



The rise of red private entrepreneurs in China: Policy shift, institutional settings and political connection

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ABSTRACT

This article examines the relationship between the Chinese Communist Party (CCP) membership and private entrepreneurship in China since 2002, the year when the party revised its constitution and officially removed ideological discrimination against private entrepreneurs in member recruitment. Drawing on the data from the six waves of a nationwide survey on privately owned enterprises in China from 1997 to 2008, we find that, while very few private entrepreneurs were recruited into the CCP during the decade we examine, the constitutional change had encouraged many party members to enter the private sector. We also show that party members who became entrepreneurs *after* the 2002 policy shift tended to be more senior than those who had started their business *before* the constitutional change. Furthermore, our difference-in-difference estimation demonstrates that the phenomenon of party members turning entrepreneurs was more prominent in regions where the level of marketization was lower, legal protection was less available, and local governments were prone to more corruption, since political rents were generally larger in environments with weaker market-supporting institutions. This study suggests that party members in general and especially the elite among them were quick to sense the opportunity and knew how to translate their political influence into economic power.

1. Introduction

The relationship between the Chinese Communist Party (CCP) and the private sector has changed dramatically over the years. During the Mao's era, the party ideology was strongly anti-capitalist, but changes in the country's socio-economic structure triggered by the "reform and opening-up" policy since 1978 pressured CCP leadership to establish a more inclusive relationship with entrepreneurs. A series of policy initiatives were introduced in an effort. The most significant of these initiatives was introduced in November 2002, when the party revised its constitution and opened its doors to progressive members from "other social strata" in addition to workers, farmers, soldiers and intellectuals. Private entrepreneurs, according to then-president Jiang Zemin's "Three Represents" theory, were among the country's "advanced social productive forces" and became eligible to join the party on this basis. Moreover, in 2004, the national constitution was amended to protect the right of citizens to own private property. While the provision was far from strictly enforced, estate-owning entrepreneurs took notice of this rhetorically important shift in party perspective.

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The ideological shift institutionalized by the initiatives of 2002 brought about significant changes in the relationship between the party and the private sector. On the one hand, the CCP soon received a flood of membership applications. On the other, many party members interpreted the new party constitution as supportive of their interest in jumping into the “sea” of the private sector (*xiahai*). The suddenly inclusive policy and the subsequent changes can be viewed as a quasi-experimental situation that offers a rare opportunity to examine the economic value of party membership and further analyze how the change in political rents directed mobility of party members and facilitated the rise of red private entrepreneurs, that is, party member-entrepreneurs, in varying institutional environments.

A large body of literature has examined the economic utilities of political ties. Scholars have extensively explored the benefits of politically privileged backgrounds of directors, board members, and large shareholders (Agrawal & Knoeber, 2001; Faccio, 2006; Fisman, 2001), family relationships with politicians (Amore & Bennedsen, 2013), and the role of a firm's campaign contributions (Claessens, Feijen, & Laeven, 2008; Cooper, Gulen, & Ovtchinnikov, 2010). That the ability of benefits of political connections to take on several forms, such as preferential access to bank credit (Charumilind, Kali, & Wiwattanakantang, 2006; Cull, Li, Sun, & Xu, 2015; Dinç, 2005; Khwaja & Mian, 2005), government contracts and subsidies (Faccio, Masulis, & McConnell, 2006; Goldman, Rocholl, & So, 2013), and lighter taxation and relaxed regulatory oversight (Adhikari, Derashid, & Zhang, 2006; Bourveau, Coulomb, & Sangnier, 2014; Chen, Guan, Zhang, & Zhao, 2017; Correia, 2014; Liu, Tang, & Tian, 2013), also has been documented.

In addition, a few studies have explored how the benefits of political ties vary with institutional environments. Boubakri, Guedhami, Mishra, and Saffar (2012) show that political ties are more valuable in less democratic countries, while Faccio (2006) finds that political connections between firms and politicians are more prevalent in corrupt countries with barriers to foreign investment. Research conducted by Li, Meng, Wang, and Zhou (2008) also demonstrates that CCP membership is more crucial to firm performance in regions with weaker market institutions and poorer legal protection.

While previous literature has paid much attention to the business value of party membership in China, few studies have examined how the ideological change (i.e., the policy shift in 2002), implemented in an environment characterized by weak market-supporting institutions, contributed to the rise of private entrepreneurs with party membership. This is important as it helps us better understand how party elites translate their political influence into economic power in a society that is undergoing drastic ideological change. To fill this gap in the literature, our article is devoted to an exploration of how the change in the value of political connections directs party members to leave “the system” (*tizhi*) and jump into the private sector and how it motivates private entrepreneurs to apply for party membership. Instead of exploring the utilities of party membership in a static setting, we take full advantage of the CCP's sudden but far-reaching policy shift in 2002, and employ the DID method to investigate how the value of party membership varies in terms of economic development, institutional building, and perhaps bureaucratic culture among provinces.

We present several results. First, we show that the change of party constitution led to a sharp increase in the number of party members among entrepreneurs. In our survey, the proportion of party members doubled in the year following the constitutional amendment, from 17% to 34%. Notably, the 2002 policy shift caused an asymmetric effect. Rather than recruiting private entrepreneurs into the party, the policy shift mainly led to a flow of party members into business.¹ About 90% of the party member-entrepreneurs in our survey had joined the party *before* starting their business. We also show that the portfolio of party members who joined the private markets *after* the 2002 policy change were significantly different from that of the party members who had started their business *before* the shift. With the removal of the barrier between business and politics, even senior party officials with managerial experience in running state-owned enterprises had fewer misgivings about their ability to retain their position and networks within the party, and joined the private market. Clearly, these more senior party members were also the ones that could more easily harvest economic value from their political connections.

Second, we show that *after* the policy shift, but not before it, private firms benefited from having a party-affiliated owner. Specifically, after the policy shift, party affiliation helped private entrepreneurs in securing loans from state-owned banks, alleviating government expropriation in the form of extra-legal payments, and improving the general performance of their firms. This is consistent with the findings of Guo, Jiang, Kim, and Xu (2014): political rents of party membership became significant only after CCP changed its ideological orientation towards the private sector. Our models deepen and refine that conclusion by taking into account the role of institutional settings, through which we control important variables that must be controlled in studying the value of party membership.

Finally, we provide causal evidence for the influence of institutional environments on the extent of returns of political ties. According to our difference-in-difference estimation, the increase of party members among private entrepreneurs following the policy shift was significantly larger in provinces with *weaker* institutional environments, as measured by poorer legal protection, lower levels of market development, and higher levels of government corruption. As expected, the benefits accrued by firms with owners of party members after the policy shift were also larger in these provinces.

The rest of the paper is organized as follows. Section 2 offers a more detailed institutional background. Section 3 discusses our methodology and presents some preliminary evidence. Section 4 details the dataset, including a discussion on party member recruitment. Our main results are presented in Section 5, along with a discussion of potential alternative explanations and an elaboration of our robustness check. Section 6 provides direct evidence on the benefits of political ties for business. Section 7 concludes.

¹ Private entrepreneurs did also apply to the Party, but only a privileged few (owners of large firms for example) were likely to be accepted. See Section 4 for a discussion.

2. Institutional background

Party ideology has a profound impact on the private sector and business-state ties in China. During the Mao era (1949–1976), the CCP pursued socialist revolution and promoted class struggles nationwide. Private enterprises in China were generally absent during the period from 1952 to 1977. As the post-Mao reform unfolded, the CCP's strategy shifted to economic modernization. The private sector began to re-emerge in the late 1970s, getting increasingly dynamic and even luring a number of party members and government employees to quit their iron-rice-bowl (*tiefanwan*) jobs and “plunge into the sea” of business. Such entrepreneurs became an important contingent of what are popularly tagged as “red capitalists” in China, that is, entrepreneurs with political ties to the party-state.

However, despite economic reforms, ideological discrimination against the private sector remained strong. Commercial and property laws, for example, were either non-existent or unenforceable (McMillan, 1995), and private enterprises were subjected to arbitrary harassment by government cadres (Pearson, 1997). To avoid discrimination, many private firms were even registered as “collective enterprises” (Che & Qian, 1998; Gore, 1998; Pearson, 1997). The disguise of “collective ownership” made these firms ideologically acceptable and offered them better access to resources monopolized by state-owned enterprises (Li, 1996; Naughton, 1994; Nee, 1992).

By the mid-1990s, the private sector had become the main engine of economic growth while the state-owned sector was suffering an accelerating decline. An increasing number of economic elites had accumulated a large amount of wealth that the state could not control directly and this independence was considered as a potential threat to the political regime. To keep the threat from developing into reality, the CCP attempted to embrace the growing private sector more warmly. As already mentioned, during the sixteenth National Congress of the Communist party in 2002, the party constitution was revised to include private entrepreneurs as eligible for member recruitment. This was a significant change of party ideology, since private entrepreneurs had long been regarded as exploiters of the working class and their presence was barely tolerated in society in general, let alone within the CCP.

This new and inclusive strategy of the party had a significant impact upon both the private sector and the business-state relationship. Once the tall ideological barrier against the private sector (i.e., the eligibility of entrepreneurs to become CCP members) was removed, entrepreneurs and state bureaucrats soon started to develop closer relationships. Consequently, there was a dramatic rise in the number of party members who plunged into the sea of business after the revision of the party constitution (see the next section for empirical evidence). In contrast, very few new CCP recruits came from private entrepreneurs, though quite a few had applied for party membership after the policy shift in 2002.² An official report by the central organization department in 2005 indicates that only 894 of 2.42 million new recruits in 2004 were of private entrepreneurs, while the total number of this population then was 9.49 million.³ In other words, the bulk of the increase of “red capitalists” was due to party members moving into the private sector, rather than vice versa.⁴ The analysis based on the survey data we use in the study confirms this asymmetry of personnel flow (see Section 4).

The combination of party membership and entrepreneurship effectively integrated power and wealth in China. Given the monopolistic position of the party-state, private entrepreneurs who were political elites or former state bureaucrats have preferential access to the resources controlled by the state (Guo et al., 2014). Party member-entrepreneurs are familiar with how state bureaus work and are knowledgeable of the implicit rules governing political activities. They have nurtured not only working relationships but also personal connections that crisscross the government and business sectors, which enables them to exploit the inconsistencies among laws and regulations in a transition period (Yang, 2004). The political capital possessed by party members, former political elites among them in particular, helps businesses reduce regulatory burdens, lower fees and taxes, and gain easier access to loans, licenses and permits (Chen et al., 2017; Guo et al., 2014; Li et al., 2008; Liu et al., 2013). Unsurprisingly, within a decade, the entrepreneurial activities of a large number of party members resulted in a new super-rich political class (Guo et al., 2014).

The influx of party members into business has aroused wide public concern. *China Comment* (Banyuetan), an official publication of the Xinhua News Agency, once expressed concern over the large number of party members entering the private sector and using the party membership to nurture political connections that benefit personal interests. Some researchers suggest that China's capitalists and government officials have developed a stable set of relationships that can be described as “crony communism” (Dickson, 2011). That political ties like party membership are associated with larger political rents in provinces with weaker market institutions, revealed later in this paper, seems to add relevance to this label.

3. Models and preliminary evidence

In this paper, we mainly use the difference-in-difference (DID) method to conduct empirical analyses. The DID framework makes use of both the sudden policy change in 2002 and the variations in local institutions across provinces. Within this framework, the

² Dickson's, 2007 study shows that the proportion of private entrepreneurs who wanted to join CCP increased by more than half between 2002 and 2005.

³ Similarly, in 2006, only around 1500 new recruits were from the private sector, but the total number of entrepreneurs had increased to 12.79 million.

⁴ According to Dickson (2007), the percentage of those who were included into the party after going into business merely increased from 13.1 to 15.7%, while the percentage of entrepreneurs who were already party members before they went into business, namely, the *xiahai* entrepreneurs, increased sharply from 25 to 34.2%.

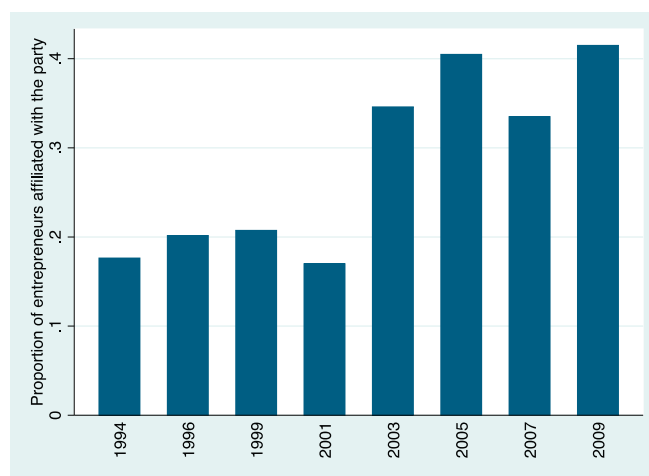


Fig. 1. Proportion of entrepreneurs affiliated with the party.

post-amendment probability for an entrepreneur holding party membership in each province is first compared to the corresponding pre-amendment probability, yielding a first level of differences. Next, these first-level differences are compared to each other, resulting in second-level differences that are used to estimate the impact of, in our case, institutional settings upon rent-seeking.

The first source of variations in our study originates from the revision of the Party constitution in 2002. Fig. 1, which is based on data from the National-wide Survey of Privately-owned Enterprises in China, provides some preliminary evidence. The proportion of private entrepreneurs with party membership was within the range of 17–20% during the late 1990s and early 2000s. In 2003, one year after the constitutional revision, the proportion rose to 34%, after which the number levelled off.

As for the second source of variations, in Fig. 2 we plot an index of the percentage change in the proportion of red private entrepreneurs between 2001 and 2003 against market development (see below for a more detailed explanation) against across Chinese provinces. Fig. 2 shows clearly that the growth of red private entrepreneurs is negatively correlated with the degree of market development of a province. This is consistent with the view that political connections are more valuable for private entrepreneurs in areas with underdeveloped markets and weaker market supporting institutions.

To investigate these relationships more systematically and more precisely, we studied a repeated cross-section model of firms surveyed before and after the constitution amendment in 2002. Our DID estimation model can be described as the following equation:

$$CCP_{ijkt} = \alpha + \beta INSTIT_{jt} + \rho INSTIT_{jt} \times AFTER2002_t + \pi X_{ijkt} + \beta_j + \beta_t + \beta_k + \theta_{jt} + \varepsilon_{ijkt} \quad (1)$$

where CCP_{ijkt} is a dummy variable which takes a value of 1 if the private entrepreneur from firm i , province j , sector k , is affiliated with the CCP in year t , $INSTIT_{jt}$ is an index representing institutional environment for province j , X_{ijkt} is a set of firm and entrepreneur variables, ε_{ijkt} denotes the random noise term. We interact $INSTIT_{jt}$ with $AFTER2002_t$, a time dummy equal to 1 for interviews occurred after the 2002 amendment and 0 before. ρ is our coefficient of interest, as it captures the heterogeneous impacts of the constitutional amendment on party memberships due to the variations in institutional settings across provinces.

To alleviate the concern of omitted variables, we include a set of firm-level covariates throughout the empirical analysis. These include *Assets*, as measured by the logarithm of total fixed assets, *Firm age* as measured by the number of years since establishment,

Table 1
Definition of variables.

Variable name	Definition
CCP	A dummy variable. 1 if an entrepreneur is a party member; otherwise 0
Extralegal payment	Firm's extralegal payment charged by local government cadres, divided by firm's revenue
ROE	Return on equity
Bank loans	Total amount of loans currently borrowed from state-owned banks
Assets	Total amount of firm assets
Firm age	The age of the firm since it registered as a private firm
Employees	Number of full time employees
Entrepreneur's education	Entrepreneur's years of schooling
Former SOE manager	A dummy variable taking value one if the private entrepreneur formerly worked as a manager in state-owned enterprises or township and village enterprises, and zero otherwise
Marketization index	NERI Index of Marketization of China's Provinces 2011
Corruption index	Number of local cadres prosecuted for corruption in the province where the firm is registered, divided by the number of government employees in the province
Legal index	Lawyer population ratio

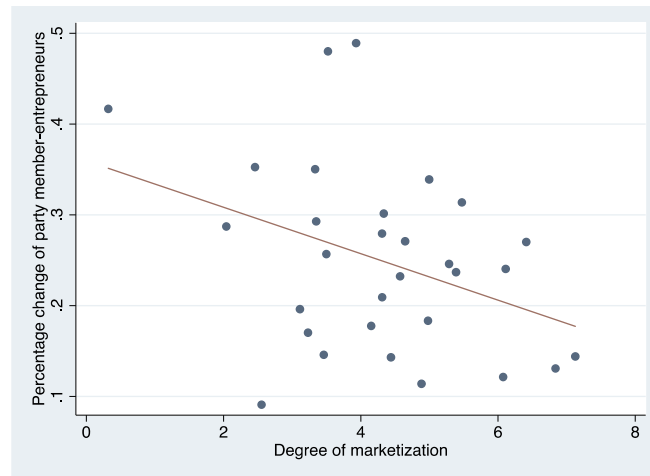


Fig. 2. Marketization and percentage change of party member-entrepreneurs.

Employees as measured by the logarithm of the number of employees. To control for the human capital of the entrepreneurs, we also include their *Education* as measured by the number of years of schooling, and *Former SOE manager* experiences, which is a dummy variable taking value 1 if the private entrepreneur formerly worked as a manager in state-owned enterprises or township and village enterprises, and 0 otherwise. Furthermore, we control for provincial, industrial, and year fixed effects, which are represented by β_j , β_k , and β_t , as well as province-specific time trend, which is denoted by θ_{jt} .

Institutional quality at the provincial level is measured by indices of market development, corruption and legal environment. The first indicator is the *marketization index*, computed by Fan, Wang, and Zhu (2011) to measure local market quality. It includes measures of private sector development of, relationships between local government and market, the development of financial and factor markets, and the development of market intermediaries. Given the central role played by local government in allocating economic resources in China, such as bank credit or land permits, we expect connections with the party to be more helpful for private entrepreneurs in areas where markets are less developed.

The second indicator quantifies the level of corruption in local government using the *proportion of local cadres prosecuted for corruption* in each province. We expect that in provinces with severe corruption and power abuse, political connections can shelter private entrepreneurs from government expropriation and harassment.

Finally, to measure the effectiveness of local legal protection, we construct a legal index using the *number of lawyers in a province weighted by its population*. A higher percentage of lawyers suggests that private firms are more likely to be able to resolve business disputes through the local legal system and with less reliance on political connections (Li et al., 2008).

The institutional indexes $INSTIT_{jt}$ are allowed to be time-variant. The use of contemporary values for the institutional indexes might, however, be problematic as they might be directly impacted by the reform, introducing a potential reverse causality problem. To tackle this problem, we construct a time-invariant variable for each institutional index, by taking the average value of the yearly indicators over 1997–2001, that is, before the constitutional amendment. By doing so, we are able to examine effectively whether party elites respond differently to constitution amendment and policy change due to variations in pre-reform institutions. Further, to assess the robustness of our conclusions, we also re-estimate Eq. (1) by substituting the time-invariant variable with one-year lagged value for each institutional index. These regression results based on lagged indices are presented in the Appendix (Table A2) and are not different from those using time-invariant institutional indices.

Another inference issue concerns human capital endowment. Because of the party selection process, party members might be endowed with a higher level of human capital. One may therefore argue that provinces witnessing a larger proportion of party members entering the private sector after 2002 could be just the ones where the returns to human capital were higher. However, this alternative explanation seems unwarranted. One would expect that areas with better market institutions would provide a higher return to human capital, yet Fig. 2 indicates that a greater proportion of party members entered markets that were less developed. Nevertheless, to take into account this potentially confounding factor, we include in all regression models several human capital measures for private entrepreneurs, including their education and managerial experience.

Showing that less market-developed regions witnessed a larger increase in “red capitalists” after the party constitutional amendment is not sufficient to argue that this effect was due to the presence of higher political rents in these provinces. Some evidence of the mechanisms at work, showing the benefits for private entrepreneurs of having a stronger connection with the party system, is also needed.

To this end, we first tested whether party member entrepreneurs were subjected to a lower level of expropriation in the form of extralegal payments collected by local governments.⁵ Belonging to the party might then provide entrepreneurs with protection

⁵ Extralegal payments (*Tanpai* in Chinese) refer to administrative charges imposed discretionally on firms by local governments. In transition

against those abusive practices.

Secondly, we tested whether party membership helps private entrepreneurs to get better access to loans from state-owned banks and other state institutions. It is well known that in China, private firms tend to be discriminated against for access to credit from the state-owned banks that dominate the financial market (Brandt & Li, 2003; Cull & Xu, 2003). Belonging to the party might facilitate easier and better access to credit.

Finally, we examined whether party affiliation ultimately helped private entrepreneurs to enhance firm profitability in general, given all the potential benefits that this affiliation might bring to the company. We use return on equity (ROE) as our general performance measure.

For each form of return, we then estimate the model in Eq. (2) below, running regressions separately for the pre- and post-amendment samples.

$$RETURN_{ijkt} = \gamma + \tau CCP_{ijkt} + \pi INSTIT_{jt} + \varphi CCP_{ijkt} \times INSTIT_{jt} + \delta X_{ijkt} + \omega_j + \omega_k + \omega_t + \vartheta_{jt} + \mu_{ijkt} \quad (2)$$

Note that CCP_{ijkt} , $INSTIT_{jt}$ and X_{ijkt} in Eq. (2) are defined as they were in Eq. (1). Provincial, industrial, and year fixed effects are represented by ω_j , ω_k and ω_t , while province-specific time trend is denoted by ϑ_{jt} . We expected the variable CCP_{ijkt} to have a significant effect on returns in the post-amendment period only and a stronger effect in the provinces with weaker institutions, as measured by φ , the coefficient of the interaction between CCP_{ijkt} and $INSTIT_{jt}$. Once again, we first estimated Eq. (2) using time-invariant values for institutional indices, and then we re-estimated using one-year lagged values. These results are presented in the Appendix (see Table A4).

4. Data

4.1. Data sources

The firm-level data used in this study originates from six waves of the Nation-wide Survey of Privately-owned Enterprises in China, sponsored by the All-China Federation of Trade Unions, which covers a random sample of private firms from 1996, 1999, 2001, 2003, 2005, and 2007.⁶ The survey was jointly conducted by the China Society of Private Economy at the Chinese Academy of Social Sciences, the All-China Federation of Industry and Commerce, and the United Front Work Department of the Chinese Communist Party. To achieve a balanced representation of private firms across all regions and industries in China, multistage-stratified random sampling was employed.

The survey was carried out through intensive interviews with firm owners. It provides detailed individual information of firm owners, including family background, educational attainment, occupational history, political status, political ties and experience, and a wide range of information on firm characteristics, such as firm size, firm age, and basic financial background. To our knowledge, this is the best publicly available dataset for the study of party members' participation in the private sector in China.

The data we used to construct the three provincial-level institutional indices were collected from various sources. The marketization index is from the *NERI Index of Marketization of China's Provinces in 2011* developed by Fan et al. (2011). The number of local cadres being prosecuted for corruption in each province appears in the *Procuratorial Yearbook of China* and the number of government officials (*gong zhi ren yuan*) is from the *China Statistical Yearbook*. Data underlying the index of legal environment is from the *Chinese Yearbook of Lawyers* of various years.

Table 2 presents summary statistics for the main variables of interest. As shown in the table, a substantial proportion (31.9%) of private entrepreneurs in our dataset were CCP members. On average, private firms were 6.7 years old and had 48 employees. Private entrepreneurs' average years of schooling was around 13 years and 26% of private entrepreneurs had possessed managerial experiences in state-owned enterprises (SOE) before starting their own private firms. In addition, the data shows that private firms exhibited large variation in terms of access to bank credit and government expropriation. As also shown in Table 2, local institution environments exhibit substantial variations across provinces in China. For instance, the marketization index is 0.32 in the least developed province and 7.12 in the most developed province. The provincial average of lawyer-population ratio is 1.1 per 10,000, with the maximum being 4.8 and the minimum 0.38.

4.2. The selection and self-selection of party members

The survey also contains other aspects of interest concerning the selection of party members and the characteristics of party members who joined the private market after the reform. First, as already anticipated, nearly 90% of the party member-entrepreneurs with indicated that they joined the CCP *before* they started their private firms. This is consistent with the evidence (from a different source) reported in Section 2. It means that the lift of the ideological ban against private entrepreneurship in 2002 had an asymmetric

(footnote continued)

economies, extralegal fees collected by local authorities impose a disproportionate burden on private firms due to their informality and arbitrariness (Fisman & Svensson, 2007; Johnson, Kaufmann, McMillan, & Woodruff, 2000).

⁶ The surveys were conducted in 1997, 2000, 2002, 2004, 2006 and 2008, but they collect information from the previous year. Thus, the firm information in our data corresponds to 1996, 1999, 2001, 2003, 2005 and 2007. For each wave, firms in the survey are re-sampled nationally, thus the data set is comprised of repeated cross-section data.

Table 2
Summary statistics.

Variable	Obs	Mean	Std. Dev.	Min	Max
CCP membership	15,737	0.319	0.466	0	1
Extralegal payment	8254	0.0084	0.0374	0	1
ROE	10,219	0.271	0.537	− 0.300	4
Bank loans	11,134	279	643	0	2750
Assets (log)	11,782	5.320	1.910	− 11.50	18.40
Firm age	15,012	6.750	4.360	0	31
Employees (log)	15,298	3.980	1.460	0	9.900
Years of schooling	15,679	13.40	3.090	0	19
Former SOE manager	13,413	0.263	0.440	0	1
Marketization index	31	4.320	1.470	0.320	7.130
Corruption index	31	33.80	9.330	11.30	49.30
Legal index	30	1.110	0.879	0.381	4.830

Notes: Data sources: firm-level data comes from National Surveys of Privately Owned Enterprises in China. Marketization index comes from *NERI Index of Marketization of China's Provinces 2011*; No. of local cadres being prosecuted for corruption is from *Procuratorial Yearbook of China* and *China Statistical Yearbook* of various years; No. of lawyers in a province is from *Chinese Yearbook of Lawyers* of various years. See Table 1 for definitions of variables.

effect. The sharp increase in the number of “red capitalists” was more the result of movement of party members towards business than the result the party recruiting private entrepreneurs.

Table 3, by using the survey data, helps to make sense of the factors at play. Part A of the Table shows that the characteristics of party member-entrepreneurs were significantly different from entrepreneurs without a party affiliation even *before* the 2002 reform. Party members generally had more working experience in the public sector as senior cadres (defined as government position above director of a division [*chuji ganbu*]) or managers in state-owned firms, and were more likely to have memberships in the local people's congress (PC membership). However, these differences became even *larger* after the reform. This result is confirmed by Table A1 in the Appendix, which shows that private entrepreneurs joining the party after the reform were more likely to be owners of large firms, educated, male and with some previous managerial experience at a public firm. As anticipated, this points more to a selection effect by the party on new members than to a lack of interest by private entrepreneurs to join the party.

Part A of Table 3 also suggests a different post-reform process of self-selection by original party members in the private markets. Part B of the Table below confirms this. As we can see, original party members entering the private sector after the 2002 constitutional change were statistically different from party members who started private businesses before 2002. After the reform, they were more likely to be senior cadres, former SOE managers, or local congress members. Table 4 provides further evidence from the regressions of party members' backgrounds on the time of entry into the private sector. Again, party members who entered the private sector after the 2002 reform were more likely to have public sector working experience.

Clearly, with the removal of the ideological ban against private entrepreneurship, even party officials holding senior positions and those with considerable managerial experience in running SOE enterprises, could now join the private market with much less risk of jeopardizing their position within the party, and many actually did. This is relevant for our analysis because one would expect that these more senior party members were also the ones that could more easily use their political connections to promote the

Table 3
Characteristics of entrepreneurs before and after 2002.

Part A. Characteristics of Entrepreneurs before and after 2002: Party vs. Non-party member						
	Before 2002			After 2002		
	Party member	Non-party member	Diff.	Party member	Non-party member	Diff.
Senior cadre	0.131	0.059	0.072***	0.142	0.049	0.093***
Former SOE manager	0.309	0.201	0.108***	0.498	0.178	0.32***
PC membership	0.235	0.148	0.087***	0.285	0.141	0.145***
Part B. Characteristics of party members entering the private sector before and after 2002						
	Before 2002			After 2002		Diff.
Senior cadre	0.162			0.252		0.090***
Former SOE manager	0.501			0.552		0.051**
PC membership	0.233			0.279		0.046***

Notes: Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. Senior cadres is defined as government position above director of a division (*chuji ganbu*); PC membership is a dummy variable which equals one if the private entrepreneur is a member of the local people's congress.

Table 4

The entry of party members into the private sector.

	(1)	(2)	(3)
	Senior cadre	Former SOE manager	PC membership
Entry After2002	0.0955** (0.0421)	0.100*** (0.0320)	0.0253*** (0.00483)
Control	Yes	Yes	Yes
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Observations	1067	2772	3499
R-squared	0.090	0.072	0.159

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level) as well as industrial, year, provincial fixed effects. The sample in this table is limited to private entrepreneurs with party membership.

performance of their firms, as their previous work experience in the government or state-owned enterprises allowed them to establish important connections with key party and government officials. This is consistent with the survey results reported in [Dickson \(2011\)](#). In his 1999 survey, roughly one-third of entrepreneurs acknowledged that party membership might provide advantages in business. In his 2005 survey, however, this percentage dramatically rose to 57%.

5. Findings

5.1. Local institutions and party members' entry into the private sector

This section presents the main results from our empirical analysis of Eq. (1). Regression results are presented in [Table 5](#). The dummy variable *After2002* was interacted separately with marketization index, cadre corruption index, and lawyer-population ratio.

As [Table 5](#) shows, all estimates of these interaction terms are statistically significant and the signs of these estimates are in accordance with our expectations. Specifically, it is more likely for an entrepreneur to be a party member in provinces characterized by lower degrees of marketization, higher levels of government corruption and less legal development. The size of the estimates of the interaction terms are also non-trivial. For instance, the estimate of marketization interaction is -0.0142 , which implies that a one-standard-deviation (1.47) increase in marketization would reduce the likelihood of holding party membership by 2.1% after the

Table 5

Regressions: Local institutions and party members' entry into the private sector.

	(1)	(2)	(3)
	Party membership		
After2002 × Marketization index	−0.0142** (0.0067)		
Marketization index	0.0211 (0.0212)		
After2002 × Corruption index		0.0025*** (0.0010)	
Corruption index		0.0010 (0.0032)	
After2002 × Legal index			−0.0176** (0.0082)
Legal index			−0.0027 (0.0084)
Control	Yes	Yes	Yes
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	11,184	11,238	11,215
R-squared	0.178	0.179	0.179

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (firm assets, firm age, number of employees) and entrepreneur attributes (entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

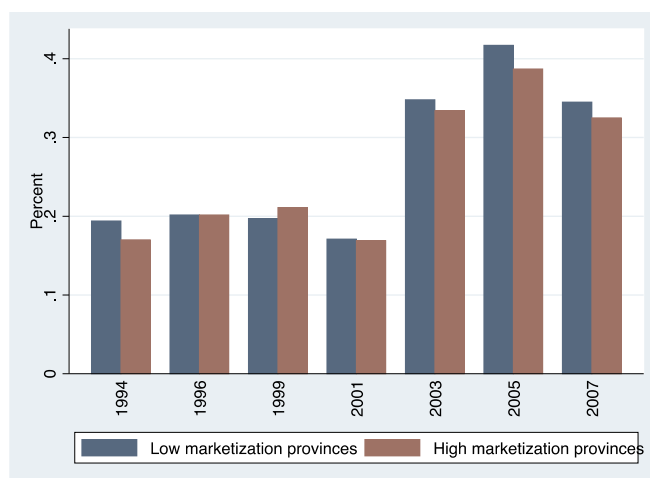


Fig. 3. Percentage of member-entrepreneurs.

revision of the party constitution. To give a more intuitive interpretation, if Ningxia, an inland province in the western part of China, improved its marketization level (2.55) to that of the coastal province of Guangdong (7.12), the probability for Ningxia entrepreneurs to be affiliated with the party would decline by 6.5 percentage points, a one-quarter of decrease relative to the sample average.

5.2. Common trends assumption test

One main concern regarding the application of the difference-in-difference approach is whether the data processes that generate outcomes of the treatment and control groups followed “common or parallel trends” prior to the treatment. In our case, we would be concerned that the common trends assumption might not hold and the estimates might be biased if we observed a stronger tendency for party members to start a business in provinces with a higher degree of marketization *prior* to the revision of party constitution. To check for this possibility, we divided the provinces into two groups, namely, high marketization and low marketization, by the score in the marketization index with respect to the median. As is apparent from Fig. 3, there was no systematic difference in the proportion of party member entrepreneurs between the two types of provinces before the change of party constitution. However, the proportion of private entrepreneurs holding party member tends to be higher in regions with poor institutions after the constitution amendment.

To further investigate the common trends assumption, we conduct a formal test to examine whether there are varying patterns during the sample periods by interacting the institutional index with year dummies. The first year, 1996, in the sample, was set as the baseline year. Corresponding estimation results are reported in Table 6. The regression coefficients are not statistically significant for the interactions between pre-amendment year dummies and institutional index. In other words, there is no systematic difference in the proportions of entrepreneurs affiliated with the CCP across regions. Consistent with the estimation results in Table 5, the regression coefficients tend to be statistically significant for interactions between post-amendment year dummies and the institutional index.⁷ Overall, the results in Table 6 show that the common trends assumption is valid in our study. Moreover, province-specific time trends have been included in our difference-in-difference analysis to minimize estimation bias due to varying time trends at the provincial level.

5.3. Robustness tests

We conducted several robustness checks for our major estimates. First of all, we conducted a placebo test for the common trends assumption, using the sample before the policy change. In this test, we assumed that the constitutional reform took place in 1999 instead of 2002 and, on this basis, re-estimated Eq. (1). Since there was no constitution amendment until 2002, the estimated coefficients of the interactions between the “After1999” dummy and institutional index should be trivial and insignificant, given the validity of the underlying assumption of parallel trends. The results for placebo test are reported in Table 7. None of the interaction terms is statistically significant.

We then address the concern that our results might be driven by new recruitments instead of entry of veteran party members, as our sample includes both veteran party members and newly recruited party members who joined the party after they set up their firms. We excluded newly recruited party members and re-estimated our baseline specifications. Regression results are reported in panel A of Table 8. As we can see, they are consistent with our findings in the previous regressions. This lends support to the view that estimation results are mainly driven by the entry of veteran party members into the private sector following the change of political sentiments.

⁷ While estimated coefficients are not statistically significant for the interaction between post-amendment year dummies and market index, their sizes and corresponding *p*-values suggest the effects of market environment since 2002 cannot be ignored.

Table 6
Common trends assumption test.

	(1)	(2)	(3)
	Party membership		
Year 1999 × Marketization index	−0.00377 (0.0121)		
Year 2001 × Marketization index	0.0102 (0.0122)		
Year 2003 × Marketization index	−0.0172 (0.0164)		
Year 2005 × Marketization index	−0.0308 (0.0201)		
Year 2007 × Marketization index	−0.0545 (0.0343)		
Marketization index	0.0384 (0.0357)		
Year 1999 × Corruption index		0.00234 (0.0041)	
Year 2001 × Corruption index		0.00296 (0.0059)	
Year 2003 × Corruption index		0.00630*** (0.00225)	
Year 2005 × Corruption index		0.00580*** (0.00220)	
Year 2007 × Corruption index		0.00603** (0.00240)	
Corruption index		−0.00276 (0.00368)	
Year 1999 × Legal index			−0.501 (0.464)
Year 2001 × Legal index			−0.830 (0.773)
Year 2003 × Legal index			−0.0406*** (7.27e-06)
Year 2005 × Legal index			−0.0667*** (0.00398)
Year 2007 × Legal index			−0.0531*** (0.00435)
Legal index			−0.00884 (0.0156)
Control	Yes	Yes	Yes
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	11,184	11,238	11,215
R-squared	0.185	0.179	0.185

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

We also examine whether our estimation results remain robust when party procedures for selecting new members are taken into account. In general, the process of joining the party takes one or two years because it involves self-selection, daily monitoring, closed-door evaluation, and probationary examination. As a result, simply focusing on party membership may under-estimate the rent-seeking incentives of private entrepreneurs. To alleviate this concern, we construct a new dependent variable that covers formal party members as well as non-party entrepreneurs who had applied for party membership, and re-estimate our baseline specification. As reported in panel B of Table 8, we find that our key estimation results remain stable after including party applicants.

Next, we consider the possibility that our empirical findings were driven by other policy changes, such as the implementation of China's Western Development Program (WDP) and the country's accession to the World Trade Organization (WTO) that happened concurrently with the change of party ideology. The WDP sought both to increase central government fiscal and credit support and to improve the investment environment through deregulation and accelerated enterprise reforms, and envisioned increased market access for all firms, regardless of the source of their capital financing. This could bring more business opportunities to the western provinces and increase the benefits of business-state ties. Similarly, China's accession to the WTO in 2001 might have led to province-specific policies related to the trade liberalization, depending on the reliance of each region's development on export. The effects of these policy changes during the study period might thus confound our findings.

Table 7
Placebo test.

	(1)	(2)	(3)
	Party membership		
After1999 × Marketization index	−0.0459 (0.0257)		
Marketization index	0.249* (0.0607)		
After1999 × Corruption index		−0.00356 (0.00223)	
Corruption index		4.551*** (0.175)	
After1999 × Legal index			−0.0123 (0.0184)
Legal index			0.383*** (0.0346)
Control	Yes	Yes	Yes
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	5919	5919	5907
R-squared	0.056	0.056	0.056

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

As a robustness test for the effect of the WDP, we re-ran our regressions after excluding observations from the Western provinces. The results are reported in panel A of [Table 9](#). As shown in the table, they are consistent with the results of the previous regressions. To check for the validity of the main results to China's participation in the WTO, we re-ran our regressions after including provincial export intensity, a measure that captures the reliance of a region's development on export, and its interaction with the After2002 dummy. The results presented in panel B of [Table 9](#) show that domestic economic changes associated with China's entering the WTO are unlikely to be the driving force of our main findings.

Another potential concern is that our estimation result might be driven by the privatization program in China during the 1990s, under which state-owned enterprises and collectively owned enterprises were transferred to private hands on a massive scale. As shown in [Table 2](#), a large proportion of party member-entrepreneurs had working experience in the state-owned enterprise before entering the private sector. One potential explanation for our key findings is that the entry of a party member into the private sector may be attributed to the privatization process during which the original state-owned enterprise manager continues to manage a now-private enterprise. Ideally, we could tackle the privatization issue by controlling for whether the firm is a privatized firm or a de novo private firm. However, our private enterprise survey only records such information after 2002, so our DID estimation cannot control directly for firm origin. Instead, we addressed this concern by excluding all firms that previously had been state-owned or collectively owned enterprises. As shown in [Table 10](#), we find that our baseline estimation remains robust after excluding privatized firms, which suggests that our findings are not very likely to be driven by the privatization process.

6. Political rent

In this section, we provide evidence for the benefits to private firms of having political ties. We first tested whether the change in party ideology produces *heterogeneous impacts* in different industries, on the idea that both nature and intensity of government engagement might vary by industry. As noted, private firms face more severe financial constraints than state-owned firms and foreign firms ([Brandt & Li, 2003](#); [Cull & Xu, 2003](#)). Given the central role of government in distributing financial resources, political connections might then help firms to overcome their financial constraint ([Cull et al., 2015](#)). As a result, we expect that political ties to be more valuable in industries with a higher reliance on external finance: party members should have a stronger incentive to enter industries with high financial constraints, to harvest the benefits of political connections.

To test this hypothesis, we split our sample into two types of industries according to their degree of financial constraint and checked if there indeed was a higher influx of red private entrepreneurs into the more financially constrained sector by running Eq. (1) again. We defined financial constraint as the average gap between amount of external finance and firms' capital demand for turnover in an industry, which is reported in the Survey. Results from this exercise are reported in [Table 11](#). As can be seen and consistent with our prediction, when we divide the sample by using the sample mean or sample median, we find that the regression coefficients are more significant for high-level, financially constrained industries.

Next, we performed a regression analysis, using Eq. (2), to investigate whether red private entrepreneurs suffer less government expropriation in the form of extralegal payments, have better access to loans from state-owned banks and other state institutions, or

Table 8

Robustness tests for alternative measures.

Robustness Test A	Dependent variable: <i>Xiahai</i> entrepreneurs		
	(1)	(2)	(3)
After2002 × Marketization index	− 0.0149** (0.0067)		
Marketization index	0.0198 (0.0223)		
After2002 × Corruption index		0.0028*** (0.0010)	
Corruption index		0.0004 (0.0033)	
After2002 × Legal index			− 0.0148* (0.0082)
Legal index			− 0.0037 (0.0084)
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	10,612	10,660	10,640
R-squared	0.166	0.167	0.167

Robustness Test B	Dependent variable: Party membership or applicants		
	(1)	(2)	(3)
After2002 × Marketization index	− 0.0146** (0.0068)		
Marketization index	0.0309 (0.0210)		
After2002 × Corruption index		0.0029*** (0.0010)	
Corruption index		0.0021 (0.0032)	
After2002 × Legal index			− 0.0210** (0.0084)
Legal index			0.0160* (0.0088)
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	12,728	12,880	12,852
R-squared	0.099	0.099	0.099

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

own firms with a higher return on equity (ROE). Results using the marketization index as provincial institutional variable are reported in Table 12.⁸

Consistent with the findings of Guo et al. (2014), the results in the table show that politically connected entrepreneurs did not enjoy statistically detectable rents before the party amended its constitution in 2002. However, the post-amendment political legitimacy conferred upon entrepreneurs, together with the selection effect we discussed previously, helps to explain why private entrepreneurs with party membership have come to be associated with less government expropriation, better access to bank loans, and ultimately better profitability. Moreover, we find that the returns to party members's enterprises are statistically larger for private entrepreneurs in areas with less developed markets, as expected.

⁸ To save space, we do not report the results using corruption index and legal index. These estimates follow the patterns seen with reference to the marketization index but the estimates are weaker. The complete set of results is available upon request. This estimation may suffer from an endogeneity problem as it is very difficult to find a valid instrument variable. We urge the reader to take caution in interpreting related findings.

Table 9
Robustness tests for alternative policies.

Panel A: Excluding Western provinces	Dependent variable: Party membership		
	(1)	(2)	(3)
After2002 × Marketization index	− 0.0172* (0.0092)		
Marketization index	− 0.0360*** (0.0125)		
After2002 × Corruption index		0.0041*** (0.0011)	
Corruption index		− 0.00012 (0.0013)	
After2002 × Legal index			− 0.0190** (0.0085)
Legal index			− 0.0022 (0.0086)
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	8905	8905	8905
R-squared	0.172	0.173	0.172

Panel B: Controlling for export intensity	Dependent variable: Party membership		
	(1)	(2)	(3)
After2002 × Marketization index	− 0.0380** (0.0186)		
Marketization index	0.0374 (0.0286)		
After2002 × Corruption index		0.0023** (0.0010)	
Corruption index		0.0011 (0.0032)	
After2002 × Legal index			− 0.0128 (0.0118)
Legal index			− 0.0044 (0.0086)
Export/GDP	− 0.0002 (0.0078)	0.0020 (0.0063)	0.0045 (0.0063)
After2002 × Export/GDP	− 0.0075 (0.0400)	− 0.0249* (0.0145)	− 0.0126 (0.0209)
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	11,184	11,238	11,215
R-squared	0.184	0.179	0.179

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

7. Conclusion

In this article, we have presented the results of a study on the effect of a policy shift in China that significantly changed the relationships between the CCP and private entrepreneurs. Exploiting the largely unexpected revision of party constitution in 2002 and the variance of market development across Chinese provinces, we examined the dynamic interaction between politics and business in a transition economy and obtained causal evidence for the influence of institutional environments upon benefits of political ties. Our study enriches the literature, which typically examine the advantages of political ties for business in static settings and based on cross-section datasets. We find that the embrace of private entrepreneurs by the party significantly increased the flow of senior party members into the private sector, with this effect larger in areas with a relatively low level of marketization, a higher percentage of corrupt officials, and poor accessibility of legal protection. After the CCP's 2002 policy shift, the economic benefits of party membership – such as alleviating government expropriation, improving access to credit, and promoting firm profitability – became more significant in provinces characterized by weak market institutions.

Table 10
Robustness tests excluding privatized firms.

	(1)	(2)	(3)
	Party membership		
After2002×Marketization index	−0.0214*** (0.00693)		
Marketization index	0.0156 (0.0213)		
After2002×Corruption index		0.000994 (0.00101)	
Corruption index		0.000406 (0.00320)	
After2002×Legal index			−0.0173** (0.00851)
Legal index			−0.00558 (0.00839)
Control	Yes	Yes	Yes
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Observations	10,055	10,095	10,073
R-squared	0.131	0.131	0.132

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

Table 11
Financial constraints and Party members' entry into the private sector.

	(1)	(2)	(3)	(4)	(5)	(6)
	Party membership			Party membership		
	Low financially constrained industries			High financially constrained industries		
After2002×Marketization index in indeindex	0.0188 (0.0199)			−0.0157** (0.0076)		
Marketization index	−0.0106 (0.0341)			0.0328 (0.0303)		
After2002×Corruption index		0.0005 (0.0030)			0.0027** (0.0011)	
Corruption index		−0.0003 (0.0051)			0.0032 (0.0046)	
After2002×Legal index			−0.0183 (0.0257)			−0.0169* (0.0095)
Legal index			−0.0249 (0.0230)			−0.0030 (0.0098)
Sector	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Province	Yes	Yes	Yes	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1087	1087	1076	8941	8993	8982
R-squared	0.170	0.170	0.169	0.189	0.190	0.191

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

Our findings warrant the concern that the large influx of party members into the private sector may strengthen the nepotistic relationships between entrepreneurs and government officials. By running private sector businesses, party elites continue to translate their political power and personal connections into various forms of economic advantage. This is alarming, since these practices can rot the political trust of the rank and file. Furthermore, entrenched nepotistic ties may create barriers for the development of market and market-supporting institutions, because those privileged entrepreneurs prefer maintaining the status quo and tend to stall reforms, which would ultimately undermine the potential for further growth. On a more positive note, however, our findings

Table 12

Market development and returns to Party membership.

	(1)	(2)	(3)	(4)	(5)	(6)
	Extralegal payment		Bank loan		ROE	
	Before	After	Before	After	Before	After
CCP	0.0033 (0.0040)	−0.0169** (0.0075)	−73.50 (81.46)	778.2** (326.2)	0.000 (0.0742)	0.633*** (0.122)
CCP × Marketization index	−0.0007 (0.0008)	0.0023* (0.0014)	21.58 (15.27)	−142.4** (59.90)	0.0025 (0.0139)	−0.119*** (0.0232)
Marketization index	−0.00159 (0.0020)	0.0036 (0.0046)	16.21 (48.42)	8.759 (226.8)	−0.0519 (0.0446)	−0.0058 (0.0606)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Sector	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Province	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3421	3228	4603	3597	4712	5045
R-squared	0.072	0.049	0.316	0.135	0.158	0.127

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, and provincial fixed effects.

demonstrate that marketization and efficient legal system can serve to curb rent-seeking behavior, which offers us a potential avenue for tackling the problem.

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Appendix

Table A1

Regressions of selection effect by the Party on new member.

	(1)	(2)
	New Party member	New Party member or new application
Ln asset	0.0006 (0.0038)	−0.0024 (0.0041)
Firm age	0.00167 (0.0010)	−0.0009 (0.0012)
Ln employees	0.0173*** (0.0051)	0.0119* (0.0062)
Female dummy	−0.0320*** (0.0113)	−0.0305* (0.0162)
Years of schooling	0.0029* (0.0015)	0.0071*** (0.0014)
Former cadre	0.0202 (0.0168)	0.0339** (0.0165)
Former manager	0.0806*** (0.0111)	0.0688*** (0.0106)
Congress membership	−0.0055 (0.0126)	0.0073 (0.0136)
Marketization index	−0.0119*** (0.0019)	−0.0109*** (0.0016)
Corruption index	0.0014** (0.0006)	0.0045*** (0.0007)
Legal index	−0.0138** (0.0057)	−0.0097 (0.0116)
Sector	Yes	Yes
Year	Yes	Yes
Province	Yes	Yes
Constant	0.117*** (0.0288)	0.0216 (0.0369)

(continued on next page)

Table A1 (continued)

	(1)	(2)
	New Party member	New Party member or new application
Observations	7060	7895
R-squared	0.096	0.038

Notes: The sample excludes entrepreneurs who were already Party members before starting their business. Congress membership denotes entrepreneur's memberships in the People's Congress or People's Political Consultative Conference at any level. Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for industrial, year, provincial fixed effects.

Table A2

Regressions on entry of Party members using lagged institutional index (one-year lagged).

	(1)	(2)	(3)
	Party membership		
After 2002 × Marketization index	−0.0157** (0.0073)		
Marketization index	0.0192 (0.0132)		
After 2002 × Corruption index		0.0029*** (0.0008)	
Corruption index		−0.0015* (0.0008)	
After 2002 × Legal index			−0.0204** (0.0102)
Legal index			0.0166 (0.0161)
Sector	Yes	Yes	Yes
Year	Yes	Yes	Yes
Province	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes
Constant	−0.0870 (0.0742)	0.184*** (0.0415)	0.583*** (0.0532)
Observations	8360	9654	8416
R-squared	0.227	0.206	0.220

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

Table A3

Robustness tests for one-year lagged institutional index.

	(1)	(2)	(3)	(4)	(5)	(6)
	Party membership			Party membership		
	Low financially constrained industries			High financially constrained industries		
After 2002 × Marketization index	0.0143 (0.0177)			−0.0192*** (0.0071)		
Marketization index	−0.0307 (0.0322)			0.0271* (0.0139)		
After 2002 × Corruption index		0.0013 (0.0026)			0.0030*** (0.0010)	
Corruption index		−0.0011 (0.0024)			−0.0012 (0.0009)	
After 2002 × Legal index			−0.0025 (0.0247)			−0.0134 (0.0106)
Legal index			−0.0205 (0.0504)			0.0038 (0.0204)
Sector	Yes	Yes	Yes	Yes	Yes	Yes

(continued on next page)

Table A3 (continued)

	(1)	(2)	(3)	(4)	(5)	(6)
	Party membership			Party membership		
	Low financially constrained industries			High financially constrained industries		
Year	Yes	Yes	Yes	Yes	Yes	Yes
Province	Yes	Yes	Yes	Yes	Yes	Yes
Province-specific time trend	Yes	Yes	Yes	Yes	Yes	Yes
Observations	944	1072	893	7884	8920	7979
R-squared	0.187	0.171	0.191	0.200	0.191	0.199

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industrial, year, provincial fixed effects and province-specific time trends.

Table A4

Benefits of Party membership using one-year lagged institutional index.

	(1)	(2)	(3)	(4)	(5)	(6)
	Extralegal payment		Bank loan		ROE	
	Before	After	Before	After	Before	After
CCP	0.0005 (0.0042)	−0.0171** (0.0067)	−75.14 (72.04)	558.1** (276.3)	0.0394 (0.0653)	0.673*** (0.118)
CCP × Marketization index	−0.0001 (0.0008)	0.0016* (0.0008)	14.52 (8.980)	−94.47* (49.23)	−0.0035 (0.0081)	−0.121*** (0.0218)
Marketization index	−0.0013 (0.0010)	−0.0007 (0.0048)	2.082 (53.36)	−95.63 (65.03)	0.0304 (0.0485)	0.0510* (0.0267)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Sector	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Province	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2621	3228	4603	3596	4712	3847
R-squared	0.061	0.039	0.309	0.116	0.146	0.121

Notes: Standard errors are clustered at the provincial level and reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and ***, respectively. All regressions control for firm attributes (includes firm assets, firm age, number of employees) and entrepreneur attributes (includes entrepreneur's education level and managerial experience in state-owned firms) as well as industry, year, and provincial fixed effects.

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