined with a sociological analysis of local state corporatism, Stiglitz and Upham offer an account of how a village government—analogueous to a board of directors—could monitor managers in charge of local TVEs.⁷⁰ What remains unexplained is how villagers might in turn oversee the local officials to ensure that *they* too acted in the interests of the village as a whole. What kept those in control of local government from expropriating the profits of TVEs to line their own pockets, or splitting them up with the managers whom they were charged with overseeing?

67. See OLIVER WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975); COASE, *supra* note 58.

68. There is a parallel argument in the literature on “market-preserving federalism,” which argues that China’s decentralized budget structure created an incentive for local governments to preserve markets in their jurisdictions and protect property on a political rather than legal basis. See, e.g., Gabriella Montinola et al., *Federalism, Chinese Style: The Political Basis for Economic Success in China*, 48 *WORLD POL.* 50 (1995); Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 *J.L. ECON. & ORG.* 1 (1995). However, as critics have pointed out, this explanation suffers from the same limitation as the more specific property rights account: it too treats the local government as a unitary entity, without considering the incentives for local officials to extract rents from the enterprises under their jurisdiction, rather than operating them in the community’s interest. See generally Jonathan Rodden & Susan Rose-Ackerman, *Does Federalism Preserve Markets?*, 83 *VA. L. REV.* 1521 (1997). Stated in terms of the argument of this Article, the political foundation of federalism is not enough without local institutions—such as local law—to regulate officials’ behavior.

69. JUVENAL, *SATIRES* 6:347.

70. For a more detailed analysis of various bureaucratic actors engaged in the monitoring, see OI, *supra* note 44, at 104–05.

Stated differently, TVEs suffered not only from the absence of legally defined property rights but also the lack of any kind of *organizational law*. The establishment of a successful enterprise certainly demands property rights, or their functional equivalent, but that alone is not enough in a world bedeviled by transactions costs. Despite his lukewarm defense of the (putative) centrality of property rights, even Coase ultimately admits that the key ingredient in TVEs' success was the organizational structure provided by the local state.⁷¹ Yet for both Stiglitz and Coase the state is ultimately a black box—an entity with discrete goals that somehow regulates itself and is able to act in the collective interest of its members. Other scholars have resorted to cultural accounts *à la* Douglass North,⁷² attributing TVEs' success to a uniquely “cooperative culture,”⁷³ and even a semi-mystical quasi-Teutonic *Genossenschaftsgeist*,⁷⁴ that purportedly prevail in rural China. These cultural explanations are so vague as to verge on the tautological.

However, if we view the Chinese village as a whole as a “government corporation” of sorts—a kind of local SOE in the countryside—we can then examine the extent to which the *law of village government* performed the functions of corporation law, ordering the local state as well as local enterprise. This is evidently an anti-formalist definition of corporation law, but not exceptionally so. In the context of the United States, Margaret Blair, for example, defines the analysis of corporate governance to encompass “the whole set of legal, cultural, and institutional arrangements” that collectively delimit what corporations “can do, who controls them, how that control is exercised, and how the risk and returns from their activities are allocated.”⁷⁵ Applied to TVEs, this definition comprises not only the positive law governing Chinese rural government but also the larger social and political institutions among which that law was embedded. It is in this extended sense that in rural China the law of village government became also the law of corporate governance.

C. *Law of Local Government as Corporation Law*

I will not seek to outline all the details of Chinese local government law *cum* corporation law in the 1980s and 1990s. Such law was by definition local and varied in its specific features from place to place.⁷⁶ The point is above all an analytic one, making room for a more

71. See COASE & WANG, *supra* note 60, at 142 (conceding that “organization is often in shorter supply than capital investment” and that “in China, this vacuum was filled up by local governments”).

72. See North, *supra* note 6.

73. Weitzman & Xu, *supra* note 51, at 136.

74. Holger Bonus, *The Cooperative Association as a Business Enterprise: A Study in the Economics of Transactions*, 142 J. INSTITUTIONAL & THEORETICAL ECON. 310, 310 (1986).

75. MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 3 (1995).

76. Cf. NAUGHTON, *supra* note 19, at 280 (“A simple but important aspect of TVE development was that there was no single organizational model that TVEs had to follow.”). For a sociological study of the diversity institutional arrangements, see CHIH-JOU JAY CHEN, TRANSFORMING RURAL CHINA: HOW LOCAL INSTITUTIONS SHAPE PROPERTY RIGHTS IN CHINA (2004).

expansive conception of enterprise law and, more broadly, of law's role in economic development. This is especially important in the context of the political economy of China where the boundaries among the political, economic, and social often align in unforeseen ways.⁷⁷

In this regard, TVEs can be viewed as a contemporary iteration of what I have elsewhere called "clan corporations" in late imperial China. In a political economy organized in Confucian terms, economic enterprise was frequently structured in the form of hierarchical Confucian lineage organizations in which kinship was often only a legal fiction (much as corporate personhood is a fiction in the Euro-American tradition of corporation law).⁷⁸ While this gave such entities—in effect, clan corporations—a legally recognized status, it also meant that their management and operation were ultimately governed by the norms of Confucian family law. In late imperial China, this was no contradiction: an entity composed of elements of both family and corporation could be no less a family for being a corporation, and vice versa.⁷⁹

Analogously, the above analysis of TVEs suggests that an entity combining aspects of government and corporation—or, more generally, public enterprise—need not be an oxymoron. Rather than an aberrant fusion of the state and the market, TVEs worked precisely because they combined elements of both. It is evident that much of the law of local government in its broadest sense, and thus of TVE governance, consisted of uncodified social expectations and local institutions—what we might call the customary law of townships and villages. It was this local law of TVE governance that protected the interests of the community as a whole.

How did the local law of TVEs operate in practice? If we view village officials as a kind of board of directors, in what sense can we view the villagers as "owners"? Not only did TVEs operate essentially without a legal basis, but the PRC did not even enact a formal Property Law until 2007.⁸⁰ Yet we should not be misled into believing that what preceded it was a vacuum. Even under Maoism there were established norms and institutionalized practices of ownership. According to inherited socialist principles, assets in public enterprises were "owned by citizens at the level of government that contributed them in the

77. I analyze the methodological problems posed by comparison of institutions embedded in different political economics in Teemu Ruskola, *What Is a Corporation? Liberal, Confucian, and Socialist Theories of Enterprise Organization (and State, Family, and Personhood)*, 37 SEATTLE U. L. REV. 637 (2013).

78. See generally Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STAN. L. REV. 1599 (2000).

79. See also Teemu Ruskola, *Home Economics: What Is the Difference Between a Family and a Corporation?*, in RETHINKING COMMODIFICATION 324 (Joan Williams & Martha Ertman eds., 2005).

80. See Zhonghua Renmin Gongheguo Wuquan Fa (中华人民共和国物权法) [Property Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., Mar. 16, 2007, effective Oct. 1, 2007), CLI.1.89386(EN) (Lawinfochina).

first place.⁸¹ Under this theory, the property of an enterprise established by a village belonged to the members of the village as whole, while control rights were exercised by village government, resulting effectively in a division between ownership by the village members and management by the village government.

Let us first consider the structure of ownership in TVEs. On the one hand, it is true that "owners [in TVEs] are not clearly identifiable."⁸² On the other hand, there is no question that as a member of the community each villager had an economic stake in village assets. To be sure, villagers' equity was not transferable. Under the household registration system, village population was essentially fixed and it could not even vote with its feet. (It is useful to keep in mind that even in formally incorporated close corporations in the United States and Europe transfer restrictions are common.) Significantly, though, while villagers could not realize their ownership by selling their stake in the village, by providing public goods TVEs in fact returned a portion of their profits as quasi-dividends, as we have seen.⁸³

Turning to TVE management, what were some of the formal and informal institutions that kept TVE managers and their official overseers accountable to the villagers as a group? As Yang Zhong recognizes in his study of Chinese village institutions, "it is not easy to define the exact legal status and role of the village authorities."⁸⁴ Yet that does not mean that we can simply ignore them. Village elections constitute the most obvious, albeit not necessarily the most effective, institution of village governance. Beginning in 1987, the Organic Law of Village Committees has provided for the election of a three- to seven-member village committee (*cunmin weiyuanhui*).⁸⁵

The larger democratic significance of village elections is a matter of debate, but as far as TVEs are concerned, it is important to be aware that they were not established with an abstract political ideal in mind. Kevin O'Brien and Lianjiang Li regard them as "first and foremost a solution to a principal-agent problem," suggesting that "they have less to

81. See Susan Whiting, *The Regional Evolution of Ownership Forms: Shareholding Cooperatives and Rural Industry in Shanghai and Wenzhou*, in PROPERTY RIGHTS AND ECONOMIC REFORM IN CHINA 171, 187 (Jean C. Oi & Andrew G. Walder eds., 1999) ("[W]hoever invests is the owner and receives the benefits' (*shei touzi, shei suoyou, shei deyi*).").

82. CHUN, *supra* note 14, at 31.

83. See *supra* text accompanying note 51.

84. ZHONG, *supra* note 38, at 159.

85. The 1987 law was promulgated for trial implementation only. See Zhonghua Renmin Gongheguo Cunmin Weiyuanhui Zuzhi Fa (Shixing) (中华人民共和国村民委员会组织法(试行)) [Organic Law of Village Committees of the People's Republic of China (for Trial Implementation)] (promulgated by the Standing Comm. Nat'l People's Cong., Nov. 24, 1987, effective June 1, 1988), CLI.1.3583(EN) (Lawinfochina). This institution, too, had immediate popular precedents in the spontaneous establishment of village committees without official sanction in some locales in 1977. See ZHONG, *supra* note 38, at 163. The Constitution characterizes village committees as "primary mass organizations of self-government at the grass-roots level." XIANFA art. 111 (1982).

do with liberal ideology or any newfound affection for pluralism and more to do with preventing local officials from thwarting measures designed to rein them in.”⁸⁶ Insofar as the central government had lost its ability to exert effective control in villages—because of the autonomy they had won during the Cultural Revolution—it now sought to recruit villagers themselves as watchdogs. It is evident that village elections have not lived up to the democratic expectations that many had of them.⁸⁷ Nevertheless, at least in some instances villagers have in fact been able to use them to police TVEs by overturning manipulated elections, reclaiming diverted village funds, and auditing suspicious government accounts.⁸⁸

Although the mere existence of formally articulated legal rights does not guarantee that they will be enforced, a growing awareness of such rights has motivated villagers to realize them also through informal means when the state has refused to uphold them. Staging a collective protest can become a kind of “class action,” and unrest is one thing that Chinese officialdom is afraid of. An expanding rights consciousness in Chinese villages has given rise to the use of traditional protest tactics in combination with assertions of formal rights, resulting in an admixture of Maoist rhetoric and claims based on local citizenship.⁸⁹ Starting in the 1980s, some villages have enacted so-called village compacts (*cungui minyue*), a Confucian institution with a history of several centuries.⁹⁰ This practice was codified in the Organic Law of Village Committees which calls for village assemblies to issue charters with management regulations.⁹¹ Insofar as such charters go beyond general ethical exhortations and provide rules for village governance, they can play a role at least roughly analogous to corporation bylaws.

86. KEVIN J. O'BRIEN & LIANJIANG LI, *RIGHTFUL RESISTANCE IN RURAL CHINA* 65 (2006). In a similar way, Lily Tsai observes that popular village elections were instituted with the hope of making “villagers responsible for monitoring and sanctioning village officials when they fail to provide adequate public goods and services.” TSAI, *supra* note 23, at 11.

87. Moreover, they have been mandatory only since 1998, after the 1987 Organic Law for Trial Implementation was replaced by a new *Zhonghua Renmin Gongheguo Cunmin Weiyuanhui Zuzhi Fa* (中华人民共和国村民委员会组织法) [Organic Law of Village Committees of the People's Republic of China] (adopted by the Standing Comm. Nat'l People's Cong., Nov. 4, 1998, effective Nov. 4, 1998), CLI.1.21056 (Lawinfochina). In both versions of the law, the village committee's specifically stated functions include managing the village's “public affairs and public welfare” (Organic Law of Village Committees of the People's Republic of China 1998 art. 2) and helping villagers set up “various forms of cooperative and other economic undertakings” (Organic Law of Village Committees of the People's Republic of China (Trial Implementation) art. 4; Organic Law of Village Committees of the People's Republic of China 1998 art. 5). The permanent 1998 law specifically requires that the village committee refer decisions involving the “use of profits gained by collective economic organizations” to the village assembly as a whole (Organic Law of Village Committees of the People's Republic of China 1998 art. 19). The 1998 law was superseded by a new law promulgated in 2010, long after TVEs had already declined as an enterprise form.

88. O'BRIEN & LI, *supra* note 86, at 102.

89. *See id.* at 9.

90. For a sample village compact, see GREGORY A. RUF, *CADRES AND KIN: MAKING A SOCIALIST VILLAGE IN WEST CHINA, 1921–1991*, at 165 (1998).

91. Organic Law of Village Committees of the People's Republic of China 1998 art. 20.

Importantly, as a selective reliance on Confucian institutional precedents suggests, TVEs combine not only the economic logic of markets with the political logic of the local state. They also draw on the reemergence of an earlier, never wholly expurgated idiom of kinship-based trust. Although the Party has sought to abolish Confucianism as a form of feudal superstition, communities' collective interest in their TVEs has been articulated consistently in both political and kinship terms. For example, the relationship between a local government and a TVE was described typically as a "father-son" relationship.⁹² Similarly, when TVE managers were caught in relatively minor acts of misbehavior, officials sought to address them locally "within the family" whenever possible.⁹³

The invocation of kinship was not merely metaphorical, as economic reforms gave it a new material basis. In many locales the strongest non-market institution in the beginning of the reform era was not the state but pre-socialist kinship structures. Maoism had rendered local lineage institutions formally invisible, yet what took place after 1949 was frequently a mere relabeling of kinship structures as local state structures.⁹⁴ When agriculture was collectivized in the 1950s, what became socialist communes and brigades were often preexisting towns and villages.⁹⁵ In many areas, pre-revolutionary villages were in turn controlled by a single lineage—instances of erstwhile "clan corporations" organized in terms of Confucian kinship norms.⁹⁶ With decollectivization after 1978, communes and brigades were again renominated as townships and villages.⁹⁷ When markets were first established in the beginning of the reform era, it is no surprise that in many villages pre-socialist kinship norms continued to structure local politics as well as the local economy, with real and fictive lineage ties providing a social foundation for pooling and managing capital.⁹⁸

92. Lina Song, *Convergence: A Comparison of Township Firms and Local State Enterprises*, in CHINA'S RURAL INDUSTRY, *supra* note 16, at 392, 396.

93. Oi, *supra* note 44, at 157.

94. See SULAMITH HEINS POTTER & JACK M. POTTER, CHINA'S PEASANTS: THE ANTHROPOLOGY OF A REVOLUTION 94-157, 251-69 (1990).

95. See JEAN OI, STATE AND PEASANT IN CONTEMPORARY CHINA: THE POLITICAL ECONOMY OF VILLAGE GOVERNMENT 4 (1989).

96. See generally Ruskola, *supra* note 78. Anthropologists distinguish between "natural" villages, based on preexisting local kinship groups, and ones that are creations of administrative fiat.

97. See *supra* text accompanying note 39.

98. See, e.g., Chih-Jou Jay Chen, *Local Institutions and the Transformation of Property Rights in Southern Fujian*, in PROPERTY RIGHTS AND ECONOMIC REFORM IN CHINA, *supra* note 81, at 49, 61 ("Jinjiang's economic organizations . . . are embedded in the local institutions of family and clan."); Oi, *supra* note 44, at 69 (observing that in Fujian, where local governments had few assets, strong kinship ties made it also possible to rely on overseas remittances for capital). On the use of kinship networks as an alternative means of enforcing property rights, see also Taisu Zhang & Xiaoxue Zhao, *Do Kinship Networks Strengthen Private Property? Evidence from Rural China*, 11 J. EMPIRICAL LEGAL STUD. 505 (2014); Huang Xiyi, *Two-Way Changes: Kinship in Contemporary Rural China*, in VILLAGE INC.: CHINESE RURAL SOCIETY IN THE 1990S, *supra* note 53, at 177; Yusheng Peng, *Kinship Networks and Entrepreneurs in China's Transitional Economy*, 109 AM. J. SOC. 1045 (2004).

In sum, in many places—especially along the southeast coastal region—norms of Confucian family law that had governed enterprises in the late imperial era re-emerged and recombined with the rural institutions of the socialist state to produce a novel, hybrid law of village government, broadly construed, which in turn functioned as a new kind of local corporation law. Indeed, in her study of informal institutions of accountability in rural China, political scientist Lily Tsai finds that the existence of local lineage organizations correlates highly with the provision of public goods which, as we have seen, was one of the principal means by which TVEs distributed their profits to the community.⁹⁹

When China finally enacted a formal Company Law in 1993 (analyzed in Part III below) with the primary purpose of restructuring SOEs, in some cases entire villages chose to convert themselves into the legal form of the corporation—not unlike the company town of Celebration, USA, for example.¹⁰⁰ This was in important ways only a belated formal recognition of what was already functionally the case. Early on, many TVEs organized themselves as “shareholder cooperative enterprises” (*gufen hezuo qiye*), issuing ownership shares to members of the community with little or no formal legal authority.¹⁰¹ At first, TVE shares were offered only to employees, and in many ways such shares were more akin to fixed-income securities,¹⁰² yet over time they became increasingly transferable.¹⁰³ By 1990, there were over-the-counter markets for enterprise shares in several locales,¹⁰⁴ and eventually some local governments began to regulate shareholding cooperative enterprises formally.¹⁰⁵

99. TSAI, *supra* note 23, at 148–86. Correspondingly, Tsai finds that the provision of public goods did not correlate strongly with the state of economic development (and thus relative prosperity).

100. Nan Lin, *Local Market Socialism: Local Corporatism in Action in Rural China*, 24 *THEORY & SOC'Y* 301, 316–17 (1995). See also Oi, *supra* note 44, at 85 (“[H]ighly industrialized wealthy villages . . . have changed their names to industrial corporations.”).

101. See WHITING, *supra* note 32, at 158 (“Beginning in 1992, experiments with shareholding cooperatives were extended to a total of 593 enterprises in Shanghai, the majority of which were in the rural industrial sector.”). Although shareholder cooperatives came into existence in the early to mid-1980s, there were no national regulations until the Ministry of Agriculture issued Provisional Rules on Farmers’ Shareholding Coop Enterprises in 1990. Donald Clarke categorizes these early shareholder cooperatives a form of “non-statutory enterprise.” See Donald Clarke, *How Do We Know When an Enterprise Exists? Unanswerable Questions and Legal Polycentricity in China*, 19 *COLUM. J. ASIAN L.* 50, 57–59 (2005).

102. See Laixiang Sun, *Evolving and Functioning Mechanisms of Employee Stock Ownership in China’s Township and Village Enterprises*, in *OWNERSHIP AND GOVERNANCE OF ENTERPRISES: RECENT INNOVATIVE DEVELOPMENTS* 159 (Laixiang Sun ed., 2003). On compulsory sales of shares, associated with “labor rights” giving each household a right to have one member employed, see RUF, *supra* note 90, at 133.

103. According to Whiting, in Wenzhou early share offerings were structured to maintain official control over a majority of voting shares, but ultimately shares came to be offered also to people not directly connected with the firm. Whiting, *supra* note 81, at 196–97.

104. CARL E. WALTER & FRASER J.T. HOWIE, *PRIVATIZING CHINA: INSIDE CHINA’S STOCK MARKETS* 6 (2d ed. 2006).

105. According to Clarke, first local regulations were issued by Wenzhou in 1987 and Liaoning in 1990. Clarke, *supra* note 101, at 57.

In effect, even before formal national regulation took place, there existed in rural China a set of social and economic practices that constituted a kind of “living law of corporations.”

D. Decline of TVEs

Whatever the virtues of TVEs may have been, we need not idealize them.¹⁰⁶ It is enough to observe that while they may defy orthodox theories of the organization of enterprise and of economic development, many of them were evidently remarkably successful over a significant period of time, helping lift millions of rural Chinese out of poverty and driving the nation's economic growth during the first phase of the reforms. As we have seen, a typical response to the puzzle posed by TVEs has been to label them a “transitional” form of enterprise, adapted to cope with an imperfect institutional environment. However, while TVEs did in fact eventually decline, their eclipse did not necessarily reflect the operation of a transcendental historical principle. Rather, a series of political decisions made by central state authorities helped precipitate their fall.

Politically, TVEs became victims of their economic success. By the late 1980s the Chinese economy was overheating, due in considerable part to TVEs' phenomenal performance. Faced with a runaway inflation, the central government feared that it was losing economic control, and with the Tiananmen Square protests in 1989 also political control. Equally importantly, competition from TVEs had made life even more difficult for already struggling urban SOEs. In the early 1990s, Chinese leadership turned its attention to restructuring the urban economy with the aid of foreign investment. Simultaneously, the state commenced a series of tax and financial sector reforms that redirected public and private funds from townships and villages to cities. These reforms in turn ushered in a financial crisis for TVEs.

Struggling to cover SOEs' ever-growing deficits,¹⁰⁷ in 1994 the central government undertook a program of fiscal recentralization with the goal of increasing its tax receipts.¹⁰⁸ As earlier fiscal contracts (*caizheng baogan*) between the center and provinces, and ultimately between the provinces and their subunits, were redrawn, the

106. Ching-Kwan Lee criticizes a “celebratory metaphysics” that informs much of the writing on TVEs. CHING-KWAN LEE, *AGAINST THE LAW: LABOR PROTEST IN CHINA'S RUSTBELT AND SUNBELT* 16 (2007). In such a spirit, Roberto Unger—one of few U.S.-based legal scholars paying attention to TVEs—heralds them as avatars of a new market-based socialism, proof that “quasi-public entities can compete and innovate just as well as traditional Western-style firms.” ROBERTO MANGABEIRA UNGER, *DEMOCRACY REALIZED: THE PROGRESSIVE ALTERNATIVE* 106 (1998). For an equally enthusiastic assessment by a Chinese scholar, see Zhiyuan Cui, *Whither China? The Discourse on Property Rights in the Chinese Reform Context*, 1998 *SOCIAL TEXT* 67.

107. By the mid-1990s, approximately half of SOEs were in the red and another third would have been but for subsidies. WHITE, *supra* note 26, at 196.

108. Oi, *supra* note 44, at 54–56. See also Jean C. Oi et al., *Shifting Fiscal Control to Limit Cadre Power in China's Townships and Villages*, 2012 *CHINA Q.* 649.

center increased its share of tax receipts and reduced that of the lower levels of government. This put severe financial stress on townships and villages in particular, as they were now required to pass up more and more of their tax receipts to higher levels of government, while remaining responsible for their local welfare expenses.¹⁰⁹

At the same time, the central government began to reform the financial sector. In particular, it cracked down on rural credit, thus depriving the local state of alternative sources of financing at a time when it needed them the most. As more and more rural residents had found employment in TVEs, they had deposited their savings in local financial institutions such as rural credit cooperatives, which had provided critical support to TVEs' growth.¹¹⁰ As part of its effort to keep urban SOEs afloat, the state now sought to redirect the rural credit boom to cities to help defray SOEs' losses and to provide financing for their restructuring.¹¹¹

Even as the central government was effectively squeezing TVEs out of business, in 1997 it enacted, for the first time, a national law regulating their establishment and operation.¹¹² While the new law finally formally spelled out ownership relations in TVEs and set out rules for their internal governance, with the aim of "separating government from enterprise" (*zhengqi fenkai*), TVEs continued to decline as an organizational form.¹¹³ Ironically, economic theory would have predicted the exact opposite. Yet this law was not so much a formal clarification of the norms by which TVEs functioned as a redefinition of their role in the political economy of the PRC. Its goal was to put the genie back in the bottle by turning TVEs into traditional small-scale undertakings by rural collectives, with the limited role of supporting agriculture.¹¹⁴ In the end, these retrofitted TVEs came to be eclipsed

109. WHITING, *supra* note 32, at 280–81.

110. The two main institutions for rural financing were credit cooperatives and the state-run Agricultural Bank of China, both of which depended on rural deposits for loan funds. See WHITING, *supra* note 32, at 227–28. Bank financing, however, was available only for agricultural, rather than industrial, investments. HUANG, *supra* note 27, at 152.

111. HUANG, *supra* note 27, at 139, 152; WHITING, *supra* note 32, at 287.

112. Zhonghua Renmin Gongheguo Xiangzhen Qiye Fa (中华人民共和国乡镇企业法) [Law of the People's Republic of China on Township Enterprises] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 29, 1996, effective Jan. 1, 1997), CLI.1.15413(EN) (Lawinfochina). One of the specific purposes of the national law was to clarify property rights in TVEs, with article 10 stating that the assets of a TVE established by a rural collective were owned collectively by the farmers who established it. Harry Williams views the clarification of property rights "the most important innovation" of the new law. See Harry Williams, *Property Rights and Legal Reform in Township and Village Enterprises in China*, 1 ASIAN-PAC. L. & POL'Y J. 227, 249 (2001). See also Louis Augustin-Jean, *Rural Enterprises and the Law*, CHINA NEWS ANALYSIS, no. 1586, June 1, 1997, at 1.

113. Hongbin Li & Scott Rozelle, *Privatizing Rural China: Insider Privatization, Innovative Contracts, and the Performance of TVEs*, 2004 CHINA Q. 981 (dating the decline of TVEs to 1997 and observing that TVEs thereafter began to be privatized, mostly to insiders).

114. See Law of the People's Republic of China on Township Enterprises art. 2.

by "true" private enterprises in the countryside, ones that no longer needed to identify publicly as quasi-socialist collectives for purposes of institutional legitimacy.¹¹⁵

In sum, rather than spontaneous incarnations of a spirit of capitalism emanating from the Chinese soil, TVEs represented a transformation in the role of the rural state, not its retreat. As Jean Oi observes, "privatization does not have a monopoly on the capacity to generate growth."¹¹⁶ In this instance, TVEs' success in relieving rural poverty was made possible in part by the existence of a local law of corporate governance which consisted of a range of formal and informal practices that integrated the local state with economic and kinship-based institutions. It preceded the enactment of the PRC's first formal Company Law by more than a decade. One of its consequences was that over the course of the 1980s and early 1990s rural development drove China's economic growth, helping to bridge the gap between city and country.

III. PEOPLE, INC.: THE STORY OF THE URBAN STATE

It is time to turn to the story of urban China to see how an analysis of the structure and governance of TVEs can help us understand the challenges faced by SOEs and their ensuing transformation. While the fiscal and financial sector reforms discussed above sought to increase the funds available to support SOEs, efforts to restructure SOEs themselves aimed at making them self-sufficient and thereby reducing the demands they made on the state in the first place. Below, I analyze first the general role of SOEs in China's political economy as a whole and then some of the specific difficulties they have faced and solutions designed to address them, notably the PRC Company Law promulgated in 1993. It turns out that even in corporatized SOEs the structures provided by a formally enacted corporation law have not been able to overcome problems arising from the administrative structure of the central state, nor have they been supplemented by other institutions of accountability, equivalent to the relatively egalitarian practices that sustained TVEs in rural China.

A. *SOEs in the Political Economy of the PRC*

SOEs emerged as a core institutional expression of the PRC economy's division into two unequal spheres, the city and the country. As we have seen, following the enactment of the Land Reform Law in 1950 agricultural production came ultimately to be organized in

115. In Yasheng Huang's observation, "today, the very term TVE has almost completely disappeared from the economic lexicon. The TVEs are history." HUANG, *supra* note 27, at 125.

116. Oi, *supra* note 44, at 194.

rural collectives while industrial enterprise took the form of urban SOEs.¹¹⁷ By commissioning grain at deflated prices from agricultural collectives, the state subsidized industrial production in cities at the expense of the rural population. SOE employees came to be seen as a kind of socialist “labor aristocracy,” representing the elite of the nation’s workers.¹¹⁸ Each SOE was effectively a miniature welfare state, providing a cradle-to-grave system of care and control. It was a medium for delivering not only employment but a host of other benefits and services as well, such as housing, childcare, schools, hospitals, and provisions for retirement.¹¹⁹ Despite variation among SOEs, their workers—in stark contrast to members of agricultural collectives in the country—enjoyed considerable welfare benefits ultimately guaranteed by the central state.

In the beginning of the reform era, collective ownership (*jiti suoyouzhi*) and state ownership (*quanmin suoyouzhi*) were the only legally recognized forms of ownership in the PRC.¹²⁰ In socialist theory, collectives are considered the owners of their local assets, whereas the assets of an SOE belong to the Chinese people as a whole.¹²¹ The term “state-owned enterprise” (*guoyou qiye*) is itself shorthand for the formal legal designation “industrial enterprise owned by the whole people” (*quanmin suoyouzhi gongye qiye*).¹²² Yet despite the carefully calibrated effort to elide the distinction between the state and the people, the people are ultimately represented by and act through the

117. Cf. *supra* text accompanying notes 21–23. SOEs were the predominant, though not only, form of industrial enterprise in cities. Smaller enterprises were organized in the form of urban collectives. Urban collectives absorbed urban labor that was not employed by SOEs and functioned much like subsidiaries of SOEs. See LEE, *supra* note 106, at 36. As a group, only urban residents had access to the central labor allocation system (which was in place until 1994) and associated welfare benefits. NEE & OPPER, *supra* note 55, at 163. Like rural agricultural collectives, urban collectives too were at least initially held responsible for their own welfare expenses, rather than being subsidized from the national budget. However, as urban collectives developed connections with SOEs, over time they lost much of their independent character and became subsidized appendages of SOEs. See WALDER, *supra* note 22, at 43–48. As a result, the members of urban collectives also came to enjoy a higher standard of life than their rural cousins in agricultural collectives, with many, though not all, of the state-provided welfare benefits that were conferred routinely on SOE employees.

118. See LEE, *supra* note 106, at 36.

119. This intimate integration of all aspects of life in one’s work unit (*danwei*) was a central and unique feature of Chinese socialism, even by comparison to other socialist states. See generally WALDER, *supra* note 22.

120. Under the 1982 Constitution, public ownership of the means of production takes two forms: “ownership by the whole people” (*quanmin suoyouzhi*) and “collective ownership by the working people” (*laodong qunzhong jiti suoyouzhi*). XIANFA art. 6 (1982).

121. See *supra* note 81 and accompanying text.

122. See Zhonghua Renmin Gongheguo Quanmin Suoyouzhi Gongye Qiye Fa (中华人民共和国全民所有制工业企业法) [Law of the People’s Republic of China on Industrial Enterprises Owned by the Whole People] (promulgated by the Nat’l People’s Cong., Apr. 13, 1988, effective Aug. 1, 1988), CLI.1.3789(EN) (Lawinfochina). The imperative that workers—as “owners”—participate in SOEs’ management is enshrined in XIANFA art. 16. See also XIANFA arts. 6, 7, 8 (describing “ownership” of the “means of production” by the “working people” and “whole people”).

state, as the more commonly used term SOE in fact acknowledges. Effectively, the term “collective ownership” denotes control by the *local state*. Similarly, “state ownership” is a term of art that denotes ultimate control by the *central state*. Together, the state sector and the collective sector represent two distinctive forms of public ownership in a larger socialist economy.

Given the historic discrimination against rural enterprise in favor of SOEs and the subsidies enjoyed by the latter, why did they have trouble, as a group, competing against TVEs?¹²³ It is important to recognize that just as TVEs constitute a diverse group, SOEs too vary considerably along several vectors, including their size, the industrial sector in which they operate, and their relative location in the state hierarchy. Although based on the Soviet model, the Chinese economy has never been as centralized as that of the Soviet Union.¹²⁴ Originally, all Chinese SOEs were envisioned as directly under ministerial supervision, but as difficulties of central planning from Beijing became quickly obvious, the immediate oversight of numerous SOEs—especially smaller ones in less vital sectors—was delegated to lower levels of government.¹²⁵ Different SOEs have therefore been controlled by different levels of central state administration, ranging from ministries in Beijing to provincial, prefectural, and municipal governments.

For all their differences, however, both SOEs and TVEs are premised on a structurally similar separation between ownership and control. A TVE—as a kind of Village, Inc.—is “owned” by the local community as a whole but its operation is overseen by the local government. Similarly, an SOE—as a kind of People, Inc.—is “owned” by the people as a whole but ultimately overseen by the central government, whether directly or through one of its lower-level representatives. Both types of entities would thus seem to be faced with similar

123. Much as the performance of SOEs has been variable, the judgments on it vary as well. For critical assessments, see, e.g., SHENG HONG & ZHAO NONG, *CHINA'S STATE-OWNED ENTERPRISES: NATURE, PERFORMANCE, AND REFORM* (2013); Shenshi Mei, *The Corporate Governance of Listed Companies in China: Some Problems and Solutions*, in *CORPORATE GOVERNANCE: CHALLENGES FOR CHINA* 422 (Roman Tomasic ed., 2005) (describing overconcentration of ownership by the state, officials with close ties to controlling shareholders, few shareholders, suspect disclosure, and “hollowing out” by dominant shareholders). For a more ambivalent view, see Roman Tomasic, *Looking at Corporate Governance in China's Large Companies: Is the Glass Half Full or Half Empty?*, in *THE DEVELOPMENT OF THE CHINESE LEGAL SYSTEM: CHANGE AND CHALLENGES* 182 (Guanghua Yu ed., 2011).

124. See Steven M. Goldstein, *China in Transition: The Political Foundations of Incremental Reform*, 1995 *CHINA Q.* 1105, 1121–22. In the beginning of China's reforms in 1978, only 791 goods were produced under the direct supervision of the central government; in the Soviet Union the number of such goods exceeded 12 million. James Kai-sing Kung et al., *From Industrialization to Urbanization: The Social Consequences of Changing Fiscal Incentives on Local Government Behavior*, in *LAW AND ECONOMICS WITH CHINESE CHARACTERISTICS: INSTITUTIONS FOR PROMOTING DEVELOPMENT IN THE TWENTY-FIRST CENTURY*, *supra* note 8, at 491, 493.

125. In 1957, the Party began a redistribution of power in favor of local authorities, with the delegation of about 88% of SOEs under central government control to local authorities. COASE & WANG, *supra* note 60, at 13–14.

principal-agent problems. How can the owners (as principals) ensure that officials (as their agents) operate the enterprises under their purview in the owners' interest? And if the local state was able to monitor effectively the agents that ran its enterprises, surely the even more powerful central state could do so as well?

Without doubt, the relatively greater average size of SOEs makes it more difficult to monitor their management. However, both SOEs and TVEs come in many shapes and sizes. SOEs have ranged from huge to modest. At the same time, some of the most successful TVEs were among the largest, providing evidence that village governments could monitor even sizeable enterprises successfully. Apart from the size of the enterprise that is being monitored, the relative distance of the monitoring entity from the enterprise is another critical factor. It is evidently easier for local village officials to supervise a TVE owned by the local community than for a central ministry in Beijing to oversee a faraway SOE owned notionally by all the Chinese. However, as noted above, the oversight of many SOEs was in fact delegated to lower levels of administration, including municipal governments, which had intimate access to the enterprises under their purview.

As we turn to consider TVEs' and SOEs' uneven records of success, let us begin by analyzing the evolving institutions of SOE management together with various legal, economic, and political solutions that have sought to address them.

B. Reform Through "Enterprise Autonomy"

Historically, Chinese SOEs' chief problem has not been the state's inability to exercise effective oversight over their management—the classic agency problem of public corporations in the United States—but rather their having *too much* control. In contrast to the relative autonomy and organizational simplicity of the rural state, the institutions that govern the urban state consist of numerous overlapping bureaucracies and agencies.¹²⁶ Historically, managers of SOEs at all levels have been subject to intensive monitoring by multiple principals with inconsistent and often contradictory interests, each seeking to use the enterprise, or enterprises, under its supervision to its own advantage—a phenomenon characterized colloquially as having “too many mothers-in-law” (*popo duo*).¹²⁷ This structural problem explains

126. See Jonathan Unger, *The Struggle to Dictate China's Administration: The Conflict of Branches vs. Areas vs. Reform*, 1987 AUSTRALIAN J. CHINESE AFF. 15; KENNETH LIEBERTHAL, GOVERNING CHINA 169–70 (1995) (describing the so-called *tiao-kuai* structure of the central state).

127. Donald C. Clarke, *Regulation and Its Discontents: Understanding Economic Law in China*, 28 STAN. J. INT'L L. 283, 293 (1992). Indeed, family metaphors have been used to describe the political economy of China as a whole, with the Ministry of Finance referring to itself recurrently as “head of the family” and characterizing various levels of local government as prodigal children spending beyond the family's means. SHIRK, *supra* note 26, at 163.

what is one of the most remarkable, yet least remarked upon, aspects of Chinese legal and economic reforms. Starting in the early 1980s, the ubiquitous catchphrase in SOE restructuring was the promotion of “enterprise autonomy,” by which was meant the establishment of an effective separation between ownership and management.¹²⁸ Paradoxically, what constitutes the central *problem* in U.S. corporate governance came to be offered as the *solution* to SOEs’ problems.¹²⁹

At first blush this seems like a perverse misunderstanding of basic tenets of corporation law. Yet in the context of SOEs, “enterprise autonomy” came to encompass at least two highly desirable goals. First, as noted, it stood for enacting a genuine functional separation between ownership and management with the aim of relieving SOE managers from excessive and inconsistent political control by state agencies. Second, it was also a call for recognizing SOEs as legal persons. In socialist theory, a traditional SOE has little organizational integrity: it is ultimately only an administrative subunit in a larger national calculus.¹³⁰ However, by recognizing SOEs as legal persons in their own right, the state could render them distinct from the rest of its institutional apparatus. This in turn held the promise of relieving the state from its ultimate financial responsibility for SOEs’ burgeoning deficits.

If this was in fact what inspired the Chinese government, why did it resort to such obscurantist jargon as “enterprise autonomy”? In the final analysis the problems of SOE reorganization were as much ideological as structural. In the absence of a legitimate socialist theory of the firm—an economic enterprise independent of the state—a seemingly technocratic concern with separation of ownership and management came to stand in for the principal functional characteristics of a Western business corporation.¹³¹ The goal was to create enterprises that functioned economically like business corporations yet continued to be owned by the state. As we have seen, this was the feat that TVEs managed to accomplish as an organizational form on the level of the local state in the countryside.

An early effort at increasing enterprise autonomy consisted of yet another extension of the contract responsibility system beyond agricultural

128. In 1984, the Party declared that ownership and management of SOEs “should be separated appropriately” and that SOEs should become independent legal persons responsible for their own losses and profits. Zhonggong Zhongyang Guanyu Jingji Tizhi Gaige de Jueding (中共中央关于经济体制改革的决定) [Decision of Central Committee of Communist Party on Reform of Economic Structure] (adopted by the Third Plenary Session of the 12th Central Comm. of the Party, Oct. 20, 1984), <http://cpc.people.com.cn/GB/64162/64168/64565/65378/4429522.html>.

129. I analyze this paradox in Ruskola, *supra* note 77, at 660–63.

130. Historically, SOEs were regarded as “appendages” (*fushu wu*) of the larger state administration. CHAO XI, CORPORATE GOVERNANCE AND LEGAL REFORM IN CHINA 19 (2009). Shirk specifically likens the national pre-reform economy to “China, Incorporated,” “a gigantic corporation . . . managed by the government planners in Beijing and overseen by the Politburo, as a board of directors.” SHIRK, *supra* note 26, at 25.

131. On the lack of a socialist theory of the firm, see Ruskola, *supra* note 77.

households and fiscal contracting among levels of government, namely the establishment of a “contract management responsibility system” (*chengbao jingying zerenzhi*) for SOEs.¹³² Under this system, the day-to-day management of SOEs was contracted to professional managers, much as was done in TVEs. Managers were obligated to submit a certain amount of SOEs’ proceeds to the state while retaining a right to all or part of any residual, depending on the specific terms of the arrangement.¹³³ Furthermore, while SOEs continued to be subject to state planning, they were also allowed to produce commodities outside the plan so long as they met their mandatory targets, much like rural households had been allowed to do earlier. The goal was thus to improve industrial efficiency while also encouraging the production of consumer goods.

Reflecting these initiatives, the Industrial Enterprise Law enacted in 1988 stated unambiguously that an SOE was an independent legal person with a right to control its own assets and liable for its own debts.¹³⁴ The law also authorized formally the use of management responsibility contracts.¹³⁵ At the same time, the state discontinued the practice of extracting SOE earnings simply as rents and began to tax their profits instead.¹³⁶ An Enterprise Bankruptcy Law had already been enacted in 1986.¹³⁷ Together, these two laws envisioned the

132. Quanmin Suoyouzhi Gongye Qiye Chengbao Jingying Zerenzhi Zanxing Tiaoli (全民所有制工业企业承包经营责任制暂行条例) [Interim Regulations on Contract Management Responsibility System for Industrial Enterprises Owned by the Whole People] (promulgated by the State Council, Feb. 27, 1988, effective Feb. 24, 1990), CLI.2.44729(EN) (Lawinfochina). As Shirk observes, “[t]he term contracting (*baogan*) had acquired great reformist cachet, derived from the dramatic success of the agricultural reforms and introduction of the enterprise contract system in 1987.” SHIRK, *supra* note 26, at 192. The use of contracting in multiple institutional contexts led some to proclaim 1988 “the year of contract” in China. WANG, *supra* note 14, at 27.

133. SHIRK, *supra* note 26, at 312–21. On the range of possible financial arrangements between an enterprise and its management, see OI, *supra* note 44, at 25–27; WHITE, *supra* note 26, at 278.

134. Zhonghua Renmin Gongheguo Quanmin Suoyouzhi Gongye Qiye Fa (中华人民共和国全民所有制工业企业法) [Law of the People’s Republic of China on Industrial Enterprises Owned by the Whole People] (promulgated by the Nat’l People’s Cong., Apr. 13, 1988, effective Aug. 1, 1988), CLI.1.3789(EN) (Lawinfochina). On the recognition of SOEs’ legal personality, see Tingmei Fu, *Legal Person in China: Essence and Limits*, 41 AM. J. COMP. L. 261, 289 (1993).

135. Law of the People’s Republic of China on Industrial Enterprises Owned by the Whole People art. 2. See also Quanmin Suoyouzhi Gongye Qiye Zhuanhuan Jingying Jizhi Tiaoli (全民所有制工业企业转换经营机制条例) [Regulation on the Transformation of Operational Mechanisms of Industrial Enterprises Owned by the Whole People] (adopted by the State Council, June 30, 1992, effective July 23, 1992), art. 22, CLI.2.5853(EN) (Lawinfochina) (providing legal remedies against organs or individuals who interfere with SOEs’ “management rights”). In the end, however, the goal of enterprise reform was to achieve only a qualified separation, leaving SOEs subject to “mandatory” state plans. Law of the People’s Republic of China on Industrial Enterprises Owned by the Whole People art. 55.

136. FAURE, *supra* note 26, at 82.

137. See Zhonghua Renmin Gongheguo Qiye Pochan Fa (Shixing) (中华人民共和国企业破产法(试行)) [Law of the People’s Republic of China on Enterprise Bankruptcy (for Trial Implementation)] (adopted by the Nat’l People’s Cong., Dec. 2, 1986, effective Dec. 2, 1986), CLI.1.3066 (Lawinfochina). The law applied specifically to SOEs (article 2) and its stated purpose was “to promote the autonomous operation” of SOEs (article 1).

ultimate possibility of a liquidation of SOEs whose liabilities exceeded their assets, and they left no doubt about their goal: SOEs were to be transformed from politico-industrial arms of the state into essentially economic entities.¹³⁸

Whatever these reforms' virtues may have been in principle, they were undermined by other practices. In theory, SOEs finally faced hard-budget constraints, much like township and village governments did after the tax-responsibility system introduced in 1980. However, in practice none were allowed to go under. Although the state was no longer directly responsible for SOEs' liabilities under the new Industrial Enterprise Law, state-owned banks continued to provide financing to insolvent enterprises in the form of so-called policy loans which had few prospects of ever being repaid.¹³⁹ The policies justifying these loans were perfectly understandable in the context of China's political economy as a whole. Simply permitting insolvent SOEs to go bankrupt would have resulted in large-scale unemployment. In the absence of both an extensive labor market and social security institutions beyond one's work unit, this was politically and socially unacceptable. The Enterprise Bankruptcy Law remained therefore little more than a form of ideological critique of inefficient management.¹⁴⁰

At the same time, SOEs found themselves faced with new competitors beyond the rural collective economy represented by booming TVEs. Chinese and foreign private enterprises emerged along separate trajectories, under distinctive ideological and structural constraints. The former originated in the legal recognition of so-called individual households (*getihu*), an indigenous form of family business that limited the number of paid workers to seven, on the theory that a greater reliance on commodified labor would transform what was meant to be a household-based entity into an ideologically suspect private firm in the proper sense of the term.¹⁴¹ Countless entrepreneurs ignored the restriction with impunity, hiring dozens and even hundreds

138. The 1988 Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People provided for a role for Party activities in enterprises (article 8) but such activities were limited to political functions, leaving economic decision-making to managers (article 48).

139. Bank lending was the chief method of supporting SOEs from the mid-1980s to the late 1990s. See Mary Gallagher & Yue Ma, *FDI and Corporate Restructuring in China: Is the Medicine Worse than the Disease?*, in *GOING PRIVATE IN CHINA: THE POLITICS OF CORPORATE RESTRUCTURING AND SYSTEM REFORM IN THE PRC* 135, 149 (Jean C. Oi ed., 2011).

140. I borrow this characterization from WHITE, *supra* note 26, at 191.

141. See Edward J. Epstein & Ye Lin, *Individual Enterprise in Contemporary Urban China: A Legal Analysis of Status and Regulation*, 21 *INT'L L.* 397 (1987). When the so-called returned youth arrived from the countryside to the cities after the Cultural Revolution, they found themselves outside the labor tenure system of SOEs and with limited jobs available in smaller collective enterprises. One of the key purposes of establishing the "individual economy" was to provide for self-employment for returnees from the country. COASE & WANG, *supra* note 60, at 57. Some attribute the seemingly arbitrary restriction on the number of employees to Marx's fictional example, in *The Capital*, of a firm with eight workers to illustrate his labor surplus theory. Unger, *supra* note 126, at 807.

of employees and thus stretching traditional fictions of kinship-based households to their breaking point and beyond.¹⁴² In recognition of this reality, in 1988 the state promulgated Provisional Regulations on Private Enterprises, a set of nationally applicable provisions legalizing private enterprises employing eight or more workers.¹⁴³

The legal recognition of foreign enterprise likewise proceeded in stages. While foreign investment was initially limited to joint ventures with Chinese parties,¹⁴⁴ wholly foreign-owned enterprises were authorized in 1986.¹⁴⁵ Putting aside their varied histories and the differing ideological justifications supporting them, among crucial features shared by the new forms of domestic and foreign private enterprise was their reliance on short-term employment contracts and their freedom from extensive welfare obligations of the kind owed by SOEs to their workers. Their proliferation put even greater pressure on SOEs, beyond the competition they already faced from TVEs. With the market encroaching upon them from several directions, SOEs' problems came to exceed those posed by their structural relationship with the state.¹⁴⁶

After a deliberate initial focus on the alleviation of rural poverty through agricultural reforms—which inadvertently led to the emergence of TVEs—in the early 1990s the state turned its attention to urban development. This turn was part of a theoretical breakthrough marked by the emergence of “socialist market economy” (*shehuizhuyi shichang jingji*) as a new political and constitutional template for economic restructuring.¹⁴⁷ As we have already seen, the central

142. Yasheng Huang cites the example of a Mr. Nian whose sunflower seed business in Shanghai employed hundreds of workers, despite the official cap at seven employees. HUANG, *supra* note 27, at 51.

143. Zhonghua Renmin Gongheguo Siying Qiye Zanzing Tiaoli (中华人民共和国私营企业暂行条例) [Interim Regulation of the People's Republic of China on Private Enterprises] (promulgated by the State Council, June 25, 1988, effective July 1, 1988), art. 2, CLI.2.3889(EN) (Lawinfochina). The Regulation was preceded by experimental regulations of limited geographic scope in a number of special economic zones (SEZs), located in historically commercialized southeastern coastal regions. See MARY E. GALLAGHER, *CONTAGIOUS CAPITALISM: GLOBALIZATION AND THE POLITICS OF LABOR IN CHINA* 38–42 (2007).

144. The two original vehicles for foreign investment were provided by Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa (中华人民共和国中外合资经营企业法) [Sino-Foreign Equity Joint Venture Law of the People's Republic of China] (adopted by the Nat'l People's Cong., July 1, 1979), CLI.1.4656(EN) (Lawinfochina) (rev'd Apr. 4, 1990 & Mar. 15, 2001); Zhonghua Renmin Gongheguo Zhongwai Hezuo Jingying Qiye Fa (中华人民共和国中外合作经营企业法) [Sino-Foreign Cooperative Joint Venture Law of the People's Republic of China] (adopted by the Standing Comm. Nat'l People's Cong., Apr. 13, 1988), CLI.1.3790(EN) (Lawinfochina) (rev'd Oct. 31, 2000).

145. Zhonghua Renmin Gongheguo Wai Zi Qiye Fa (中华人民共和国外资企业法) [Law of the People's Republic of China on Wholly Foreign-Owned Enterprises] (adopted by the Standing Comm. Nat'l People's Cong., Apr. 12, 1986), CLI.1.2782(EN) (Lawinfochina) (re'd Oct. 31, 2000).

146. In Naughton's well-known formulation, China did not so much abolish its planned economy as grew out of it, by allowing it to be overwhelmed by an ever-growing nonstate economy. See BARRY NAUGHTON, *GROWING OUT OF THE PLAN: CHINESE ECONOMIC REFORM 1978–1993* (1995).

147. The seemingly oxymoronic concept of a “socialist market economy” was constitutionalized in 1993 by amending Article 15 of the Constitution, declaring that China “practices socialist market economy.” XIANFA art. 15 (1982) (amended 1993).

government's tax and financial sector reforms began to channel public as well as private funds from the countryside to cities. As part of a larger reorientation toward the urban economy, in 1993 the PRC promulgated its first-ever Company Law, signaling the establishment of a "modern enterprise system" (*xiandai qiye zhidu*) and heralding the beginning of a new era of technocratic development financed by global capital.¹⁴⁸ The enactment of the Company Law was accompanied by the promulgation of a new Labor Law in 1994, which in turn restructured the state's relationship to labor (analyzed in Part IV).

C. "Corporatizing" SOEs Under the Company Law

Insofar as the business corporation is the quintessential form of enterprise under capitalism, the very enactment of the first-ever Company Law of the People's Republic of China was a major ideological event.¹⁴⁹ As we have seen, for over a decade Chinese legal reforms had proceeded piecemeal, providing distinctive forms of enterprise for state, collective, and private sectors of the economy, as well as separate legal forms for Chinese and foreign private enterprise. For the first time, the Company Law provided a single enterprise form that was available in principle to all actors—public as well private, urban as well as rural, Chinese as well as foreign. In terms of legal theory, this was a major milestone toward creating a unified legal system.

In practical terms, however, the Law's formally universal quality is highly misleading. It is of utmost significance that it was written first and foremost for the state sector, to provide a vehicle for the structural transformation of the urban economy. That transformation was never envisioned as an outright privatization (*siyouhua*), which remained anathema for political as well as economic reasons. Rather, the Law's aim was characterized deliberately as the "corporatization" (*gongsihua*) of SOEs.¹⁵⁰ This was not intended to inaugurate the abolition of the fundamental ideological and constitutional principle of state ownership of the means of production, but only a modification of it, with the state remaining the controlling shareholder even in newly corporatized SOEs.¹⁵¹

148. Zhonghua Renmin Gongheguo Gongsifa (中华人民共和国公司法) [Company Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective July 1, 1994), CLI.1.7672(EN) (Lawinfochina).

149. See generally XI, *supra* note 130, at 14–18.

150. See generally Robert C. Art & Minkang Gu, *China Incorporated: The First Corporation Law of the People's Republic of China*, 20 YALE J. INT'L L. 273 (1995); Fang Liufang, *China's Corporatization Experiment*, 5 DUKE J. COMP. & INT'L L. 149 (1995).

151. See XIANFA art. 6 ("[T]he basis of the economic system is socialist public ownership of the means of production."). Private enterprise was to remain only a supplement to the state and collective sectors, and the corporatization of SOEs was justified as only a change in the form in which the state would continue to exercise its primary ownership of the means of production in key parts of the economy.

However, while rearticulating the state's role from that of an administrator to a shareholder may have been intended to effect a change only in the form through which the state exercised its ownership in SOEs, it revolutionized SOE financing. By providing for ownership in shares—rather than an undivided and nontransferable ownership held by the state on behalf of “the whole people”—the Company Law made it possible for corporatized SOEs to sell shares to investors, thereby giving them a source of much-needed nonstate capital as they struggled to compete with TVEs as well as Chinese and foreign private enterprises.

The state's determination to maintain its control over SOEs dominating the urban economy was reflected in the structure of China's securities markets. Although the Company Law declared from the beginning all shares to be of equal value,¹⁵² this commitment was undermined by an administrative classification of shares into several types with varying restrictions on their alienability: so-called state shares (*guojia gu*), legal person shares (*faren gu*), and social shares (*shehui gongzhong gu*). This taxonomy—denounced by critics as the “Original Sin” of Chinese securities markets—was based on a shareholder's relationship to the state.¹⁵³ Most notably, state shares were transferable only among state entities, while legal person shares could be owned and held only by legal persons. Only social shares could be owned and exchanged freely by individuals.¹⁵⁴ Foreigners' participation in turn was limited to special “B shares,” transferable among foreigners only.¹⁵⁵ The evident goal of this administrative scheme was to ensure that the state would be able to maintain its controlling stake in corporatized SOEs.

It is only against this background that we can make sense of the Company Law and its accompanying regulatory apparatus, many elements of which have struck outside observers as anomalous. They include the Law's preference for mandatory rules over default ones and the fact that much of Chinese corporate and securities law tends to be restrictive, as attested by the share classification system. An Anglo-American observer is indeed likely to regard such features as interference with the liberty of market actors, and even Chinese

152. Company Law of the People's Republic of China arts. 3, 29.

153. Carl E. Walter, *Stock Markets and Corporate Reform: A Pandora's Box of Unintended Consequences*, in GOING PRIVATE IN CHINA: THE POLITICS OF CORPORATE RESTRUCTURING AND SYSTEM REFORM IN THE PRC, *supra* note 139, at 203, 211.

154. Under this schema, state shares belonged to the government agency, ministry, or local government that contributed its assets to the SOE being corporatized. The SOE itself received legal person shares in return for the assets it contributes directly. (Because of the contract responsibility system, an SOE could own in its own account assets it acquired with the profits that it was allowed to keep after remitting its quota to the central government.) Outside investors received social shares. See generally XI, *supra* note 130, at 48–49; WALTER & HOWIE, *supra* note 104, at 73–83.

155. *Id.*

critics agree that the Company Law is “pervaded with the attitude of ‘making decisions on behalf of the people.’”¹⁵⁶

At the same time—and seemingly in contradiction to its restrictive elements—one of the Company Law’s central features is the exceptionally wide freedom it gives to shareholders as a body, providing them with control over a broad range of issues in corporate governance, far exceeding the power to hire and fire officers and to vote on constitutional changes.¹⁵⁷ In Anglo-American corporation law, the purpose of limiting shareholders’ direct powers over managers is to ensure precisely that the separation between ownership and control is real, not only nominal. Yet in the political economy of the PRC, empowering shareholders is eminently logical insofar as corporatized SOEs have one controlling shareholder: the state. A Chinese entrepreneur’s assertion that the Company Law “just does not fit the requirements of a private firm” may well be true, but the observation is ultimately beside the point.¹⁵⁸

It is hardly a coincidence that the theory of the firm that informs the Company Law parallels the Chinese theory of the state. While the PRC Constitution decrees a functional division among legislative, executive, and administrative state organs, that division does not imply a “separation of powers” analogous to that of liberal constitutionalism. The National People’s Congress enjoys supremacy over other branches, reflecting the ultimate (theoretical) supremacy of the people. Likewise, despite a formal separation between ownership and management, in recognition of the democratic supremacy of the shareholders’ meeting, the Company Law designates it the “organ of power” (*quanli jigou*) of the corporation—analogous to the political term the PRC Constitution uses to characterize the National People’s Congress.¹⁵⁹

156. The characterization of the Company Law is by Fang Liufang (方流芳), *Wen Gu Zhi Xin: Tan Gongsi Fa Xiugai* (温故知新: 谈公司法修改) [Reviewing the Old to Understand the New: A Discussion of Reform of the Company Law], in GONGSI FA XIUGAI ZONGHENG TAN (公司法修改纵横谈) [AN ALL-AROUND DISCUSSION OF REVISED COMPANY LAW] (F. Guo & J. Wang eds., 2000), cited in Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494, 500 (2003).

157. See Company Law of the People’s Republic of China art. 103. It is an indication of the breadth of these powers that they overlap significantly with several of the expressly stated powers of the board of directors. *Id.* art. 112.

158. NEE & OPPER, *supra* note 55, at 120 (quoting a Changzhou entrepreneur).

159. This term remains unchanged even in the latest revision the Company Law. Compare Company Law of the People’s Republic of China arts. 36, 98 (rev’d 2013), with XIANFA art. 57. On the parallel theories of state and corporation, see Xi, *supra* note 130, at 36–37; Cindy A. Schipani & Junhai Liu, *Corporate Governance in China: Then and Now*, 2002 COLUM. BUS. REV. 1, 34–35. Indeed, just as the Party plays a crucial role in the operation of the state, especially by means of the *nomenklatura* system, it continues to occupy a parallel position in corporatized SOEs as well. See ANDREW SZAMOSSZEGI & COLE KYLE, AN ANALYSIS OF STATE-OWNED ENTERPRISES AND STATE CAPITALISM IN CHINA 75 (2011) (“[I]n practice . . . the CCP still appoints the majority of senior SOE managers despite a nominal separation of ownership and management.”). See also Wang Jiangyu, *The Political Logic of Corporate Governance in China’s State-Owned Enterprises*, 47 CORNELL INT’L L.J. 631 (2014).

Even corporatized SOEs are modeled on the state because they are in effect a part of it. Much of China's Company Law and securities regulation can be best understood as part of a larger regime whereby the state administers components of itself. Viewed from this perspective, the distinctive fusion of the economic and the political in SOEs constitutes a mirror image of their integration in TVEs. In the latter, the law of village administration functioned as a kind of corporation law, whereas in corporatized SOEs corporation law often functions as a kind of administrative law.

Crucially, given the state's continuing control over its corporatized SOEs, their agency problems are distinctive as well. The chief problem in a typical publicly held U.S. corporation is the difficulty of a large number of diffuse shareholders to monitor managers effectively.¹⁶⁰ In contrast, as a controlling shareholder with extensive powers the Chinese state is in principle at least in an excellent position to oversee the management of its enterprises. Yet this arrangement creates another problem that is inherent in shareholder democracy, and indeed in democracy more generally: majoritarian tyranny. Who or what is to ensure that the state will not take advantage of its controlling position at the expense of those with a minority stake? Much as the socialist state is to be trusted to act in the interests of all in the political sphere, so in corporatized SOEs, too.

To be sure, this regime has continued to evolve. For example, overt discrimination among different types of shares has been abandoned. In a multi-stage reform that began in 2005, all previously non-tradable shares are turned into tradable ones,¹⁶¹ and with full WTO implementation, foreigners have been required to have access to the PRC stock market without restrictions since 2007.¹⁶² Moreover, as a result of amendments in 2005 and a revision in 2013, the Company Law has eliminated a number of mandatory provisions, such as minimum capital requirements, while adding new protections for minority shareholders.¹⁶³

However, the effects of such changes must not be overestimated. After the 2013 revision of the Company Law, some observers concluded that China is "freeing private capital."¹⁶⁴ Be that as it may, one thing the state seems uninterested in doing is freeing *state* capital. While

160. See generally MARK ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE GOVERNANCE* (1996); ADOLF BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

161. Lee Suet Lin Joyce, *From Non-tradable to Tradable Shares: Split Share Structure Reform of China's Listed Companies*, 8 J. CORP. L. STUD. 57 (2008); XI, *supra* note 130, at 51.

162. WALTER & HOWIE, *supra* note 104, at 131.

163. See, e.g., *Company Law of the People's Republic of China* arts. 122, 105, 147–48 (rev'd 2013) (providing for independent directors, cumulative voting, and a statement of fiduciary duties).

164. Sun Hong & Tony Zhong, *Freeing Private Capital*, 28 CHINA L. & PRAC. 11 (2014).

trading in state-owned shares may have become permissible, the state is by no means *obligated* to trade in them.¹⁶⁵ In fact, while there are no longer officially designated “state shares” as such, state entities are still not allowed to sell shares they own without administrative approval.¹⁶⁶ Similarly, despite the enactment of minority shareholder protections, there is little evidence that they have resulted in real change in how the state governs its corporatized SOEs.¹⁶⁷

Finally, insofar as many of the basic features of the Company Law draw on Anglo-American models, it ultimately relies on market-based institutions to discipline managers’ behavior. In the context of the political economy of the PRC, such features are simply not an adequate substitute for the lack of other institutions of accountability. To the extent that the state owns a controlling share in corporatized SOEs, the market for corporate control is fatally compromised. Moreover, even in a setting where markets work, they alone do not provide sufficient deterrence against abuses such as asset stripping and outright fraud, both of which have plagued Chinese SOEs.¹⁶⁸

D. *Limits of Legal Reform*

In light of the experience of TVEs, how, then, should we assess the Company Law’s significance in the restructuring of Chinese SOEs? Some have observed that the Company Law only recognized formally the reality of ongoing local SOE experiments with issuing shares. In the late 1980s and early 1990s, many lower-level SOEs had already corporatized themselves with the twin goals of raising

165. On the lack of trade in state-owned shares, see Curtis Milhaupt & Katharina Pistor, *The China Aviation Oil Episode*, in LAW AND ECONOMICS WITH CHINESE CHARACTERISTICS: INSTITUTIONS FOR PROMOTING DEVELOPMENT IN THE TWENTY-FIRST CENTURY, *supra* note 8, at 329, 344 (noting that shares held by the state and its affiliates are not widely traded).

166. With respect to corporatized SOEs, share transfers involving national SOEs still require administrative approval, even though the Company Law does not mandate it. See Zhonghua Renmin Gongheguo Qiye Guoyou Zichan Fa (中华人民共和国企业国有资产法) [Law of the People’s Republic of China on State-Owned Assets of Enterprises] (promulgated by the Standing Comm. Nat’l People’s Cong., Oct. 28, 2008, effective May 1, 2009), art. 40, CLI.1.109891(EN) (Lawinfochina). See also XI, *supra* note 130, at 51.

167. See, e.g., Donald C. Clarke, *The Independent Director in Chinese Corporate Governance*, 31 DEL. J. CORP. L. 125 (2006).

168. Zhong Zhang observes that Chinese “[l]egislation remains extraordinarily lenient in terms of criminal punishment and administrative penalties” while “the conditions imposed for shareholders to bring derivative actions or securities litigation are inhibitive.” Zhong Zhang, *Legal Deterrence: The Foundation for Corporate Governance—Evidence from China*, in LAW AND ECONOMICS WITH CHINESE CHARACTERISTICS: INSTITUTIONS FOR PROMOTING DEVELOPMENT IN THE TWENTY-FIRST CENTURY, *supra* note 8, at 359. In the absence of independent asset valuation agencies, asset stripping has been common, and China did not establish a unified national system for monitoring privatization of local level SOEs until 2003. Jin Zeng & Kellee S. Tsai, *The Local Politics of Restructuring State-Owned Enterprises in China*, in GOING PRIVATE IN CHINA: THE POLITICS OF CORPORATE RESTRUCTURING AND SYSTEM REFORM IN THE PRC, *supra* note 139, at 39, 39.

capital and achieving greater autonomy from supervisory state agencies.¹⁶⁹ As early as 1986, the number of various types of enterprises issuing shares had reached 6,000 to 7,000 nationwide.¹⁷⁰ Most did so with little or no formal authorization, while others were supported by a patchwork of rudimentary regulations promulgated by local governments short on revenues.¹⁷¹ With active over-the-counter markets in place in several major cities, the year 1989 witnessed a veritable “stock fever.”¹⁷²

By 1990 even large SOEs in major cities were issuing shares to the public, despite the fact the PRC had not yet promulgated either a company law or a securities law.¹⁷³ Despite an otherwise conservative political climate, at that point the state had little choice but to recognize the fact that there existed an active capital market that was spinning out of control. It established a stock exchange in Shanghai in 1990 and one in Shenzhen in 1991. Viewed against this background, the Company Law confirms the dictum of law and development literature that “law follows development.” Much as in the case of rural industry, urban economic institutions had developed ahead of formal legal institutions.¹⁷⁴

However, it was not only the sequencing of economic and legal reforms—the former preceding the latter—that reflected the rural

169. See WALTER & HOWIE, *supra* note 104, at 67–68.

170. *Id.* at 5. As in the case of TVEs, share issuance experiments typically began with offerings to employees. See Heping Cao, *Property and Intellectual Property Exchanged in China Since the 1990s*, in LAW AND ECONOMICS WITH CHINESE CHARACTERISTICS: INSTITUTIONS FOR PROMOTING DEVELOPMENT IN THE TWENTY-FIRST CENTURY, *supra* note 8, at 315, 318–19; ELLEN HERTZ, *THE TRADING CROWD: AN ETHNOGRAPHY OF THE SHANGHAI STOCK MARKET* 45 (1998).

171. WALTER & HOWIE, *supra* note 104, at 6 (“The early 1980s period of spontaneous experimentation with corporate forms and securities was entirely unregulated, promoted by local governments and largely unnoticed by Beijing.”).

172. *Id.* at 3–6.

173. Lynn White describes a shareholding boom in 1987, with several large SOEs raising capital by selling stock, mostly to workers, resulting in the State Council prohibiting issuance of shares without permission. WHITE, *supra* note 26, at 323. Even earlier, in 1984, a state-owned shopping center in Beijing sold stock to the public, while in 1986 Shanghai Feilo Acoustics Company sold stock to employees as well as to the public. See COASE & WANG, *supra* note 60, at 90. Walter and Howie note that the so-called Standard Opinion of 1992 constituted the “first systematic codification of a legal basis for corporate form,” yet SOEs started to be corporatized long before 1992. WALTER & HOWIE, *supra* note 104, at 8.

174. See, e.g., Donald Clarke et al., *The Role of Law in China's Economic Development*, in CHINA'S GREAT TRANSFORMATION 420 (Loren Brandt & Thomas Rawski eds., 2004); Tom Ginsburg, *Does Law Matter for Economic Development? Evidence from East Asia*, 34 LAW & SOC'Y 829 (2000); Ronald Gilson & Curtis Milhaupt, *Economically Benevolent: Lessons for Developing Democracies*, 59 AM. J. COMP. L. 227 (2011); Sebastian Heilmann, *Experience First, Laws Later: Experimentation and Breakthrough in the Restructuring of China's State Sector*, in GOING PRIVATE IN CHINA: THE POLITICS OF CORPORATE RESTRUCTURING AND SYSTEM REFORM IN THE PRC, *supra* note 139, at 95. See also Brett H. McDonnell, *Lessons from the Rise and (Possible) Fall of Chinese Township-Village Enterprises*, 45 WM. & MARY L. REV. 953, 996 (2004) (arguing that in China property rights were as much the effect of economic development as their cause); QIAO, *supra* note 65, at 57–63 (describing the phenomenon of “development against law” in rural China).

experience. The urban economic reforms themselves drew on rural precedents. As we have seen, the first shareholding experiments began in the countryside, with TVEs taking the form of shareholding cooperatives.¹⁷⁵ Considered within a longer timeframe and a wider context that encompasses rural China as well, the enactment of the Company Law appears as less of a revolutionary institutional breakthrough. Rather, it is better viewed as an effort to codify practices pioneered by TVEs.¹⁷⁶

Yet the Company Law's formalization of property rights in SOEs failed to alleviate their enduring agency problems. As we have already observed, some of the differences in TVEs' and SOEs' relative success can no doubt be attributed to differences in size and scale, but the distinctive structure of the urban state is at least equally significant. Re-articulating various state entities' interests in SOEs in terms of shares did little to solve the inherited problem of "too many mothers-in-law."¹⁷⁷ Insofar as they were still driven by conflicting interests, corporatized SOEs continued to be pulled in different directions. Ultimately the state sought to address this problem administratively, by establishing a State-Owned Assets Supervision and Administration Commission (*Guoyou zichan jingying gongsi*, SASAC).¹⁷⁸ All state shares held by various entities were consolidated with SASAC. At least in theory, there finally existed a single principal associated with the state, one that enjoyed a considerable degree of real control over corporatized SOEs. Nevertheless, there is a widespread consensus that the creation of SASAC has not helped to address corporatized SOEs' fundamental governance problems.¹⁷⁹

175. See *supra* text accompanying notes 101–05.

176. Recognizing "non-statutory enterprises" such as TVEs as a vital part of a longer history of corporation law in the PRC can help us obtain a broader view of American corporation law as well. Suffering from a formalist bias, legal histories of the modern business corporation ordinarily regard individually chartered companies of the eighteenth and early nineteenth centuries as its immediate predecessors. The number of such companies was necessarily small. However, we can identify a more significant, roughly analogous American tradition of "non-statutory enterprises" in Shaw Livermore's largely neglected study of early American land companies. SHAW LIVERMORE, *EARLY AMERICAN LAND COMPANIES: THEIR INFLUENCE ON CORPORATE DEVELOPMENT* (1939). Livermore argues that the historical and customary institutions and expectations that regulated the land companies' operation gave rise to an "American common law of corporations" which was "adopted" by state legislatures in the nineteenth century as they enacted general incorporation laws. *Id.* at xxii, 216. Livermore's analysis suggests that, much like in the PRC, in the United States too the evolution of a statutory law of the corporation represents a codification of a set of earlier formal as well as informal practices.

177. See *supra* text accompanying note 127.

178. See Li-Wen Lin & Curtis Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 *STAN. L. REV.* 697, 735 (2013). SASAC was established in 2003. In 2009, its role as an investor was formalized by article 12 of the Law of the People's Republic of China on State-Owned Assets of Enterprises.

179. On SASAC's shortcomings as a monitor of SOEs, see Curtis Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 *GEO. L.J.* 665, 682 (2015); SHENG & ZHAO, *supra* note 123, at 267. It is notable that SASAC's

How should we interpret SOEs' failure to reproduce the overall success of TVEs? On paper, SOEs' agency problems seem more intractable than those of TVEs. The officials of the rural state that oversaw them were not embedded in a fractured administrative structure divided into several overlapping and competing bureaucracies. However, the creation of SASAC should have alleviated this particular problem. By the same token, when comparing the agency problems of SOEs and TVEs, it would be a mistake to assume that rural villages are somehow naturally harmonious entities. They too give rise to conflicts, often even more intense and personal ones than in cities, yet such conflicts evidently did not compromise TVEs' governance—at least not necessarily and not as severely as has been the case with many SOEs. It seems more plausible that the relative success of the formal and informal institutions of village government had less to do with a “natural” consensus among TVE stakeholders than with the relatively close-knit nature of the village community. Insofar as a village is a discrete community—even if characterized by dissensus—it provides a setting in which information tends to travel and informal sanctions can be highly effective.¹⁸⁰

Insofar as an SOE is analogous to a People, Inc., “the People” constitutes a highly abstract and diffuse entity, especially by comparison to a village. Nonetheless the existence of the People as a collective subject is not solely ideological. It too takes on various forms and degrees of institutionalization within the administrative hierarchy. Therefore, understanding public enterprise requires a fine-grained, even anthropological, analysis of the state, not only in the case of rural institutions of local governance but also with respect to the institutions of the central state. Because even the central state is not a singular entity, *where* an enterprise is located in the administrative structure can be at least as important as the *form* in which it is organized.¹⁸¹

task is to maximize the output of the centrally controlled SOE sector as a whole while also attending to larger macroeconomic goals on the national level. *See generally* Zhaofeng Fang, *Corporate Governance Under State Control: The Chinese Experience*, 13 THEORETICAL INQUIRIES L. 487 (2012). Moreover, as Lin and Milhaupt observe, the Party remains an important “shadow principal” monitoring SOE performance. *See* Lin & Milhaupt, *supra* note 178, at 737. It is equally notable that while the control of SOEs has been consolidated with SASAC, SASAC itself is not a unitary entity. Fewer than 150 wholly state-owned entities are currently controlled by SASAC's offices in Beijing; the rest are controlled by various local level SASACs. Jean Oi, *Politics in China's Corporate Restructuring*, in GOING PRIVATE IN CHINA: THE POLITICS OF CORPORATE RESTRUCTURING AND SYSTEM REFORM IN THE PRC, *supra* note 139, at 1, 3.

180. Indeed, Wang Hui, for example, believes that part of the reason why rural reforms have tended to promote equality—unlike their urban counterparts—is that villages enjoy the benefit of relatively democratic traditions accompanied by “suitable economic structures.” WANG, *supra* note 14, at 25.

181. *Cf.* Oi, *supra* note 44, at 56 (“The key variable is not the form of ownership but the incentive structure for the officials who manage these firms.”); DOUG GUTHRIE, DRAGON IN A THREE-PIECE SUIT: THE EMERGENCE OF CAPITALISM IN CHINA 27 (1999) (“[W]e need to look beyond distinctions of ownership type to the institutional structure of state administration.”).

In fact, empirical evidence suggests that SOE reforms may have been more successful in the case of urban industrial enterprises managed by lower levels of administration. If we accept the premise that the state's chief challenge has been creating *greater* distance between itself and its enterprises—enacting a genuine separation between management and ownership—this seems counterintuitive. By definition, provincial, prefectural, and city governments are closer and more intimately involved with the enterprises under their jurisdiction than central ministries. Entities they oversee would therefore seem especially vulnerable to “interference” by state officials.

However, according to sociologist Doug Guthrie it has been precisely lower-level officials' proximity to the enterprises under their control that has allowed them to succeed.¹⁸² Much like in the case of rural TVEs, Guthrie's study had difficulty distinguishing where an urban enterprise ended and the institutions of the local state began. He found that a municipal government with a group of enterprises under its jurisdiction functioned in effect like a holding company, providing governance and oversight as needed—not unlike a village owning and overseeing multiple TVEs.¹⁸³ Conversely, higher-level SOEs with more autonomy were beset with the most problems. After analyzing TVEs, we should not be surprised that the participation of the state in enterprise governance can be an asset, not a liability, even in an urban setting—so long as its representatives are accountable for their actions in their specific institutional configuration.

As a group, however, SOEs have been unsuccessful in reproducing the kind of “living law” of enterprise governance that propelled TVEs' success, except perhaps to a limited degree at lower levels of SOE hierarchy. Indeed, studies of corporatized SOEs operated directly by the central state suggest that the increasing withdrawal of bureaucratic administrators from their management has led to an overreliance on market mechanisms in corporate governance. In effect, the prospect of too much state control has been exchanged for too little of it.¹⁸⁴

If so, what explains the presence of numerous corporatized SOEs among the ranks of China's largest and most successful companies? Although the state for a long time rejected outright privatization, in recognition of the continuing problems of SOEs, in the late 1990s it adopted a policy known as “grasping the large, letting go of the small”

182. See GUTHRIE, *supra* note 181, at 148.

183. *Id.* at 59. On local governments' relatively greater ability to monitor the enterprises under their control, see also Walder, *supra* note 37, at 266.

184. See, e.g., QIN XIAO, *THE THEORY OF THE FIRM AND CHINESE ENTERPRISE REFORM: THE CASE OF CHINA INTERNATIONAL TRUST AND INVESTMENT CORPORATION* 7 (2004) (observing that many of the problems of reform-era SOEs were caused by the overuse of market mechanisms within SOEs).

(*zhuada, fangxiao*), or selling off small and medium-sized SOEs.¹⁸⁵ Subsequently the least productive SOEs have been privatized. At the same time, the largest and most successful ones have been reorganized and grouped by industry. Collectively they are known as National Champions, a group of vast conglomerates that perform an outsized role in key sectors of the national economy.¹⁸⁶ The state has consistently retained a controlling ownership in these enterprises.

Such corporatized SOEs' success must be considered in the context of Chinese state capitalism more generally. It is an order in which legal structures reinforce an economic system where the state plays an active role.¹⁸⁷ For entities associated with the central state, corporate governance may well be less crucial to economic success than access to state-conferred privilege. However capitalist and commercialized the Chinese economy may be, the state maintains control over key economic and financial institutions. Notably, it restricts access to capital through securities regulation, with the result that most companies listed on the Shanghai and Shenzhen stock exchanges are corporatized SOEs. Indeed, thriving by utilizing political connections does not necessarily distinguish SOEs from the most successful private corporations. *All* successful firms in China rely on connections to state power, suggesting a striking, and growing, degree of institutional convergence between corporatized SOEs and private enterprises.¹⁸⁸

Paradoxically, one of the main reasons for the Company Law's appeal to private entrepreneurs is the very fact that it was enacted primarily for the purpose of reorganizing the state sector. As we have seen, throughout the 1980s and mid-1990s private enterprise was in search of organizational forms that would provide it with legitimacy, beyond the limited family business model of the "individual household."¹⁸⁹ Even after private enterprise as such was first formally (albeit provisionally) authorized in 1988, it remained politically stigmatized and ideologically suspect. Significantly, even today the word "private" (*si*) remains pejorative, while the word "public" (*gong*) enjoys positive connotations.¹⁹⁰ This is why private entrepreneurs were more numerous in the countryside than in cities through the mid-1990s:

185. See Jean Oi & Han Chao-hua, *China's Corporate Restructuring: A Multistep Process*, in GOING PRIVATE IN CHINA: THE POLITICS OF CORPORATE RESTRUCTURING AND SYSTEM REFORM IN THE PRC, *supra* note 139, at 19, 31.

186. See generally Lin & Milhaupt, *supra* note 178.

187. *Id.* at 752.

188. See Milhaupt & Zheng, *supra* note 179, at 669. For an analysis of the difficulties posed by the opacity of the public-private distinction to the application of WTO rules, see Mark Wu, *The "China, Inc." Challenge to Global Trade Governance*, 57 HARV. J. INT'L L. 262 (2016).

189. See *supra* text accompanying note 141.

190. As Yasheng Huang notes, for this reason even private entrepreneurs prefer to describe their enterprises as *minjian*, or "popular," rather than *siren*, or "private." HUANG, *supra* note 27, at 138.

already consigned to an inferior status without access to the job and welfare privileges of their urban counterparts, rural entrepreneurs were more willing to take on the demeaned status associated with private enterprise and official discrimination against it.¹⁹¹

After the corporatization of SOEs, however, an outside observer has no obvious way of telling whether an enterprise incorporated under the Company Law is ultimately controlled by the state or held privately.¹⁹² This political opacity has provided the corporate form with a new kind of legitimacy that earlier legal forms reserved exclusively for private enterprise never could. Today even a private enterprise can gain an identity as a “public corporation” of sorts by incorporating and selling shares—an effect not unlike the earlier phenomenon of rural entrepreneurs dressing up their businesses as “fake collectives” in the guise of TVEs. In both instances, a firm’s public identity alone does not reveal its underlying relationship to the state. Once again, the PRC defies standard economic theory. The Company Law has legitimized and accelerated the expansion of private enterprise, not by clarifying the distinction between public and private ownership, but by blurring it.

In sum, the Company Law can be viewed as a codification of a tradition of enterprise organization that began in the Chinese countryside in the 1980s, helping reduce the legally enforced economic inequality between city and country. Insofar as it has provided the legal groundwork for the consolidation of the state-controlled National Champions and the privatization of less-than-stellar SOEs, while at the same time inviting a seemingly endless influx of foreign capital, the Company Law has without a doubt made a signal contribution to the explosive growth of urban China over the past two decades. In fact, the evidence suggests that most corporatized SOEs’ success owes far more to their access to new sources of capital—domestic as well as international—and to political favoritism than to tangible improvements in their governance. This conclusion echoes the lesson of numerous other studies: on their own, formally enacted laws are rarely, if ever, sufficient guarantors of good corporate governance.¹⁹³ However, apart from its contributions to the aggregate growth of the urban economy, the corporatization of SOEs has had a major effect on the development of inequality throughout society.

191. See Jonathan Unger, *Bridges: Private Business, the Chinese Government and the Rise of New Associations*, 1996 CHINA Q. 795, 806 (“In the public image, a *getihu*, a ‘self-employed household,’ is considered of lower-class origin, and in that sense disreputable.”).

192. NEE & OPPER, *supra* note 55, at 114–15.

193. See, e.g., Donald Clarke, *The Role of Non-legal Institutions in Chinese Corporate Governance*, in *TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA* 168 (Hideki Kanda et al. eds., 2008).

IV. CODA: FROM POLITICAL TO MARKET INEQUALITY

Academically, there is a division of labor between analyzing the organization of capital and the organization of labor in industrial enterprise, with the former belonging under the purview of corporation law and securities law and the latter under employment and labor law.¹⁹⁴ At least in the Chinese case, it is simply not enough to discuss the restructuring of capital without considering, however briefly, its implications for the reorganization of labor. The creation of new structures for both private enterprise and state capital has shattered the erstwhile legal and ideological unity of capital and labor—the very premise of an SOE, and of the notion of a “People’s Republic” more generally.

Therefore, the restructuring of the state sector has entailed far more than “just” a reorganization of capital. It has also entailed the establishment of an institutional *separation* between capital and labor, with necessarily radical implications for both. While it is not possible to consider the effects of that transformation in full within the confines of a single article, it is analytically vital at least to take note of them in order to grasp the full significance of Chinese SOE reform. Looking back, they have overwhelmed an earlier state-enforced inequality between city and country with a more general inequality between the rich and the poor. In the process, they have reversed the gains made by the initial rural reforms in closing the city–country divide.¹⁹⁵

The commodification of work in essentially one generation is likely the single most consequential aspect of China’s post-1978 development. Indeed, the term “reform” is profoundly inadequate for analyzing the new deal between capital and labor forged by the corporatization of SOEs.¹⁹⁶ With the introduction of wage labor, the meaning of work, and even what it means to be a working being, has changed fundamentally. What has taken place is nothing less than a revolution in the organization of work—or from a Marxian perspective, a counterrevolution.

While China’s economy today may qualify as an instance of *state* capitalism, it is nevertheless a *capitalism*. The modern enterprise system envisioned by the Company Law is one where the state continues to own (the bulk of) the capital, but its workers are no longer “the masters

194. See JOHN HASSARD ET AL., CHINA’S STATE ENTERPRISE REFORM: FROM MARX TO THE MARKET 36 (2007) (observing that transformation of labor has been “one of the least addressed issues in public-enterprise reform and restructuring”).

195. I do not, of course, mean to deny that the forms of inequality in China are multiple, overlapping, and constantly evolving (as they are everywhere). Other forms include gender inequality, inequality between inland and littoral areas, and inequality between the majority Han population and “minority nationalities” (*shaoshu minzu*), perhaps most notably.

196. On the transformation of China’s labor market, see generally CYNTHIA ESTLUND, A NEW DEAL FOR CHINA’S WORKERS? (2017); SEAN COONEY ET AL., LAW AND FAIR WORK IN CHINA (2013).

of the enterprise.” Rather than figurative owners, they have been transformed into contractual employees, owning simply their labor.¹⁹⁷ As we have seen, a traditional Chinese SOE represented a near-total integration of all aspects of urban life: it was factory, home, school, hospital, and retirement community all rolled into one. Reimagining an SOE as a business corporation with the state as the controlling shareholder means that the workplace becomes just that—a place for work. Social welfare benefits that were previously delivered by the work unit must be provided through other means. In addition to transforming the employment relationship, the corporatization of SOEs has thus entailed a reordering of the family, and, in the final analysis, a reconfiguring of individual subjectivity—the transformation of the revolutionary political subject of the Maoist era into a new, economic one.

In legal terms, the commodification of labor has required the creation of a body of employment law. The enactment of the Company Law 1993 was followed by a Labor Law in 1994. It required, for the first time, that all employers—regardless of their ownership form—enter into contracts with their workers.¹⁹⁸ On the simplest level, the mandatory institution of the employment contract establishes the worker as an economic subject who agrees to the terms of his or her employment.¹⁹⁹ In comparison to the more or less coercive cultivation of socialist unity in SOEs, the employment contract has been described as an “anti-solidarity machine.”²⁰⁰ In effect it atomizes the revolutionary political subject of Maoism—“the people”—and breaks it into independent economic subjects responsible for their own material needs. Stated differently, the transformation of SOEs into autonomous market actors has been paralleled by the creation of the same on the level of the individual. With growing pressure from private enterprises with even fewer obligations to their workers, corporatized SOEs have come to treat their employees more and more like their foreign competitors, many of which have gained notoriety for their labor standards.²⁰¹ In effect worker exploitation is no longer a privilege reserved exclusively to foreign and private employers.

197. On the transition from a property-based interest in one’s job, premised on ownership of enterprise assets by “the whole people,” to a contractual one, see Tao Rong, *Employees’ Property Rights in China’s State-Owned Enterprise Reorganization*, 13 COLUM. J. ASIAN L. 153 (1999).

198. Zhonghua Renmin Gongheguo Laodong Fa (中华人民共和国劳动法) [Labor Law of the People’s Republic of China] (promulgated by the Standing Comm. Nat’l People’s Cong., July 5, 1994, effective Jan. 1, 1995), arts. 2, 16, CLI.1.9587(EN) (Lawinfochina).

199. See generally MICHAEL BURAWOY, *MANUFACTURING CONSENT: CHANGES IN THE LABOR PROCESS UNDER MONOPOLY CAPITALISM* (1979).

200. Ching-Kwan Lee & Yuan Shen, *An Anti-Solidarity Machine? Labor Nongovernmental Organizations in China*, in *FROM IRON RICE BOWL TO INFORMALIZATION: MARKETS, WORKERS, AND THE STATE IN A CHANGING CHINA* 175 (Sarosh Kuruvilla, Ching Kwan Lee & Mary E. Gallagher eds., 2011).

201. In a nationwide race to the bottom, the labor practices of all Chinese enterprises, regardless of ownership form, have increasingly converged to those of foreign employers—a phenomenon Mary Gallagher describes more generally as “contagious capitalism.” GALLAGHER, *supra* note 143, at 16.

From a national perspective, SOEs' corporatization reflects a new deal not only between SOEs and their workers but also between rural and urban labor, unsettling the very boundary between the two. With the emergence of markets for labor and housing in the cities, the household registration system of the Maoist period has been unable to keep the rural poor in place, as they migrate to cities in search of work. At the same time, as more and more urban residents are being left out of the benefits of development as well, the earlier legally enforced inequality between rural and urban citizens is being replaced, increasingly, with a simple distinction between the rich and the poor, no longer strictly correlated with geography.²⁰²

Indeed, while contract labor—in contrast to a permanent assignment in a work unit—has always been the province of indigent rural migrants, with the contractualization of *all* employment even urban citizens no longer enjoy a guaranteed share of the benefits of economic growth. This has produced an impoverished and radically powerless proletariat of rural as well as urban origin. The erstwhile ideologically glorified—albeit politically subordinated—Chinese workers have been transformed into an army of servants of globalization.²⁰³

The irony is rich. The political premise for the economic reforms was the Party's desire to put the Cultural Revolution behind with a declaration in 1978 that "class struggle" had come to an end.²⁰⁴ This provided an indispensable ideological justification for a turn toward economic development, with a primary focus on reducing rural poverty. Paradoxically, as a result of four decades of "reform" there exists today, for the first time in China's history, a large and growing industrial working class. However, because the term "class" has been retired from the official lexicon, there is no adequate political vocabulary to describe their economic and political disempowerment. On the contrary, all labor protests are seen as a threat to the "harmonious society" (*hexie shehui*) and the "Chinese dream" (*Zhongguo meng*) which the Party-state claims to be presiding over.

202. To be sure, migrant workers' wages in China have been rising, as part of a general rise in labor standards, yet they remain far below those of registered urban residents. For a cautiously optimistic view that after the corporatization of SOEs China may now be beginning "to modestly 'socialize'" private enterprises and their labor conditions, see ESTLUND, *supra* note 196, at 207–08. It is also important to note that, not only is rural labor migrating to cities, but the urban–rural boundary itself is shifting geographically. With export-oriented industrialization nearing its limits as a development strategy, continued economic growth requires the creation of new domestic markets. This demands that rural households must be turned from largely self-reliant agricultural producers into modern consumers. To accomplish this, China has adopted a deliberate policy of market-driven urbanization—requisitioning rural land belonging to villages and converting it to urban uses. See generally YOU-TIEN HSING, *THE GREAT URBAN TRANSFORMATION: POLITICS OF LAND AND PROPERTY IN CHINA* (2010).

203. I borrow the term from RHACEL SALAZAR PARREÑAS, *SERVANTS OF GLOBALIZATION: WOMEN, MIGRATION, AND DOMESTIC WORK* (2001).

204. See Communiqué of the Third Plenary Session of the 11th Central Committee of the Communist Party of China, *supra* note 20.

Apart from labor, the restructuring of SOEs has had no less revolutionary implications for domestic relations. One of the express purposes of the all-encompassing socialist work unit was to displace “feudal” notions of patriarchal Confucian kinship and to replace them with a radical egalitarianism—an ethos of everyone “eating from the same pot” that was to be shared by rural communes and urban SOEs alike (with the important qualification that the pots in the latter were a great deal more plentiful). In this vision even the most intimate aspects of life were legitimate objects of state administration. The one-child policy, notoriously, made even family-planning a matter of state-planning.²⁰⁵

With the corporatization of SOEs, however, family has been separated from work. Simply in terms of physical space, this separation has required the creation of a housing market. In addition to housing, markets must be created for all other welfare needs previously satisfied by the state, unless the state continues to deliver them through alternative institutions, as has been the case with education, notably, and to some degree with health care.²⁰⁶ Growing economic inequality in turn has given rise to ever more urgent political demands for the family to take on what were previously SOE responsibilities for the poor, the disabled, and the old, in what amounts to privatization of welfare.²⁰⁷ As a result, family law is increasingly making family members responsible for adult dependents who are unable to take care of themselves.²⁰⁸ Even the one-child policy has been repealed, as it has become woefully evident that a cohort of only-children will not be prepared—psychologically or materially—to support their aging parents.

205. See XIANFA art. 25 (1982); Zhonghua Renmin Gongheguo Hunyin Fa (中华人民共和国婚姻法) [Marriage Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., Sept. 20, 1980, effective Jan. 1, 1981), arts. 2, 16, CLI.1.35339(EN) (Lawinfochina) (amended Apr. 28, 2001).

206. See generally Worawut Smuthkalin, *The Politics of Social Security Reform in Corporate Restructuring in China*, in GOING PRIVATE IN CHINA: THE POLITICS OF CORPORATE RESTRUCTURING AND SYSTEM REFORM IN THE PRC, *supra* note 139, at 175. See also Zhonghua Renmin Gongheguo Shehui Baoxian Fa (中华人民共和国社会保险法) [Social Insurance Law of the People's Republic of China] (adopted by the Standing Comm. Nat'l People's Cong., Oct. 28, 2010, effective July 1, 2011), arts. 16–19, 23, CLI.1.139683(EN) (Lawinfochina) (requiring firms to provide health care and retirement insurance for all workers).

207. One consequence has been a “reverse migration” of women from the public to the private sphere. See Margarit Y.K. Woo, *Shaping Citizenship: Chinese Family Law and Women*, 15 YALE J.L. & FEMINISM 99 (2003).

208. For example, the Marriage Law—essentially a family law code, despite its name—provides for duties for children to maintain indigent parents and even grand-parents, and for siblings to support each other when their parents are unable to do so. Marriage Law of the People's Republic of China arts. 21, 28–29. See also Zhonghua Renmin Gongheguo Laonianren Quanyi Baozhang Fa (中华人民共和国老年人权益保障法) [Law of the People's Republic of China on Protection of Rights and Interests of the Elderly] (promulgated by the Nat'l People's Cong., Aug. 29, 1996, effective Oct. 1, 1996), art. 18, CLI.1.15020(EN) (Lawinfochina) (providing that parents' remarriage does not release children from their obligation to support their parents). The Chinese

Paradoxically, precisely at the moment when economic reforms are making it increasingly vital for the family to reassume many of its traditional welfare functions, those same reforms are undermining it as an extended group responsible for its members. Much as labor has become contractualized, so has the family, and not only in the sense that it relies increasingly on the market for satisfying its material needs—a domestic form of outsourcing. The ideological foundations of the family itself have become less stable, as it has come to be seen less as a vertical unit consisting of multiple generations and more as a horizontal union between two individuals satisfying their private desires.²⁰⁹ This shift from a Confucian conception centered on the father–son axis to a contractual one between husband and wife has led to an increase in divorce, among other things, and a declining sense of intergenerational responsibility.²¹⁰

In sum, the ongoing reforms, in conjunction with the corporatization of SOEs, have produced new kinds of legal, economic, and social subjects, giving rise to profound contradictions in a state whose officially articulated political ideology remains socialism.²¹¹ While Mao Zedong insisted on the irreducibility of contradictions, he also distinguished between antagonistic and non-antagonistic contradictions.²¹² Today's official invocations of “harmonious society” are unlikely to placate the new working class, and they are certainly not enough to mask the glaring inequality between the rich and the poor—an increasingly antagonistic contradiction.

CONCLUSION

This Article has taken stock of legal and economic developments in the PRC since 1978, with a focus on two key forms of public enterprise, TVEs and SOEs. We have seen how Chinese enterprise reforms have been inextricably connected with evolving structures of economic

Inheritance Law embodies similar goals. Although the rules for statutory succession provide for equal shares among first-order heirs, they carve out an exception for indigent heirs in need of additional support. *Zhonghua Renmin Gongheguo Jicheng Fa* (中华人民共和国继承法) [Law of Succession of the People's Republic of China] (promulgated by the Nat'l People's Cong., Apr. 20, 1985, effective Oct. 1, 1985), art. 13, CL1.1.2368(EN) (Lawinfochina). Perhaps most remarkably, China's inheritance law calls for the provision of an “appropriate share” to any needy dependent of an intestate decedent, whether related or not. Law of Succession of the People's Republic of China art. 14.

209. On the changing understanding of marriage even in rural China, see YUNXIANG YAN, *PRIVATE LIFE UNDER SOCIALISM: LOVE, INTIMACY, AND FAMILY CHANGE IN A CHINESE VILLAGE, 1949–1999*, at 86–111 (2003).

210. On the normalization of divorce, see William P. Alford & Yuanyuan Shen, *Have You Eaten, Have You Divorced? Debating the Meaning of Freedom of Marriage in China*, in *REALMS OF FREEDOM IN MODERN CHINA* 234 (William C. Kirby ed., 2004).

211. See, e.g., *CHINA: THE RISE OF THE INDIVIDUAL IN MODERN CHINESE SOCIETY* (Mette Halskov Hansen & Rune Svarverud eds., 2010).

212. See Mao Tse-tung, *On the Correct Handling of Contradictions Among the People*, in 5 *SELECTED WORKS OF MAO TSE-TUNG*, *supra* note 1, at 384 (1978).

inequality and an even greater social, cultural, and psychological transformation. At the same time, although the state's role has undergone a profound transformation, it would be a mistake to interpret that transformation as its withdrawal from the economic arena. On the contrary, insofar as the state's economic power has even increased, China's reforms can be interpreted as a form of state building, through the institutions of state capitalism.

As China remains riddled with countless political and economic contradictions, to speculate where these transformations will ultimately lead would be just that—speculation. At a minimum, though, what the preceding analysis has demonstrated is the multiplicity of ways in which political, economic, and social institutions can be combined, and recombined, to serve diverse purposes. The story of corporation law in the PRC since 1978 is a crucial part of understanding China's development on its terms. Equally importantly, it reminds us that what corporation law is, and what its proper goals are, are questions with many possible answers, with consequences far beyond corporations.