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### **NEW CO-OPERATIVES IN CHINA: THE EMERGENCE OF AN INDIGENOUS MODEL OF SOCIAL ENTERPRISES**

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## INTRODUCTION

Co-operatives are under renaissance in many developing countries nowadays (Develtere, 1994; Develtere et al., 2008), including in China. With the shift to the household contract responsibility system (HCRS) in the late 1970s and the dismantling of the commune system in 1982, rural co-operatives in China have re-emerged. Under different periods of rural economic and political development, agricultural co-operatives were also experiencing gradual yet striking changes. A New Co-operative Movement, different from the former revolutionary communalist co-operative movement, has been observed as an alternative way to deal with the tensions which have occurred in rural China (Zhao, 2009).

In rural China, the emergence of shareholding co-operatives has been witnessed. With the dismantling of People's Commune in the early 1980s, the shareholding co-operative system (SHCS) was invented as an experiment in the reform of property rights and management systems in the rural enterprises and as a response to the problems created by the dismantling the collective properties. Afterwards this system has further been used in community co-operatives and land co-operatives, as well as by the new and prosperous farmers' specialized co-operatives. In Jiangsu Province, by the end of June of 2008, the total number of those three kinds of co-operatives reached 11.6 thousand, in which 5.223 million rural households are involved (35.2% of total provincial rural households)<sup>1</sup>. While in Suzhou City alone, in 2008 80% of total households were involved in this new co-operative system<sup>2</sup>. In Zhejiang Province, by the end of October 2005, there were 502 villages that applied the shareholding co-operative system, in which RMB14.93 billion are quantified, and 535 thousand members are involved<sup>3</sup>. In Foshan City, Guangdong Province, the birthplace of land SHCS, 2957 shareholding co-operative economic organisations have been established by the end of 2007. The land area involved in this system (or rural land into shares) accounts for 97.73% of the total area of land transfer<sup>4</sup>.

The emergence of shareholding co-operatives is just one example and a start for a new co-operative movement in China. This revival of co-operatives in China, however, has not been widely emphasized and examined internationally. The systematic study of co-operative development in China under transition from a central-planning to a social market economy is underdeveloped. The heterogeneity and complexity of co-operative sectors in present-day rural China have not been fully understood and examined as an independent theme. Another constraint of the existing analyses lies in their lack of attention for the innovative mechanisms within the co-operative sector and their future perspectives. For those two reasons we presume that it requires an elaborated and dynamic framework of analysis to re-examine co-operative development in China from an insistent and developmental perspective.

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<sup>1</sup> From: <http://xinnongcun.agri.gov.cn/counter.asp?id=27383&IClass=0904> (25-09-2008)

<sup>2</sup> The Statistics Bulletin of Suzhou on the 2008 National Economy and Social Development: <http://www.tjcn.org/suzhou/tjgb/9468.html> (21-01-2009)

<sup>3</sup> Zhao Xingquan, Speech on Land/Community Shareholding Co-operative System of Zhejiang Province: <http://www.zjagri.gov.cn/html/main/zjAgriInfoView/2006012664002.html> (26-12-2005)

<sup>4</sup> In Guangdong Province The land area involved in shareholding system reaches 1.51 million mu (0.1 million ha) in 2007, accounts for 35.9% of the total area of land transfer. From: <http://nc.people.com.cn/GB/8475571.html> (08-12-2008).

In order to begin to fill these gaps and to get a more comprehensive idea of new co-operatives operating as home-grown social enterprises in present-day China, this paper aims to explore the dynamic process of co-operative practice and social innovation involved in rural China. We develop a conceptual model that incorporates ideas implied in resource dependency theory and path dependency theory. Through the analysis, we would like to answer the following questions: How can we understand change and social innovation within the co-operative sector in China? How do various actors interplay with each other in shaping this co-operative process?

This paper proceeds as follows: in the next section we begin by outlining the theoretical debates in the literature concerning SHCS in China. We will focus more specifically on the discussion concerning the non-compliance of the SHCS with the international standards of an ideal type of co-operative. After that we present our own analytical framework within which the heterogeneity and complexity of co-operative development can be examined. This conceptual framework is developed based on historical neo-institutionalism and organisational theory of resource dependency. In section 2 we go on to discuss a path-dependent co-operative development especially the emergence of shareholding co-operatives and their evolution. An empirical observation follows in section 3, in which we then delve into the practice of SHCS through analyzing the most prominent form of it, namely, land-based shareholding co-operatives. This helps to better examine the interaction between different actors (namely, the innovative promoters and the public authorities) in a standard co-operative sense rather than rural enterprises. Hereafter a final conclusion will be presented in section 4.

## **1. A THEORETICAL FRAMEWORK**

Discussing on SHCS as one of new types of co-operatives in rural China requires orienting our time-scale in the economic transitional background. To begin with observing this indigenous innovation in rural China, it should be borne in mind that its emergence came with the dismantling of the commune system in the early 1980s. As a result, local residents were faced with the problem of ambiguity of the collective ownership of land as well as the property right for the other indivisible collective assets; and at the same time, local governments were deprived of revenues and turned to the promotion of rural enterprises.

### **1.1. Literature review**

SHCS creates a new organisational ownership form, which is to achieve an alliance between capital and labour (combining "one share one vote" and "one member one vote"), as well as to achieve a cooperation between local governments, collective enterprises and community residents (combining the interests from outside stockholders and internal members). It is regarded and acknowledged by the state as a collective sector and is considered as a new solution to revive the public economy<sup>5</sup>. This practice is established upon powerful egalitarian social norms prevailing during the socialist planned economy era. However, this "ideal" institutional design does not work well in reality, and a considerable divergence exists between the original policy intentions and the eventual outcomes of the converted SHCS (Zeng, 2005). In the wake of the promotion of this new system, scholars have studied intensively in order to understand this new type of

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<sup>5</sup> Guidelines for developing urban shareholding co-operatives (*Guanyu fazhan chengshi gufen hezuozhi qiye de zhidao yijian*), State Committee for Economic System Reform (*Guojia jingji tizhi gaige weiyuanhui*), June, 1997.

socialist mixed economy<sup>6</sup> in rural China. As a result, many descriptions and terms occur in the literature, like "multi-stakeholder cooperation" (Jordan, 1989)<sup>7</sup>, "hybrid property" (Nee, 1992), "moebius-strip collective ownership" (Cui, 1993)<sup>8</sup>, "a kaleidoscope of mixed public and private property forms" (Stark, 1996, p996), "a joint stock cooperation system" (Chen, 1996), "hybrid forms of ownership" (Clegg, 1998), etc.

Although shareholding co-operatives have experienced rapid development and thus contributed significantly to the development of rural industry in China, they have also been assaulted with many criticism and an ambiguous attitude on the part of Chinese and foreign scholars. On the one hand, it is argued that shareholding and co-operative systems cannot be integrated and the concept of "shareholding co-operative" is a false one (Li, 1994, p10). In other words, SHCS is "neither a donkey nor a horse"<sup>9</sup>, and they are "implementing the private ownership system under guise of public ownership" (Tung, 1994, p30)<sup>10</sup>. Smith (1993) argued that the blurring of collective and private ownership in the rural industrial sector is a form of "creeping capitalism". Moreover, Oi (1992, 1995) posits the concept of "local state corporatism" to highlight the symbiosis of bureaucratic power and rural capitalism, etc. On the other hand, many studies have contributed to the idea indicating the intimate involvement of local government in rural enterprises and their role in shaping the hybrid collective ownership form (Nolan and Liu, 1992; Bowles and Dong, 1994; Oi, 1992, 1995, 1998; Watson et al., 1996; Sjöberg and Zhang, 1998; Pei, 1998; Selden, 1998). Therefore, it is a "vaguely defined co-operative" system (Weitzman and Xu, 1994). In other words, it is not regarded as an ideal co-operative system in the conventional sense.

The SHCS operates in a different way than the internationally recognized ICA-type<sup>11</sup> of co-operatives. First of all, the voting system is not according to "one member one vote" but a

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<sup>6</sup> The term "socialist mixed economy" was invented by Hungarian economist Gábor István (1986) and Szelényi Ivan (1988) to describe the new organisational model emerged in the post-socialist context in East European context.

<sup>7</sup> Here Jordan draws on Ackoff's stakeholder view of a firm that takes into account the interests of all those inside or outside an organisation who are directly affected by its activities, including employees, suppliers, customers, investors, debtors and government.

<sup>8</sup> Here Cui's term is based on the term "moebius strip enterprise" by Charles Sabel that was originally meant to identify Sabel's feeling of some of new organisational structures emerging in response to turbulent market conditions of the late 1980s. Cui explains further that due to the strong influence of the Western mainstream economics, even some Chinese economists believe the ownership of China's rural enterprises is "obscured" and "inefficient". By this term, he defines the ownership structure which facilitates both interests of insiders and outsiders of the firms (Cui, 1993).

<sup>9</sup> Because at that time there were no other forms except those of state-owned, collective-owned or private-owned. This system is neither collective owned nor private owned. At the very early stage of the reform and opening up, non-public-owned economic sectors were still severely restricted. Those who would like to develop this system had to petition for protection from the local governments by way of "wearing a red hat of collective form". Therefore, "Some TVEs are indeed 'fake collectives' in terms of using only the collective label for protection and economic benefit" (Liu, 1992).

<sup>10</sup> Because private entrepreneurs frequently register their enterprises as TVEs for purposes both of security and to obtain benefits denied to private enterprises (Nee, 1989; Young, 1995, pp96-97).

<sup>11</sup> ICA stands for the International Co-operative Alliance.

combination of "one member one vote" and "one share one vote"<sup>12</sup>. Secondly, it allows investment from outsiders, thereby exposing a co-operative enterprise to the threat of external takeover. Thirdly, it permits direct local government influence, which inhibits enterprise autonomy.

## **1.2. A theoretical framework**

Before presenting our analytical framework, we need to mention the several conscious choices we have made in writing this paper in order to gain theoretical leverage applied to a broader changing and vibrant socio-political environment. First, academic scholars as well as co-operative practitioners have commonly criticized that co-operatives in China nowadays have still little resemblance and congruency with the ICA principles. So, co-operative development in China is said to be led by a "distorted" process which impedes the emergence of ICA-style co-operatives in China (Ying, 2002; ISCRR, 2008, Wang, 2009, etc.). However, instead of providing a more rounded explanation of this "distortion", it is generally argued that factors such as local governments' predation, farmers' lack of spirit in cooperation, or the existing influence from the historical legacy of co-operatives account(s) for this fact (Clegg, 1998; Liu, 2004; Shi, 2005; Liu and Zhang, 2007, etc.). The reality can yet in no way be captured by a partial description, but rather requires a consistent, systematic analysis. Second, we provide an integral relations between the past and the present. Rather than focusing on institutional stability which we found from those analyses on co-operative development in China with a static perspective presented above, we emphasize the institutional development and change. Third, we concern a broad background of environment which combines different resources, the distribution and exchange of resources, and reciprocal relationship between formal and informal institutions in the co-operative practice. Through it we will provide the significance of recent transitional context in rural China by way of an experiential study instead of a functional or statistical one. Our last concern is to pay special attention to those "institutional entrepreneurs" (Fligstein, 2001), whom we consider the capable farmers in rural communities rather than local officials or other outsiders of the local communities. We analyze this bottom-up institutional innovation process in order to show that local residents are actually innovative promoters.

As we have showed above, the departure point of most of the traditional theoretical reflections on co-operative development in China is its incongruence and inconsistency with the ideal type of co-operatives. This ideal-co-operative reference is most commonly made to the ICA principles and the Rochdale charter. These principles are said to be universal and are used to distinguish genuine co-operatives from false or hybrid ones (Develtere, 1994, p15). However, there are multiply limitations to the ideal-co-operative perspective<sup>13</sup>. Contrary to "the ideal-co-operative perspective", co-operative development in China has indeed followed an alternative path which is shaped by past legacies, and at the same time shapes "the real type co-operative" model. Therefore, the historical path and trace which have characterized the co-operative development in

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<sup>12</sup> Clegg (1998, p77) argues that "one share one vote" system provides a particular example of symbiosis between local governments and large individual shareholders, since it allows them both to maintain influential positions, and to be more attractive to outside investors", and "to protect the collective economy, local governments may prefer to retain a substantial shareholding but they too may manipulate the use of profits".

<sup>13</sup> This approach utilizes an outsider definition of cooperation as a verificational instrument for looking at co-operatives, impedes an understanding of the heterogeneity of the co-operative sectors, thus leads to an atomic perspective of co-operative development as well as produces a static analysis of isolated co-operative units rather than movements.

China need to be examined, on the one hand, and variance and change in new co-operatives at present should be discerned so as to find a dynamic way of evolution and a real co-operative type evolved from the historical path, on the other hand.

Departing from this ideal-co-operative perspective, we develop our model on co-operative development in China from the perspective of a real-type co-operative concept, by employing a historical neo-institutional perspective combined with power-and-resource-related theories, which in our paper will be the theory of resource dependency.

### 1.3. Path dependency theory

As a must-be discussed concept within historical neo-institutionalism, path dependency theory, has been used widely. Since this concept, which is rooted in the field of economics, has been applied to political sciences, it engenders many discussions among which three main perspectives arise, i.e. institutional stability and continuity, institutional development and change, as well as a composite model combining the first two perspectives<sup>14</sup>.

If we look at a more sociological approach which suggests a broader range of mechanisms including functional, power and legitimacy mechanisms (Mahoney 2000; Thelen 2003), we can observe that the importance of power-related conflict and interests is increasingly underlined. For example, Thelen (1999) argues that institutions can be considered as the enduring legacy of political struggles, in other words, a continuous struggle for power. Considering countervailing forces for irreversible lock-in situations, new mechanisms which include layering and conversion processes account for institutional change. *Conversion* is the process where an existing institution is reoriented to serve new purposes or to reflect new power dynamics (Thelen, 2003, p331–4). Such reorientation occurs either when a shift in the external environment demands that an existing institution change in order to survive, or when the institution incorporates (or is captured by) a new constituency. Whereas a *layering process* is a mechanism that has been proposed to account for change, over time, in the development of political institutions (Schickler, 2001; Thelen, 2003). Typically, institutional evolution through layering results from actors' efforts to shape the development of an institution when they are either incapable of changing it at a macro-level or do not seek to do so (Boas, 2007). In a word, although institutions may reinforce certain power disparities, today's "losers" do not disappear and they may wait for "a more favourable initial condition to come" (Zhao, 2009) in order to be capable of managing their environment and thus changing power relations.

Although we consider the path dependency perspective as a useful instrument, we should indeed be cautious because of the substantial critique it receives. The key issue at stake is said to be the argument that path dependency is not a sufficient notion to explain reality. As Sydow et al. (2005) state, path dependency shows to be overly deterministic as compared to the reality outside. However, thanks to this critique, the development of a complementary perspective within the framework of historical neo-institutionalism has been encouraged, focusing on power-related theories (Thelen, 1999; Mahoney, 2000; Pierson, 2000; Thoenig, 2003) to give an additional instrument to explain institutional change and evolution (e.g. Alexander, 2001; Thelen, 2003, 2004; Hacker, 2004; Crouch and Farrell, 2004; Boas, 2007). At the same time, we bear it clearly in mind that by employing a dynamic path-dependency model, we still need to make our

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<sup>14</sup> Zhao (2009) provides a concrete part of literature review on path dependency theory. The full literature review is omitted here. Please consult Zhao (2009) for more discussion on the introduction of path dependency theory into analyzing historically evolving process of co-operative development in China.

framework link to other potentially powerful explanations, in order to present a more rounded interpretation.

#### **1.4. Resource dependency theory**

We further choose resource dependency theory to mend our analytical framework. Three primary reasons are suggested here why we take this theory into account. First, resource and power are discussed in the adjustment of both ideal-type co-operative theory and path-dependency model<sup>15</sup>. In making up the shortages in both of these two perspectives, resource dependency theory has its potential in examining concepts of power and conflict (power relations), power and interests as well as social exchange thus would provide an important instrument to adjust our analytical framework. Second, although approaches such as social exchange theory (Homans, 1958; Emerson, 1962; Blau, 1964; Cook, 1977) and transaction cost economics (Coase, 1937, 1960; Williamson, 1979, 1981, 1985) are both related to our wish, they are insufficient to provide an more elaborated and coherent framework to explain the interplay of a variety of actors (the government from central level and local level, institutional entrepreneurs, small farmer households, etc.—the "organisation" aspect), nor the outside indeterminate environment in shaping the co-operative reality in China as well as the driving forces of change and adaptation in the co-operative sector (under constant reinterpretation and reorientation—the "ideology" aspect), nor dynamic process of co-operative development (practice/participation—the "praxis" aspect). Finally, the advantage provided by this theory is that by including the outside environment as an important part in forming this theory and by emphasizing uncertainty, this theory is thought to be a useful alternative in providing a dynamic analytical mechanism.

In order to explain organisational and inter-organisational behaviour in terms of those critical resources which an organisation must have in order to survive and function, resource dependency comes from one actor's ability to control access and use of the resources on which others depend. Pfeffer & Salancik (1978) argue that the resource dependency theory assumes that focal organisations are rational and adaptive; they also need resources from the environment and face constraints from the environment. Moreover, resource dependency theory concerns the implementation of a variety of strategies to manage the outside environment. The ability to manage the environment to its advantage is driven by the possibility of the focal organisation to gain potential control and power, which are inherent in the state of dependency and uncertainty (Stump and Heide, 1996; Jap and Ganesan, 2000). In the literature on inter-company behaviour and relations, this dependency and uncertainty have been studied by several researchers (Ulrich and Barney, 1984; Clark et al., 1994; Scott, 1998).

Figure 1 illustrates our conceptual framework of a "real-type co-operative model" in rural China. Co-operative development is a sort of social movement, according to which, ideology, praxis and organisation are three interlinked components. As Develtere (1994) has suggested, the ideology of co-operative development presents both the images of a desirable or ideal model based on a set of values and norms, and the ways to achieve them. The praxis or the production of the ideology demonstrates the alternative but also refers to the mobilization and participation of adherents. The organisation of the ideology provides an instrument for ideological transmission by way of collective actions or hidden strategies but also positions the co-operative as a socio-economic

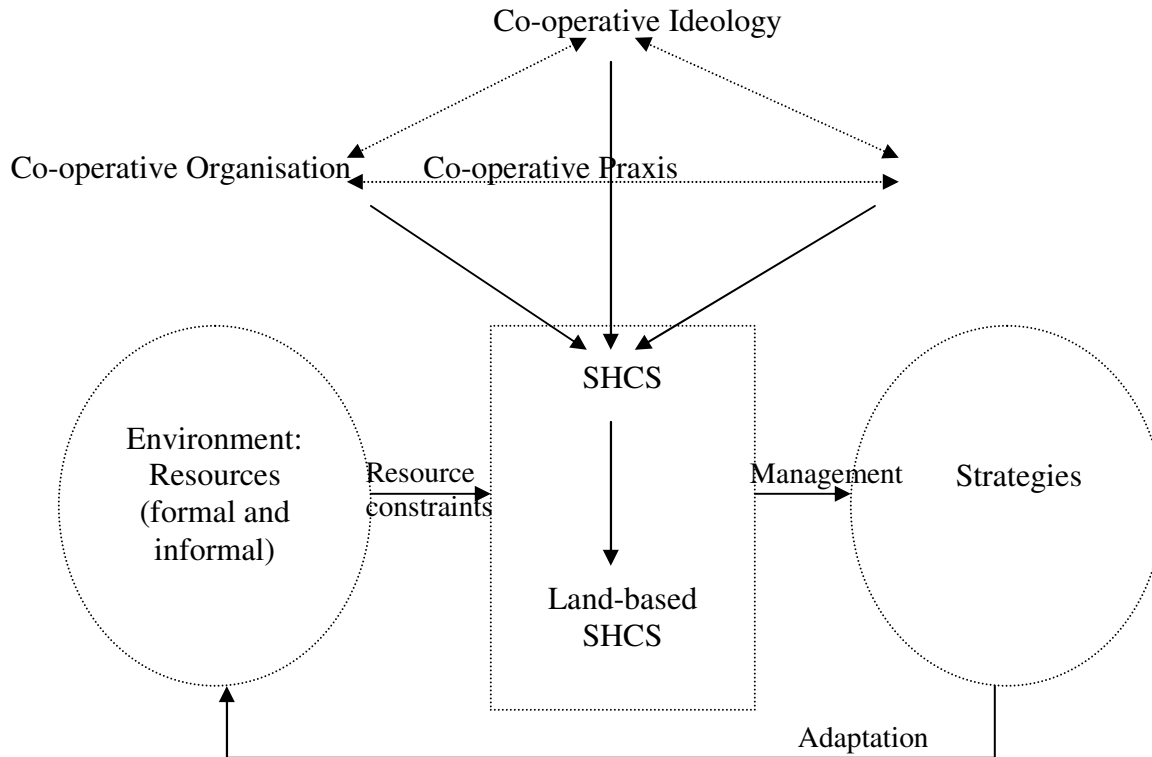
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<sup>15</sup> Focusing on the literature from path-dependency-theory scholars dealing with power-and-resource-related approaches, a number of key factors can be found. See, for example, Hall and Taylor (1998), Immergut (1998), Thelen (1999), Mahoney (2000), Thoenig (2003), Peters et al. (2005), etc..



actor in the market and society. In this triangular shape, each component interacts continuously with the others, although at certain times, one component can take a dominant position (Develtere, 1994, p. 22-24). In reality, each of them evolves in a path-dependent way. This process of evolution leads to the emergence of SHCS first based in rural enterprises (collective enterprises, Township and Village Enterprises (TVEs), etc.), which can be regarded as one best example of showing institutional continuity and variance. This form evolves further into the farming-based organisational structure which presents agricultural co-operative sector. At the same time, there is an external environment which refers to access to resources (formal and informal ones) and the distribution of resources. Resource constraints influence power-related conflicts and interests. Because organisations/influencing actors in the organisations are rational and adaptive to the outside environment by way of employing different strategies, power relations among different organisations can actually vary from time to time. This is power-and-resource-related way of how a real type model finally comes into being.

*Figure 1 - Conceptual Framework of "Real-type Co-operative model" in Rural China*



## 2. PATH-AND-RESOURCE-DEPENDENT CO-OPERATIVE DEVELOPMENT

Shareholding reform is a recently launched social innovation. Generally speaking, there are two types of shareholding co-operatives, namely, community shareholding co-operatives and farmers' specialized co-operatives. The former type consists of land-based shareholding co-operatives and factory-leasing shareholding co-operatives, among which the first one is the most dominant form. Till now land shareholding co-operatives have been established in many areas in rural China. Although the name of farmers' specialized co-operatives does not contain the term "shareholding", they have in several cases adopted a shareholding structure in ownership right.

This happens commonly in developed areas in China with advanced level of co-operative development. Therefore, SHCS in farmers' specialized co-operatives is still not as popular as that in land-based shareholding co-operatives.

The emergence of shareholding co-operatives is regarded as a start for new co-operative development in rural China. Although this paper focuses on rural new co-operatives in general sense, they have their roots in SHCS in rural industrial enterprises or companies. Therefore, in order to know the early stage of shareholding co-operative practice we have to start with shareholding co-operative rural industrial enterprises.

### **2.1. A path-dependent organisational form**

Examining the emergence of SHCS in rural industries has to be interlinked with the background of economic development and marketisation. Before the reform and opening-up, there were generally three types of co-operative organisations in rural China: community economic co-operative organisations, supply and marketing co-operatives and rural credit co-operatives. The last two types have since the period of the commune system lost any semblance of their co-operative characteristics<sup>16</sup>; therefore, the first type, which is the only choice in the existing organisational forms to be available of undergoing institutional reform later, has indeed developed into community shareholding co-operative organisation dealing with collective-owned assets like rural land. But how did its path depended change happen?

After the reform and opening up, many farmers began to seek non-agricultural employment in rural enterprises in order to gain more incomes and part-time farming was generally becoming the mainstream. As they have gained more and more economic capital, most households had begun to gain some amounts of savings deposited in state banks, while at the same time the village on its own account had to borrow from state banks, State-Owned Enterprises (SOEs), and other institutions. One of the main features of the rural economy in China is the coexistence of capital scarcity and labour surplus. Therefore, on the one hand, although rural farmers became generally in the possession of some capital, the amount they owned was often not enough to motivate them to take a great interest in the enterprises. On the other hand, team and brigade leaders (later village's leaders) generally supported reforms initiated by farmers because first, they got their income not from the salaries paid by the collective commune (later the higher level government of township<sup>17</sup>) but from their own farming activities, especially in poorer areas. They were often closely aligned with the interests of farmers, being close relatives or acquaintances. Therefore, they supported the farmers' desire of reform. Second, the scope for rent collection that local officials could earn from their position would increase with the reforms as the level of wealth in the local economy grew (Swinnen and Rozelle, 2006, p161)<sup>18</sup>. As a result, both villagers and village leaders have had an incentive to look for a mechanism to directly link their own household savings with the investment demand of their own village enterprises. Although this motivation may not have directly initiated community-based shareholding co-operative enterprises, it has significantly contributed to their development and improvement.

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<sup>16</sup> See Zhao (2009).

<sup>17</sup> The attitude from the officials in collective commune has nonetheless also played a role. Concerning the economic reform here, this factor is not included in my analysis. More reference can be reached from Luo (2006), p23.

<sup>18</sup> This section draws on Zhao (2009).

The operation of HCRS in rural area has liberated a great amount of rural labour force, who could do the household-run and self-employed industrial business. The region of southern Zhejiang Province (Wenzhou and Taizhou), where shareholding co-operative structure was first initiated, is a place with very little investment from the state (from 1950 till 1978, the state investment to Wenzhou accounted for only one seventh of the average national level). The per capita arable land was far less than national per capita arable land (equals to only 22% of the national average). Scarce natural resources and a underdeveloped transportation system have all made the initial conditions of development extremely disadvantaged. There were very few SOEs and a weak collective economy. Therefore, private-run business became the best available option. At that time, there were basically three kinds of enterprises, namely, TVEs, household-run or self-employed enterprises, and private-run enterprises. The great and rapid development of private economy has made household-run industries necessary to upgrade to a much larger scale industry, in which the problem of capital/resources constraints became more severe. Cooperation in capital deposits and other production materials (skill, information, labour forces, land) inter-household has thus emerged. This structure was actually not a new matter. Because during the agricultural co-operative movement before 1956 in China, the tremendous changes in the organisational form and distribution system (in the process of evolution from individual family production to mutual-aid groups and elementary agricultural co-operatives) has already witnessed the emergence of shareholding co-operative structure.

In the mutual-aid system from 1950, collaborative efforts intended to overcome production difficulties. Developed into the elementary agricultural co-operatives, farmers started to turn their individual plots over to co-operatives for centralized management. At the same time, remuneration was also distributed by the co-operative according to work contribution, with the exception of the land provided by the farmers, which was considered as part of their share in the co-operative and taken into account when the harvests were distributed. The production on each plot had thus no longer any direct relationship to the owner. The benefits that the households could expect depended on the overall performance of the co-operative, which represented a profound change for the Chinese farmers who were used to family farming. But private landownership remained respected. In the advanced agricultural co-operatives starting from 1956, the cost of land, draught animals and machinery was evaluated as shares and these assets were turned over to the co-operative. However, only 5% of the total land area of the co-operative was reserved for individual use by the farmers as private plots, and farmers were also not allowed to sell, lease or transfer freely their individual plots (FAO, 2004).

## **2.2. Ideological constraints and breakthrough**

To understand the ideological constraints of the re-emergence of shareholding co-operative enterprises after the reform and opening-up, Yu Guangyuan, a popular leading economist and philosopher in China, has best described the situation at that moment: before China's reform really started, no one had dared to advocate a market economy in China. the term that the most radical person in the reform movement dared to use was "commodity economy", which was used as a substitute for the term "market economy"<sup>19</sup> .... The resolution of the Third Plenary Session of the Twelfth Central Committee of the Party included the following statement: "We do not

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<sup>19</sup> Yu argues that it was Deng Xiaoping who first advocated that China practice a market economy: "in 1979 he discussed this idea with Jenny, the chief editor of *Britannica*. He talked only with foreigners, and, at that time, he did not want to discuss the idea with any Chinese people (including those around him)." (Yu, 2005, p37)

practice the market economy which is completely regulated by the market." Based on this sentence, those who opposed the market economy said, "the document of the Party demonstrates that China does not allow the practice of a market economy." However, those who advocated the market economy said that the market economy they were going to conduct was not the one that would be completely regulated by the market—and thus the market economy should be allowed. (Yu, 2005, p37-38)

Just as the economists and politicians at the beginning of China's reform who "really lacked an understanding and knowledge of the modern market economy" (Yu, 2005, p38), farmers and local officials, at the very beginning of the emergence of SHCS, did not have any training background towards it. At that time, SHCS was running with people's own subsistence-based concepts of property rights and cooperation featured with collective economy<sup>20</sup>.

However, local officials and (especially farmers) have the incentive to initiate innovative practices during the reform. For example, at the very beginning of the reform, the document of the Third Plenary Session required the implementation of the decentralization of power, but the state financial departments did not implement this policy because they were concerned about the reduction of financial income. By contrast, local officials in a coastal province first began to implement flexible policies and did not follow the regulations from the upper levels. But they did not make any statements concerning the practices in order to protect themselves (Yu, 2005, p33). More issues on innovative practices on SHCS will be discussed in the next part.

In order to prevent from the critique of being "capitalist economy", the initiators (at the very beginning they were a group of farmer entrepreneurs) of SHCS proposed that their revenue of enterprises were based upon cooperation of working together by villagers collectively. Besides that, they claimed of having public accumulation funds, due to which this form of collective economy they were operating should indeed belong to "socialist public economy".

Furthermore, Because of their common interests with institutional initiators, local officials sought to protect this collective sector. The incentives of local leaders for ideological breakthrough to participate in the "market economy" and support the development of rural collective enterprises comes from the fact that the profits turned over to the township government from the enterprises are an important source of self-raised revenue for local government. At village level, the profits turned over from the village-run collective enterprises to the village community organisations are important economic bases for the implementation of those organisations' functions. The township and village leaders will, therefore, inevitably control and protect the collective enterprises, as well as promoting their development. When the costs of intervention (blind command, incorrect decisions, etc.) exceed the benefit of protection (reduced transaction costs for enterprises), reform of the township and village collective enterprises will become a priority. Township cadres and village leaders will be less resistant to institutional change if, during reform, the township government and village leaders can acquire shares from the residual of the enterprises which will enable them to cover expenses and fulfil their tasks (Zhang, 1999). Therefore, examining the

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<sup>20</sup> In another paper, this issue is described as follows: because the reality of Chinese co-operative is a hybrid result influenced by liberal democratic tradition, Marxist tradition together with the guerilla experience of the communists, the practice to conduct the co-operative according to ICA principles would be no easy issue. It would be not easy and practical especially if we take into account the emergence of shareholding co-operative system as an indigenous model of co-operative instead of a classical co-operative model. Therefore the long period popularity of this double-edged sword in both rural and urban China also hinders the people from learning and understanding the classical theory of co-operative (Zhao, 2009).

debate concerning rural enterprises in China in the 1980s and 1990s of whether they did not have completely hard budget constraints (Naughton, 1995, p153) or whether it existed a softening of local government's budget constraint and that of rural enterprises (Qian and Roland, 1998), we can see that budget constraint on collective rural enterprises are softer than that on non-collective rural enterprises (Sjöberg and Zhang, 1998). It also contributes to another reason why the organisational form of "collective economy"/having the collective share was preferred in this shareholding co-operative structure.

### 2.3. Institutional evolution and collective participation

Identified by the Ministry of Agriculture, there are three types of co-operatives under SHCS: rural shareholding co-operative enterprises (*nongmin gufen hezuo qiye*), rural co-operative (credit) funds (*nongcun hezuo jijinhu*), and community shareholding co-operative organisation (*shequxing gufen hezuo zuzhi*). In 1990, the Ministry of Agriculture issued a temporary provision and, in December 1992, it promulgated an announcement on practising and perfecting the SHCS of TVEs. According to the definition given in the 1992 announcement, a shareholding co-operative enterprise is a corporate legal person or economic entity organized voluntarily by more than two labourers or investors, according to regulations or agreements, to pool their capital, physical assets, technology, land tenure, etc. as shares and to take up various kinds of production, management and service activities. These enterprises were to implement the principles of democratic management, distribute benefits according to a combination of labour and shares and accumulate shared assets.

SHCS is a distinctive response to the particular demands of China's transition to a modern industrial market-based economy. In a rural economy in transition, as processes of urbanisation and industrialisation dissolve local ties and disrupt communities, the SHCS at best represents an attempt to alleviate the tensions of property rights problem and sustain a community-oriented enterprise cohesiveness by creating new mechanisms of participation, allowing for the emergence of new solidarities based on bonds of profit-and risk-sharing among stakeholder groups (Clegg, 1998, p81). In contrast to traditional sense of co-operatives, shareholding co-operatives are more oriented to the whole community/village and putting more emphasis on multiple stakeholder ownership (township and village governments, local communities as collectivities, and their members as individuals, as well as workers and managers<sup>21</sup>. etc.). These new co-operatives usually have multiply objectives. These objectives include economical ones (rising incomes for farmers and revenues for local governments and village collectives, and capital returns), social ones (job security, using rural land more effectively, local development and spreading the benefits of development more widely<sup>22</sup>), and political ones (lessening arising tensions between managers and workers, farmers and local officials over the share of benefits during rural industrialisation and land expropriation, collective empowerment and greater voices to farmers and workers, achieving "socialist market economy" and maintaining social stability through the management of land, water resources and population).

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<sup>21</sup> Clegg (1998), p69.

<sup>22</sup> Many studies show that township and village officials place lower emphasis on profits than on assuring remunerative employment and welfare for a significant group of villagers and local workers (Weitzman and Xu, 1994; Naughton, 1994, p268; Oi, 1992, p119; Walder 1995).

### **3. LAND-BASED SHAREHOLDING CO-OPERATIVES IN CHINA**

As we have mentioned above, land-based shareholding co-operatives are till now the most popular type in agricultural co-operatives with shareholding system in rural China. This section accordingly presents our empirical observation focused on this type.

#### **3.1. A general description**

Land-based shareholding co-operatives is a China-specific form of farmer-owned co-operatives. This form has emerged in some of the most developed coastal areas as well as in peri-urban rural areas with rapid urbanisation and industrialisation. The basic feature of this form is to convert the land contract right of each member household in the village into shares, and local residents are determined to be shareholders. After the affirmation of villagers' ownership of land and other materials collectively owned, two kinds of shares are then generally identified: the basic share or land share (based on rights in the land resources, distributed among the households of the village according to family size, and it is not transferable), and investment share (based on labour, capital, technology and expertise contributions, and it is inheritable and transferable but not marketable). The consideration of distribution of land shares is based on the principle of egalitarianism among co-operative members, besides which age is an additional consideration. Children (under 16 years old) are normally entitled to half shares. Concerning the measurement of the land value, there are basically three valuation methods in the absence of a standard approach: one based on the prices paid by government for land conversion; one based on the net incomes of land after deducting input costs; and a mixture of the first two methods. Although the methods are imprecise, this has not hindered the implementation of the system. After receiving land shares, farmers return their land contract right to the natural village to which they belong. The natural village then offers the land entitlement to the administrative village to which it belongs. The administrative village is now in charge of land use. Usually an agricultural company subordinated to the administrative village will be founded, which becomes responsible for agricultural land (Chen and Davis, 1998). It pays a proportion of its revenues as dividends to the families holding shares besides land-use fees to the village collective. Then the latter divides the land-use fees to the villagers. The share value is usually determined by way of discussing and negotiating with the cadres of village collective. It has to nevertheless get the permission of the landowners who have the right to vote and express their opinions. Thus the villagers who are not working as farmers can enjoy their land contract rights in terms of shares.

#### **3.2. Power-related conflicts and interests**

Land is the fundamental form of property for farmers in China and the most important natural resource in rural areas. After the implementation of the HCRS in rural China, China's rural land system was continuously confirmed and protected over the past three decades through several laws and policies<sup>23</sup>. As an institutional innovation, HCRS was a great success in maintaining egalitarianism and social security, but thirty years of practice have exposed a number of limitations and weaknesses in terms of economic efficiency. Those limitations can be illustrated

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<sup>23</sup> With regard to laws, there are: The Land Management Law (LML, first adopted in 1986 and amended in 1988, 1998 and further in 2004), the Rural Land Contracting Law in 2003, and the Property Law in 2007, among others; With regard to policies, the No.1 document of the central state released in 2008 pointed out "to establish and improve the rural land contracting right registration system"; the policy paper put forward by the No. 17<sup>th</sup> by the Third Plenary Session of the 17<sup>th</sup> CCP central committee in 2008 pointed out that "well proceed the work of adjudication, registration and certification of rural land rights".

by several problems, like, being incapable of meeting the demand of large-scaled plantation, redistribution of land by local officials and farmers' limited incentives for long-term consideration of land use, unbalance of land demand-supply inter-households, etc.. The last problem becomes especially significant in the rural suburbs of rapid developing cities, as well as most rapidly developing coastal areas. With the high-speed industrialisation and urbanisation those areas have witnessed the widespread land conversion and transformation of rural land to non-agricultural uses.

According to the Constitution (revised in 1982), urban land is owned by the state and rural land by the rural collectives. According to HCRS, all rural families may "contract" farm land from their rural collectives (mostly village collectives, or *cun jiti*). When rural land is to be converted to non-agricultural and urban uses, it must undergo a process of state requisition, which compensates farmers based on their annual agricultural output value. In the process of land requisitions, it is usually the local officials that receive various benefits, while at the same time, the local citizens get very little land compensation fees. Farmers are dissatisfied or even angry with the forced land expropriation and requisitions, land leasing-out to developers at very low prices in the least transparent approach, the far-from-desirable compensation fees, an increasing gap in benefits received between local officials and farmers, being deprived of power in negotiating land prices with land users and compensation packages with local governments, etc.. Accordingly, numerous land-related disputes have arisen and become the major source of rural unrest in China<sup>24</sup>.

It can be said, therefore, that land institution in China has emerged as a difficult issue of balance of interests between local officials and farmers, as well as social equity and economic efficiency. To solve the above-mentioned problems, different areas in China started to pursue new measures according to their own external environments, utilizing different organisational forms and strategies to meet their different needs and priorities. As a result, different ideas have emerged and different ways have been followed. For example, Chen and Davis (1998) witness four kinds of experimental reform models since mid-1980s in four areas, including Nanhai (Guangdong) model of a farmland SHCS. With the increasing development of SHCS initiated in Guangdong Province, multiple versions of this shareholding system have been practiced in various regions. Accordingly, Po (2008) examines the practice of land-based shareholding co-operatives in three major economic regions in China: the Pearl River delta in the south, the Yangtze River delta in the East and the Beijing metropolitan area in the north. This study helps to understand regional disparities of land conversion as well as the reaction of local governments in this reforms. But he pays little attention to the interplay of various actors involved during the process, nor the reaction of the capable local farmers, as whom we consider institutional entrepreneurs. Therefore, this paper emphasizes the sorting-out stage during the path dependent development of land-based shareholding co-operatives, presenting how this dynamic real type co-operative model emerged.

As we have mentioned above, SHCS first emerged in rural enterprises. Accordingly, this system has already set up an institutional model which can be potentially used to deal with land problems. Another important background for the emergence of land-based SHCS has to do with the theoretical debate among the academics. This debate has exerted considerable influence not

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<sup>24</sup> Some scholars presume that more than one third of the numerous contentions in China are related to land disputes, which account for two third of the contentions in the rural China. see Yu (2004) and <http://www.huaxia.com/tslj/flsj/nl/2008/12/1269999.html> (25-12-2008).

only on the evolution of the theories themselves, but also on reforms in practice. Generally speaking, the focus of the debate is on whether collective ownership should be maintained and what form of property rights can be adopted. There are three groups of opinions, one group of academics in China advocates land nationalization, one advocates land individualization, and a recently one advocates remaining the collective ownership of land yet reforming land use rights. The last opinion is seen to be less socially and politically risky and more easily accepted by the central government. Accordingly, the government has issued a number of policies and measures<sup>25</sup>.

### 3.3. Resources, power and strategies

In our paper, the interest groups can be categorized into three main parts: 1) local governments; 2) the central state; and 3) ordinary farmers, rural elites as well as village collectives. In our analysis, the three actors in the last part do not necessarily cooperate with each other, therefore the situation in the local rural community can be very complicated.

#### *Local governments*

The 1994 tax and fiscal reforms has resulted in a fiscal squeeze on local governments. Land has emerged as an important source of funds for revenue-strapped local governments in China in recent years (Whiting, 2008). Local governments have many expenditure duties, but do not have enough revenues to meet them (China Development Brief, 2007). The complete abolition of the agriculture tax in 2006 removed another source of local revenue and thus exacerbated this unbalance between revenue power and expenditure duties. For local governments, land is their most directly available resources, which provide them with extra-budgetary revenue.

Land requisition to generate revenue can be accompanied by different strategies implemented by local officials. First of all, although in principle local governments should in most cases use competitive bidding (*zhaobiao*), auctions (*paimai*), or public listings (*guapian*) in order to ensure that land transfers take place at market levels, in practice, however, most of the land after requisition has been leased out by negotiation (*xieyi*), which is the least transparent approach (Cao et al., 2008). Although under Central Government pressure since the early 2000s, an increasing share of land used for residential and commercial purposes has been leased through the "open" ways, most of industrial land for manufacturing purposes is still leased out through negotiation, and constitutes the majority of all the land leased out. Based on the data provided by Ministry of Land and Resources, the total percentage of land transfer through bidding, auctions and public listings from 2002 to 2005 increases from 14.57% to just 35.06%<sup>26</sup>. Obviously, a majority of land transfer is still operating by way of negotiation. This is usually done at very low prices. Because local governments need to finance land requisitions and infrastructure preparation costs *ex ante*, leasing out industrial land at low prices inevitably implies that local governments are incurring net losses in the process of land requisition, land preparation and land leasing (Cao et al., 2008). It also explains why compensation fees delivered by them are low because the cost of taking land from farmers should be how lower how better. But why are local governments still willing to lease out the land to land developers at this relatively low prices? The reasons can be: on the one hand, they have to compete with other regions to attract the investment

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<sup>25</sup> More on theoretical debate on land ownership, please see Chen and Davis (1998).

<sup>26</sup> 国土资源部有关负责人就国有土地出让答记者问, from:  
<http://politics.people.com.cn/GB/1027/4647543.html> (30-07-2006)



from land developers from whom they can also gain their personal financial opportunities by providing most favourable prices; and on the other hand, local industrial development also promotes local economic growth and broadens the tax-base in the long run.

The second strategy that local officials use is to re-assign land to ensure that land is in use and to generate tax and revenues. It happened especially before the abolition of the agricultural tax. The financial pressure prompted them to do it, even regardless of existing land contracts. Although LML regulates that readjustment of contracted land should be under the approval of the local government at the appropriate level, there is another condition regulating that the village collective economic organisation receives the agreement of two-thirds of the members of the villagers' conference or two-thirds of the villagers' representatives. In some cases, readjustment of contracted land has however just happened without going through the voting process among the villagers. Therefore, as we have mentioned before, farmers became worried about the risk of losing their land at-hand as well as investment made<sup>27</sup>.

Besides fiscal consideration, local governments have the other responsibilities of promoting local economic development and preventing local instability. These responsibilities are essential for their career and position. Subject to a top-down evaluation based on a set of quantitative performance targets, local officials have to make sure that land-related disputes be contained at the local level, otherwise their job would be lost and their career would be jeopardized. The State Council has assigned particular responsibility for mediating disputes to township and village leaders.<sup>28</sup> Accordingly, local officials, in the process of land requisitions and land transfers, could implement another strategy to try to avoid the disputes and at the same time to safeguard their career and position, that is, getting involved in the land disputes together with local courts. Despite the emphasis on the "rule of law" and the right of villagers to file suit in court in land disputes, courts are often impotent—especially if the government is involved in the dispute (Whiting, 2008). Local governments exert their influence over the local courts' decision. Local courts, accordingly, having in most cases a close connection with the local governments, tend to be less impartial in resolving conflicts.

After all, land transfer is controlled by local governments. In China, the government is the only agent that can sell agricultural land (after state requisition and under the leasing system) or transfer the land to the third party. Therefore, land is mostly used by local governments both as a critical financial resource and as a career promotion condition. Although China's reform and separation of responsibilities have given the local governments more freedom and independence, which make it more important for local institutional innovations, in reality, local governments are very unlikely to become the innovator of land-based shareholding co-operatives rather than profiteer of land use due to their own consideration of power and wealth<sup>29</sup>.

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<sup>27</sup> But after the implementation of the Land Contracting Law in 2003, restrictions on readjustments were tightened, and readjustments are only allowed in cases of extreme natural disasters that destroy farmland. In these cases, readjustments also have to receive the approval of two-thirds of the members of the villagers' conference or two-thirds of the villagers' representatives, as well as the approval of the local government.

<sup>28</sup> State Council Document 2004 No. 21.

<sup>29</sup> We can see later that only after the emergence of land-based SHCS does their attitude becomes important to its development..

### *The central state*

Although central government has no power to decide rural land use, it has indeed the power to implement fiscal and tax reform and to issue documents concerning land and tax. The primary purpose of the fiscal reform in 1994 was to restructure China's tax system by drawing a line between central and local governments with regard to their fiscal responsibilities and duties as well as by separating tax collection between them. However, this reform gives the local government indirectly an informal power to deal with the land as a local revenue resource. Local officials, accordingly, attempt to capture the value of the land for fiscal purposes in the context of fiscal revenue inadequacy. These attempts have led to an apparent increase in the illegal tax raising incidences as well as in land disputes. Later on, the central state issued various documents to regulate local governments' behaviour as well as to improve local governance. But after the abolition of agricultural taxes that were a heavy "farmers' burden" by the central state, the resources of local governments' revenues have actually further decreased. In fact, therefore, the land policies by the central state can not be effective in reducing unfair treatment of farmers during the acquisition of land, because in practice, local governments make every effort to take land from farmers by evading central regulations on arable land protection. A survey of 16 cities by the Ministry of Land and Resources in 2005 showed that nearly 50 percent of the new land under development was acquired illegally. The figure was as high as 90 percent in some cities<sup>30</sup>.

During the process of interests of balance between the central state and the local governments, the central state has—besides the power to implement reforms and issue documents—another power to evaluate local officials' ability and to decide their career prospects. Although the original intentions of the behaviours between the central state and the local governments are not always consonant with each other (the former concerns political stability, economic development as well as national social welfare, whereas the latter cares more about the economic development in their own areas, as well as their own interests and political attainment), the central state can use evaluation system as a strategy to curb the divergent development way in the local level and to reduce conflicts at the local level. For cadre evaluation, public order has become a primary "hard target"<sup>31</sup> (Whiting, 2008).

The third power that the central state has is the power through transferring payments from the central state to the local state. These payments fall into two broad categories—general transfers and special transfers. General transfers are a relatively transparent and more predictable way because they are calculated according to a formula that takes 1993 as a base year. But they are based on a tax rebate system, therefore, the richer provinces receive larger transfers than the poorer ones due to the reason that they pay more revenue to the central state. This clearly reinforces rather than reduces horizontal revenue disparities. About 40% of fiscal transfers are through tax rebates. In other words, central governments tend to give more support to the local governments with more resources. This support includes not only wealth transfers but also attitude support to endow more freedom and space to local innovation. Therefore, "the state is constrained from pursuing policies that alienate key constituents. The relative bargaining power of the state vis-à-vis its constituents is determined by the extent to which one party controls of

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<sup>30</sup> Xinhua News Agency: Land Availability Tightened to Curb Economic Overheating, [http://www.china.org.cn/archive/2006-09/06/content\\_1180255.htm](http://www.china.org.cn/archive/2006-09/06/content_1180255.htm) (06-09-2006)

<sup>31</sup> Moreover, with the abolition of the agriculture tax, local cadres in agricultural areas are no longer evaluated on the fulfillment of tax targets.

resources on which the other party depends—be they coercive, political, or economic in nature. For instance, the state may confer special bargaining power is a relative concept: a constituent who supplies a small share of a needed resource holds less bargaining power than a constituent who provides proportionally more" (Whiting, 2006, p20). In addition to the general transfers, there are more than 200 kinds of special transfer for which provincial governments may apply. Contrary to the first category, special transfers are made by executive order, without formal legislative approval by the People's Congress to introduce some degree of transparency and accountability, so these processes of allocation is highly complex<sup>32</sup>. However, the most important factor lies in the fact that for some special transfers, the central government often requires more additional conditions as well as counterpart funding from localities, thus imposing new financial obligations on already overstretched local governments. They have to meet those conditions and obligations in order to get these special transfers. Since in most cases, special transfers are intended to support the local development of disadvantaged areas with less resources (the Middle and Western areas in China)<sup>33</sup>, this situation would not be in favor of creating an atmosphere of local institutional innovation because they are constrained by external conditions to use the payments.

Therefore, although the central state has no power to decide rural land use, it exerts significant influence in shaping local governments' behaviours with regard to local land use by reforming revenue and tax systems as well as cadres' evaluation system. Under the influence of reforming tax systems, some local governments, in order to offset financial constraints, have actually gained more freedom and informal power to deal with the local land as a local extra-budgetary revenue resource. Whereas under the influence of cadres' evaluation system, local governments have to constrain themselves to the legal regulation thus tend to convert land in an informal way<sup>34</sup>. The Central Government, through transfer payments, would be responsible for maintaining a balance between the provinces with more resources and the provinces with less resources. In reality, however, local governments with more resources could have more freedom to decide how to further use land resource to generate local revenue, as well as more power to regulate local practice concerning rural land conversion. But during the power game played out between the central state and local governments, neither of the party could become the initiator of institutional innovation of rural collective land. The most elementary explanation for it would be that the rural collective land belongs actually to the farmers collectively in the rural community.

#### *Ordinary farmers, rural elites and village collectives*

Village collectives, according to the LML, are the owners of rural land. In rural China, there exist the village collective economic organisation (the basic unit for management of community property) and the villagers' committee (the basic unit for local governance), both of which can

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<sup>32</sup> Provinces frequently send officials to Beijing to lobby the central government for the special transfers, and this "affects the integrity of the government and increases the administration costs," Auditor General Li Jinhua told the China Economic Weekly (中国经济周刊) last (2006) July. from China Development Brief: <http://www.chinadevelopmentbrief.com/node/969> (25-01-2007)

<sup>33</sup> In 2008, 54.4% of total expenditure in the Middle and Western areas derives from central transfer payments. In 2009, the central state increases the amount of general transfers (till 47.5%), special transfers nevertheless still accounts for more than half of the total transfers. From Ministry of Finance: [http://www.mof.gov.cn/mof/zhengwuxinxi/diaochayanjiu/200905/t20090512\\_141388.html](http://www.mof.gov.cn/mof/zhengwuxinxi/diaochayanjiu/200905/t20090512_141388.html) (12-05-2009)

<sup>34</sup> Here Po (2008) refers it as the development of an informal market in rural land.

act as the administrator of rural lands. Generally speaking, the former concludes land use contracts with individual villagers. This separation of village political administration and economic resource management seems attractive, but both of them are actually managed by the same group of people. The game played out between the central state and the local governments has left little space for farmers to hold down the benefits they should possess. They are supposed to be in a politically weak position during this power game played out between the central state and its local agencies. They are supposed to have to accept the political arrangement already made. Therefore, "during the requisition process, peasants get compensation fees settled according to the standard of agricultural output, not the land price which is to be traded in the market after the requisition is completed. The villages, as landowners, have no ground to negotiate with government, the land-taker" (Po, 2008). Moreover, compensation fees are normally delivered to the village collectives, who have the power to manage and distribute the funds on behalf of all the villages. Since collective ownership of land has become "cadre ownership" (Cai, 2003), the collective compensation fees can be drained simply by poor management, let alone outright corruption (Po, 2008).

However, ever since the reform and opening-up, farmers have sought to expand their opportunities in participating in market activities and in gaining more power. Economic liberation enables them to pursue income-generating activities by allocating capital and labour to different sectors. Migrant workers running into cities in coastal areas and for non-agricultural employment in the peri-urban rural areas, on their own initiatives, have become since long common for villagers. In those areas, non-agricultural shareholding enterprises had developed significantly as mentioned above. Many rural people sought employment in those enterprises and part-time farming was generally becoming the mainstream. As they have gained more and more economic capital, they seek to create more and more new opportunities for meaningful participation in village resource management decisions. This process goes along with the development of grass-root autonomy and bottom-up democracy in rural China<sup>35</sup>.

To make farmers more powerful, it should be noted that the most special resources for them should probably be their relationship network and its socio-cultural embeddedness. But facing with local officials and village collective's authoritative resources (as their political capital) and their revenues and other material resources (as their economic capital), farmers tend to bring cultural tradition and relationship into play to balance gains against losses, rather than rise up for contest at first instance. In order to offset resource flows in favour of local officials they adopt appropriate methods to strive for objective resources (such as reciprocal gift exchange, establishing kinship relationship, direct and/or indirect bribery, etc.). Through these interactive behaviour between farmers and local leaders, farmers are able to challenge the authorities over resource deprivation and therefore obtain greater space for employing strategy in the exchange of material resources for political power. With an increase in family income from marketing activities, farmers are able to pay increased taxes and to "purchase" the resources they desperately need. In this sense, economic benefits and cultural tradition play a key part in relaxing the tension between local leaders and rural residents. Only where farmers are economically incapable of "purchasing" resources and where their increase in income is less than the amount which has been drained off do they go in for popular protest (Huang, 2007, p192).

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<sup>35</sup> See Zhao (2009).

Although non-agricultural employment is common for villagers in those peri-urban communities, such employment tends to be unstable. Therefore, land is still a key element for their social security<sup>36</sup>. Besides, before the abolition of the main agriculture taxes in 2006, farming was relatively unprofitable and earnings from non-agricultural employment was relatively attractive. But the recently rising of agricultural commodity prices (in this case for cotton in particular) and the increase of farming subsidies from 2006, make farming, once again, increasingly more attractive to local residents. At the same time, villagers report that migrant workers find it harder to get a job in cities thus earnings from non-agricultural employment have stagnated. Consequently, migrant workers are inclined to back home again to farm. Land is regarded once more important for local farmers as valuable resources. While at the same time, village officials still enjoyed complete control over collective assets but did not need to bear the downside risks. Their assets-stripping behaviours, repeated loss-making decisions and unclear business deals, finally induced open conflicts. the widespread transformation of land uses and the problem of collective land ownership have made land conflicts significantly acute.

In rural areas where industrialisation and urbanisation have increased more fastly, the economic resources and political power farmers owned have also greatly increased. The use of rural collective land and the outbreaks of property rights conflicts have led to a series of bottom-up institutional changes, among which land-based shareholding co-operative reform has emerged. In this process, rural elites—as farmers’ representatives—have, together with farmers, initiated shareholding system into collective land use.

Rural elites in rural communities in China can be regarded as a bridge between local/collective officials and ordinary farmers. In this paper, "rural elite" is a descriptive concept referring to elites of wealth, respect and knowledge rather than elite of power. It is because besides having the resources that ordinary farmers have, rural elites are also likely to have better educated background and greater access to modern technologies, as well as more market and relationship networks. Therefore, they tend to have more advantage over small farmer producers. Different from collective officials, rural elites tend to have the same interests with ordinary farmers. Farmers have more trust in them than in collective officials and therefore, under the grass-root election system, they tend to obtain their interests and power through choosing rural elites as their own representatives in local governance. A number of capable farmers have been elected or appointed and supported by local residents, as deputy heads of village committees, directors of collective economic organisations, or even deputy Party secretaries. This emergence of entrepreneurs in the bureaucratic system has helped to negotiate with collective leaders with authoritative resources on behalf of ordinary farmers. At the same time, because they tend to have a general awareness that problems could be solved through a rational approach, they are capable of interpreting the rational, bureaucratic norms of the government to local residents thanks to their strength and power based on social networks and enjoyed reputation. Therefore, they indeed have the bargaining power with the collective and local leaders and thus can exert their influence in the village development decision making processes.

The typical example of the emergence of Nanhai model of land-based sharesholding co-operatives can best illustrate the role played by rural elites in this process. Zhoubiao is a natural

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<sup>36</sup> It happened only recently that local officials try to incorporate social security schemes into land conversion project, in which farmers can voluntarily choose to get an urban house (or more houses according to the size of their housing land in rural area) at the price of giving up their rural housing land, as well as to exchange rural contracting land right for social security. From the field work in Jiaying, Zhejiang Province in March, 2009.

village in Nanhai City, Guangdong Province. Before 1986, there were originally six production teams. In order to increase collective economy to "be capable of doing more significant issues", economic organisation in the community was established, which has then incorporated into the village committee. At that time, land was still managed by production teams and the new economic commune was just an empty shell. Therefore, the cadres in the village collective have racked their brains to consider how the land could be collectively developed. In 1992, Deng Xiaoping's southern tour to Guangdong Province has brought a new opportunity, under which period people's mind has become more liberated and open to new matters. Under this circumstance, all the land, fixed assets and capitals have been finally incorporated from various production teams. At the same time, Nanhai was planned to be upgraded from county to city. More than 500 mu (approximately 33.5 ha) arable land have been expropriated by the government for urban construction. Although the compensation fees reached RMB28,000 per mu, it made per capita arable land also sharply decrease of more than 70%. Local farmers who have long lived on the land became to be worried about their living situation. At the same time, they were also far from satisfied and even suspicious with compensation fee distribution: the village collective cadres planned to give only RMB6,000 per mu to farmer individuals, remaining the rest to village economic commune for collective development issues. Furthermore, they planned to distribute the funds completely according to the village population, regardless of the difference of how much the expropriated land from various former production teams came. Therefore, the villagers in one production team whose land has been at most taken out were least agreed with the distribution program. But the village cadres would not to compromise to make a re-settlement. Tensions have finally broke out. The villagers sent their petition letters to the higher level government to clamour the economic commune in the village into dissolution, which has been called "the most significant collective incidents since liberation" in local area<sup>37</sup>.

At that time, the local officials at the township level would not agree to disband the economic commune in the village. In such a context, SHCS was taken into consideration. Rural elites (as villagers' representatives) were, together with the village cadres as well as officials from the higher level, involved into coping with the conflicts as well as establishing a new program. Some local residents, who were served as the leader of production teams or the boss of the private-run or self-employed enterprises, were actively using their relations with fellow villagers as well as their connections with local officials and outside forces to draw up a new plan. They worked together with the officials to influence villager's decision making behaviour. But contrary to what the officials had done by using official demands before, they took all villagers' opinion into consideration, both of the members in the least developed production teams and of the elder members who have made more contribution to the collective economy. The informal institutions (the high reputation they enjoyed and fully trust they received) made them further become the elected directors in the board of shareholding co-operatives, which has been established in 1993. Since then, rural elites have become busy with going around looking for more benefits and with distributing shares among the villagers.

Therefore, the political and social tensions ultimately helped to consolidate the economic power and cultural connection at the hands of rural elites. By incorporating and identifying common ground of interests that would engender economic development to the local community, they

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<sup>37</sup> From Southern Daily, May 23<sup>rd</sup>, 2008 (D04), 《洲表村：试水股份合作制成就"南海模式"》. <http://www.nanfangdaily.com.cn/epaper/nfrb/content/20080523/ArticleND04002FM.htm#> (23-05-2008)

participated in changing unpopular official demands and in creating a new institution/making it feasible. In doing so, they not only proved themselves as capable managers but can also gained more economic and political opportunities for themselves. Their participation has made the future leadership likely to be based on conditions of achievements rather than on authoritative power.

#### **4. CONCLUSIONS**

The case of the emergence of land-based shareholding co-operatives illustrates both the reality of one of the most popular forms of co-operative sector in China and the process of its evolution. Using a Real-type Co-operative Model this paper shows how institutional legacies in the past and resource and environments in the present can influence to shape a real type co-operative development in rural China.

By examining the interplay between various actors in shaping this co-operative process, we have shown the important role played by institutional entrepreneurs. As local and collective officials generally failed to forge the necessary alliance and common interests with the villagers, the rise of rural elites in the 1990s, and their conscious contribution to a new redistribution system of new fortunes from collective land use, is an important vector in the emergence of the land-based SHCS. During the sorting out process, resource and power are important for the game played out by different players in that: first, unequal distribution of resources and power made the emergence of asymmetrical exchange and forced resource-owners (collective farmers) to be "depended" upon official demands of resource-takers (local and collective cadres). Thanks to the rise of rural elites' power, the move to a more complete rationality tends to be more foreseeable, thus making it possible to change the cumulative effect of this dependency and power relations. Second, the flow of visible (land, revenue and tax, human resource, personal achievement) and invisible resources (authoritative power, social support, various relation and connection inside and outside of the village) among different players lead them to make different decisions at different periods. Lastly, the requests and demands asked by the farmers (as resource providers) can gradually change under the influence of their representatives. Therefore, local and collective officials who previously had authoritative power to capture and control the collective assets could fail to exercise substantial power discretionarily over the ordinary residents for the long run.

All the abovementioned arguments suggest that shareholding co-operatives in China, due to their features of multiple stakeholder ownership and multi-purpose character which is derived from a local village and also oriented to the whole community, resemble more or less social enterprises (Borzaga and Defourny, 2001; Nyssens, 2006; Defourny and Nyssens, 2008) in Europe. It is therefore expected that they might be inspired and might have the tendency to follow the Western road of development. However, these initiatives in China are happening in the process of urbanisation and industrialisation in rural China, rooted in the government-steered process of building a socialist market economy and are at the same time a response to the grass-root demand for a more rational resource allocation and redistribution pattern of dividends generated from collective assets such as land. In this sense, new co-operatives in China should be considered as an indigenous social innovation which is different from social enterprises in the West.

In addition, some of the points deserve mentioning in our paper.

1. While our paper seeks to offer a conceptual framework of the concrete, creative process of co-operative practice in grass-roots society, as well as a real understanding of the interplay among various actors in shaping this dynamic co-operative development, we are

fully aware of the importance of external environments in co-operative variation among different regions, as Chen and Davis (1998), as well as Po (2008) have showed. In this paper, we did not intend to repeat the studies already done. By presenting the potential external constraints local governments faced due to the conditions required by the central state on payment transfers, this paper provides another explanation of this regional difference with regard to institutional innovation capacities and possibilities. Concerning the fact that many regions later organize numerous study tours and visits to learn the experience from the initiating place, and afterwards adapt it to their own environments, we can conclude therefore that, on the one hand, the model of land-based SHCS has spread widely and rapidly, on the other hand, it also contributes to the regional variation concerning this institution.

2. This paper restricts the analysis to the main issues of the SHCS as an institutional innovation in rural China, casting light on the current co-operative development relating to this structure. Therefore, some other important agricultural co-operatives (like farmers' specialized co-operatives) are not included in our paper.
3. Furthermore, describing this new shareholding co-operatives' reality and analyzing its emergence is only the first task to accomplish. For further research, there remain some new phenomena that need more research and interpretation, in particular, how does a shareholding co-operative structure in farmers' specialized agricultural co-operatives look like? What kind of farmers' specialized agricultural co-operatives can function as shareholding co-operatives? In those cases, what kind of voting and distribution system do they apply? Who can be the stakeholders? What kind of role do local governments play and what is their influence? Etc..

A final remark that we would like to mention is that, as SHCS became more and more popular and people gained more and more knowledge about it, this form was then regarded broader and broader as a solution in those villages that suffered from open conflicts caused from distribution of land-generated profits. This spontaneous nature of shareholding reforms has however been changed subsequently as the result of the increasingly strong government intervention. Although this on-going top-down shareholding reform of rural collectives has not been included in this paper's discussion, it would be interesting to know its effect and impact vis-à-vis those of the bottom-up initiatives that this paper presents.



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