The Political Economy of Private Firms in China[1]

(very preliminary)

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Abstract

Since taking off in the late 1990s the Chinese private sector becomes the largest sector in Chinese economy. Many CPC members became owners of private firms, and become very rich. This paper explores the dynamics when the CPC changes from anti- to pro-capitalism. Specifically, the following questions are addressed using nationwide sampling survey datasets for 1995-2010. Did party-member entrepreneurs enjoy rents at different periods of time? What are the dynamics of the rent-seeking activities of these party-member entrepreneurs? What is the impact of the rents on the performance of their firms? Endogeneity problems are addressed.

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

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

-- Liang Wengen (12 Nov 2012, *Guangming Daily)*

Founder and CEO of the Sany Group

The richest person in China in 2011

Deputy of the 17th,18th CPC National Congress

I. Introduction

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 counted for zero percent of the Chinese GDP. But the reform has changed, the CPC constitution was amended again[2], the state constitution was changed (2004), the institutions were changed. Party members are encouraged to do private business. As a result, now private sector counts for more than half of the Chinese GDP. Moreover, ironically, most of the richest people in China are Communist Party members and many of those are selected (not elected) to the People's Congress, the legislator. Yet most striking phenomenon is that China's National People's Congress becomes far the wealthiest in the world, even with a highly incomplete and heavily underestimated data about these elites. The total wealth of the richest 70 People's Congress members in China is US$90 billion, which is 12 times that of the total wealth of all the members in the Congress, the Supreme Court and the White House of the U.S., which is US$7.5 billion (Bloomberg, 27/2/2012).

The central question to be addressed by this paper is the following. Comparing with non-political elite entrepreneurs, do political elite entrepreneurs enjoy rents when they enter the private sector in the old anti-capitalism regime? And what is the answer for the same question but in the new pro-capitalism regime? Addressing these questions will reveal the dynamics of rent creation from political connections associated with the changes of laws and institutions. Since the Party is the dominant force both in politics and in the national economy in China (next section will elaborate this point), political connections in this paper are captured by a membership of the Communist Party of China (CPC) or a People's Congress (PC)

[2]"We must and we are determined to encourage, support and guide the development of the non-public sectors of the economy…' ' non-public sectors are important elements of the socialist market economy…"(*Jiang Zhemin Speech at the 16th CPC National Congress, 2002*)

membership.[3] And we use the terms "political connection" and "political elites" interchangeably. This paper will identify the causality of rents and private entrepreneurs' political connections, and will explore the implications of these political elites' rents for social welfare in terms of productivity.

There is an extensive literature on the relationships between political connections and economic variables. A group of economists investigate the economic value of political connections. In a seminal paper, Fisman (2001) finds that the Suharto's health-related events caused significant loss in the return on the price of the securities of politically connected firms. By extending the scope of investigation to 47 countries, Faccio (2006) suggests that the announcement of entering politics by officers or large shareholders of a company is positively associated with cumulative abnormal return which varies depending upon political power. This line of research applied to various countries in different settings: 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 looks at 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 percent more but they are more likely to default by 50 percent in comparison with ones without political connections. Johnson and Mitton (2003) and Faccio, Masulis and McConnell (2006)'s findings support that political connections affect government or bank decisions. The former presents results that the decision on government subsidies is associated with political connections while 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) find that joining the Party at earlier careers makes the difference. In more detail, those who have become a party member at early time of their careers are found to have significantly higher chances to become social elites while those who are already successful before joining the Party would not make the difference in their career by joining the Party. Bian (2001) suggests that everything being equal, i.e. controlling for talents and education/experience backgrounds etc., Party members have higher chances than non-Party members to become top managers in state-owned firms. By investigating the changes after the massive purges of the "Cultural Revolution", Walder and Hu (2009) find that party elites, particularly their offspring, recovered much more quickly than others.

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[3] A PC member may not be a CPC member, but he/she must be pro-CPC since all the PC members are selected by the CPC. Moreover, statistically a PC member is at higher level elite than an average CPC member.

Political connections and their associated economic performance among Chinese firms have attracted attention from economists. Using the listed firms, Fan et.al (2007) show that firms with politically connected top executives of newly partially privatized firms are less efficient than others in terms of post-IPO performance. In contrast, Peng and Luo (2007) and Francis et.al (2009) use listed data to show that political ties are beneficial to firms in terms of obtaining resources but these are efficiency enhancing. Li et al. (2008) find the positive effect of political connection 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: performance of SOEs is negatively affected while that of private firms little or positively by political connections. Unlike works using cross sectional differences among Chinese firms, Calomiris, Fisman and Wang (2010) apply the event study method to firm level data, and find that the policy announcement of the sale of government-owned shares received a negative response in stock markets but the cancellation of such policy a symmetric a positive response.

Our project complements the literature in the following ways: First, it is the first paper that studies the dynamics of political economy of Chinese private firms. Our approach provides a more credible identification of the impact of political connections on firm performance by showing that it depends critically on institutional settings, more specifically the change in the Constitution. To our best knowledge, none of the current literature except Calomiris, Fisman and Wang (2010) looks at dynamics of the effects of political connections on economic variables.[4] Second, this 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 deal with reversed causality. We also show evidence about those who want to join the Party to further resolve the identification problem. Finally, the data we use, many years of nationwide random sampling survey firm level data of Chinese private sector in the years of 1995, 2000, 2006 and 2010, is unique in the literature.

Our major findings are summarized in the following. First, the Party social elites did not enjoy statistically detectable rents before the amendment in Constitutions in 2002-2004. However, following the change in 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 a form of dividends.

The rest of the paper is organized as follows. In Section II, we discuss the institutional background about the Communist Party vis-à-vis the private sector. Section III discusses institutional background surrounding the amendment in the Constitution. Section IV

[4]A main difference between our paper and Calomiris, Fisman and Wang (2010) is that we look at a more fundamental change in Constitution on private property rights while the latter focuses on policy change on the sales of government-owned shares while. 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 do not need such assumptions.

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

II. Institutional Background

It is well documented that 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, like the CEOs and presidents of the major banks and largest state-owned enterprises. Almost 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 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 county, mostly through influences of selecting members of the congress. Literally, all non-party congress members must be party-trusted persons.

The Communist Party launched economic reform 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 private sector and privatization occurred after the mid-1990s when the state sector was in deep trouble (Xu, 2011). Once had a chance to grow, the private sector took off rapidly. From 1998 to 2005 the output of private sector increased by 20 times, and the share of the private sector in total GDP increased from only 2.5% in 1998 to nearly 50% in 2009, so it becomes the largest sector in the Chinese economy.

Becoming the major engine of Chinese economy out of reform agenda, the very fast growth of private sector surprised the party. From 1998 to 2002, when the private sector has expanded by six folds, the Party's presence in terms of the number of members in the private sector was shrinking. The official nationwide statistics shows, the share of the party membership in the private sector declined by more than 36%, from 2.8% in 1995 to 1.7% in 2002 (Table 1). This is echoed by the fact that in the year 2000 only 17% of private firms in our sample have party organizations within the firm.[5]

These conflicting consequences between a fast economic growth resulted from the abrupt progress of private economy and the sign of the ruling party's losing representation in the private sector are due to the self-conflicting institutions, which put private business in an

[5]In 2004 the Financial Times reported that in Shanghai only 1.1% of the private firms had party organizations. One should keep in mind that the average size of the firms in our sample is larger than the average size of the firms in the population, thus it is over representing the firms which have established party branches.

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, the Chairman of the Party and the President of the state, challenged the constitutions of the party and the state. In his inspection tour in Guangdong province at the beginning of year 2000, he proclaimed that entrepreneurs should be recognized as "advanced productive force" (The CPC Maoming City Propaganda Department, 2002)[6], that party members should be encouraged to become entrepreneurs and the Party should legitimately recruit entrepreneurs in a large scale. Two years later at the 16th National Congress of the Chinese Communist Party this principle is 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 is the first time in the international communist movement history that capitalists are explicitly embraced by a communist party both ideologically and organizationally. This change not only reflects the Chinese Communist Party's recognition of the growing importance of the private sector to China's economy, but more importantly, it is a change of institution, and a change of business environment.

It is well-publicized that a large number of party elites have entered the private sector since the changes of constitutions. Our data confirms this (Table 3). It is also widely reported or alleged that political elites benefit from the political connections they have to obtain scarce resources when they become private entrepreneurs. Furthermore, many non-party member entrepreneurs under the new environment might love to be recruited by the party-state (either joining the party or try hard to become a congressman), since by doing so they may improve their chances of accessing scarce resources.

The central question to be addressed by this paper is 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 first question is, comparing with commoners do political elites enjoy rents when they enter the private sector in the old regime and in the new regime? How did the relationship between political connections and economic rents evolve from the old regime to the new regime?

From our data, which are collected from nationwide random sampling surveys over 15 years, we find in the period of 1995 and 2000, the Party social elites did not enjoy statistically detectable rents. Controlled for all other factors (e.g. characteristics of individual, firm, industry and location etc.), the resources (such as bank loans) that they obtained are not different from other entrepreneurs. However, the political rent became significant. In 2006 and 2010 firms owned by Party members associated social elites obtained significantly more bank loans than others.

[6] The term "productive force" is a central concept in Marxism. The productive forces consist of 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 data set used in this paper is four cross-sectional surveys on 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 which involved economists and sociologists from the CAAS and some 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 is the largest of this kind in China that it has traced the development of the private sector nationwide since the sector emerges from scratch.

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

Tables 3A, 3B, 4A, and 4B are the summary statistics of the firms' financial data over the four survey years. The statistics show that by average firms owned by CPC or PC members are larger than those by non CPC/PC owners in terms of sales, number of employees, and the value of equity for all the years. It is also noteworthy that by average CPC member owners and PC member owners obtain more bank loans (measured by bank loan to equity ratio) than other owners for the years of 2006 and 2010.

Table 5 is the summary statistics of entrepreneurs' perceptions about the Party. Each variable in the table is a response to a survey question. The table shows that from 1995 to 2000, the perception of entrepreneurs who regards being a CPC member helpful in improving his/her status declined from 17.9% to 7.8%. From the point of view of the party's leadership, this decline is worse than a bad news. Given the rapid expansion of the private sector and the drastic deterioration of the private entrepreneurs' perceptions about the party, this must be frightening. However, the trend is changed in 2006. The perception of entrepreneurs who believe being a party member jumped to 35.5%. A similar change of trend is also found for the value of PC membership. In parallel to the above-mentioned phenomenon, the proportion of the entrepreneurs who have a desire to join the party dropped from 23.6% in 1995 to 14.2% in 2000; but showed an upturn to 24.5% in 2006, and further increased to 48% in 2010.

IV. Political Connections, Rents, and Firm Performance

Political Connections and Rents

The amendments of the Constitution of the party (the CPC) in 2002[7] and of the Constitution of the state (the PRC) in 2004[8] have transformed institutional settings for economic agents in China. Before the amendments, private entrepreneurship was not legal by state constitution and was in direct conflict with the party's ideology and constitution. Chinese private enterprises were formally discriminated against state-owned ones in terms of access to bank loan and land (Brendt and Li, 2003). For anyone with political capital, e.g. a PC member or a veteran party member working in a government agency or SOE, consider to convert his/her –self to become a private entrepreneur, he/she needed to weigh between the political/economic risks and economic gains, which might be temporary.

In contrast, after the amendments of the two constitutions, when private entrepreneurship becomes legitimate and is encouraged, the risks and benefits for becoming an entrepreneur might be changed, at least formally. Moreover, given the monopolistic position of the government in controlling resources, those PC members or veteran party members might gain access to resources from their political connections. Hence, we hypothesize that, the years of 2003-2004 is a turning point that political connections became a significant factor in determining business advantages for those with connections, whereas was unlike before the period.

One of the important advantages in running businesses in China is access to bank loans. On the one hand, the majority of the bank loans are issued by the State-owned banks and the interest rates are set by the government. In this case, it means the government has a lot say on the allocation of the credit. On the other hand, 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 from 2004 (Lardy, 2012). Consequently, whoever is able to obtain bank loans enjoys the rent, enjoys subsidies. In order to test whether a significant change occurred after the amendment in the Constitution, we regressed "access to bank loans" on "CPC/PC membership". The cross-section estimations were made using the four different datasets or part of them collected in 1995, 2000, 2006 and 2010. The definitions of the variables used in estimations are presented in Appendix (Table A1).

We measure political connections by CPC and PC membership, and estimate the effects of CPC/PC memberships on bank loans employing two different variables relative to bank loan. The first dependent variable is derived from the answer to the question on whether the firm has bank loans. The second one is a measurement of amount of loans borrowed from

[7] The key of this amendment is to recognize private entrepreneurs' legitimate social status and encourage private entrepreneurship.

[8] The key of this amendment is to recognize and protect private ownership, including private businesses.

banks, measured by the ratio of total bank loans over the value of total equity. The former variable is available for all the four years while the latter only for the years of 2000, 2006 and 2010. Tables 6 and 7 show the estimation results using the two dependent variables respectively. In each table, we conduct regressions using yearly data but also using 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 6 indicates that CPC membership is positively and significantly correlated with bank loan only for the post-amendment period, i.e. years of 2006 and 2010 (columns (5)-(8)). Moreover, the interaction term between CPC and period is also significant in the pooled regressions (columns (9) and (10)), suggesting that political connections resulted in better access to bank loan only for the period of 2006 and 2010. Similar results are obtained from OLS estimations using the bank-loan over total-equity ratio.[9] As shown in Table 7, a firm owned by a CPC member gained significant more bank loans measured by the ratio in 2006 and 2010 (columns (3)-(6)) but not in 2000 (column (1)) comparing to a firm owned by non-CPC member.

Although the PC member entrepreneurs follow the same pattern as the CPC member entrepreneurs, there is one notable difference between the two groups. In both Tables 6 and 7, although insignificant for the year 1995 (column (2) in Table 6), the same as for CPC membership, PC membership is significant in determining bank loans for the year 2000 (column (4) in Table 6 and column (2) in Table 7). 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 might be able to take advantage of their prestigious position and information earlier and faster than CPC members. When Jiang Zemin proclaimed recognizing entrepreneurs at the beginning of year 2000, many of them might be informed about the profound political/economic meaning of this. Thus, some of them already moved ahead before the laws are formally changed. Moreover, with more prestigious position and deeper political connections they are more likely to enjoy greater benefits than CPC members.

It is a natural concern that our results might also be driven by some other factors between the entrepreneur/firm and the government, e.g. a connection with the government regardless of party membership or connections with the government inherited in the case of privatized former SOEs.[10] In order to rule out these concerns, in the above-mentioned regressions we controlled two related variables. First, we controlled the previous working experience of the entrepreneur. This is a dummy variable that equals to one if the entrepreneur once worked as a civil servant or a manager in a SOE, or, served in the army before he started up the private business and equals to zero if otherwise. As shown in Table 6, indeed, having worked in

[9] The data for this ratio is not available for the year of 1995. Hence, we use the data from the remaining three surveys, namely, ones in 2000, 2006, and 2010.

[10] Staring from the late 1990s, there has been a strong wave of privatization of SOEs in China (Guo et al., 2010). A concern is whether with the inherited relationships with the governments, these privatized former SOEs have better access to bank loans than others.

government-related agencies increased the probability of the entrepreneur to gain bank loan access for the firm in 2006 and 2010. At the same time, according to Table 7, these working experiences of the entrepreneur are significantly and positively associated with the firm's bank loan over equity ratio in 2006. As our results stand, yet, the effects of the CPC membership and PC membership of the entrepreneur stay robust after controlling the previous working experience of the entrepreneur.

Secondly, we also controlled whether the firm was privatized from a SOE for the year 2006 and 2010 (this data is unavailable for earlier years). According to our estimates, the privatized firms do not seem be different from the *de novo* firms in bank loan access. Again, controlling this variable does not affect the impacts of the CPC membership and PC membership of the entrepreneur on the firm's bank loan access.

Political Connections and Firm Performance

The findings of previous section imply rent-seeking in bank credits for the entrepreneurs with political connections. An interesting question to be addressed is weather the rents are productive enhancing or not. If the answer is yes, then the consequence of rent-seeking is mainly inequality; and a remedy policy might be designed to correct this distortion. As a result, the Chinese-style capitalism may be sustainable. However, if the answer is no, if political connections have little influence on firm performance but enrich politically-connected entrepreneurs, it means the rent-seeking leads to social welfare losses and there is little economic justification. If so, prevalence and growing of this kind of unjustified rent-seeking could lead to undermine political support for Chinese-style capitalism.

In this section, we will explore the social welfare implications of the rents. The key is to find out if the CPC/PC member-owned firms perform better than others. In case they are not, then a question of interest is what they do with the bank loans that they obtained.

The existing discussions on the effect of political connections on firm performance in China are divided. Fan et al (2007) suggest that political connections hurt firm performance but Li et al (2008) and Francis et.al (2009) find their positive impacts on firm performance. Recent papers by Chen et al (2011) and Wu et al (2012) highlight that political connections affect firms differently depending on whether the firm is state-owned or private-owned.[11]

We measure the performance of private firms as return on equity (ROE) for the

[11] Except Li et al (2008), which measure political connection using CPC membership, the other papers such as Fan et al (2007), Chen et al (2011), Wu et al (2012) define a politically-connected firm as one whose CEO or Chairman is a current or former government official.

period of 1995-2010. In our regressions, we controlled broad range of variables related to CEOs and firms, which may affect firm performance. For example, the CEO share of investment can exert influence on firm performance through managerial incentives. Table 8 shows that political connections are not correlated with firm performance measured by ROE, across all four years. Controlled characteristics of firm-owners and firms, and finance of the firm, neither CPC membership nor PC membership have significant impact to performance in any of the years (columns (1)-(8)) and in all the years when we pool the data together (columns (9)-(10)).[12]

To explore how political connections affect performance via the channel of bank loans, we include the interaction term between bank loans and CPC/PC membership in the regressions.[13] It is not surprise that in the years of 1995 and 2000, when political connections did not lead to obtaining more bank loans, these interaction terms are all insignificant (columns (1)-(4)). However, for the other years, the CPC and bank-loan interaction term is 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), and the magnitude is small. When we pool all the cross section data together, we obtain similar results (column (9)-(10)).

Overall, we can conclude that political connections failed to lead to better performance. Although there are some positive effects of political connections on firm performance for CPC members when they obtained bank loan, the effects are found only for 2010 and the size is small. If the elite owners borrowed more from banks but did not perform better, a natural question arises is the way resources used.

To address this question, we investigate personal gains of the elite owners from their firms. Given elite entrepreneurs own at least 60% of total shares of equity in their firms (Tables 3-4), paying dividends could be an effective channel to benefit from the resources they obtained. A major feature of Chinese private firms is that most of them do not regularly distribute dividends. This is partly because the difficulties in accessing bank loans, which forces them rely on self-financing, e.g. from re-investing accumulated profits of their firms. In Table 9 we look at factors which may affect firms' decision on either to pay dividends, with a particular attention to political connections of the firm owners.

Our overall estimates are clear cut when we pool all the cross-sectional data together. The elites are more likely to pay dividends to themselves than other entrepreneurs, as shown

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[12] The seemingly different results between this paper and Li et al (2008) are likely due to the following reasons. a) We use different data than Li et al (2008), which is based on the data of year 2002. Given data of year 2002 reflects the business environment before the change of constitution, the operations in that year should be more similar to that of year 2000, and not surprise should be significantly different from those of year 2006 and 2010. b) We deploy more control variables than theirs. For example, CEO share of investment is significant for most years, but their paper does not control this. c) They use leverage in all regressions, which is likely to be correlated with CPC membership.

[13] We find bank loans have positive impact on performance. This is in line with existing studies (Khwaja and Mian, 2005; Claessens et al., 2008; Li et al., 2008).

in columns (9) and (10) of Table 9. Columns (1) and (2) of Table 9 show that CPC/PC memberships has insignificant impact to distribution of dividends in year 1995. However, as shown in columns (3), (5) and (7), firms owned by CPC members are significantly more likely to pay dividends than other firms in years 2000, 2006 and 2010. What happened in 2000 is particularly problematic since in that year they did not obtain more bank loans (column (4) of Table 6 and column (2) of Table 7), and the interaction term between CPC-membership and bank loan plays a negative and significant role in performance of their firms (column (4) of Table 8).

These findings indicate serious problems in resource allocation of the Chinese economy. Looks like bank loans in the hand of politically-connected private firms are used less efficiently than those without political connections. The Chinese Communist Party encouraged its elites to enter the private sector to strengthen its grip on the economy and the society, but, as a result, economic efficiency sacrificed as economic power has acquired political influence and used it mainly for their own benefits. In other words, since the change in the Constitution, economic rents and thus inefficiency have increased because those who have political connections obtained more resources but failed to improve firm performance. In a typical capitalist economy, entrepreneurs have the incentives to re-invest (Smith, 1776), and thus increases in bank loans likely lead to more investment. This has been systematically documented all over the world. However, our findings imply this is not the case in Chinese politically connected entrepreneurs. Instead, our findings indicate losses from distorted incentives due to their political connections and the institutional environment.

V. Robustness Check: Dealing Endogeneity

There may be different interpretations of the above-shown correlations. For example, when we use party membership as an independent variable, we implicitly assume its exogeneity to outcomes. However, it is not very likely that this is true. It might be possible that more successful entrepreneurs are recruited into the Party. In this case, there would be a positive correlation between party membership and firm performance and the nature of the story might be changed. Moreover, some worse-performing entrepreneurs might join the Party if he thought failing in business was due to lack of political connections. In this case there would be a negative correlation between party membership and firm performance. If both cases appear, the overall effects of the two could cancelled out, and could might drive the result that there is no performance difference between the elite owned firms and other firms. The other potential problem is that party membership might be positively related with ability. Capable individuals might have become party members and also successful entrepreneurs. Consequently, firm performance or bank loans are affected not by party membership itself but by ability which is conveyed in the variable of party membership. Indeed we have controlled entrepreneurs' characteristics, including capabilities, as much as we can. Still, there are omitted factors.

We address these problems in the following aspects. The first is to apply an instrument-variable approach. The second approach is to directly exploit the data by excluding the party member recruited after starting up a private business. This allows us to focus on the veteran Party members, i.e. the true political elites that are senior enough. Thirdly, we are going to investigate the qualifications of entrepreneurs who want to join the Party. Through this channel, we can figure out whether they are better performers or not. Lastly, we examine if the reason that CPC/PC member owners borrow more bank loans is due to extra financial constraints than others. If so, it might be somewhat justifiable.

We start from the instrument-variable approach. We instrument entrepreneurs' party membership by the existence of party branches within the firms. A good instrument should satisfy two conditions: relevance and exogeneity. We believe that party organization within the firm satisfies these two conditions. First, it can be relevant to our key variables, CPC and PC memberships, because if the firm owner is a Party member or PC member, he/ she will have more incentives and also easier to set up a party branch. In the following we are going to further elaborate this point. Second, it is likely to be exogenous to dependent variable such as bank loan or firm performance.

Under the rule of Communist Party of China and socialist ownership (i.e. no private ownership allowed), all firms and business units in China must have party branches until the appearance of private firms in the 1990s. When the private sector becomes significant in the national economy, the fact that these firms do not have CPC's grassroots' branches[14] has drawn serious concerns from the party. In response, the CPC central committee issued a decree in September 2000, which asks all the private firms set up grassroots party branches. [15] Therefore, if an owner is a veteran party member, under the request of the party and to keep good political connections with the party, he/she should be more likely to set up a party branch in his/her own firm than non-party member entrepreneurs. The same should also be true for the PC members, at least for those who are also party members, since they are political elites at higher up levels, which means they would follow closer to the party's appeals. These are all statistically confirmed in the first-stage regressions.

In the first stage, we look at how the CPC or PC membership of the owners is determined by the existence of party branch in their firms, the instrument variable, together with a set of control variables. The results displayed in the Table 10b confirm that party branch is highly significant in determining an owner's CPC/PC membership.[16] In addition, Wald test statistic

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[14] In the 2000 only 17% of private firms in our sample have party branches. In 2004 the Financial Times reported that in Shanghai only 1.1% of the private firms had party branches.

[15] 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. Concretely, it requested all private firms with more than three CPC members to establish grassroots branches. Moreover, it appeals city and county party committees send party representatives to firms with less than three CPC members, particularly large private firms, to attract more people to join the party and to guide them set up grassroots party branches.

[16]Summary statistics between party organizations and its owners as party members and People's Congress

shows it is highly relevant.

Table 10a presents estimation results of the second stage, where CPC or PC membership are instrumented using the predicted value of the first stage regressions. Panel (a) of Table 10 shows that that both CPC and PC memberships are positively and significantly correlated with the bank loan to equity ratio.[17] This establishes the causality that political connections lead to easy access to bank loans. Moreover, if we compare the 2SLS estimates (columns (1) - (4) in Table 10a) with the OLS estimates (columns (1) - (4) in Table 7), it is clear that both statistically and economically the significant levels of the 2SLS estimates are much higher than the OLS estimates. It indicates that the OLS estimates may under-estimate the benefits of the connections.

To further confirm the causality, our second approach is to focus only at veteran party members by using a subsample of the data and excluding other data. This eliminates all the party members who join the party after starting private business. Unfortunately, this kind of data is only available in 2006. Table 11 presents estimation results.

We have two sets of data measuring bank loans. One is banks loans for the four largest banks and the other is the total amount of bank loans. The upper panel is the result of OLS regressions and the lower panel is the result from the 2SLS. In the 2SLS regressions, the CPC/PC memberships are instrumented in the same way as in Table 10, i.e. by the existence of party branches in the firm. Columns (1) and (2) are for the Party members, and (3) and (4) are for Congress members. The results show that both CPC and PC memberships are significant in all OLS and 2SLS regressions. This further confirms that the veteran party members, who are more likely to be senior elites, obtain more bank loans than others.

Comment [D1]: These should be changed to loan-over-equity ratio for two reasons. a) to be consistent with all previous estimations. B) to control the size of the firms, i.e. normalize the measurement.

In the next step, we are going to address a question concerning the motive of borrowing more bank loans by politically connected entrepreneurs. Concretely, when the party-member owners obtain more bank loans than others, did they face more financial constraints than others? If so, the extra bank loans they obtained should rather be interpreted as neediness to deal with financial difficulties. To address this matter, we are going to borrowing from informal financial sector as a proxy to measure financial constraints. The reason this is a valid proxy to measure the financial constraints of a firm is because the high interest rates and the legal risks associated with the loans in that sector.[18] Firms without serious financial constraints tend to avoid this kind of high-cost high-risk loans.

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members are presented in appendix.

[17] The reason we only look at 2006 and 2010 is because only in these two years the political elites get more bank loans.

[18] In China, financial sector is highly regulated. Informal lending in almost any form 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 state-owned enterprises (WSJ, March 14, 2012). According to UBS's report, informal loans could be between two trillion yuan and four trillion yuan in total, or $316 billion to $632 billion, a bit less than 10% of the country's gross domestic product 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%-70% for loans (reported by Credit Suisse, Spet, 2011).

Table 12 shows regressions results for the three years (1995, 2000, and 2006) (no relevant data available for 2010). From all the cross-sections and pooled data, we find no evidence that the CPC and PC membership of the firm owners involve different informal lending activities than others. Together with the evidence that these firms are more likely to distribute dividends than other firms, all of these findings indicate that they are not financially more constrained than the others.

The last question we are going to address in this paper is what types of entrepreneurs were recruited into the party? Are those recruited into the party performed better or worse than others? In the questionnaires of 2006 and 2010, we have the data on those who indicated that they want to join the party. In the regressions shown in Table 13, we look at the correlation between those who want to join the party and their performance, which is measured by the return-over-sales ratio (ROS) in the past years (this is the only data available for tracking down their past performance). Overall it is clear that those who want to join the party do not statistically perform differently from the others.

VI. Conclusion

Most existing studies on political connections looked at their relationships with firm performance in a static setting. The amendment in the Chinese Constitution in 2002-2004 presents an important opportunity to analyze the effects of political connections on resource allocations and firm performance in a dynamic setting, by looking at what happened before and after major changes of laws and institutional settings.

Our results suggest that politically connected entrepreneurs did not have much rent-seeking opportunities when the private sector was not appreciated by the party and the constitutions. However, after the laws and institutions were changed, the political elite entrepreneurs were treated differently, although these changes might not be written down in the law and might not be formal. What we discovered is that rent-seeking opportunities now became available. Concretely, we find everything else being equal these entrepreneurs could obtain more bank loans than others. Moreover, with more low-cost financial resources they did not perform better than others. Instead, we find politically-connected entrepreneurs are more likely to pay dividends to themselves than other entrepreneurs.

In addition to these discoveries, methodologically, this paper uses four cross-section data. Not only this is necessary for dealing with dynamics, this multiple cross-section data also reduce the omitted variable bias which is caused frequently in a single-year cross-section analysis due to the uncontrolled association between political connections and an omitted variable. Moreover, we have addressed endogeneity problem carefully by deploying instrument variable approach and several other approaches. Furthermore, our instrument variable, the existence of party branches within a firm, not only solves causality problem, but also reveals an interesting mechanism of party-firm relationship.

Our findings imply that the rents enjoyed by politically connected entrepreneurs lead to inefficiencies and unjustifiable collusion of economic power with political influence in China. What is the implication of this phenomenon to Chinese economic growth? What are the implications of these to the citizens, the ruling party, and the social stability? These are important open questions 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 3A Summary Statistics for 1995

	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
Variables	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 3B: Summary Statistics for 2000

	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
Variables	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 4A: Summary Statistics for 2006

	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
Variables	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 4B: Summary Statistics for 2010

	CPC Owner		PC Owner		Non CPC/PC Owner		Full Sample	
Variables	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 5: Entrepreneurs' perspectives on the Party

Down and up: Entrepreneurs' perspectives on the Party				
	1995	2000	2006	2010
Is the entrepreneur a CPC member?	17%	19.90%	40.50%	41.50%
Does the entrepreneur want to join CPC if he/she is not a member yet?	23.6%	14.15%	24.48%	48.25%
Did the entrepreneur join the Party before you startup?			84.20%	
Does the entrepreneur regard being a CPC member helpful in improving his/her status?	17.90%	7.80%	35.50%	
Does the entrepreneur regard being a PC member be helpful for his/her status?	33.40%	27.10%	48%	
Does the firm have a party organization?	7.05%	17.18%	34.66%	34.55%
No. of observation	2869	3073	3837	4624

Table 6: 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	.044	.058	.032	.030	.020	.020	-.011	-.100
	(-.003)	(-.003)	(-.012)	(-.018)	(.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 7: 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 8: 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 9: 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

Table 10: 2SLS regressions for bank loan over equity

(a) Second stage regression

	2006		2010	
	(1)	(2)	(3)	(4)
Owner C.				
CPC	2.762***		5.393***	
membr	(.596)		(1.502)	
PC		4.358***		4.611***
membr		(.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	.003	.000	.012***	.003
shr	(.003)	(.003)	(.004)	(.004)
Owner	-.267	.347**	-.424	.456
exp	(.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

	2006		2010	
Dep.V	(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	-.001**	.000	-.001**	.001*
shr	(.001)	(.000)	(.000)	(.000)
Owner	.237***	-.001	.166***	.033
exp	(.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 11: 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***	.445***		
	(.141)	(.155)		
PC membr			.632***	.564***
			(.142)	(.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***	2.885***		
	(.570)	(.617)		
PC membr			4.450***	4.614***
			(.886)	(1.006)

Table 12: 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 13: 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).