The Political Economy of Private Firms in China*

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Abstract

The sweeping change in political economy associated with the spectacular growth of the private sector in China is rarely studied in the economics literature. This paper fills this gap. The central subject of this paper is the nature of the political economy of the Chinese private sector and of the Communist Party of China. We empirically examine the dynamics of rent creation from the Party membership and other political connections when the regime is changed from anti-capitalistic to pro-capitalistic. Endogeneity problems are addressed. We identify the causality of rents and the political connections of private entrepreneurs, and explore the implications of these political elites' rents on social welfare in terms of productivity.

Keywords: Party membership, China, political connections, private firms

"My property, even my life, belongs to the Party. This is the quality a Communist must have."

—Liang Wengen (November 12, 2012, *Guangming Daily*)
Founder and CEO of the Sany Group
The richest person in China in 2011
Deputy of the 17th and 18th CPC National Congress

I.   Introduction

The spectacular growth of the private sector in China, which started from scratch in the 1990s, is well documented. This growth would not have occurred without changes in politics. However, the sweeping change in political economy associated with this growth is rarely studied empirically in the economics literature. This paper fills this gap.

Without a surprise, the first amended version of the Constitution of the Communist Party of China (CPC) when "the reform" started is unambiguously anti-capitalism. It declares, "[t]he proletariat dictatorship will inevitably replace the dictatorship of bourgeoisie…Basically, the socialist system has incomparable superiority over the capitalist system …" (*The CPC Constitution*, 1982). Consistently, the reform agenda did not allow for setting up private firms, neither for privatization, and the private sector accounted for 0% of the Chinese GDP. However, the reform agenda has transformed; both the CPC Constitution and the state Constitution were amended again in 2002[1] and 2004, respectively, and the institutions were changed (for the reasons of these changes, see Xu, 2011). Party members are now encouraged to become private entrepreneurs. Consequently, the private sector currently accounts for over half of the Chinese GDP. Moreover, ironically, most of the richest people in China are Communist Party members, and several of them are selected (not elected) to the People's Congress, the legislator. Nevertheless, the most striking phenomenon is that members of the National People's Congress of China have become, by far, the wealthiest in the world, despite the highly incomplete and heavily underestimated data about these elites. The total wealth of the 70 richest members of the People's Congress of China is US$90 billion, which is 12 times that of the total wealth of all the members of Congress, Supreme Court, and White House of the United States, which is US$7.5 billion (Bloomberg, February 27, 2012).

The central subject of the current paper is the nature of the political economy of the Chinese private sector and of the CPC. Hence, we examine the dynamics of rent creation from Party membership and other political connections when the regime is changed from anti-capitalistic to pro-capitalistic. Given that the Party is the dominant force both in politics and in the national economy in China (the next section elaborates this point), political connections in this paper are captured by a CPC membership or a People's Congress (PC) membership.[2] We interchangeably use the terms "political

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[1] "We must and we are determined to encourage, support and guide the development of the nonpublic sectors of the economy…"; "nonpublic sectors are important elements of the socialist market economy…" (Jiang Zhemin's speech at the 16[t][h] CPC National Congress, 2002).

[2] A PC member may not be a CPC member, but he/she must be pro-CPC because all the PC members are selected by the

connection" and "political elites." We attempt to address two major questions. (1) Compared to non-political elite entrepreneurs, do political elite entrepreneurs enjoy rents when they enter the private sector in the old regime (before 2002)? (2) What happened in the new regime (after 2002)? This paper identifies the causality of rents and the political connections of private entrepreneurs, and explores the implications of these political elites' rents on social welfare in terms of productivity.

Literature on the relationships between political connections and economic variables is extensive. A group of economists investigate the economic value of political connections. In a seminal paper, Fisman (2001) reports that the Suharto's health-related events caused a significant loss in the return on the price of the securities of politically connected firms. Faccio (2006) extends the scope of the investigation to 47 countries, and reveals that the announcement of entering politics by officers or large shareholders of a company is positively associated with the cumulative abnormal return, which varies depending upon political power. This line of research applied to various countries in different settings, namely, late Victorian Britain (Braggion and Moore, 2011), a longitudinal dataset of Italian companies (Cingano and Pinotti, 2009), Russia's politically connected firms receiving preferential treatments by regional laws and regulations (Slinko, Yakovlev, and Zhuravskaya, 2005), and U.S. firms connected to Geithner as a nominee for Treasury Secretary by President Obama (Acemoglu, Johnson, and Kermani, 2010).

Another group identifies the effect of political connections on access to bank loans and government subsidies. Using data from Pakistan, Khwaja and Mian (2005) claim that politically connected firms are able to borrow 45% more, but they are more likely to default by 50% compared to those without political connections. The findings of Johnson and Mitton (2003) and Faccio, Masulis, and McConnell (2006) support that political connections affect government or bank decisions. The former presents results that the decision on government subsidies is associated with political connections, whereas the latter shows that politically connected firms are more likely to be bailed out.

A multiple number of sociological studies document the potential advantages of being a Party member in China. Evidence documented by Walder (2000) shows that joining the Party is a necessary condition to become a leader in China. Li and Walder (2001) reveal that joining the Party in earlier periods of careers brings a difference. Those who have become Party members at an early time of their careers are reported to have significantly higher chances to become social elites, whereas those who are already successful before joining the Party would not bring a difference to their careers by joining the Party. Bian (2001) suggests that everything being equal (i.e., controlling for talents and education/experience backgrounds), Party members have higher chances than non-Party members to become top managers in state-owned enterprises (SOEs). In their investigation of the changes after the massive purges of the "Cultural Revolution," Walder and Hu (2009) argue that party elites, particularly their offspring, recovered much more quickly than others.

CPC. Moreover, in terms of social status and power, average PC members are elites at a higher level than average CPC members.

Political connections and their associated economic performance among Chinese firms have attracted the attention of economists. Using the listed firms, Fan et al. (2007) indicate that firms with politically connected top executives of new partially privatized firms are less efficient than other firms in terms of post-IPO performance. In contrast, Peng and Luo (2007) and Francis et al. (2009) use listed data to demonstrate that political ties are beneficial to firms in terms of obtaining resources that enhance efficiency. Li et al. (2008) point out the positive effect of political connections on firm performance using one year cross-sectional data of private firms collected in 2002. Chen et al. (2011) and Wu et al. (2012) document the heterogeneous effects of political connections; that is, the performance of SOEs is negatively affected by political connections, whereas that of private firms is slightly or positively affected by political connections. Different from studies that use cross-sectional differences among Chinese firms, Calomiris, Fisman, and Wang (2010) apply the event study method to firm-level data, and reveal that the policy announcement of the sale of government-owned shares received a negative response in stock markets.

Our project complements the literature in several ways. First, our paper is the first work that investigates the change or the dynamics of the political economy of Chinese private firms. Our approach provides a more credible identification of the impact of political connections on firm performance by showing its critical dependence on institutional settings, such as changes in the Constitutions. To our best knowledge, none of the studies in the current literature, except that of Calomiris, Fisman, and Wang (2010), examine the dynamics of the effects of political connections on economic variables.[3] Second, the present paper carefully addresses the endogeneity and identification problem. We instrument the Party members by the existence of Party branches or Party organizations within the firm. In addition, we use part of the data to exclude new Party members from the sample to address reversed causality. We also present evidence about those who intend to join the Party to further resolve the identification problem. Finally, the data we use (i.e., several years of nationwide random sampling survey firm-level data of the Chinese private sector in 1995, 2000, 2006, and 2010) are unique in the literature.

Our major findings are summarized as follows. First, the politically connected elites did not enjoy statistically detectable rents before the amendments in the Constitution in 2002 to 2004. However, following the changes in the Constitution that recognized the private sector, political connections became a major determinant of access to bank loans. Second, political connections failed to improve firm performance. Rather, they are positively associated with paying themselves in the form of dividends.

The rest of the paper is organized as follows. In Section II discusses the institutional background about the Communist Party vis-à-vis the private sector. Section III describes the institutional background surrounding the amendments in the Constitution. Section IV introduces the data and

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[3] A main difference between our paper and that of Calomiris, Fisman, and Wang (2010) is that we investigate a more fundamental change in the Constitution on private property rights, whereas the latter focuses on policy change on the sale of government-owned shares. In addition, Calomiris, Fisman, and Wang (2010) apply the event study method that requires the efficiency of Chinese financial markets and the unexpected policy change. Our method using cross-sectional comparisons of firms across different periods does not need such assumptions.

provides the basic observations. Section IV presents our baseline results. Section V addresses the endogeneity and identification problem using an instrumental variable approach and excluding the sample that might be affected by reverse causality. Section VI concludes the paper.

II.   Institutional Background

The backbone of China's institution is the Communist Party of China (CPC) (Xu, 2011). The Party controls all levels of governments, which directly determines or deeply influences the allocation of local resources through personnel control. Moreover the Party determines the appointments of all the most important posts in the state sector, such as the CEOs and presidents of the major banks and the largest SOEs. Nearly all important posts are occupied by Party members; the rest are occupied by Party-trusted non-Party members. Thus, being a Party member, particularly being a veteran Party member, facilitates opportunities for political connections, which can be used for business. This premise is particularly true for those who purposely cultivate the connections. Furthermore, the Party controls all levels of the legislature, the People's Congress, from the national down to the county level, mostly through the influence of selecting members of Congress. Literally, all non-Party Congress members must be Party-trusted persons.

The Communist Party has launched economic reforms since 1978. The private sector was not allowed under the communist rule, and a change in this policy was not in the reform agenda. The major development of the private sector and privatization occurred after the mid-1990s when the state sector was in deep trouble (Xu, 2011). The private sector took off rapidly after having a chance to grow. From 1998 to 2005, the output of the private sector increased by 20 times, and its share in total GDP increased from only 2.5% in 1998 to nearly 50% in 2009, thus becoming the largest sector in the Chinese economy.

As the private sector became the major engine of the Chinese economy out of the reform agenda, its extremely fast growth surprised the Party. From 1998 to 2002, when the private sector expanded sixfold, the Party's presence in terms of the number of members in the private sector was shrinking. The official nationwide statistics shows that the share of Party membership in the private sector declined by over 36%, from 2.8% in 1995 to 1.7% in 2002 (Table 1). This information is echoed by the fact that in 2000, only 17% of private firms in our sample have Party organizations within the firm.[4]

These conflicting consequences between fast economic growth resulting from the abrupt progress of the private economy and the sign of the ruling party's losing representation in the private sector are

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[4] In 2004, the *Financial Times* reported that only 1.1% of the private firms in Shanghai had Party organizations. The average size of the firms in our sample is larger than the average size of the firms in the population; thus, our sample is over-representing the firms that have established Party branches.

due to the self-conflicting institutions, which put private business in an illegal status or at least a disadvantageous status.

Facing a fast-growing private sector, which is rocking the social foundation of the CPC, Jiang Zemin, Chairman of the Party and President of the state, challenged the Constitutions of the Party and of the state. In his inspection tour in Guangdong province at the beginning of 2000, he proclaimed that entrepreneurs should be recognized as "advanced productive force" (The CPC Maoming City Propaganda Department, 2002),[5] that Party members should be encouraged to become entrepreneurs, and the Party should legitimately recruit entrepreneurs on a large scale. Two years later at the 16th National Congress of the Chinese Communist Party, this principle was codified into the Constitution of the Party. Following this change, in 2004, the Constitution of the state was also amended that the Chinese government will recognize and protect private property rights. Contradicting Marxism, the core spirit of communist ideology, this case is the first instance in the international communist movement history in which capitalists are explicitly embraced by a communist party both ideologically and organizationally. This change reflects not only the Chinese Communist Party's recognition of the growing importance of the private sector to China's economy; more importantly, it also illustrates a change of institution and a change of business environment.

A large number of party elites have entered the private sector since changes were made to the Constitutions. Our data confirm this fact (Table 3). Political elites reportedly benefit from their political connections by obtaining scarce resources when they become private entrepreneurs. Furthermore, numerous non-Party member entrepreneurs under the new environment may prefer to be recruited by the Party-state (either by joining the Party or striving to become a member of Congress) because doing so could improve their chances of accessing scarce resources.

This paper addresses the central issue about the impact of the change of laws and institutions on the relationship between political connections and economic rents. This dynamics is unexplored in the existing literature. The research questions are as follows. (1) Compared to commoners, do political elites enjoy rents when they enter the private sector in the old regime (and in the new regime)? (2) How did the relationship between political connections and economic rents evolve from the old regime to the new regime?

Based on our data collected from nationwide random sampling surveys over 15 years, we find that in 1995 and 2000, the Party social elites did not enjoy statistically detectable rents. Controlling for all other factors (e.g., characteristics of the individual, firm, industry, location, etc.), the resources (i.e., bank loans) the Party social elites obtained are similar to those obtained by other entrepreneurs. However, the political rent became significant. In 2006 and 2010, firms owned by Party members associated with the social elites significantly obtained more bank loans compared to other firms.

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[5] The term "productive force" is a central concept in Marxism. The productive forces consist of the means of production, and labor power. The central argument of Marxism is that advanced productive forces determine the progress of an economy, but capitalism inherently and ultimately prevents the advancement of productive forces.

III. Data and Descriptive Statistics

The major dataset used in this paper comprises four cross-sectional surveys on the private sector in China. These surveys were conducted in 1995, 2000, 2006, and 2010 through face-to-face interviews. The survey questionnaires and sampling schemes were designed by a research team consisting of economists and sociologists from the Chinese Academy of Social Sciences and several Chinese universities. The survey series was organized by a CPC central committee department, the United Front Work Department, and two ministry-level central government agencies, The National Association of Industry and Commerce, and The State Administration for Industry and Commerce. This survey series, which is the largest of its kind in China, has traced the development of the private sector nationwide since the sector emerged from scratch.

A stratified random sampling procedure is applied to ensure that the survey is representative of the population of registered private firms nationwide. The stratifications include locations, industries, stages of economic development, and distribution of private firms in urban and rural areas within each location (a city or a county). The surveys covered over one-third of the cities in China. The sample size of the 1995 survey comprises 2,869 private firms located in 160 cities; 3,073 private firms located in 129 cities for the 2000 survey; 3,837 private firms located in 109 cities for the 2006 survey; and 4,624 private firms located in 158 cities for the 2010 survey.

Tables 2A, 2B, 3A, and 3B present the summary statistics of the firms' financial data over the four survey years. The statistics indicates that on average, firms owned by CPC or PC members are larger than those owned by non-CPC/PC owners in terms of sales, number of employees, and equity value for all the years. Moreover, on average, CPC member owners and PC member owners obtain more bank loans (measured by the bank loan to equity ratio) than other owners for 2006 and 2010.

IV. Political Connections, Rents, and Firm Performance

Political Connections and Rents

The amendments of the Constitution of the Party (CPC) in 2002[6] and of the Constitution of the state (PRC) in 2004[7] have transformed institutional settings for economic agents in China. Prior to the amendments, private entrepreneurship was illegal under the state Constitution, and was in direct

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[6] The key aspects of this amendment are the recognition of the legitimate social status of private entrepreneurs, and encouragement of private entrepreneurship.
[7] The key aspect of this amendment is the recognition and protection of private ownership, including private businesses.

conflict with the Party's ideology and policy. Chinese private enterprises were formally discriminated against SOEs in terms of access to bank loans and other resources (Brendt and Li, 2003). Anyone with political capital (e.g., a PC member or a veteran Party member working in a government agency or SOE) who considers his/her conversion into a private entrepreneur should weigh the political/economic risks against economic gains, which may only be temporary.

In contrast, after the amendments to the two Constitutions, when private entrepreneurship becomes legitimate and is encouraged, the risks and benefits for becoming an entrepreneur may be changed, at least formally. Moreover, given the monopolistic position of the government in controlling resources, those PC members or veteran Party members may gain access to resources from their political connections. Hence, we hypothesize that the period of 2003 to 2004 is a turning point in which political connections became a significant factor in determining business advantages for those with connections, whereas political connections was not significant before the period.

Potentially, access to bank loans is one of the important advantages for political elites in running private businesses than commoners. Conversely, the majority of the bank loans are issued by the state-owned banks, and the interest rates are set by the government. This case implies that the government has a considerable involvement in the allocation of credit. Bank loans are heavily subsidized, such that the cost of capital and other important input factors in China are among the lowest in the world. Starting from 2003, the cost of capital in China became the lowest in the world (Lardy, 2012). Consequently, whoever is able to obtain bank loans enjoys the rent and subsidies. To test whether a significant change occurred after the amendment in the Constitution, "access to bank loans" is regressed against "CPC/PC membership" for four cross-sections, namely, 1995, 2000, 2006, and 2010. The definitions of the variables used in estimations are presented in the Appendix (Table A1).

We measure political connections by CPC and PC membership, and estimate the effects of CPC/PC memberships on bank loans through two measurements. The first measurement is derived from the answer to the question on whether the firm has bank loans (i.e., yes or no). The second one is the ratio of total bank loans over the value of total equity. The former variable is available for all the four years, whereas the latter is available only for 2000, 2006, and 2010. Tables 6 and 7 show the estimation results using the two measurements, respectively. In each table, we conduct regressions using both yearly data and the pooled data. For the latter, we test whether the interaction term between political membership and period (0: pre-amendment period, 1: post-amendment period) is significant.

Table 4 indicates that CPC membership is positively and significantly correlated with bank loans only for the post-amendment period, that is, 2006 and 2010 [columns (5) to (8)]. Moreover, the interaction term between CPC and period is also significant in the pooled regressions [columns (9) and (10)]. These results suggest that political connections improved access to bank loans only for 2006 and 2010. Similar results are obtained from the OLS estimations using the bank loans over total equity ratio. As shown in Table 5, a firm owned by a CPC member significantly gained more bank

loans measured by the ratio in 2006 and 2010 [columns (3) to (6)] but not in 2000 [column (1)] compared to a firm owned by a non-CPC member.

The impact of PC membership on access to bank loans follows the same pattern as that of CPC membership. Nevertheless, one notable difference exists between the two groups. In Tables 4 and 5, although insignificant for 1995 [column (2) in Table 4], similar to CPC membership, PC membership is significant in determining bank loans for 2000 [column (4) in Table 4 and column (2) in Table 5]. Moreover, the magnitude of the effects and the coefficient of the significance are larger than those of CPC membership. These results may reflect the fact that PC members are higher level elites than CPC members. Thus, they may be able to take advantage of their more prestigious position and better information in advance and in a faster manner than CPC members. When Jiang Zemin proclaimed the recognition of entrepreneurs at the beginning of 2000, a number of them may be informed about the profound political/economic meaning of such a proclamation. Thus, several entrepreneurs already moved ahead before the laws are formally changed. Moreover, given their more prestigious positions and deeper political connections, they are more likely to enjoy greater benefits than CPC members.

These results may have been driven by several other factors between the entrepreneur/firm and the government, such as a connection with the government regardless of Party membership, or inherited connections with the government in the case of privatized SOEs.[8] Two related variables are controlled in the abovementioned regressions to rule out these concerns. First, the previous working experience of the entrepreneur is controlled. This dummy variable equals to one if the entrepreneur has previously worked as a civil servant or a manager in an SOE, or has served in the army before starting up a private business. Otherwise, this variable equals to zero. Table 4 shows that having a previous experience in government-affiliated agencies increases the entrepreneur's access to bank loans for the firm in 2006 and 2010. Table 5 shows that an entrepreneur's working experience is significantly and positively associated with the firm's bank loan over equity ratio in 2006. The CPC and PC memberships of the entrepreneur show robust effects after controlling his/her previous working experience.

Second, the privatization of a firm from an SOE in 2006 and 2010 is also controlled (the data for the earlier years are unavailable). Our estimates show that the privatized firms do not seem to be different from the *de novo* firms in terms of bank loan access. Controlling this variable does not affect the impacts of the entrepreneur's CPC and PC memberships on the firm's bank loan access.

Political Connections and Firm Performance

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[8] A strong wave of privatization of SOEs in China occurred beginning from the late 1990s (Guo et al., 2010). Our concern is to determine whether these inherited relationships with the government have given privatized SOEs better access to bank loans than the other firms.

The findings in the previous section imply rent-seeking in bank credits for entrepreneurs with political connections. This study attempts to determine whether such rents can enhance a firm's production. Rent-seeking produces an unequal consequence when it enhances a firm's production, and such consequence needs to be remedied. Thus, the Chinese-style capitalism may become sustainable. Rent-seeking results in social welfare losses and little economic justification if political connections have little influence on firm performance. The prevalence of this unjustifiable rent-seeking can undermine the political support for Chinese-style capitalism.

This section explores the implications of the rents on social welfare, and attempts to ascertain whether the CPC/PC member-owned firms can perform better than the other firms. How such firms utilize their obtained bank loans in case they perform worse than the other firms is also interesting to determine.

The existing discussions on the effect of political connections on the performance of Chinese firms are divided. Fan et al. (2007) suggest that political connections can hurt firm performance, but Li et al. (2008) and Francis et Al. (2009) argue that such connections have positive impacts on firm performance. Chen et al. (2011) and Wu et al. (2012) emphasize that the effects of such political connections differ between state- and private-owned firms.[9]

The performance of private firms is measured based on their return on equity (ROE) from 1995 to 2010. The variables related to CEOs and firms, which may affect firm performance, are controlled in our regressions. The CEO's share of investment can influence firm performance through managerial incentives. Table 6 shows that in all of the four years, the political connections are not correlated with firm performance as measured by ROE. The controlled characteristics, the financing, and the CPC/PC membership of the firms and their owners do not have any significant impact on firm performance in any of the years [columns (1) to (8)] and in all of the years when the data are pooled together [columns (9) and (10)].[10]

The interaction term between bank loans and CPC/PC membership is included in the regressions to determine how political connections affect firm performance via bank loans.[11] Unsurprisingly, the interaction terms in 1995 and 2000 are insignificant [columns (1) to (4)], given that political connections could not secure bank loans at the time. The CPC and bank loan interaction term is

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[9] Most of the studies, with the exception of Li et al.'s (2008) work that measures political connections using CPC membership, consider a firm as politically connected if its CEO or Chairman is a current or former government official.

[10] The different results between this paper and that of Li et al. (2008) are likely caused by the following reasons: a) The data that we have used, which are based in 2002, are different from those that are used by Li et al. (2008). Given that the data from 2002 reflect the business environment before the Constitution change, the operations during that year should be more similar to those of 2000, and significantly different from those of 2006 and 2010. b) We have deployed more control variables than Li et al (2008). For instance, the CEO's share of investment is significant for most of the years, but Li et al. (2008) have not controlled this variable. c) Li et al. (2008) have used leverage in all of their regressions, which is likely to be correlated with CPC membership.

[11] We have found that bank loans have a positive impact on firm performance. This finding is in line with that in the existing studies (Khwaja and Mian, 2005; Claessens et al., 2008; Li et al., 2008).

negative and significant in 2006 [column (5)], but insignificant in 2010 [column (7)]. The PC and bank loan interaction term is insignificant in 2006 [column (6)], but positive and significant in 2010 [column (8)] with a small magnitude. Similar results are obtained when all of the cross-section data are pooled together [columns (9) and (10)].

Therefore, political connections do not necessarily improve firm performance. The positive effects of political connections on the performance of CPC firms after the attainment of a bank loan are found only in 2010 with a small magnitude. Questions arise when firm owners borrow more from banks without producing positive effects on the performance of their firms.

This question is addressed in this study by investigating the personal gains of the elite owners from their firms. Given that elite entrepreneurs own at least 60% of their firms' total shares of equity (Tables 2 and 3), the payment of dividends can act as an effective channel for these owners to benefit from the resources they have obtained. Most Chinese private firms do not regularly distribute their dividends because of the difficulties in accessing bank loans, which forces these companies to rely on self-financing, such as re-investing the accumulated profits of their firms. Table 7 shows the factors that may affect a firm's decision on paying dividends, particularly focusing on the political connections of the firm owners.

Our overall estimates are ascertained by pooling together all of the cross-sectional data. Columns (9) and (10) of Table 7 show that elites are more likely to pay dividends to themselves than to other entrepreneurs. Columns (1) and (2) of Table 7 show that CPC/PC memberships have an insignificant impact on the distribution of dividends in 1995. Columns (3), (5), and (7) show that in 2000, 2006, and 2010, CPC firms are significantly more likely to pay dividends than the other firms. 2000 is particularly problematic because no bank loans have been extended during that year [column (4) of Table 4 and column (2) of Table 5], and the interaction term between CPC membership and bank loan has played a negative and significant role in firm performance [column (4) of Table 6].

These findings indicate serious problems in the resource allocation of the Chinese economy. The bank loans that are given to politically connected private firms are used less efficiently than those that are given to firms without political connections. The Chinese Communist Party encourages its elites to enter the private sector to strengthen its grip on the economy and the society. However, such political influence has lessened the economic efficiency, and has been used by the elites mainly for their own benefits. Such changes in the Constitution have increased the economic rents and inefficiency because these politically affiliated elites obtain more resources without using them to improve their firms' performance. Entrepreneurs in a typical capitalist economy have the incentive to re-invest (Smith, 1776), which increases the bank loans and result in more investment. This scenario has been systematically documented all over the world. However, our findings imply that this case does not apply to Chinese politically connected entrepreneurs. Losses from distorted incentives are due to these elites' political connections and the institutional environment.

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I.   Robustness Check: Addressing Endogeneity

Different interpretations for the abovementioned correlations may exist. When Party membership is used as an independent variable, we implicitly assume its exogeneity to outcomes; however, this case is not proven to be true. The recruitment of more successful entrepreneurs into the Party is a possibility, which establishes a positive correlation between Party membership and firm performance. A number of the worst performing entrepreneurs may join the Party because they may think that their business failure may be due to their lack of political connections. Therefore, a negative correlation between Party membership and firm performance is established. If these two cases are simultaneously observed, both of their effects are cancelled out, and no difference is observed in their performance. The positive relationship between Party membership and an entrepreneur's capability raises another problem. Capable individuals may simultaneously become Party members and successful entrepreneurs. The firm's performance or bank loans are consequently affected, not by Party membership itself but by the ability that is conveyed in the variable of Party membership. We have controlled the characteristics of entrepreneurs and their capabilities as much as we can; however, certain factors are omitted.

These problems are addressed in different aspects. First, an instrument-variable approach has to be applied. Second, the data have to be directly exploited by excluding the Party member who is merely recruited after he/she has set up a private business. This aspect excludes the endogeneity that an owner of a private enterprise has become a Party member for the sole purpose of obtaining bank loans. Our estimates are sharpened by focusing on the veteran Party members or the true political elites that have remained in the Party for a long time. Third, the qualifications of the entrepreneurs who are aiming to join the Party are investigated to determine whether or not they are good entrepreneurs. Fourth, the motives of CPC/PC members in borrowing more bank loans are examined. These members' availment of such loans due to financial constraints is a somewhat justifiable action.

The instrument-variable approach measures the entrepreneurs' Party membership based on the existence of Party branches within their firms. A good instrument must satisfy two conditions, namely, relevance and exogeneity. The Party organization within the firm has satisfied these two conditions because (1) if the firm owner is a Party or PC member, he/she receives more incentives, and the establishment of a Party branch within his/her firm is facilitated (this factor is further elaborated in the following sections), and (2) dependent variables such as bank loans and firm performance are likely to be exogenous.

The CPC and the socialist ownership (i.e., no private ownership is allowed) have directed that all Chinese firms and business units must have Party branches, a rule that has been followed until the appearance of private firms in the 1990s. The fact that these firms do not have CPC grassroots branches[12] has drawn serious concerns from the Party. The CPC central committee has issued a

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[12] Only 17% of the sample private firms that are established in 2001 have Party branches. The *Financial Times* has

decree in September 2000 that requires all of the private firms to set up grassroots Party branches.[13] Therefore, if the private firm owner is a veteran Party member, he/she has to set up a Party branch in his/her own firm. The PC members who are also Party members are expected to abide by this decree because they are political elites with higher positions, which implies that they have to submit themselves more to the Party's appeals. These findings are all statistically confirmed in the first-stage regressions.

How the CPC/PC membership of the firm owners is determined by the existence of a Party branch in their firms, the instrument variable, and a set of control variables is examined in the first stage. Table 8b confirms that Party branch is highly significant in determining an owner's CPC/PC membership.[14] The same result is observed in the Wald test statistics.

Table 8a presents the estimation results of the second stage, in which the CPC/PC membership is instrumented using the predicted value of the first-stage regressions. Panel (a) of Table 8 shows that both CPC and PC memberships are positively and significantly correlated with the bank loan to equity ratio,[15] which establishes the causality that political connections ease the access to bank loans. Moreover, comparison of the 2SLS estimates [columns (1) to (4) in Table 8a] to the OLS estimates [columns (1) to (4) in Table 5] has clarified that both the statistically and economically significant levels of the 2SLS estimates are much higher than those of the OLS estimates, which indicates that the OLS estimates may underestimate the benefits of such connections.

This causality is further confirmed through our second approach, which focuses only on veteran Party members using a subsample of the data and excluding the other data. This approach eliminates from the sample all of the Party members who have joined the Party after starting their private businesses. However, the data on the veteran Party members are only available in 2006. Table 9 presents the estimation results.

Two sets of data for measuring bank loans are prepared, namely, bank loans from the four largest banks, and the total amount of bank loans. The upper panel is the result of the OLS regressions, whereas the lower panel is the result from the 2SLS regressions. The CPC/PC memberships are instrumented by the existence of Party branches in the firm. Columns (1) and (2) are for the Party members, whereas columns (3) and (4) are for the Congress members. The results imply that both CPC and PC memberships are significant in all OLS and 2SLS regressions. This outcome further

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reported in 2004 that only 1.1% of the private firms in Shanghai have Party branches.

[13] The decree is entitled, "The provisions on strengthening grassroots Party branches in private and non-state-owned enterprises [guan-yu zai ge-ti he si-ying deng fei-gong-you-zhi jingji zhuzhi zhong jiaqiang dang de jianshe gongzuo de yijian (shixing)]." It emphasizes the importance of the Party's leadership and influence in non-state-owned enterprises. This decree requests all private firms with over three CPC members to establish grassroots branches. Moreover, it appeals to the city and county Party committees to send Party representatives to firms with less than three CPC members, particularly to large private firms, to attract more people to join the Party and guide them in setting up grassroots Party branches.

[14] Summary statistics between Party organizations and their CPC/PC-member owners are presented in the Appendix.

[15] We only focused on 2006 and 2010 because the political elites have received more bank loans during these years.

confirms that the veteran Party members, who are more likely to be senior elites, obtain more bank loans than the others.

The motives of politically connected entrepreneurs in borrowing more bank loans are addressed in the next step. Party-member firm owners who are experiencing heavy financial constraints obtain more bank loans than non-Party-member firm owners to resolve their monetary troubles. The financial constraints are measured using the informal financial sector lending as a proxy, because the loans from such sector have high interest rates and plenty of associated legal risks.[16] Firms without serious financial constraints tend to avoid these high-cost, high-risk loans.

Table 10 shows the regression results for 1995, 2000, and 2006 (relevant data are unavailable for 2010). No evidence has been found to support the argument that the CPC/PC membership of the firm owners involves different informal lending activities. These firms are also proven to be more likely to distribute dividends than other firms. All of these findings indicate that CPC-affiliated firms are not experiencing heavier financial constraints than the non-CPC-affiliated firms.

The types of entrepreneurs that are recruited into the Party are lastly addressed in this study. The question of whether these Party members perform better or worse than non-Party members has been raised. Data on entrepreneurs who have expressed their intent to join the Party are collected through a survey in 2006 and 2010 using questionnaires. Table 11 shows the correlation between those who intend to join the Party and their performance, which is measured by their return-over-sales ratio (ROS) in the past years (this piece of data is the only one available for tracking down their previous performance). The issue that those who want to join the Party do not perform differently from the others has been clarified.[17]

II.   Conclusion

Most existing studies on political connections have focused on their relationships with the firm's performance in a static setting. The amendments in the Chinese Constitution from 2002 to 2004 present an important opportunity to analyze the effects of political connections on resource allocation and firm performance in a dynamic setting by comparing the events before and after the Constitution and the institutional settings have been drastically changed.

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[16] The financial sector in China is highly regulated. Almost any form of informal lending is illegal. Nonetheless, informal lending has surged as small businesses are often eschewed by the nation's major state-owned banks, which lend mainly to major SOEs (*Wall Street Journal*, March 14, 2012). According to the UBS report, the informal loans could be between two trillion yuan and four trillion yuan in total, or $316 billion to $632 billion, which is slightly less than 10% of the country's GDP in 2011. Without legal protection, entrepreneurs who borrow informal loans not only take legal risks, but also pay a reported annualized lending rate of 14% to 70% for loans (reported by Credit Suisse, September 2011).

[17] In the pooled regression shown in column (7), ROS (t-1) and ROS (t-2) are significant, but the sign and the magnitudes of the coefficients suggest that the effects are cancelled out.

Our results suggest that the politically connected entrepreneurs do not have much rent-seeking opportunities, whereas the private sector is not appreciated by the Party and the Constitution. However, the political elite entrepreneurs have been treated differently after changes have been made to the laws and institutions, although these changes may not have been formally signed into law. Rent-seeking opportunities have now become available to these entrepreneurs. These entrepreneurs have also been found to obtain more bank loans than other entrepreneurs, but the performance of their firms has not advanced despite their possession of loans. We have found instead that politically connected entrepreneurs are more likely to pay dividends to themselves than the other entrepreneurs.

The methodology of this paper uses four cross-section data, which is not only necessary in dealing with dynamics, but also reduces the omitted variable bias that frequently occurs in a single-year cross-section analysis due to the uncontrolled association between political connections and an omitted variable. The problem of endogeneity has been addressed carefully by deploying an instrument variable approach and several other approaches. Our instrument variable, the existence of Party branches within a firm, not only solves the problem of causality, but also reveals an interesting mechanism of the Party–firm relationship.

Our findings imply that the rents enjoyed by politically connected entrepreneurs result in inefficiencies and an unjustifiable collusion of economic power with the political influence in China. The implication of this phenomenon on the Chinese economic growth, the citizens, the ruling party, and social stability are important open questions that have to be addressed in future research.

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Table 1: Growth of China's Private Sector and the Share of CPC Members

Year	Private Industrial Enterprises			Share of CPC Members	
	Gross Output (100 million Yuan)	Share of GDP (%)	Share of National Industrial Output (%)	CPC Members in SOE Sector (%)	CPC Members in Private Sector (%)
1998	2082.9	2.47	3.07	32.37	2.76
1999	3244.6	3.62	4.46	32.37	2.40
2000	5220.4	5.26	6.09	31.89	2.29
2001	8760.9	7.99	9.18	32.63	1.86
2002	12950.9	10.76	11.69	31.88	1.70
2003	20980.2	15.45	14.75	29.09	3.08
2004	35141.3	21.98	17.42	28.26	3.60
2005	47778.2	25.83	18.99	27.95	3.87
2006	67239.8	31.08	21.24	27.75	4.15
2007	94023.3	35.37	23.21	27.40	4.55
2008	136340.3	43.41	26.87	27.17	4.71
2009	162026.2	47.58	29.55	-	-

Sources: *China Statistical Yearbook, 1999-*2010; Selected *Statistics of Communist Party of China, 1921-2010*, Beijing: Dangjian Duwu Press 2011

Table 2A Summary Statistics for 1995

Variables	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
	Mean	S.D	Mean	S.D.	Mean	S.D.	Mean	S.D.
Age of firm	4.32	2.64	5.9	4.26	4.53	3.66	4.61	3.72
State share (%)	1.2	5.4	1.02	4.98	0.68	3.97	0.77	4.27
CEO share (%)	89.9	23.0	87.7	25.2	92.0	20.5	91.4	21.0
Sales (RMB mil)	6.7	19.6	11.9	23.9	5.3	14.1	5.6	14.9
No. of employees	104.0	177.3	160.7	224.9	80.7	149.9	85.0	153.2
Equity (RMB mil)	2.7	7.1	4.8	10.6	2.1	6.3	2.4	6.8
Donation/ Profit (%)	2.4	3.6	2.6	3.4	2.3	3.5	2.3	3.6
Forced Fee/ Profit (%)	1.8	3.1	1.9	3.2	1.8	3.1	1.8	3.1
PR Fee/ Profit (%)	5.3	6.8	5.0	5.3	5.3	6.1	5.4	6.3
ROE	0.62	1.19	0.68	1.27	0.68	1.34	0.65	1.27
ROA	0.18	0.25	0.17	0.26	0.21	0.34	0.21	0.32

Table 2B: Summary Statistics for 2000

Variables	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
	Mean	S.D	Mean	S.D.	Mean	S.D.	Mean	S.D.
Age of firm	5.82	3.86	6.80	4.21	6.51	5.9	6.48	4.00
State share (%)	0.3	2.0	0.0	0.0	0.0	0.0	0.2	2.3
CEO share (%)	72.6	30.4	75.5	28.8	81.0	25.6	78.2	27.7
Sales (RMB mil)	18.6	39.8	28.2	49.8	9.9	26.9	15.9	37.0
No. of employees	216.3	636.6	319.3	730.2	92.5	230.9	171.1	637.2
Equity (RMB mil)	9.4	21.3	13.7	26.2	4.5	12.8	7.8	19.7
Bank loan/Equity (%)	0.6	0.9	0.7	1.0	0.3	0.7	0.5	0.8
Donation/sales (%)	0.5	1.0	0.4	0.9	0.5	1.0	0.5	1.0
Forced Fee/sales (%)	0.5	1.0	0.3	0.7	0.5	1.1	0.5	1.1
PR Fee/sales (%)	1.1	1.7	0.8	1.4	1.4	2.1	1.3	2.0
ROS	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
ROA	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.2
ROE	0.2	0.3	0.2	0.3	0.2	0.3	0.2	0.3

Table 3A: Summary Statistics for 2006

Variables	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
	Mean	S.D	Mean	S.D.	Mean	S.D.	Mean	S.D.
Age of firm	7.4	4.4	8.4	4.5	6.6	4.3	7.04	4.4
State share (%)	0.8	4.9	0.6	3.6	0.3	2.9	0.5	3.8
CEO share (%)	64.5	28.3	67.3	26.6	70.2	25.4	68.2	26.7
Sales (RMB mil)	53.9	118.6	86.9	145.7	21.4	57.3	39.2	96.8
No. of employees	209.1	423.5	357.1	548.5	106.0	262.5	157.9	348.7
Equity (RMB mil)	12.2	24.6	20.6	32.6	7.1	18.6	10.2	22.6
Bank loan/Equity (%)	0.7	1.7	0.9	1.8	0.4	1.2	0.6	1.5
Land/ Equity (%)	9.6	14.7	10.8	14.3	6.9	13.7	8.3	14.3
Donation/sales (%)	0.4	1.1	0.5	1.3	0.6	1.3	0.5	1.2
Forced Fee/sales (%)	0.5	1.4	0.5	1.6	0.8	2.0	0.7	1.7
PR Fee/sales (%)	1.1	2.5	1.0	2.5	1.6	3.2	1.4	2.9
ROS	0.1	0.2	0.1	0.1	0.1	0.2	0.1	0.2
ROE	0.3	0.6	0.4	0.7	0.3	0.5	0.3	0.6

Table 3B: Summary Statistics for 2010

Variables	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
	Mean	S.D	Mean	S.D.	Mean	S.D.	Mean	S.D.
Age of firm	8.9	4.5	10.2	4.2	7.9	4.7	8.7	4.7
State share (%)	0.4	3.8	0.3	2.8	0.2	2.8	0.3	3.3
CEO share (%)	61.7	29.5	64.3	28.7	67.3	28.2	65.2	28.8
Sales (RMB mil)	74.9	182.3	122.6	242.1	33.1	114.4	57.8	160.1
No. of employees	198.4	381.0	320.1	491.8	94.3	255.3	157.2	341.3
Equity (RMB mil)	21.8	46.8	35.6	59.9	10.1	33.1	17.4	42.5
Bank loan/Equity (%)	0.9	2.5	1.1	2.5	0.7	2.0	0.8	2.3
Land/ Equity (%)	6.6	12.2	8.1	12.8	5.9	12.8	6.3	12.5
Donation/sales (%)	0.6	1.9	0.8	2.2	0.5	1.4	0.6	1.8
Forced Fee/sales (%)	0.9	2.6	0.7	2.5	0.6	2.1	0.7	2.3
PR Fee/sales (%)	1.9	5.0	1.7	5.1	2.4	6.1	2.1	5.5
ROS	0.1	0.2	0.1	0.2	0.1	0.2	0.1	0.2
ROE	0.4	0.8	0.4	0.8	0.3	0.7	0.3	0.8

Table 4: Logit Regression on Whether the Firm Has Bank Loans

	1995		2000		2006		2010		Pooled	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Owner C.										
CPC membr	.125		.071		.191***		.146**			
	(.133)		(.081)		(.072)		(.062)			
PC membr		.018		.215**		.354***		.479***		
		(.187)		(.100)		(.080)		(.075)		
CPC*prd									.234***	
									(.070)	
PC*prd										.872***
										(.086)
Gender	-.153	-.103	-.162	-.064	-.184*	-.258***	-.027	-.012	-.279***	-.292***
	(.157)	(.164)	(.101)	(.124)	(.104)	(.099)	(.089)	(.095)	(.087)	(.092)
Edu	.017	.030	-.018*	-.006	.005	.005	.008	-.002	.025**	.018
	(.019)	(.021)	(.011)	(.015)	(.014)	(.013)	(.012)	(.013)	(.011)	(.012)
Age	-.009	-.006	-.009**	-.012**	-.009*	-.008*	-.004	-.001	-.008**	-.007*
	(.006)	(.006)	(.004)	(.005)	(.004)	(.004)	(.004)	(.004)	(.004)	(.004)
Owner shr	-.006***	-.005*	-.012	.026	.000	.000	.001	.000	-.012***	-.011***
	(.002)	(.002)	(.124)	(.158)	(.001)	(.001)	(.001)	(.001)	(.001)	(.001)
Owner exp	.032	-.040	.060	.035	.148**	.187***	.243***	.293***	.289***	.327***
	(.175)	(.194)	(.071)	(.088)	(.074)	(.070)	(.091)	(.010)	(.069)	(.072)
Firm C.										
Age	.022	.012	-.015*	-.016	.026***	.024***	.028***	.025***	.068***	.061***
	(.014)	(.015)	(.008)	(.010)	(.010)	(.009)	(.007)	(.008)	(.007)	(.007)
Size	.005	.004	.004***	.006***	.032	.030	.020	.020	-.011	-.100
	(.003)	(.003)	(.001)	(.002)	(.005)	(.005)	(.003)	(.003)	(.006)	(.006)
Org	.036	-.027	.172**	.135	.147*	.099	.217***	.204**	.249***	.201***
	(.114)	(-.126)	(.069)	(.087)	(.082)	(.079)	(.076)	(.081)	(.066)	(.071)
Privtz					.008	.037	-.215*	-.279*		
					(.127)	(.125)	(.129)	(.146)		
Ros (lagged)					-.128	-.119	.133	.083		
					(.089)	(.086)	(.164)	(.176)		
Control V.										
Prd									-.172*	-.096
									(.088)	(.091)
Ind. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reg. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Const	.067	-0.196	1.291***	1.360***	.238	.190	-.102	-.135	.748***	.546**
	(.463)	(.501)	(-.307)	(-.402)	(.354)	(.343)	(.303)	(.328)	(.253)	(.268)
N	997	860	1865	1252	1707	1819	2135	1896	6302	5666
pseudo R^2	.047	.047	.037	.038	.113	.114	.116	.139	.125	.130

Table 5: OLS Regression on Bank Loan over Equity Ratio

	2000		2006		2010		Pooled	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Owner chrtcs								
CPC membr	.072		.403***		.316*			
	(.076)		(.145)		(.184)			
PC membr		.507***		.551***		.740***		
		(.087)		(.154)		(.203)		
CPC * prd							.345***	
							(.100)	
PC * membr								.678***
								(.114)
Gender	-.170	-.058	-.279	-.342	-.059	-.194	-.282**	-.392***
	(.117)	(.136)	(.220)	(.210)	(.277)	(.285)	(.137)	(.145)
Edu	-.025**	-.025*	.034	.045*	.047	.053	.023	.033*
	(.013)	(.015)	(.028)	(.027)	(.036)	(.037)	(.017)	(.018)
Age	-.008*	-.011**	-.027***	-.021**	-.021*	-.019	-.016***	-.015**
	(.004)	(.005)	(.009)	(.009)	(.012)	(.012)	(.006)	(.006)
Owner shr	-.216*	-.206	.001	.001	.003	.002	.001	.001
	(.118)	(.145)	(.003)	(.003)	(.003)	(.003)	(.002)	(.002)
Owner exp	.051	.126	.363**	.421***	.421	.585**	.228**	.336***
	(.069)	(.081)	(.149)	(.140)	(.259)	(.270)	(.098)	(.103)
Firm chrtcs								
Age	-.020**	-.027***	.042**	.036*	.103***	.093***	.059***	.053***
	(.008)	(.009)	(.020)	(.019)	(.021)	(.022)	(.010)	(.010)
Size	.023***	.017*	.047***	.041***	.027***	.023***	.031***	.028***
	(.008)	(.010)	(.007)	(.007)	(.005)	(.005)	(.003)	(.004)
Org	.141**	.101	.296*	.274*	.383*	.310	.327***	.267**
	(.070)	(.083)	(.169)	(.163)	(.231)	(.241)	(.101)	(.109)
Privtz			.034	.075	-.462	-.554		
			(.250)	(.246)	(.369)	(.397)		
ROS			.075	.066	-1.119**	-1.096**		
			(.179)	(.172)	(.516)	(.531)		
Control vars								
Prd							-.934***	-.802***
							(.174)	(.183)
Ind. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reg. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Const	1.531***	1.201***	-.505	-.873	-1.287	-1.347	.222	-.084
	(.309)	(.371)	(.712)	(.688)	(.899)	(.938)	(.381)	(.407)
N	1031	726	1715	1827	1922	1733	4980	4571
pseudo R^2	.034	.056	.044	.042	.026	.030	.025	.029

Table 6: Party-member owners and their firms' performance (ROE)

	1995		2000		2006		2010		Pooled	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Owner C.										
CPC membr	-.119		.012		.013		-.001		-.006	
	(.152)		(.034)		(.031)		(.036)		(.022)	
PC membr		-.003		-.077		.009		-.049		-.035
		(.201)		(.044)		(.036)		(.042)		(.023)
Gender	.081	.072	.121***	.122**	.075*	.054	.087*	.102**	.086***	.089***
	(.143)	(.150)	(.046)	(.057)	(.042)	(.041)	(.047)	(.049)	(.027)	(.028)
Edu	-.037**	-.044**	-.005	-.007	.009	.005	.008	.015**	.007*	.008**
	(.018)	(.020)	(.005)	(.006)	(.006)	(.005)	(.007)	(.007)	(.004)	(.004)
Age	-.006	-.008	-.001	.001	.000	-.001	-.003	-.003	-.001	-.001
	(.005)	(.006)	(.002)	(.002)	(.002)	(.002)	(.002)	(.002)	(.001)	(.001)
Owner shr	-.004*	-.005*	.086*	.023	.001	.000	.001	.000	.001***	.001*
	(.002)	(.002)	(.046)	(.059)	(.001)	(.001)	(.001)	(.001)	(.000)	(.000)
Owner exp	.164	.221	.007	-.016	-.024	-.036	-.052	-.063	-.030	-.040*
	(.171)	(.187)	(.026)	(.033)	(.030)	(.029)	(.049)	(.050)	(.021)	(.022)
Firm C.										
Age	.066***	.066***	-.003	-.002	-.005	-.004	-.005	-.004	-.005**	-.003
	(.013)	(.015)	(.003)	(.004)	(.003)	(.003)	(.004)	(.004)	(.002)	(.002)
Size	.000	.001	.009***	.011***	.005***	.006***	.007***	.007***	.007***	.007***
	(.003)	(.004)	(.003)	(.004)	(.001)	(.002)	(.001)	(.001)	(.001)	(.001)
Org	-.328***	-.412***	.008	.024	-.051	-.063*	-.155***	-.158***	-.079***	-.078***
	(.109)	(.121)	(.027)	(.033)	(.033)	(.033)	(.041)	(.042)	(.021)	(.022)
Privtz					-.126**	-.140***	-.021	-.025		
					(.051)	(.051)	(.070)	(.075)		
Land	-.026	-.031	.002	-.002	-.001	-.001	-.001	-.000		
	(.096)	(.104)	(.028)	(.034)	(.001)	(.001)	(.001)	(.001)		
Loan & (C)PC										
Bank Loan	-.176	-.058	-.021	-.026	.171***	.115***	.080***	.064***	.093***	.081***
	(.137)	(.143)	(.021)	(.026)	(.013)	(.011)	(.009)	(.009)	(.006)	(.006)
Loan*CPC	.314		.046		-.077***		.020		-.006	
	(.324)		(.043)		(.018)		(.012)		(.009)	
Loan*PC		-.558		.042		.029		.051***		.036***
		(.506)		(.051)		(.019)		(.015)		(.011)
Control V.										
Yr. Eff.									Yes	Yes
Ind. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reg. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Const	1.634***	1.802***	.192	.153	.097	.265**	.335**	.208	.249***	.131
	(.455)	(.496)	(.123)	(.152)	(.139)	(.135)	(.160)	(.165)	(.080)	(.093)
N	799	707	808	568	1594	1696	1996	1815	4722	4344
R^2	.081	.090	.048	.061	.169	.150	.130	.138	.008	.122

Table 7: Logit Regressions on Whether the Firm Distributed Dividends

	1995		2000		2006		2010		Pooled	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Owner C.										
CPC membr	-.066		.204*		.181**		.186***		.250***	
	(.122)		(.112)		(.075)		(.063)		(.065)	
PC membr		.140		.159		-.026		.360***		.292***
		(.164)		(.141)		(.083)		(.077)		(.077)
Gender	.098	.089	-.189	-.272	-.066	-.098	.038	-.013	.020	-.040
	(.129)	(.135)	(.159)	(.202)	(.102)	(.099)	(.084)	(.089)	(.085)	(.090)
Edu	.000	-.009	.033*	.015	-.033**	-.032**	-.017	-.024*	-.006	-.021*
	(.017)	(.018)	(.018)	(.022)	(.014)	(.013)	(.012)	(.013)	(.011)	(.012)
Age	.000	-.003	-.005	.000	-.003	-.002	-.011***	-.010***	-.008**	-.007*
	(.005)	(.005)	(.006)	(.007)	(.005)	(.004)	(.004)	(.004)	(.004)	(.004)
Owner shr	.000	-.001	-.671***	-.657***	-.008***	-.008***	-.002**	-.004***	-.006***	-.007***
	(.002)	(.002)	(.176)	(.215)	(.001)	(.001)	(.001)	(.001)	(.001)	(.001)
Owner exp	-.088	-.092	.082	.099	-.077	-.020	.173*	.266***	.074	.132*
	(.160)	(.173)	(.102)	(.127)	(.077)	(.072)	(.090)	(.095)	(.074)	(.077)
Firm C.										
Age	.020*	.011	-.009	-.024*	.009	.005	.012*	.006	.014**	.005
	(.012)	(.013)	(.012)	(.014)	(.008)	(.008)	(.007)	(.007)	(.007)	(.007)
Size	.004	.004	.013	-.001	.002	.003	.005***	.003*	.000	.000
	(.003)	(.003)	(.013)	(.015)	(.004)	(.004)	(.002)	(.002)	(.000)	(.000)
Org	-.023	-.027	.339***	.357***	.088	.147*	-.028	-.005	.208***	.217***
	(.103)	(.112)	(.100)	(.124)	(.084)	(.081)	(.075)	(.081)	(.068)	(.073)
Privtz					.012	.040	.201	.076		
					(.134)	(.132)	(.130)	(.142)		
Control V.										
Yr Eff.									Yes	Yes
Ind. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reg. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Const	-.542	-.227	.182	-.007	.986***	.945***	.529*	.646**	.390	.717**
	(.421)	(.453)	(.457)	(.557)	(.340)	(.330)	(.292)	(.312)	(.281)	(.296)
N	927	794	824	561	1556	1643	1989	1791	5329	4817

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Table 8: 2SLS regressions for bank loan over equity

(a) Second stage regression

	2006		2010	
	(1)	(2)	(3)	(4)
Owner C.				
CPC membr	2.762***		5.393***	
	(.596)		(1.502)	
PC membr		4.358***		4.611***
		(.942)		(1.193)
Gender	-.192	-.507*	.500	-.253
	(.259)	(.271)	(.385)	(.338)
Edu	.011	.015	-.046	-.001
	(.032)	(.034)	(.052)	(.046)
Age	-.056***	-.036***	-.071***	-.036**
	(.012)	(.011)	(.022)	(.016)
Owner shr	.003	.000	.012***	.003
	(.003)	(.003)	(.004)	(.004)
Owner exp	-.267	.347**	-.424	.456
	(.233)	(.174)	(.412)	(.315)
Firm C.				
Age	.038*	.017	.115***	.031
	(.022)	(.024)	(.028)	(.031)
Size	.041***	.002	.023***	.008
	(.008)	(.013)	(.006)	(.007)
Org	.047	.050	-.183	-.131
	(.205)	(.215)	(.333)	(.322)
Privtz	-.385	.296	-1.527***	-1.230**
	(.291)	(.301)	(.538)	(.484)
ROS('07)	.041	.267	-1.642**	-1.687**
	(.203)	(.219)	(.691)	(.665)
Control				
Ind. eff.	Yes	Yes	Yes	Yes
Reg. eff.	Yes	Yes	Yes	Yes
Const	.591	-.552	.384	-.270
	(.834)	(.856)	(1.239)	(1.164)
N	1523	1614	1648	1480
chi^2	160.6	142.7	113.4	123.8

(b) First stage regression

Dep.V	2006		2010	
	(1) CPC	(2) PC	(3) CPC	(4) PC
Owner C.				
Gender	-.033	.067**	-.099***	.029
	(.037)	(.032)	(.036)	(.035)
Edu	.004	.004	.011**	.005
	(.005)	(.004)	(.005)	(.005)
Age	.009***	.002*	.010***	.004**
	(.002)	(.001)	(.002)	(.002)
Owner shr	-.001**	.000	-.001**	.001*
	(.001)	(.000)	(.000)	(.000)
Owner exp	.237***	-.001	.166***	.033
	(.0257)	(.022)	(.034)	(.034)
Firm C.				
Age	-.003	.002	-.006*	.011***
	(.003)	(.003)	(.003)	(.003)
Size	-.001	.008***	-.000	.002***
	(.001)	(.001)	(.001)	(.001)
Privtz	.094**	-.103***	.151***	.101**
	(.042)	(.038)	(.047)	(.048)
ROS('07)	.010	-.056*	.096	.107
	(.030)	(.027)	(.069)	(.067)
Org	.004	.011	.053	.069**
	(.030)	(.027)	(.033)	(.032)
Ins.V.				
Party org	.285***	.190***	.165***	.199***
	(.026)	(.023)	(.026)	(.026)
Control				
Ind. eff.	Yes	Yes	Yes	Yes
Reg. eff.	Yes	Yes	Yes	Yes
Const	-.190	.054	-.230*	-.153
	(.122)	(.109)	(.121)	(.120)
Wald test stats	16.51	17.33	12.56	11.22

Table 9: Veteran CPC-member owners & access to bank loan, 06

(a) OLS estimation

	(1) Bank loan from Big 4	(2) Total bank loan	(3) Bank loan from Big 4	(4) Total bank loan
CPC membr	.527*** (.141)	.445*** (.155)		
PC membr			.632*** (.142)	.564*** (.160)

(b) 2SLS estimation

	(1) Bank loan from Big 4	(2) Total bank loan	(3) Bank loan from Big 4	(4) Total bank loan
CPC membr	2.980*** (.570)	2.885*** (.617)		
PC membr			4.450*** (.886)	4.614*** (1.006)

Notes: Estimations were conducted with the full set of the explanatory variables used in Table 7 but presented without the results on the other variables for the sake of the space. In 2SLS, as in Table 7, party organization was used as an instrument variable. The F-statistic of the first stage regression exceeds 15. The full results are available upon the request.

Table 10: Logit Regressions on Whether the Firm has Informal Loans

	1995		2000		2006		Pooled	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Owner chrcts								
CPC membr	.110		.035		-.022		.078	
	(.132)		(.077)		(.124)		(.102)	
PC membr		.207		-.036		.017		-.008
		(.178)		(.094)		(.136)		(.123)
Gender	-.248	-.196	-.235**	-.275**	-.119	-.083	-.409***	-.402**
	(.162)	(.168)	(.104)	(.127)	(.191)	(.175)	(.144)	(.161)
Edu	.032*	.034	.000	-.017	-.045**	-.051**	.000	-.018
	(.019)	(.021)	(.009)	(.015)	(.023)	(.022)	(.014)	(.018)
Age	.017***	.015**	-.009**	-.009*	-.002	-.002	-.001	-.000
	(.006)	(.006)	(.004)	(.005)	(.008)	(.007)	(.005)	(.006)
Owner shr	-.002	-.000	-.467***	-.381**	.002	.002	-.001	.001
	(.002)	(.003)	(.117)	(.148)	(.002)	(.002)	(.003)	(.003)
Owner exp	.095	.235	.172**	.160*	.342***	.316***	.299***	.315***
	(.166)	(.175)	(.068)	(.084)	(.126)	(.115)	(.095)	(.111)
Firm chrcts								
Age	-.026*	-.026*	.000	.010	-.028*	-.024*	-.021*	-.014
	(.015)	(.016)	(.008)	(.010)	(.015)	(.014)	(.011)	(.013)
Size	-.001	-.001	-.031***	-.016	.000	.000	.000	.000
	(.004)	(.004)	(.010)	(.012)	(.006)	(.006)	(.001)	(.001)
Org	-.043	-.025	.027	.092	.231	.182	.081	.167
	(.115)	(.126)	(.067)	(.084)	(.147)	(.137)	(.089)	(.105)
Privtz					.140	.130		
					(.192)	(.190)		
Control vars								
Yr Eff.							Yes	Yes
Ind. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reg. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Const	-1.562***	-1.971***	.508*	.390	-1.104**	-1.021*	-1.305***	-1.656***
	(.464)	(.512)	(.289)	(.382)	(.561)	(.537)	(.457)	(.525)
N	1135	966	1824	1227	2027	2178	5044	4426
pseudo R^2	.029	.027	.031	.029	.054	.051	.169	.178

Table 11: Who Has Applied for Joining the Party?

	2006			2010			Pooled
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Firm perf							
ROS (t-1)	.447*			.024			.559**
	(.247)			(.158)			(.257)
ROS (t-2)		-.043			-.217		-.546***
		(.112)			(.173)		(.167)
ROS (2000)			.087			-.198	
			(.112)			(.205)	
Owner chrtcs							
Gender	.253**	.218*	.220*	-.111	-.100	-.050	.009
	(.119)	(.114)	(.114)	(.092)	(.095)	(.099)	(.127)
Edu	.070***	.075***	.075***	-.008	-.008	-.008	.031*
	(.018)	(.017)	(.017)	(.014)	(.014)	(.015)	(.019)
Age	-.007	-.005	-.005	-.017***	-.018***	-.016***	-.027***
	(.006)	(.006)	(.007)	(.004)	(.005)	(.005)	(.006)
Owner shr	-.003*	-.003	-.002	-.003**	-.003**	-.003**	-.004**
	(.002)	(.002)	(.002)	(.0011)	(.001)	(.001)	(.002)
Owner exp	.120	.084	.092	-.205	-.172	-.246*	-.032
	(.102)	(.098)	(.098)	(.139)	(.139)	(.146)	(.143)
Firm chrtcs							
Age	.019*	.014	.019*	-.017**	-.014*	-.015*	-.009
	(.011)	(.012)	(.010)	(.008)	(.008)	(.009)	(.012)
Size	.004	.003	.004	.001	.001	-.001	.001
	(.005)	(.005)	(.005)	(.003)	(.003)	(.003)	(.004)
Org	-.330***	-.313***	-.292***	.044	.032	.074	-.197*
	(.102)	(.098)	(.099)	(.083)	(.086)	(.090)	(.112)
Privtz	.151	.114	.141	-.113	-.091	-.218	.047
	(.223)	(.219)	(.221)	(.231)	(.235)	(.250)	(.159)
Control vars							
Yr Eff.							Yes
Ind. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reg. Eff.	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Const	-1.300***	-1.343***	-1.478***	1.229***	1.302***	1.212***	1.682***
	(.441)	(.442)	(.427)	(.335)	(.343)	(.363)	(.472)
N	1279	1363	1361	1421	1355	1240	2548
pseudo R2	.050	.042	.043	.025	.024	.025	.123

Appendix

Table A1: Definition of variables

	Variables	Definition
Dependent variable	Bank loan	A dummy variable that equals to one if the firm has bank loans at the time of the survey and equals to zero if otherwise
	Bank loan/ Equity	The ratio of the bank loans to total equity of the firm in the survey year
	ROE	the return over equity of the firm in the survey year
	Dividends	a dummy variable that equals to one if the firm distributed dividends in the previous year and equals to zero if otherwise
	CPC application	a dummy variable that equals to one if the entrepreneur has submitted an application to join CPC (2006 survey) or has the desire to join CPC (2010 survey) at the time of survey and equals to zero if otherwise
Independent variable – owner characters	CPC membership	a dummy variable that equals to one if the entrepreneur of the firm is a CPC member at the time of the survey and equals to zero if otherwise.
	PC membership	a dummy variable that equals to one if the entrepreneur of the firm is a PC member at the time of the survey and equals to zero if otherwise.
	Gender	a dummy variable that equals to one if the entrepreneur is a female and equals to zero if otherwise
	Education	the total schooling years of the entrepreneur
	Age	the age of the entrepreneur at the time of the survey
	Owner share	the percentage of equity held by the entrepreneur in total shares
	Owner experience	a dummy variable that equals to one if the entrepreneur once worked as a civil servant or a manager of a SOE firm, or, served in army before he/she started this business and equals to zero if otherwise.
Independent variable – firm characteristics	Age	the age of the firm at the time of the survey
	Size	the total sales of the firm in the survey year
	Organization	a dummy variable that equals to one if the firm is a limited liability company and equals to zero if otherwise
	Privatization	a dummy variable that equals to one if the firm was privatized from a State-owned enterprise and equals to zero if otherwise
	ROS	the return over sales of the firm
Independent variable – other characteristics	CPC branch	a dummy variable that equals to one if the firm has a CPC branch at the time of survey
	Informal loan	a dummy that equals to one if the firm has borrowed from informal lending at the time of survey and equals to zero if otherwise (only for 1995, 2000, 2006).