

THE POLITICAL ECONOMY OF FACTIONALISM IN REFORM-ERA  
CHINA: INFORMAL INSTITUTIONS AND THE REGIONAL  
DISTRIBUTION OF NON-PUBLIC INVESTMENT

by

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## ABSTRACT

### THE POLITICAL ECONOMY OF FACTIONALISM IN REFORM-ERA CHINA: INFORMAL INSTITUTIONS AND THE REGIONAL DISTRIBUTION OF NON-PUBLIC INVESTMENT

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This dissertation discusses the effects of the Chinese Communist Party's (CCP) formal personnel management and informal politics on Chinese reform and development. It argues that the CCP's informal politics can help to improve China's economic reform performance. In the absence of strong rule-of-law institutions to sustain the market economy, the CCP's organizational resources enable the supreme leaders to control their political factions. The CCP's supreme leaders thus can induce non-public investors to follow the party's economic development goals. Thus, the CCP's informal politics may not result primarily in inefficiency or chaos. Instead, it may be a driving force for informal cooperation between the party officials and private entrepreneurs, which makes well-connected provinces especially attractive destinations for private investment. Quantitative research methods are applied to conduct several original empirical studies. The first study analyzes how the party's top leaders control provincial personnel through factions. It shows that the CCP's supreme leaders still dominate personnel management at the highest levels of China's party-state. The second study analyzes the relationship between factional politics and the growth rate of domestic non-public investment. Analysis of provincial-level panel data from 1993 to 2017 shows that shared working experiences between provincial leaders and the CCP's incumbent

supreme leader significantly increase the growth rate of private investment. The third part further illustrates the impacts of such factions on the regional distribution of foreign direct investment (FDI). Empirical evidence shows that provincial leaders' personal connections with the CCP's incumbent general secretary had positive and statistically significant effects on the annual growth rate of provincial FDI inflows. These effects were more salient in inland provinces and during the Xi Jinping era. Overall, this research shows the importance of informal politics in promoting China's economic reform and prosperity. Although informal politics may contribute to sub-optimal distribution of economic resources, it may also compensate for the weaknesses of Chinese formal legal system in promoting the non-public economy.

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To  
my parents

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## LIST OF ABBREVIATIONS

CCP	Chinese Communist Party
SOE	state-owned enterprise
FDI	foreign direct investment
NBS	National Bureau of Statistics
PSC	Politburo Standing Committee
NPC	National People's Congress
CPPCC	Chinese People's Political Consultative Conference
SPC	Supreme People's Court
HKMAO	Hong Kong and Macau Affairs Office
HKCLO	Hong Kong-based Liaison Office of the Central People's Government in the Hong Kong SAR
GMM	Arellano-Bond Generalized Methods of Moments
CIED	Chinese Industrial Enterprises Database
RMB	Chinese yuan
CYL	Communist Youth League
SEZs	special economic zones

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## **Chapter 1: Introduction**

### **1.1 Research Questions**

Xi Jinping became the supreme leader of the Chinese Communist Party at the 18th Party Congress in 2012. The following year, at the Third Plenary Session of the 18th Central Committee, he initiated a comprehensive reform blueprint. In this plenary session, the Central Comprehensively Deepening Reforms Commission was established. This reform was intended to be even more far-reaching than the previous ones, concerning the economy, democracy and legal systems, culture, social institutions, and the CCP's discipline inspection system.

In general, this plenary session announced many reform policy initiatives that tended toward economic liberalization. For the first time, it emphasized that the market should play a “decisive role” in the allocation of resources. Thus, it was said to be necessary to develop an open and competitive market; improve the decisive role of the market in determining prices; reform the fiscal and taxation system; establish a unified land market across urban and rural areas; and promote urban and rural integration. Excessive governmental intervention into the market was to be constrained. It also stressed improvement of the property right protection system. For the state-owned enterprises, this session proposed to promote the separation of government and business; continue to implement corporate autonomy and self-management; and finally establish a modern enterprise system. Most importantly, the plenary session also accentuated the role of the non-public sectors in promoting growth, innovation, employment and fiscal health; and proposed to support the development of the non-public economy by upholding the equal rights, opportunities and rules, and abolishing unreasonable regulations.

These new policies encouraged non-public enterprises to participate in SOE reform and develop the mixed ownership system.

The ambitions of the CCP's new leadership to push forward a comprehensive market-oriented reform could not easily be more salient than in this plan. The reform intentions of the CCP are evidently not a passing fancy but a serious, long-term commitment. For decades, since the policy of "reform and opening" was adopted in 1978, the Communist Party has been successful in pushing China's transition from a planned, totalitarian economic system under Mao to a market system (Fu 2000; Zhou 2008). Given that the communist political institutions in the former Soviet Union and some East European countries were so rigid and hostile to innovation (Frye and Shleifer 1997), China's political and economic elites would have been expected to defend their vested interests by blocking market reforms. But the CCP's top leadership overcame such obstacles to achieve remarkable success in economic reform and development. What puzzles scholars most is that, while this market transition has fundamentally changed almost every aspect of China's economy and society, the CCP's authoritarian system survives with its basic features intact (Nathan 2003).

Why did China succeed in economic reform? Why could the private economy break through the barriers of communist ideology and the command system to play an increasingly important role in China's economic development? How could foreign investment bypass institutional barriers and take root in China's economic system? What are the outcomes of Chinese political institutionalization? And what are the roles of political institutionalization in promoting economic reform performance?

One common view, which emphasizes China's success in developing formal, market-friendly institutions, is as follows. Since the early 1980s, the Chinese Communist Party's top leadership has engaged in a 30-year-long ideological dispute over whether to prioritize conservatism or reform. These ideological struggles are about whether the planned economy or the market economy is more in line with the ideological fundamentals of communism and about which ideology is more conducive to the continued rule of the CCP. In this view, the reformists within the CCP gradually prevailed over the conservatives. The neo-liberal market economy was grafted onto the one-party dictatorship, and China's economy was gradually shifted from an closed and internally recycling system to an export-oriented market system. Under the conditions of an export-oriented development strategy, institutional evolution brought about the success of China's economic reform (Ang 2016). China has developed a set of formal institutions that take the form of laws and regulations that protect the development of private economy.

This gradual change is not only economic, but also political in nature (Shirk 1993). Shortly after the Cultural Revolution, Deng Xiaoping proposed the reform and opening up policy to transform the communist regime and make it more pragmatic (Yang 1997). In the 1980s, the central government allowed regional autonomy. The provincial units could deal with local affairs related to economic development, thus giving local bureaucracies incentives to benefit from reform from its early stages. Meanwhile, the CCP established a personnel management system to guide its bureaucracies in accordance with the established reform policy. Through this formal arrangement, the interaction between economic decentralization and political dominance leads to the success of reform and opening up. The inefficient state

economy is gradually phased out. Private property rights are protected to promote rapid growth of private economy. Also, China is deeply involved in the tide of economic globalization. Through these methods, economic change and political reform work together to establish market-oriented, rule-of-law institutions.

However, this view has at least two weaknesses. First, it may exaggerate the intensity of ideological confrontation within the party center. Ideological conflicts on the developmental path of China did exist shortly after Mao's death. Even though the small circle of Cultural Revolution supporters was defeated politically, the remaining conservative revolutionaries still favored a Stalin-style planned economy and opposed radical market reforms. In this context, the top factions that supported pragmatic economic policies won the competition against the conservative revolutionaries by offering policy benefits. Their cronies in the lower-level bureaucracy implemented some reform policies and successfully promoted local growth. This helped their superiors at the party center to appeal to the elite selectorate by demonstrating improving regional economic performance (Cai, Park, and Zhao 2008). After the top leadership was consolidated and unified by the reformists, the party center gradually ratified the policy decision to move toward reform and opening up (Shirk 1993). The 1989 Tiananmen Square protests and the corresponding mass killing further destroyed the CCP's political legitimacy. After that, the CCP's top leaders agreed that only economic reform and improved economic performance could legitimize the CCP's authoritarianism. Since the early 1990s, therefore, there has been no ideological conflict over the fundamental reform path among the CCP's top leaders. The political struggles, if any, are mainly focusing on power conflicts rather than ideological confrontations.

Second, it may also overstate the achievements of China's institutional evolution. In fact, a defining feature of the socialist economy in China during the market transition is the lack of fully legitimated and well-defined private property rights (Nee 1989). Although the CCP has accepted a more open economic system, the communist hierarchy is frozen in time. The hierarchical system shapes the process of Chinese market transition and consistently adjusts its economic policies in response to the forces unleashed by the changing international political economy (Lardy 2012). The stagnation of political reform blocks China from establishing rule-of-law institutions. The CCP's dictatorship and lack of checks and balances may discredit and undermine its market-oriented reforms.

Under these conditions, market forces are still constrained by political interventions. China has to continue its economic development using structurally weak rule-of-law institutions. Personal connections between state agencies and firms may provide crucial informal linkages. Entrepreneurs have to mobilize these personal networks or even bribe cadres to gain access to economic resources and opportunities. Therefore, many of the basic features of the reform process may be explained by the informal structure of the CCP's political system. Informal institutions here refer to implicit norms and customs, and most importantly, to the patronage network within the CCP's bureaucratic system that fulfills the changing needs of the politicians to sustain their rule (Tsou and Nathan 1976; Nathan and Tsai 1995; Tsou 1995). I argue that the CCP's informal politics can help to improve the market-oriented reform performance. In the absence of strong rule-of-law institutions to sustain the market economy, the CCP's organizational resources enable the top leaders to manipulate their political factions, thus inducing the economic behavior of non-public

businesses and investors to follow the party's economic development goals. It seems that the CCP's informal politics may not result primarily in inefficiency or chaos. Instead, it may be a driving force for informal cooperation between the party officials and private entrepreneurs, which makes well-connected provinces especially attractive destinations for private investment.

By arguing this, I do not intend to deny the importance of formal institutions. I contend that market reforms in China are not shaped by formal institutions alone. Instead, it is the formal and informal institutions that jointly drive China's economic reform. Markets are not perfect and have various limitations and weaknesses. Thus, they require institutions that support property rights, regulation, macroeconomic stabilization, social insurance, and conflict management (Rodrik, 2009). These formal institutions also reduce the uncertainty and transaction costs of economic activities, induce entrepreneurship, and encourage technological innovation, all of which contribute to economic liberalization and development. However, the rigid authoritarian regime may prevent the evolution of formal institutions from meeting the requirements of economic reform and development. In this situation, informal institutions encourage the local officials to follow the policy preferences of the CCP's top leadership. Also, informal institutions strengthen the collusion of political and economic elites. Given that the officials affiliated with strong factions may have more political resources to preserve their power, they could do more to ensure the private investors' prospects of rewards. In this way, informal institutions can help the private economy to circumvent the obstacles of the old system and obtain future benefits.

In the following sections, I discuss how past researchers elaborate the relationship between China's economic decentralization and institutional development, and how the CCP's formal personnel management system produces reform incentives. These studies reveal the great importance of institutional evolution in China's reform and opening up. In addition, I summarize some recent studies and evidence on the role of informal politics in Chinese economic reform. They explain how informal institutions, usually seen as the CCP's patronage network, complement the weaknesses of China's legal system and bolster market prosperity.

## **1.2 Economic Decentralization and Institutional Evolution**

Naughton (2008) argues that the starting point of China's economic reform was the command economy equilibrium, within which the communist leaders distributed physical goods and promotion opportunities in exchange for their followers' allegiance and political support. Economically, the protected state-owned enterprises delivered enormous profits to the government through the financial system. In turn, the party allowed consistent governmental protection of SOEs and delivered job and promotion opportunities to their clients in SOEs through personnel management. Governmental officials and urban workers were all fully incorporated into this hierarchical system. China's economic transformation would be expected to be very costly in the absence of market-like flexibility that drives resource allocation toward Pareto Optimality. Under these conditions, decentralization within the system may be helpful in breaking the ice (Qian and Xu 1993).

China's command economy to some extent, if not fully, differed from the planned economy of the classical Stalinist system (Jowitt 1992). The Stalinist system was based on a

series of hierarchical organizations along ministerial lines, within which there was almost no substantial participation of regional governments in economic plans. In contrast, China's old system entailed meaningful participation of local governments in the planning process. This might be because Mao Zedong tended to promote local officials' political radicalism with regard to the achievement of rapid industrialization (Yang 1998; Kung and Chen 2011). Thus, it was the radical movements during Mao era that broke the Stalin-style centralized structure to form a decentralized system. Maskin, Qian, and Xu (2000) regard the decentralized structure as an M-form system, which is organized along regional lines rather than along industrial and ministerial lines. Since the late 1950s, this M-form economic system replaced the power of specialized ministries with regional power, establishing an almost self-contained and self-sufficient system in function at the county level and above. Under the M-form system, the subnational governments, including the provinces, municipalities, and counties, are empowered with local economic affairs, controlling a substantial amount of resources, such as land, energy, raw materials, firms and budgets, and holding the responsibility for initiating, coordinating and regulating reform process, providing public services, as well as making laws and enforcing policies within their jurisdictions (Qian, Roland, and Xu 2006, 2007).

Since 1958, local governments had gradually acquired the power of economic plan and enterprise management, distribution of goods and materials, approvals of infrastructure construction, investment and bank credit, taxation and finance, as well as labor management, which were also strengthened during the Cultural Revolution (Wu, 2005). Under the authority of the central government, the local government in China gained the economic power far

beyond the local governments of the Soviet Union. Without market-oriented reforms to encourage enterprises and individuals, Chinese local governments became the main forces in promoting economic development, which was very different from the planned economic system in the Soviet Union. In such a system, China's four-level administrations below the central government were also given wide discretion in implementing new policies to promote economic transition (Chung 2016). Thus, economic decentralization continued to be influential after Mao's death, which created favorable conditions for the subsequent economic reform (Landry 2008). The combination of centralized policy-making and delegated implementation was better than the Soviet hyper-centralized system in facilitating local reform experimentation.

Although disputes on market reform policies remained intense between the conservative factions and the reformists in the central government, Chinese local governments could take steps toward market reform without political instructions or pressure from the top. China's crucial early agricultural reform—which moved peasants from a collectivized system to a household responsibility system—was carried out under the leadership of local governments. After that, the economic reform of the lower-level units triggered political reform among the ruling groups. A heated debate over the right and wrong of rural reform was launched among the central leaders. The conservatives asserted that it shook the foundation of the socialist system under the CCP's leadership, while the more pragmatic reformers proposed that any policy conducive for economic development should be accepted. The debate over the tendency of reform policy eventually evolved into a fierce political struggle. Historians dispute on the roles of Hua Guofeng and Deng Xiaoping in this political struggle (Ruan,

1994). But there is no doubt that the reformists successfully demonstrated brilliant economic performance in the provinces they controlled. Their achievements were proved to be more urgently needed by a poor and backward China. Deng Xiaoping used the power of the reformists to defeat Hua Guofeng. One of his major achievements was the establishment of the so-called collective leadership of the CCP in the 1980s. In this system, there were checks and balances among various factions within the party but nobody could challenge Deng's personal power. Ironically, it also institutionalized the political process of China and promoted power-sharing among various elite groups (Shirk 1993). The Chinese Communist Party is seemingly no longer a Leninist party dominated by a charismatic leader, but a power-sharing system for China's ruling elites.

Such political changes opened the door to further reform. After that, the CCP carried out comprehensive reforms of China's economic system. Private firms were allowed to enter the economic sectors previously monopolized by the state. Although reducing the supply of traditional forms of patronage, emerging technocrats on balance benefited from reform. Reform expanded obtainable asset values and created new income streams. Reform also increased the space available for rent-seeking activities. Consequently, the ruling elites became less loyal to the old system. Rigid communist institutions were gradually abandoned and replaced by market-oriented institutions (Naughton 2008). Highly educated technocrats were substituted for fanatical revolutionaries. These technocrats followed the rules and principles of the market economy in designing industrial policies. Agricultural collectivization policies in rural areas had been abolished. The autonomy of managing land was given back to the peasant. The restrictions on labor mobility were gradually abrogated. A large number of rural people

were allowed to enter the city to provide cheap labor for the process of industrialization, which forms China's comparative advantage in international trade (Cai, Park, and Zhao 2008). Price controls were completely liberalized. Privatization reform also occurred in urban areas. Inefficient state-owned sectors were transformed. Economic resources were reallocated to improve efficiency. Investments in low-efficiency regions and industries in old system were transferred to more efficient areas and businesses, which enabled the rapid development of the coastal provinces (Chan, Henderson, and Tsui 2008). The renewed protection of private property rights boosted investors' confidence in future profits and led to a boom in the private economy (Lardy 2014). Therefore, market-oriented policies and institutions promoted the development of China's economy. In turn, the development of China's economy in legitimized the CCP's authoritarian regime.

In this context, most of the past literature views China's economic reform as a process of institutional evolution from a communist system to a market-oriented economy. Ang (2016) argues that institutional evolution helped China to escape from the poverty trap. Because of the decentralization and innovation incentives, bottom-up improvisation among ground-level officials drove China's economic transformation. Through gradual reform and development, local officials actively overcome the old institutional weaknesses, such as rampant corruption, weak property rights protection and under-regulation. Thus, economic growth could precede good governance. The development of the market economy then generated problems that required the local officials to improve formal institutions, which in turn fostered further economic development. This implies that China's institutional evolution is based on a flexible and adaptive governing system that empowers the local bureaucracies to solve evolving

problems. Thus, China could harness existing resources to initiate reform without full-fledged market-friendly institutions.

Apart from its effects on domestic reform and growth, China's newly established institutions also attracted large-scale foreign investment. Based on theories regarding effects of institutions on economic behaviour (North 1990), Fu (2000) claims that China benefitted from the evolution of pro-competition, predictable, and transparent institutions. These institutions are favorable for protection of property rights and reduction of transaction costs. This is especially true for the growth of foreign direct investment, because formal regulatory frameworks are far better than informal factors in facilitating large-scale foreign investment projects that are capital-intensive, complex, interpersonal, intertemporal, and geographically distant from the source. Therefore, China has come a long way from a command system with bureaucratic interference to an open market system. Its sustainable economic development relies on the steady improvement and solidification of a market-oriented rule of law institutional framework.

Overall, institutional theorists of economic development stress the crucial roles of Weberian-style bureaucracies, market-oriented economic systems and an effective legal framework that can protect private property. The more complete the shift to market coordination, the less likely that economic transactions will be embedded in political networks, and the more likely economic power will be located in market institutions. Advocates of this standard explanation claim that, based on decentralization, China gradually established a market system through institutional innovation. China's market reform has resulted in bypassing hierarchies to establish horizontal market relationships. The new system

could support tax reform, high accumulation and investment, free flow of domestic labor, an export-oriented economy, as well as a restructuring of state-owned enterprises, all of which are conducive to sustain rapid growth.

However, the role of formal institutions in China's economic reform and development remain controversial in some recent literature. For instance, Cai and Treisman (2006) are skeptical about the effectiveness of decentralization on regional reform experimentation because the initiators of some crucial reform were not the empowered local officials. Empirical evidence on the causal influence of economic decentralization on hardened SOE budget constraints is weak. The performance incentives of fiscal decentralization are offset by the sharp decline of available tax revenue. And more seriously, without substantial political reform, economic decentralization cannot enable local governments to monitor the power center to limit predation and convince investors that reforms will last. Instead, the central government can change the rules at any time to shrink the pool available for sharing, which undermines the credibility of economic incentives. Based on this reasoning, Cai and Treisman (2006) propose that it is the central political struggles among rival factions that stimulate the lower-level reform competition. Although being retarded by the conservative factions, the reformist leaders tended to support and promote the local officials who achieved brilliant economic performance to endorse their reform preferences and consolidate their central power. While the local officials connected with these factional leaders have sought to impress their superiors at the power center through spontaneous and sometimes illegal initiatives to break the old system. These initiatives might be sufficient to break up the old system to promote growth-promoting market reforms. Thus, Cai and Treisman (2006) remind us that

the driving forces of China's economic reform may be present in the factional politics of the CCP's personnel management system.

### **1.3 The Rules of the CCP's Personnel Management**

Leninism advocates establishing a totalitarian state with a pyramid structure, within which the vanguard party possesses absolute power over people's thoughts and actions. Following Leninist principle, the CCP established a party-state system in the year 1949. The CCP tried to promote national industrialization at the expense of the agricultural sector. This was an important strategy for China to develop from a backward agricultural country to an advanced industrial country, which would also prove the superiority of the Leninist system. Soon after that, however, the efforts made to rapidly industrialize this country were interrupted by political fanaticism fueled by Mao Zedong. The Cultural Revolution almost destroyed China's national economy and broke the communist bureaucracy's control over the state. A large group of radical revolutionaries who had absolute allegiance to Mao replaced the orthodox Marxist bureaucracy at the power center. But this did not weaken the party's leadership.

After Mao Zedong's death, the party's conservative cadres regained power. Radical mass movements and factional struggles were no longer the main aspects of political life. More pragmatic policies were carried out to liberalize the economic and even the political system. During the Deng era, a separation of powers was implemented to adjust the relationship between the party and the state. Although the party was seemingly weakened shortly after Cultural Revolution, Deng Xiaoping was not willing to accept the prospect of losing power. He formulated the Four Cardinal Principles to accentuate the party's sacrosanct position in

Chinese politics: China still adhered to the CCP's leadership, Marxist ideology, the socialist system, and the people's democracy and dictatorship. After that, economic reform continued, while political liberalization movements were suppressed.

Nevertheless, Mao Zedong's political heritage was seemingly replaced by a modern bureaucratic system. The party power was withdrawn from some economic domains, but remained dominant in this bureaucratic system. In this context, China's bureaucracy has also become the basic unit for political analysis. Huang (1996) argues that the party center distributes political and economic resources by appointing different kinds of provincial officials. When a province is assigned a leader who has a close relationship with the localities, the region's privileges would be better defended. On the other hand, if a leader who has a close relationship with the party center is appointed, the local units would be more of the agent faithfully implementing the mandate of the central government. Through this bureaucratic mechanism, the party center influences the central-local conflicts in various policy areas.

Because the reform-era CCP legitimizes its authoritarian regime by fostering economic growth, the bureaucratic selection system is designed based on meritocratic principles (Wang 2008). The CCP selects its cadres by examining their political integrity and ability. Education, expertise, work experiences, political loyalty, and usually most importantly, past economic outcome performance, are scrutinized. The candidates must show such qualifications to gain access to higher positions. Advocates of the CCP's meritocracy speak highly of this system, because it can select qualified officials to increase developmental efficiency and achieve economic goals (Bell 2016). Under this system, the bureaucracy has more formal legal

legitimacy. It formalizes China's political process and enhanced the credible commitment of institutions as a whole. And political loyalty is no longer the primary criterion of selecting cadres (Zhou 2013). Along these lines, some empirical studies show that provincial leaders who have good economic performance are more likely to be promoted to senior positions (Li and Zhou 2005; Chen, Li, and Zhou 2005).

Accordingly, Zhou (2008) argues that a promotion tournament plays a crucial role in achieving China's economic miracle. Although keeping a very tight grip on political power, the party center can delegate economic power to lower levels without worrying about regional centrifugal tendencies. The superiors make development plans and evaluate the economic performance of their inferiors. At the same time, local officials have discretion about local economic affairs. They take responsibility to implement developmental policies and achieve economic goals. The top leaders work closely with the bureaucrats to implement policies that favor rapid growth (Lieberthal and Oksenberg 1988). In this promotion tournament, the local GDP growth rate becomes a major criterion for evaluating local officials' career performance. Local officials seeking career promotion spare no effort to increase the growth rate in their jurisdictions. This highly institutionalized cadre evaluation system encourages competition to increase the efficiency of public goods production (Naughton 1995; Wu 2005; Xu 2011).

However, some more recent literature questions this reasoning. Although economic development and improved living standards of ordinary people in authoritarian countries are important for the survival of dictators (Gallagher 2002; Doner, Richie, and Slater 2005; Wang 2016), the top leadership is as much preoccupied with winning the political struggle as with

achieving economic performance (Tullock 1987; Svobik 2009). This is because the distribution of power may have a direct effect on consolidating authoritarian rule (Nathan 1973; MacFarquhar and Schoenhals 2006; Svobik 2012; Albertus 2015). In China, the peaceful periods serve renewed conflicts while the periods of conflicts motivate the subsequent power dominance (Dittmer and Wu 1995). That is, the balance of power at the party center results in political struggle among different factions, which may in turn improve the power center's control over the provincial bureaucracy. Political struggle may result in cross-factional power-sharing with effects similar to formal checks and balances (Li 2012), and fending off the centrifugal tendencies deriving from prosperous provinces (Sheng 2007). Political struggle may also help to purge ambitious officials who have better economic performance but are not loyal to the CCP's top leadership. In this way, the party ensures that power is limited to a political elite coalition loyal to the current leaders. Therefore, it is argued that the priority of the party's personnel management is not so much selecting gifted cadres to promote economic growth, as preserving the bureaucracies' political loyalty to the party's incumbent leadership (Guo 2007; Shih, Adolph, and Liu 2012).

Theoretically, promotion tournaments constrain the discretion of the authoritarian leaders in selecting cadres. Merit-based recruitment seems to be a set of fair rules that induce local officials to serve economic development goals. Yet, Tao et al. (2010) argue that such rules go against the nature of authoritarianism. If superior leaders select cadres according to some clearly defined criteria, they cannot promote their cronies and cultivate a ruling elite group that is loyal to its patrons. They also point out that there are no open sources showing that the government has established and effectively implemented quantifiable criteria for cadre

selection. Instead, public information with regard to the criteria for assessing cadres are rather vague. In addition, exaggeration and concealment coexist. Chinese local officials commonly exaggerate local GDP data to show better performance. On the other hand, local governments in some poor areas deliberately curtail GDP data to attract and siphon off additional financial subsidies. Advocates of promotion tournament theories fail to explain how to correct for the impact of widely existed data falsification among local officials.

Landry, Lü, and Duan (2018) conjecture that the party employs a multilevel appointment strategy. Specifically, the power center controls personnel management by appointing and dismissing the main local leaders in the provincial party standing committee, while the provincial leadership has a political voice in determining the sub-provincial leaders. The career promotion of the sub-provincial level officials is mainly based on their working performance, while factional politics may become more important when selecting provincial-level leaders. For Chinese authoritarianism, this strategy can synthesize the advantages of meritocracy and cronyism. Economic technocrats are selected to hold local governmental posts with direct influence on regional economic development, while trusted cadres are more likely to enter the power center. This can achieve economic development incentives and simultaneously ensure that the party's power is in the hands of loyal political elites. Therefore, the influences of informal politics among the high-level officials of the Chinese Communist Party should not be ignored. Given the decisive role of the central government in advancing economic reform policies, the impacts of informal politics of economic reform needs further discussion.

## 1.4 Informal Politics and Economic Reform

It is far from clear that increasing economic performance in exchange for promotion opportunities is the only significant rule for the functioning of the CCP's bureaucracy. It seems that the CCP still depends on informal politics during reform era. Opper, Nee, and Brehm (2015) show that officials who have close relationships with superiors are more likely to be promoted. Jia, Kudamatsu, and Seim (2015) prove that personal connections with China's top politicians in the central government accentuate the effects of a province's economic growth on its leader's promotion chances. In other words, patronage networks help the provincial leaders' hard work get recognized and rewarded. This might be because patronage networks solve the commitment problem, ensuring that the officials newly promoted are less likely to become potential competitor political threats for incumbents (Pye 1992; Egorov and Sonin 2011).

Therefore, incentives are likely to be especially effective for well-connected followers. Officials who have brighter vocational prospects are more likely to comply with their bosses' wishes. Strong evidence is provided in some past studies showing that officials within patronage network coteries are inspired to cooperate with their superiors and follow their policy preferences (Kung and Chen 2011) and to work hard to increase economic performance (Jiang 2018). Therefore, Wang (2000) argues that clientelism complements the weak Chinese meritocracy in generating reform incentives. The CCP's patronage network provides trusted followers with incentives to comply with the center's policy preferences and boost market-oriented reform. At the same time, these additional incentives are constrained to officials within this network.

Wang (2001) further argues that officials' personal connections with the top gives private entrepreneurs greater confidence that their investments are safe and may yield higher returns. In China, the subtle relationship between power and economic interests makes entrepreneurs concerned with the politics behind investment programs. In the absence of adequate rule of law and property rights protection, private sector actors prefer to seek extra political protection. Chan, Henderson, and Chan, Henderson, and Tsui (2008) claim that Chinese private firms obtain special deals to either break the formal rules or gain favorable access to scarce resources. This is mainly because, on one hand, Chinese local officials have enormous administrative capacity to provide a "helping hand" to favored firms, while on the other hand, these local officials can benefit from collusion between the government and private sectors. The cronies of the top leaders have better chances to be promoted to higher levels of power, thus gaining greater ability to allocate economic resources to reward connected investors. Hence, seeking a reliable political backer is sometimes more rewarding than cultivating a market. Entrepreneurs have an incentive to invest in setting up intimate politics-commerce collusion (Wei and Yang 2020).

One interesting example is the recent explosive growth of private investment in Guizhou province. As a remote province located in the hinterland of southwest China, Guizhou is one of China's most impoverished regions. It is located on a high, hilly plateau, with comparatively poor climate conditions and few natural resources. Due to geographical limitations, infrastructural facilities in Guizhou are backward. In such a region, it is not easy to develop economic critical mass by increasing agricultural output, carrying out large-scale manufacturing production, or establishing a large service industry. Thus, economic growth

there has long been slow and lagged behind most other provinces. It is not an ideal place for private investment. Although growing fast during Jiang Zemin era, Guizhou failed to keep pace with the upward economic cycle and expansion of private investment during the first term of Hu Jintao. From 2003 to 2007, the average value of the national private investment growth rate peaked at 39.7%. Guizhou province only reached 23.6%. In the downward cycle of Hu Jintao's second term, the reform performance of Guizhou did not rebound. It slightly decreased to 23.3%, which was still much lower than the average value of 25.5% for the whole country and ranked at the bottom end.

Yet Guizhou's economic situation has changed dramatically since the arrival of its new leader, Chen Min'er. Chen spent most of his career working in Zhejiang province. He used to serve as the Propaganda Chief of the CCP's Zhejiang Committee from 2002 to 2007. During this period, he worked under Zhejiang party secretary Xi Jinping. This experience gave him a precious opportunity to establish a close patronage connection with Xi Jinping. From then on, Chen has been portrayed by foreign media as a confidante of Xi Jinping and a rising political star. Chen Min'er became a vice governor of Zhejiang in 2007. In 2012, the year when Xi became the CCP's General Secretary, Chen was transferred to the southwestern interior province Guizhou as the governor. He became the party secretary in 2015. Chen Min'er was fortunate to be one of the youngest provincial party secretaries in China. Under the rigid age-based promotion norms in the CCP's personnel management system, taking a provincial leadership position at a relatively young age is a great political advantage for one's future career. The advantages of Chen's young age and his shared work experience with the CCP's top leader, Xi Jinping, jointly signaled that Chen was a candidate for next-generation supreme

leadership of the CCP.

After becoming the provincial leader in Guizhou, Chen had been devoted to advancing Xi's policies. His most important contributions were made to promote the Guizhou's economic growth to lift the province out of grinding poverty. Chen enthusiastically led an initiative to set up a program of regional development and invested heavily in making Guizhou a center of innovation for recently emergent industries. The brightest fields for new investment, such as electronic information technology and big data industries, high-tech equipment manufacturing, bioengineering and drug research, and modern mountain agriculture and tourism, were introduced in Guizhou to drive economic growth. As one of the poorest provinces in China, the relative advantage of Guizhou to develop new industries is its low electricity price for supporting large high-tech factories and big data computation centers. International high-tech giants, such as Apple, Tencent and Huawei, have shifted their equipment factories to Guizhou. Electronic platform construction, big data innovation and cyber transaction technology were located there, making this backward province into a gigantic computer laboratory for the whole country.

Chen's performance in promoting private investment of Guizhou is remarkable. According to the data from China's National Bureau of Statistics, private investment grew very fast in Guizhou from 2013 to 2017, rising to 27.4% and ranking the first in the whole country. In contrast, the average value of the whole nation is only 16.2%. The extent to which the success of Guizhou in attracting private investment to advance big data industries relied on Chen Min'er's personal connection with Xi Jinping is still unknown. But it is suggestive that Chen did not depend only on private investment. Actually, the development of Guizhou

also relied on governmental investment. In recent years the central government had poured in billions of yuan in fix-asset investment. Urban and rural infrastructure construction was accelerated. Highway, railway, and water-carriage facilities were upgraded. Removing this bottleneck on long-term economic and social development has improved the efficiency of economic resources allocation and increased regional competitiveness. In Guizhou, both the proportion of private investment in total fixed-asset investment and the difference between the growth rates of private and state-owned investment are not larger than the national data. It suggests that, alongside fostering private sectors, the development of Guizhou has also relied heavily on governmental investment.

Therefore, both theory and anecdotes indicate that the effects of personal connections with the top on provincial economic reform performance are positive. These effects might be more significant in the growth rate of private investment than in the increase of reform policy environment indicators. By appointing their confidants to the important provincial leadership positions, the CCP's top leaders are able to better implement their reform intentions. This also shows the significance of informal relationships in promoting China's economic reform. When the party's supreme leaders encounter resistance to changing status quo policy preferences, patronage networks might be the most reliable instruments to overcome these difficulties.

### **1.5 Plan of the Dissertation**

Politics and economics are closely interrelated. This is especially true in China, since it is a highly politicized authoritarian regime ruled by a Leninist party and integrated with a quasi-market economy. Studies of contemporary China cannot deliberately separate economic

issues from political changes. For an authoritarian regime that has based its legitimacy on economic performance, promoting efficient growth of the domestic private sector and deepening engagement with the outside world are among the most important political strategies. Thus, it is important to figure out how political factors affect China's reform performance in fostering private and foreign investment.

Several empirical studies are conducted to discuss the CCP's personnel management and test its effects on China's private and foreign investment distribution. The empirical part of the dissertation is organized into three chapters. The second chapter analyzes how the party's top leaders control provincial personnel through factions. I identify a number of specific variables that are regarded as important factors affecting provincial leaders' career prospects and prove that provincial leaders' personal connections with the incumbent general secretary matter the most. This reveals the highly informal nature of China's political development, where changes have been far less fundamental than those in the economic realm. The third chapter analyzes the relationship between factional politics and the growth rate of domestic non-public investment. The purpose is to find out how the provincial leaders' factional coalitions affect the overall situation of provincial investment. The fourth chapter further illustrates the impacts of such factions on FDI. Both of the two chapters on investment show that, although informal politics may contribute to sub-optimal distribution of economic resources, it may also compensate for the weaknesses of Chinese formal legal system in promoting the non-public economy. The fifth chapter draws conclusions and discusses some larger issues.

## **Chapter 2: Selection of China's Top Leadership Cadre: The Roles of Supreme Leaders, Factional Networks, and Candidate Attributes**

**Abstract.** This article provides empirical evidence to show how the general secretaries of the Chinese Communist Party dominated provincial personnel through their factional ties. Based on panel data from 1993 to 2017, this study finds that the provincial leaders' personal connections with the incumbent party head significantly increased their promotion chances. The positive effect of the incumbent party heads on promotion did not depend on provincial leaders' economic performance and seniority. This study further uncovers that working experiences in the prefectural leading positions strongly increased the likelihood of promotion. However, connection with other important top leaders did not have similar effects. These findings challenge the traditional wisdom on the collective leadership and indicate the dominance of the CCP's heads for provincial personnel arrangements.

## 2.1 Introduction

Recently, a growing body of literature examines authoritarianism using institutional perspectives (Geddes 1999; Magaloni 2008; Boix and Svobik 2013; Reuter and Robertson 2015). Formal political institutions help mitigate many of the worst features of authoritarianism. Perhaps most importantly, they enable regular interaction between dictators and their allies, thereby facilitating power-sharing. In this way, institutions prevent conflicts among ruling coalitions from escalating into ruinous confrontations, thus enhancing authoritarian stability (Svobik 2012). In China, however, this mechanism may not function effectively. The absolute power concentration at the top, and the absence of overt ideological differentiation, might preempt or mitigate serious political conflicts at the center. Under these conditions, institutions may be no more than a tool of the top leadership to regulate lower levels of government and induce them to follow the center.

What are the roles of the supreme leaders of the Chinese Communist Party in these established institutions? Do the CCP's formal or informal institutions have a significant independent influence on the behavior of these supreme leaders? Or do these institutions become the dependent tool of each new supreme leader? China's governmental structure is mainly based on geographical principles. This self-contained structure allows provincial leaders to impose substantive direction regarding regional economic policies (Qian and Xu 1993; Qian, Roland and Xu 2006, 2007). The CCP's provincial personnel management power provides more political resources to determine policy orientation than does central personnel power. Therefore, the CCP's provincial-level personnel management is an excellent dependent variable with which to evaluate these broader questions.

Scholars who study the determinants of the CCP's personnel management disagree about the importance of meritocracy and clientelism. Pro-meritocracy scholars believe that the CCP selects its cadres based on their performance (Zhou 2008; Bell 2016).

Institutionalization of this meritocracy occurs via a promotion tournament that encourage local bureaucracies to align with the top (Nathan 2003; Miller 2008). However, pro-clientelism scholars depict China's bureaucracy as being a web of political networks (Keller 2016). They see the CCP's collective leadership as the basis of underlying informal patron-client networks that sustain the factional balance of power at the center (Shih, Shan, and Liu 2010). Under these conditions, the CCP's leaders strive to appoint their trusted followers to important positions.

These studies enlarge our knowledge of the CCP's personnel management. However, the influence of the CCP's incumbent supreme leaders on high officials' career promotions seems to have been underestimated. Therefore, This article discusses the power of the CCP's supreme leaders in selecting the CCP's top leadership cadre. I argue that the CCP's personnel management institutions may be a tool of the CCP's supreme leaders to extend their factional power. Although institutions seem to constrain the career mobility of province-level leading cadres, the party heads in power might be able to overcome these constraints and appoint sycophants and loyalists from their own factions. To test these arguments, this study draws on a set of panel data to test the effects of performance-based and seniority-based institutional constraints on provincial leaders' career mobility from 1993 to 2017. Apart from the greater availability of data sources, I focus on this historical period mainly because it incorporated the major institutionalization of China's personnel management, which has arguably generated both political stability and economic prosperity. Thus, focusing on this period enlarges our understanding of China's bureaucratic politics. Through quantitative analyses of career mobility, I find that personal connections between the CCP's supreme leaders and the provincial party secretaries and governors significantly increase the probability of provincial leaders' promotion. However, connection with other incumbent top leaders imposes opposite effects. It may largely dim their political prospect.

This study advances the existing literature on the China's leadership promotion methods and outcomes in the following ways. First, I summarize multiple quantifiable factors related to career mobility, and compare their different effects in a provincial-level panel. I also discuss the interactions among them. Second, I distinguish the influence of the CCP's supreme leaders from that of other top leaders, which helps to distinguish the uniquely important role of party heads in China's political system. Based on this, the current study attempts to answer the broader question concerning the extent to which the Chinese Communist Party's supreme leaders are able to impose discretionary control over the whole political system. The Leninist party cultivates its leaders and shapes their political behavior in political practice. The party's supreme leaders, in turn, enjoy a unique position in this system, which empowers them to change the status quo of the party's institutions (McAdams 2017). Therefore, it appears that the party's heads are by far the most powerful actors in Chinese politics.

The roadmap of this article is as follows. In the next two sections, I briefly review the prior literature on the determinants of career promotion at the higher levels of the CCP party-state, and develop my own theories. The fourth section discusses the data and methods. The fifth section presents baseline results and robustness checks. Moreover, I further test the effects of the personal connection with other Politburo Standing Committee members affect career promotion. The sixth section discusses how my results relate to prior findings. The conclusions are presented in the final section.

## **2.2 Institutionalization of Authoritarianism and Meritocratic Bureaucracy**

Since the 1990s, the CCP's ruling elites have gradually come to a consensus over sustaining long-term prosperity as a strategy to preserve the leadership of the CCP (Cai and Treisman 2006). For this purpose, the party center tried to institutionalize personnel

management, decentralize power and transfer economic profits to generate reform incentives (Tsou 1984; Solinger 1987; Wong 1987). Contrary to what many expected, the ensuing expansion of local autonomy, conflicts of interest, and corruption among cadres has not undermined reform performance as in other transition economies (Burns 1989; Huang 1996; Frye and Shleifer 1997; Bo 2004; Landry 2008). Most scholars attribute this to the CCP's formal meritocratic institutions (Huang 2008; Bell 2016).

First, meritocracy provides a solution to the inconsistency of policy preferences among levels of governments. The Chinese Communist Party stands at the pinnacle of central autocracy to master the organizational resources (Yan 1995; Burns 1994; Huang 1996). Economic reform has not substantially attenuated party control over the bureaucratic system. Instead, the party has built a performance-based elite promotion system (Naughton 1995; Xu 2011). It can reward those officials achieving better economic performance by appointing them to important posts, which increases bureaucratic competition among different regions to increase economic growth (Chen, Li and Zhou 2005; Li and Zhou 2005). Under these conditions, bureaucracies often stay in line with the party's overall economic purposes. Therefore, this "veritable bureaucratic revolution" (Li 1998, 395) induces local bureaucrats to be devoted to growth (Lieberthal and Oksenberg 1988).

Second, this meritocratic bureaucracy places importance on professional qualifications to select officials with the potential to advance growth. A nominee should show his or her future performance capabilities to most of the top leaders (Xu 2011). In this case, quantitative evidence revealed that the candidates' past political experiences matter (Zhang 2010; Du, Zeng and Wu 2012). This is mainly because these job records convincingly show the candidates' political training in policy-making, regional development, social control, crisis management, and other important policy areas. In addition, a wider variety of career

experiences may reduce the likelihood of collusion with particular regions and increase political loyalty to the party center (Zhou 2016; Zhou et al. 2018; Xiang 2019).

Age is another crucial factor in examining the qualifications of provincial leaders. To allow younger but more qualified technical officials to replace older revolutionaries, the de facto lifetime tenure of leading cadres has been abolished since the early the 1980s (Li 2004). Before the strict retirement age arrives (usually 65 years old for provincial-level leaders), younger officials have more time to accumulate the leadership experiences required; they also have more time to secure higher positions. In contrast, provincial officials are less likely to be promoted to a higher position when approaching retirement age. Because of this, holding provincial positions at relatively young ages has gradually become a political advantage for future leaders.

Meritocratic scholars believe that the CCP cultivated a pro-market bureaucracy through established institutions. However, Tao et al. (2010) were skeptical of this viewpoint, claiming that any unambiguous formal institutional configuration would constrain the behavior of authoritarian rulers, which runs counter to their discretion and interests. For autocratic rulers, supervising the subordinates' political behavior to ensure loyalty is actually more important than improving performance (Landry, Lu and Duan 2018). Thus, China's dictators may place a higher priority on maintaining short-term power by buying the support of winning coalitions than on improving economic performance (Shih, Adolph and Liu 2012; Jiang 2018). Therefore, opinions that performance concerns have trumped factions in determining the career promotion of China's provincial leaders may be misunderstandings. Along these lines, more recent studies have stressed the role of personal favoritism or clientelism in the CCP's personnel management (Jia, Kudamatsu and Seim 2015; Opper, Nee, and Brehm 2015). The presence of collective leadership has been widely accepted by some Chinese politics observers (Nathan 2003; Hu 2013; Li 2016). This collective leadership system

empowers the Standing Committee of the Central Political Bureau of the Chinese Communist Party, usually known as the Politburo Standing Committee, to make the final decisions on provincial leaders' career mobility (Zhang 2009). Thus, a close relationship with incumbent PSC members is expected to be a crucial factor in such mobility.

### **2.3 Institutional Constraints on the CCP's Supreme Leaders**

Previous researchers have revealed multiple criteria of political selection, proving that both performance and factionalism are relevant for elite mobility (Walder 1995; Zhang 2009; Choi 2012; Jia, Kudamatsu and Seim 2015). However, they might underestimate the capacities of the CCP's heads to change the status quo of the bureaucracy via factional ties. Goldstein (1991) argued that, in the Chinese Communist Party's established hierarchy, a commitment to the unified image and organizational vitality of the Leninist vanguard party sustains a well-functioning political system, which endows the CCP's supreme leaders with ultimate authority. Tsou (1995) claimed that the political struggle of the CCP is basically "a game to win all." He thus stood in sharp contrast with Nathan's (1973) popular view that balance-of-power politics can be sustained on a regular basis within the party center. As the individuals who hold the real power of the CCP, the personal authority of the supreme leaders is at the apex of the party-state's political order. Successive supreme leaders endeavor to concentrate power tightly in their hands, which may even affect the collective leadership of the PSC. In this view, the role of formal institutions in constraining the CCP's top leaders should not be exaggerated. Neither the formal institutions of the personnel evaluation system nor the so-called collective leadership at the apex can effectively constrain the political behavior of the CCP's supreme leaders. The party heads are able to develop their own factions to change China's bureaucracy (Keller 2016; Meyer, Shih and Lee 2016).

Therefore, from my perspective, the CCP's incumbent supreme leaders seem to be able to bend the rules of meritocracy. In addition, they may have a strong desire to do so. First, the

supreme leaders are most anxious about the political loyalty of their subordinates. Under the CCP's pyramid hierarchy, the party's supreme leaders stand at the peak of the political pecking order (Yan 1995). Any political threats to their power are most likely to come from below. The expansion of autonomy and the centrifugal tendency of local governments may pose substantial threats to the power of the center, and may trigger a sense of insecurity in the party's supreme leaders. Therefore, they tend to adjust personnel selection rules to fulfill their demands for personal loyalty. Second, the party's supreme leaders do not rely completely on economic performance to consolidate power. Although prosperity legitimizes the CCP's authoritarian regime, it does not necessarily strengthen the power of the supreme leaders. Instead, different factions within the party may challenge their authority by building the prestige of their circles through regional economic achievements (Cai and Treisman 2006). If the performance-based personnel selection rules were strictly followed, hostile factions would have expanded their strength through excellent performance, and would thus be able to challenge the power of the CCP's supreme leaders. From this understanding of personnel management in China, I derived the following hypothesis (H1):

***H1: Factional connections with the CCP's incumbent supreme leader make provincial leaders more likely to be promoted.***

Under the CCP's institutionalized personnel management rules, economic performance, past working experiences, and age should be the crucial factors affecting provincial leaders' career promotions. However, any established rules in the party seem to run counter to the dictators' ambition of pursuing power, because they may impose a constraint on the political behavior of the dictators. Strong leaders should be able to break constraining rules when they have a personal political interest in doing so. Thus, the interactive hypotheses (H2–4) specify:

***H2: The effect of factional connections on career promotion do not depend on the economic performance of provincial leaders.***

*H3: The effect of factional connections on career promotion do not depend on the past working experiences of provincial leaders.*

*H4: The effect of factional connections on career promotion do not depend on the age of provincial leaders.*

## **2.4 Data and Methods**

### **2.4.1 Panel Data**

To test the theories and hypotheses above, panel data on provincial leadership was gathered. It takes the province-year as the unit of analysis, incorporating almost all of the provincial party secretaries and governors from 1993 to 2017.<sup>1</sup> I replaced leaders whose tenure was less than half a year with their successors because their short tenure was unlikely to generate any meaningful policy influences. I excluded leaders who died during their tenure. I also excluded those transferred to the People's Congress or to the Consultative Conference after the age of 63, because their exit from power circles seemed to be due to age rather than performance or any other political concerns.

Biographical information was mainly from Jiang's (2018) *Chinese Political Elite Database*. I double-checked the data by using other independent data sources from the websites *China Vitae*, *Wikipedia*, and *Baidu Baike*. Data on provincial economies were obtained from China's National Bureau of Statistics website and the annually published *China Statistical Yearbooks*.

### **2.4.2 Baseline Model**

This study incorporates a binary variable accounting for promotion or non-promotion as its independent variable. In this case, a logit model is valid for estimating the effects of factionalism on provincial leaders' career mobility. The probability of promotion is given by

$$Promotion_{p,t+1} = \alpha_0 + \alpha_1 Faction_{p,t} + \alpha_2 X_{p,t} + \alpha_3 Faction_{p,t} X_{p,t} + \alpha_4 Z_{p,t} + \gamma_{p,t} + \eta_p + \varepsilon_{p,t}$$

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<sup>1</sup> Since 1997, Chongqing has been upgraded to a municipality directly under the central government, and has become an independent provincial administrative unit. Thus, the provincial leadership data for Chongqing begins in 1997.

where  $p$  denotes the province and  $t$  indicates the year.  $Promotion_{p, t+1}$  is the career mobility status of one provincial leader.  $Faction_{p, t}$  is the main independent variable indicating the personal connection of the provincial leaders to the incumbent party head.  $X_{p, t}$  is a vector of the performance, experience, and age characteristics of provincial leaders. I incorporated  $X_{p, t}$  and its interaction with  $Faction_{p, t}$  to test whether there is any differentiation of the effects of these promotion determinants between connected and non-connected leaders. For technical reasons, the continuous variables in  $X_{p, t}$  are centered to avoid collinearity caused by interaction terms.  $Z_{p, t}$  is a vector of control variables. The year dummies  $\gamma_{p, t}$  and the province dummies  $\eta_p$  capture common shocks and time-invariant heterogeneity among different observations. Both of them are allowed to differ between party secretaries and governors. The standard errors are clustered at the province level to avoid serial correlation. For convenience of explanation, I will report the odds ratio of coefficients in the final models.

### 2.4.3 Dependent Variables

As the main dependent variable of this study, *Promotion* indicates whether a party secretary or governor of province  $p$  in year  $t$  was appointed to a higher position during the period between July of year  $t$  and June of year  $t+1$ , which was to be matched with their economic performance in year  $t$ . Given the ambiguous rules of the CCP's bureaucratic hierarchy, scholars have held varying opinions on criteria for judging provincial officials' upward mobility (Geng, Ling and Pang 2014; Zhong, Geng and Chen 2016). I regard a provincial leader as being promoted if he or she assumed a national-level office, including becoming a member of the Politburo, a vice president of the PRC, a vice-premier, or a state councilor in the central government. Provincial governors becoming provincial party secretaries or heads of a central party department or a ministry could also be seen as promotions. For comparability to some previous studies (Jia, Kudamatsu and Seim 2015), I also regard occupying the secretary of the Secretariat of the CCP's Central Committee, the

vice chairmanship of the National People's Congress or the Chinese People's Political Consultative Conference, and the head of the Supreme People's Court as a promotion. In robustness check, exclusion of these factors generates very similar results.

#### 2.4.4 Independent Variables

In this study, the most important independent variable shows the factional connections of provincial party secretaries and governors. I designated the variable *Personal Connection* as the measure of the relationship between provincial leaders and the CCP's incumbent heads (general secretary of the Central Committee). In this regard, past researchers often regarded shared working experiences as evidence of interpersonal ties (Keller 2016). Working in the same place during the same period increases the probability of knowing each other and establishing mutual trust. However, intimate factional ties are also built on hierarchical relationships within a regional or departmental bureaucracy. In particular, incumbent supreme leaders might be expected to promote their past subordinates. Therefore, I coded the variable *Personal Connection* as 1 if a provincial party secretary or governor used to work with one of the subsequent supreme leaders as a subordinate within a regional or departmental bureaucracy at the same time; otherwise, it was coded as 0.<sup>2</sup> This patronage connection is only coded as existing when the supreme leader is in office, and not before or after he is in office.

To encourage local bureaucrats to follow the party center, the CCP's top leaders may evaluate the performance of their inferiors via important economic indicators (Zhang 2009). Accordingly, I measured a provincial leader's *Economic Performance* using the average provincial GDP growth rate. It was measured by the mean value of the provincial GDP

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<sup>2</sup> China's bureaucracies are organized mainly along territorial lines (Qian, Roland and Xu 2006). Regional governments are responsible for supervising bureaucratic functioning throughout their regions. Therefore, regional party-government leaders can easily establish relationships among superiors and subordinates within regional bureaucracies, which give them opportunities to foster cronyism. By contrast, the leading figures of a central or local department can only establish personal connections with the officials in these systems. Based on this principle, I defined all the officials in a given region as one party leader's cronies if this leader was the head of the party or government in that region; however, I defined the officials of a central ministry or local department in a given region as the cronies of other officials in that department.

growth rate during one leader's tenure. The average provincial GDP growth rate reflects the provincial leaders' contributions to regional prosperity, which would be expected to be a criterion for calculating the performance of provincial cadres.

To capture seniority, I constructed several dummy variables, including *SOE*, *INTERPRO*, *REMOTE*, *CENT*, *CITY*, and *CYL*. *SOE* measures work experiences at state-owned enterprises. *INTERPRO* measures work experiences in other provinces. To ensure the significance of these political experiences, all these positions need to be at or above the departmental level. *REMOTE* measures work experiences in the local government of Xinjiang and/or Tibet. *CENT* measures past experiences of working in branches of the central government. *CITY* measures past experiences of assuming prefectural-level party secretary and/or city mayor posts. *CYL* measures whether the officials used to work at or above a departmental level branch of the Communist Youth League (Wu 2006). I simplified my model by creating a count variable *Experiences*, which ranges from 0 to 6. It measured the number of these different work experiences that provincial leaders have. In addition, I included the *age* of the provincial leaders as an independent variable. All of these variables show the seniority of provincial leaders within the party.

#### **2.4.5 Control Variables**

Career promotion may be influenced by other confounding factors. In the baseline models, several control variables were introduced to isolate such potential effects. First, I followed previous studies by including Provincial *GDP* to control for provincial welfare effects (Li and Zhou 2005; Opper, Nee, and Brehm 2015), which allows for the possibility that taking charge of economically developed regions may provide crucial professional experiences for promotion. Second, I included a dummy variable, *Graduate*, to show when officials have a graduate degree or above. Finally, I incorporated a continuous variable, *Tenure*, to show the number of years a provincial leader has already served in the current

post. I assume that longer office terms reduce the promotion chances of a provincial leader, because it tends to strengthen officials' local favoritism and decrease their linkage with the center. Moreover, longer tenures might imply poor performance at current positions.

Table 1 Descriptive Statistics

	(1) All Leaders (last tenure year)	(2) Party Secretary (last tenure year)	(3) Governor (last tenure year)	(4) All Samples
Promotion	42%	22%	61%	12%
Personal Connection	10%	8%	12%	10%
Economic Performance	111.10 (2.33)	111.12 (2.29)	111.08 (2.36)	111.13 (2.68)
SOE	30%	28%	31%	29%
INTERPRO	40%	39%	41%	37%
REMOTE	9%	10%	8%	9%
CENT	34%	0.37%	32%	34%
CITY	66%	70%	63%	65%
CYL	21%	21%	22%	22%
Experiences	2.00 (1.07)	2.04 (1.13)	1.96 (1.00)	1.96 (1.04)
Age	60.04 (4.19)	61.20 (4.16)	59.02 (3.95)	58.72 (4.08)
Tenure	4.37 (2.29)	4.60 (2.38)	4.17 (2.20)	3.19 (2.15)
Graduate	0.43	0.40	0.46	0.46
GDP (in trillion RMB)	1.02 (1.30)	1.00 (1.20)	1.03 (1.39)	1.01 (1.32)
Observations	358	168	190	1526

Notes: Reported in each cell are the sample means for continuous variables and the percentage for dummy variables. Reported in parentheses is the standard deviation for continuous variables. SOE means work experiences at state-owned enterprise. INTERPRO = work experiences in other provinces; REMOTE = work experiences in Xinjiang and/or Tibet; CENT = past experiences of working in the central government; CITY = past experiences of assuming prefectural-level party secretary and/or city mayor posts; CYL = past experiences of working in the Communist Youth League.

The descriptive statistics are shown in Table 1. It shows that about 42% provincial leaders are promoted at the end of their tenure in office. But governors have much more chances than party secretaries in career promotion, 61% and 22% respectively. About 10% observations have personal connection with the CCP's incumbent top leader. And over 60% of them used to work at the prefectural leading positions. On average, each observation has at least two working experience items.

## **2.5 Empirical Results**

### **2.5.1 Baseline Models**

The baseline results are presented in Table 2. A personal connection with the incumbent supreme leader has significantly positive effects on promotion in several separate models, including isolated regression (Model 1), regression with separate interaction terms of economic performance (Model 2), experiences (Model 3) and age (Model 4). Even with the inclusion of the complete set of variables and fixed effects, the effects of the personal connection variable are significant at the five per cent level (Model 5). The odds ratio suggests that, all else being equal, the likelihood of provincial leaders' career promotion is increased by approximately 105.7 per cent when there is a personal connection with the incumbent supreme leader.

In addition to factionalism, past working experiences and age also had significantly positive effects on provincial leaders' career promotion. Models 3 and 5 jointly show that richer work experiences increase the probability of career promotion, and the results are still significant at the ten per cent level, even when all of the control variables are included. Specifically, the odds ratio shows that the likelihood of career promotion is increased by 60.6 per cent for each additional item of past working experience. The effects of interaction between personal connections and past working experiences are not significant once I incorporated control variables in Model 5, which suggests that the decision of the supreme leaders to promote provincial officials may not depend on their seniority. However, the effects of age on promotion are more complicated. Models 4 and 5 demonstrates that the likelihood of career promotion does not increase with age. Nevertheless, Models 4 and 5 show that the coefficient on the interaction term of personal connection and age is negative and statistically significant at the one per cent level, implying that increased age might decrease the likelihood of the career promotion of the connected officials.

Table 2 Baseline Results

	(1)	(2)	(3)	(4)	(5)	Odds Ratio
	Promotion	Promotion	Promotion	Promotion	Promotion	
Personal Connection	0.879*** (0.313)	0.886*** (0.337)	0.666** (0.276)	0.629* (0.326)	0.721** (0.365)	2.057**
Economic Performance		0.034 (0.049)			0.064 (0.064)	1.066
Personal Connection* Economic Performance Experiences		0.127 (0.089)	0.360*** (0.120)		0.474*** (0.165)	1.606***
Personal Connection* Experiences			0.575** (0.265)		0.359 (0.291)	1.432
Age				0.029 (0.022)	-0.004 (0.030)	0.996
Personal Connection* Age Tenure				-0.261*** (0.072)	-0.246*** (0.092)	0.782***
Graduate					0.336*** (0.072)	1.399***
GDP					0.223 (0.259)	1.250
					-0.184 (0.176)	0.832
Fixed Effects	Yes	Yes	Yes	Yes	Yes	
N of Province	31	31	31	31	31	
pseudo-R <sup>2</sup>	0.406	0.408	0.422	0.413	0.459	
Log likelihood	-324.10	-322.84	-315.38	-320.33	-295.36	
Obs.	1526	1526	1526	1526	1526	

Notes: Independent variables are lagged one year. Robust standard errors clustered at the province level are reported in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

In sum, first, both personal connection and seniority impose significantly positive effects on career promotion. Second, neither performance-based nor seniority-based criteria effectively influence the decision-making of the CCP's supreme leaders on bureaucracy mobility. Third, only personnel management rules about age limits constrain the CCP's supreme leaders' efforts to promote their cronies into higher positions. Therefore, these stepwise logit regressions strongly support the hypothesis (H1) of a positive association between factionalism and career promotion chances. H3 is weakly accepted. H4 is strongly rejected. In contrast, the evidence does not support the traditional wisdom on meritocracy. Neither economic performance nor the interaction terms between personal connection and economic performance significantly increase the chances of promotion. Therefore, H2 is strongly accepted.

Table 3 Robustness Checks

	(1) Modification of Promotion	(2) Modification of Personal Connection	(3) Modification of Economic Performance
Personal Connection	0.650* (0.360)	0.655** (0.330)	0.977** (0.453)
Economic Performance	0.071 (0.066)	0.086 (0.064)	0.057 (0.059)
Experiences	0.480*** (0.164)	0.512*** (0.155)	0.477*** (0.165)
Age	-0.009 (0.035)	-0.019 (0.029)	-0.002 (0.030)
Personal Connection* Economic Performance	0.027 (0.094)	-0.107 (0.153)	-0.149 (0.095)
Personal Connection* Experiences	0.260 (0.270)	-0.024 (0.203)	0.358 (0.288)
Personal Connection* Age	-0.298** (0.116)	-0.190* (0.101)	-0.198* (0.103)
Tenure	0.310*** (0.069)	0.343*** (0.074)	0.340*** (0.074)
Graduate	0.430 (0.268)	0.240 (0.241)	0.232 (0.258)
GDP	-0.162 (0.175)	-0.204 (0.175)	-0.208 (0.176)
Fixed Effects	Yes	Yes	Yes
N of Province	31	31	31
pseudo-R <sup>2</sup>	0.459	0.451	0.460
Log likelihood	-278.12	-299.65	-294.84
Obs.	1526	1526	1526

Notes: Independent variables are lagged one year. Robust standard errors clustered at the province level are reported in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

## 2.5.2 Robustness Checks

For robustness checks, I conducted a series of modifications on the baseline models.

First, I modified the coding strategies of *Promotion*, as mentioned before. Second, I changed the coding strategies for *Personal Connection*. I followed some new literature (Keller 2016; Meyer, Shih and Lee 2016) to take overlapping time and rotation of provincial unit into consideration. In this case, a leader's personal connection was coded as 1 if he or she used to be a provincial subordinate of the subsequent supreme leader for at least one year, and while working together, he or she was transferred into or out of their patron's work unit.<sup>3</sup> Third, I took the difference of average GDP growth rate relative to adjoining provinces to measure provincial leaders' performance. This reflects the superiority of a given provincial leader in

<sup>3</sup> I am interested in the rotation of these politicians because a workplace change under the watch of their patrons might signal a very strong factional coalition. A newly appointed senior official in provincial unit would have an incentive to bring close allies to the new posting and then send them on to other units to extend their factional influences. Conversely, a party leader has no incentive to appoint and transfer untrustworthy subordinates in the localities under his purview.

regional economic competition. This variable was calculated by subtracting the mean value of economic performance of the adjoining provinces from the economic performance of the provincial leader's province. Table 3 shows that they yield similar results to the baseline models. In addition, I regressed the five indicators of past working experiences separately. Table 4 shows that working as a party secretary and/or mayor of a prefecture-level city increased the likelihood of promotion by 174.2 per cent when all the variables are included. Past working experiences in state-owned enterprises, central government and Communist Youth League also impose some positive effects on their likelihood of promotion.

Table 4 Working Experiences

	(1) Promotion	(2) Promotion	(3) Promotion	(4) Promotion	(5) Promotion	Odds Ratio
SOE	0.561* (0.290)	0.618** (0.296)	0.638** (0.303)	0.611* (0.327)	0.603* (0.333)	1.827*
INTERPRO	0.085 (0.255)	0.020 (0.263)	0.023 (0.266)	0.199 (0.340)	0.158 (0.353)	1.171
REMOTE	0.687 (0.465)	0.780 (0.479)	0.743 (0.509)	0.594 (0.590)	0.692 (0.590)	1.998
CENT	0.307 (0.263)	0.360 (0.263)	0.394 (0.273)	0.553* (0.319)	0.570* (0.319)	1.769*
CITY	0.740*** (0.231)	0.822*** (0.254)	0.835*** (0.260)	0.989*** (0.281)	1.009*** (0.290)	2.742***
CYL	0.689*** (0.265)	0.634** (0.271)	0.685** (0.297)	0.574* (0.348)	0.508 (0.370)	1.662
Personal Connection	0.894*** (0.312)	0.849*** (0.308)	0.844*** (0.316)	1.087*** (0.338)	1.095*** (0.344)	2.988***
Economic Performance		0.088 (0.054)	0.091* (0.054)	0.101 (0.070)	0.083 (0.069)	1.086
Age			0.025 (0.026)	-0.032 (0.029)	-0.031 (0.029)	0.969
Tenure				0.350*** (0.075)	0.353*** (0.075)	1.423***
Graduate					0.178 (0.304)	1.195
GDP					-0.219 (0.167)	0.803
Fixed Effects	YES	YES	YES	YES	YES	
N of Province	31	31	31	31	31	
pseudo-R <sup>2</sup>	0.423	0.425	0.426	0.455	0.456	
Log likelihood	-314.55	-313.46	-313.11	-297.55	-296.58	
Obs.	1526	1526	1526	1526	1526	

Notes: Independent variables are one-year lagged. Robust standard errors clustered at the province level are reported in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$ .

### 2.5.3 Patronage Ties with PSC Members

Some quantitative studies have indicated significantly positive effects of personal ties with the incumbent PSC members on provincial leaders' career promotion (Jia, Kudamatsu

and Seim 2015; Opper, Nee, and Brehm 2015). However, I posited that this was caused by incidental correlation, because the party's supreme leaders were among the PSC members. One way to separate the confounding effects of the supreme leaders from other PSC members is to regress on the personal connection with them. I coded one provincial leader as having *Personal Connection with other PSC* if he or she used to work with at least one incumbent PSC member, except for the CCP's supreme leader. For comparison, I also measured the provincial officials' *Personal Connection with all PSC*.

I regressed these variables separately using logit regression models, and incorporated the interaction term of *Personal Connection* and *Personal Connection with other PSC* to test their complementary effects. I also included the control variables from the periodicity regressions. Table 5 displays the results. Model 1 suggests that personal ties with any one PSC member increase the likelihood of promotion, but the result is not significant. Model 2 generates similar results to my baseline models. Model 3 shows that personal ties with any other PSC members do not significantly improve the promotion chances of provincial leaders. More interestingly, Models 4 and 5 suggest that the probability of promotion becomes much higher after including the connection with the top, the connection with other PSC leaders, and their interaction term. Model 5 shows that the promotion chance of those provincial leaders exclusively connected with the incumbent general secretary is over 8 times larger than others. However, their promotion chances declined dramatically if they also have personal connection with other PSC leaders.

## **2.6 Discussion**

This article, in general, shows the importance of patronage networks in affecting elite selection of the CCP at provincial level. However, there is little evidence to support either the effects of economic performance alone, or the complementarity of economic performance and political connection. Given the widely accepted notion that merit-based recruitment has

played a crucial role in China’s economic and political reform after the Mao era (Chen, Li and Zhou 2005; Li and Zhou 2005; Zhang 2009; Choi 2012, 2016), these results may seem to run counter to common sense. Nevertheless, not all the studies on the cadres assigned to provincial leading posts strongly support the performance hypotheses (Oppen, Nee, and Brehm 2015). One plausible explanation for this distinction is that the CCP employs a multilevel appointment strategy in which sub-provincial level officials are promoted according to their performance (Guo 2007; Landry 2008; Yao and Zhang 2015), while political conformity may become more important for provincial-level leaders (Li 2014). This is because lower-level officials are essential to regional economic development, but have no substantial influence at the center of power. Promoting competent officials is crucial to regional growth, while the political consequences of promoting potentially disloyal officials are acceptable. Conversely, higher-level cadres directly influence the selection of central leaders. A national official with a high degree of competence and a low degree of loyalty may increase political risks for supreme leaders. Thus, performance-based recruitment at higher levels is replaced by political concerns (Landry, Lu and Duan 2018).

Table 5 Personal Connection with PSC Members

	(1) Promotion	(2) Promotion	(3) Promotion	(4) Promotion	(5) Promotion	Odds Ratio
Personal Connection with all PSC	0.398 (0.275)					
Personal Connection		0.879*** (0.313)		2.303** (0.965)	2.236*** (0.841)	9.352***
Personal Connection with other PSC			0.100 (0.282)	0.151 (0.309)	0.096 (0.349)	1.100
Personal Connection* Personal Connection with other PSC				-2.001* (1.059)	-1.965** (0.999)	0.140**
Controls	No	No	No	No	Yes	
Fixed Effects	YES	YES	YES	YES	YES	
N of Province	31	31	31	31	31	
pseudo-R <sup>2</sup>	0.403	0.406	0.401	0.411	0.426	
Log likelihood	-325.57	-324.10	-326.64	-321.26	-313.19	
Obs.	1526	1526	1526	1526	1526	

Notes: Independent variables are one-year lagged. Robust standard errors clustered at the province level are reported in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

More importantly, unlike some previous works (Jia, Kudamatsu and Seim 2015; Opper, Nee, and Brehm 2015), this study accentuates the significance of personal ties with the CCP's supreme leaders in career promotion of China's provincial elites. This article shows that, first, the exclusive patronage ties with incumbent general secretary of the CCP, to the largest extent, increases the probability of the provincial leaders' career promotion; second, the personal ties with any other PSC members alone can not help them to be promoted; and third, personal connection with both incumbent general secretary and any other PSC members only slightly increases the likelihood of promotion. In other words, the empirical evidence does not support the complementarity between connection with supreme leaders and connection with other top leaders. The effects of the two are offsetting. This is probably because connection with other PSC members undermined the perceived loyalty of the provincial officials to the incumbent supreme leaders. This finding is very important. It further reveals not only concerns of the CCP's top leaders on personal loyalty but also the weaknesses of the collective leadership rules at the top.

## **2.7 Conclusion**

Based on panel data from 1993 to 2017, this study proves that personal connections with the CCP's incumbent supreme leaders significantly increased the promotion chances of provincial leaders. These positive effects did not depend on economic performance or past work experience. Age limits and retirement rules still mattered for provincial leaders' career promotion. Past working experiences of being a prefectural party secretary and/or city mayor also increased provincial leaders' promotion chances. In addition, this study does not support the argument that economic performance is an important determinant for the provincial leaders' political future. The study also challenges our understanding of the CCP's collective leadership. The effects of factional ties with other incumbent PSC members on career promotion were weak. Therefore, this study strongly supports the existence of the power of

the incumbent supreme leader in selecting the CCP's high-level leadership. The CCP's established institutions seem to be a dependent tool for each new supreme leader.

Given the crucial role of provincial leaders in implementing central policies, controlling the provincial personnel is pivotal to advancing the policy agenda. The party's supreme leaders are able to use career incentives to induce their factional coalitions to follow their policy preferences. In this way, they consolidate their personal control over the party as a whole, which in turn allows them to change the status quo policies of the party-state. For instance, Jiang's dominance was reflected in his efforts to allow capitalists to join the party. In this way, he transformed the class base of the CCP (Gore 2015). Another example is Xi Jinping's power of control. Although Xi's seniority as a national leader was that of a lightweight, he successfully purged the opposing factions and assigned his cronies to important posts to control the CCP's bureaucracy before the 19th Party Congress (Li 2016). This was the political outcome of the anti-corruption movement. Based on this makeover, he could move on to abolish the institutionalized tenure restriction of the national leader by amending the constitution. In 2020, the appointment of his retired cronies to crucial departments supervising Hong Kong seemingly signals a break in enforcing age limit rules for assigning higher officials.<sup>4</sup> Xi Jinping's decisive determination and power once again demonstrates the unchallenged authority available to the CCP's supreme leaders.

Some may be interested in the rise and fall of Hu Jintao's power as well as in his association with the CYL. It is unclear whether the CYL is Hu Jintao's personal faction. Past observers often regarded the CYL as Hu's power base (Wu 2006). Nevertheless, the evidence showing Hu Jintao's efforts to affect the CCP's provincial personnel through this faction is very weak. The effects of CYL on provincial leaders' career promotion disappear after

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<sup>4</sup> Xi Jinping assigned Xia Baolong (68 years old) and Luo Huining (66 years old) to the State Council's Hong Kong and Macau Affairs Office and the Liaison Office of the Central People's Government in the Hong Kong SAR respectively. Both senior officials are clearly above the 65-year-old retirement threshold. Please see Lam (2020). Available at <https://jamestown.org/program/beijings-appointment-of-xia-baolong-signals-a-harder-line-on-hong-kong/> (accessed on 21 June 2020).

including some control variables. From this standpoint, it seems that the CYL is not an effective faction in the CCP's bureaucracy. From another perspective, however, Xi Jinping's antipathy toward and vigilance against the CYL<sup>5</sup> suggests that the CYL used to be an independent faction influencing Chinese politics and possibly even challenging the power of the supreme leaders. Was the CYL a subordinate faction under Hu Jintao's personal control or an independent elite group? Or should we regard it as only a valuable type of work experience in the CCP's bureaucracy? So far, these questions remain unresolved and require further study.

Furthermore, This study does not tell us whether the past and incoming supreme leaders did not have significant effects on the promotion of connected provincial leaders. But some previous studies have shown the impacts of already designated and retired general secretaries of the party on the composition of the party center. For instance, Meyer, Shih, and Lee (2016) suggest that Jiang Zemin helped his factions come into the 16th Central Committee, and Xi Jinping exerted a strong influence on the composition of the 18th Central Committee. However, my study was able to find no strong evidence of Jiang Zemin's or Hu Jintao's impact on provincial leaders' promotion when they were not in power. It seems, rather, that the Party Congress is a crucial component of a political mechanism in generating the next selectorate, within which two successive generations of party leaders and their factional coalitions compete with each other directly. The Party Congress meeting finally confirms the legitimacy of these political outcomes (Wu 2018). After that, the newly selected supreme leaders are able to exclude other leaders from intervening in the selection of officials to more important provincial leading posts. Therefore, I supposed that the previous and future leaders

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<sup>5</sup> For detailed reports on how Xi Jinping curbed the Communist Youth League to consolidate his power, see Lim and Blanchard (2016). Available at <https://www.reuters.com/article/us-china-politics-league-exclusive/exclusive-xi-set-to-consolidate-power-in-china-by-curbing-communist-youth-league-idUSKCN12000L> (accessed on 21 June 2020).

might influence choices of new supreme leaders, but not subsequent choices of provincial leaders. Further studies should be done to testify such theories and assumptions.

### **Chapter 3: Informal Political Coalitions and Private Investment in China**

**Abstract.** This paper attempts to estimate the effects of informal political coalitions on China's private investment. Theoretically, the party-state clients of China's supreme leaders are expected to have stronger incentives to foster economic growth. One way of doing so is to encourage private investment by reducing its political risks. Analysis of provincial-level panel data from 1993 to 2017 shows that personal connections—based on shared experience in the same work unit—between provincial leaders and the Chinese Communist Party's incumbent supreme leader significantly increase the growth rate of private investment. This suggests that informal institutional relations may assist the development of China's private economy by partially compensating for the weaknesses of formal rule-of-law institutions.

### 3.1 Introduction

Fixed asset investment has long played an important role in promoting China's economic prosperity. Compared with state-owned investment, private investment is more conducive to efficient allocation of economic resources. Due to the importance attached to more market-oriented economic development since the time of Deng Xiaoping's leadership, the Chinese government should have strong incentives to promote private investment. Overall, conventional wisdom ascribes increasing private investment in China to the evolution of Weberian-style formal institutions (Fu 2000). These institutions maintain a balance between decentralization and centralization, through which the high-ups encourage their subordinates to fulfill the party's developmental goals (Miller 2008; Zhou 2018).

Nevertheless, informal institutions are of growing interest to China specialists. More recent studies prove that informal politics, particularly as seen in the factionalism of the Chinese Communist Party, help to explain a wide range of political and economic outcomes in China (Wang 2000; Shih 2004; Bai, Hsieh, and Song 2020; Jiang and Zhang 2020). This implies that factional ties may assist the CCP's local bureaucracies in their efforts to compete for economic resources and improve development performance. What are the effects of informal political coalitions on the development of private investment in China? Do personal connections with the Chinese Communist Party's supreme leaders bolster provincial private investment? This paper hypothesizes that provincial leaders having personal connections with the CCP's incumbent general secretary should perform better in promoting the growth rate of overall private investment at the provincial level. Given weak institutions of private property protection, this patronage network may encourage provincial leading figures to facilitate

private investment. It may also attract private investors by reducing the investors' political risks. Thus, informal institutions may not always be synonymous with inefficiency (Jiang 2018; Bai, Hsieh, and Song 2020). Instead, they may serve as a path for cooperation between provincial officials and private entrepreneurs under the CCP's system, which makes connected provinces more attractive destinations for private investors.

In order to test such effects, I design a quantitative analysis on a panel of China's province-level administrations using time-series, cross-sectional data across 31 provinces from 1993 to 2017. The empirical evidence is consistent with my assumption that provincial connections with the CCP's top leaders deliver better private investment performance. During the sample period, the growth rate of fixed-asset investment by private firms in the provinces having a close relationship with the top is about 15.0% higher than in other provinces. This result persists across several robustness checks. Empirical evidence also indicate that governors have more significant effects on private investment growth rate than provincial party secretaries. This suggests that provincial governments exert more influence than party agencies on regional economic policies.

The remainder of the paper is organized as follows. The next section theorizes the effects of factional coalitions on private investment. The third section provides a research design. The fourth section summarizes the empirical results; and the final section offers conclusions.

### **3.2 Personal Connection and Provincial Private Investment**

Long-term, rapid economic development is typically based on formal institutions that provide rule of law and transparent, fair market competition (North 1982). Based on this argument, past researchers attribute China's remarkable growth of private investment to its institutional

evolution since Deng's reform (Ang 2016). Some assert that China's self-sufficient and internally diversified economy facilitates regional autonomy and reform experiments (Qian and Xu 1993). Tax-sharing programs and state-owned enterprises reforms harden budget constraints and compel local governments to promote growth by encouraging private investment (Cull et al. 2017; Qian and Roland 2018). Additionally, other observers attach great importance to promotion tournaments (Zhou 2004; Li and Zhou 2005). Specifically, the leaders reward those who deliver economic prosperity by providing career promotion, which in turn promotes regional competition and gives local officials enduring incentives to promote growth. Under such pressure, local administrations may foster private sectors as a long-term strategy of increasing economic efficiency.

However, these formal institutions seem not to be as reliable as scholars suppose. This is partly because China has a very strong and effective authoritarian regime. First, central government can change the rules at any time to shrink the pool available for sharing, which may weaken the institutional incentives of economic decentralization (Cai and Treisman 2006). Next, the CCP's leaders are inclined to appoint local officials based on personal favoritism, as illustrated by some recent empirical studies on the homophilic features of political career mobility paths, which leads to dysfunction of promotion tournament (Opper, Nee, and Brehm 2015). Thus, Chinese authoritarianism may undermine the credibility of formal institutions.

Under these conditions, property rights protection remains weak. The formal institutions underlying economic reform may not provide adequate incentives for private investment. However, such less-than-ideal institutions do not necessarily result in low private investment.

China's bureaucracy has distinctive ways of regulating markets, which do not function exactly like traditional market-oriented, rule-of-law institutions. Instead, they provide private investors with additional inducements through factional coalitions.

Central leaders' consensus on marketization requires economic growth as a strategy to legitimize the regime. The development of the private economy tends to improve the efficiency of the national economy as a whole. Arguably, then, the party's top leadership seeks to implement policies favorable to private sector growth. For provincial government officials, economic decentralization enables them to have discretion in how the private-sector-oriented policies are enforced in their jurisdiction. They can regulate the use of natural resources, land tenure, labor welfare, investment projects, bank credit, and even environment protection (Huang 1996; Zhou 2008), which are important for the development of the private economy. Therefore, the provincial party secretaries and governors, as the top leaders of provincial governments, may have more tools than the party center to boost economic growth in their regions.

In this case, local officials face two choices. One is to seek career promotion by following the economic development priorities coming down from above. To this end, local governments should rationally allocate resources at hand to induce private investment. The other one is to feather their own nests by engaging in corruption and plundering the private economy. In this case, local officials may capitalize on the power at hand for rent-seeking. Because the party values political loyalty when selecting senior cadres, the officials having factional ties with the party's top leaders are more likely to be trusted and promoted. Therefore, the connected provincial leaders hold stronger incentives to bolster development

through inducing private investment. They may help the private investors navigate the complexities of the bureaucratic regulatory system to gain higher returns on investment. By contrast, local officials without connections to the top have weaker promotion prospects and a correspondingly greater incentive to discourage private investment by engaging in corrupt regulatory activities.

Due to frequent transfer and promotion, the provincial leading figures often have short tenures in office of provincial secretaries and governors. Because of this, some may argue that the provincial officials do not have sufficient time to help private sector actors realize a higher return on long-term investments. Yet a few years spent with connected officials are better than nothing. Such officials can help to reduce the political risks of private investment in their jurisdictions. Moreover, those few years spent cooperating with the provincial leaders may provide time and an advantageous position to develop other local connections, among which the city-level leaders may provide more direct and near-term benefits (Landry 2008).

How exactly might private investors benefit from ties with well-connected local officials? First, political backing by connected officials decreases the short-term uncertainty of private investment. Empirical evidence shows that officials having factional ties with the party's top leaders are less likely to be purged in anti-corruption campaigns (Jiang and Xu 2015). Because of this, private investment can be better protected through sustained leadership stability and more limited, predictable corruption (Zhu and Zhang 2017a). More importantly, with the help of the connected officials, the private investors may escape from judicial sanctions if they are involved in such illegal business activities as rent-seeking or commercial bribery. Although immoral, these informal channels can help the development of private

economies.

Second, political backing by connected officials sustains private investors' long-term confidence. The entrepreneurs who tend to curry favour with promising officials are often rewarded in business. For example, Li Shufu, a rising private entrepreneur, seemed to establish close relationships with the local bureaucracies of Zhejiang province in the 2000s. Li Shufu made a fortune after 2010, when the past leading figure of Zhejiang province, Xi Jinping, became the CCP's general secretary. Therefore, it is the prospect of future rewards that motivates present confidence and activities. Local bureaucracies having a close relationship with the top are more likely to be promoted in the next few years or at least to prolong their political influence (Jia, Kudamatsu, and Seim 2015). If these connected officials are promoted in the future, for example, by entering the Politburo Standing Committee or becoming the CCP's next generation supreme leader, they may enable private investors to gain even greater commercial benefits. In this way, well-connected bureaucracies have a better prospect of continuing the reciprocal exchange of benefits in the future, which makes connected private entrepreneurs believe that their investments are safer and may yield greater long-run returns.

Additionally, it is worth noting that not all the provincial leaders connected with the power center can reduce the political risks of private investors. Elite competition among CCP factions may stimulate intensive anti-corruption campaigns, which often occur during the transfer of power from one provincial party leader to the next (Zhu and Zhang 2017b). When outgoing leaders and their successors belong to competing factions, the successors tend to purge the subordinates of their predecessors. It hinders predictability of provincial leadership

and may undermine the associated private entrepreneurs (An et al. 2016). Therefore, general cooperation is sometimes risky for private entrepreneurs, while cooperation with the faction of the party's incumbent supreme leader may offset such risks. This is because the party's supreme leaders rarely if ever become the target of anti-corruption campaigns. They may also preserve their political influence on personnel arrangements after retiring, which may help to protect their old subordinates from political purges.

Based on these considerations, I contend that provinces led by those with connections to the supreme leader are more attractive to private investors. In addition to relying on market competition, China's private investors are always eager to seek and exploit the more reliable patronage networks between local officials and the top. These local factions are often related with the CCP's incumbent supreme leader, the general secretary. This reasoning supports the following hypothesis:

*H: Provincial private investment is higher where provincial leaders have personal connections with the CCP's incumbent supreme leader.*

### **3.3 Research Design**

#### **3.3.1 Provincial Private Investment**

Provincial private investment is the dependent variable. The Chinese government has a dominance on almost all investment projects. Through national economic plans, governmental scrutiny and approval are required for any fixed-asset investment above a fairly low threshold (Haggard and Huang 2008). Nevertheless, private investors seem to be more sensitive to the factions of provincial leadership than others. In addition to their benefit-seeking motivations and flexibility in decision-making, private sectors are

disadvantaged in ideology and politics and thus have an incentive to seek political backing. In contrast, state-owned enterprises already have built-in patrons (Chen et al. 2011). It is costly for SOEs to curry favor with new influential leaders by shifting their investments, because it may offend their old patrons and thus undermine the credibility of the established system of mutual benefits. Therefore, the inflow of private investment may be affected by investors' assessments of changes in the local political environment, whereas SOEs may be more constrained and derive less benefit from seeking new patrons. Based on these arguments, I take the annual growth rate of fixed asset investment by de jure private and individual firms as the proxy for the provincial private investment growth rate. I expect that the provincial leaders' connections with the top may increase the private investment growth rate.

### **3.3.2 Measuring Factional Ties with the CCP's Supreme Leaders**

Factional ties are the main independent variable. There are two commonly used approaches to trace personal ties among high-level officials. The explanatory approach uses open qualitative information to identify such ties, while the structural approach uses biographical data and quantitative analyses to code factions (Keller 2016). Through explanatory analyses, we find that, first, Jiang Zemin and Xi Jinping developed most of their factional networks within prefecture-level or even county-level bureaucracies when they were in office as provincial party secretary and governor in Shanghai, Zhejiang and Fujian; second, Hu Jintao cultivated his faction when he served as the leading figure of the Communist Youth League. It seems quite likely that domestic private investors would be aware of such personal connections—more so, probably, than would foreign investors. In addition, Meyer, Shih, and Lee (2016) derived a series of structural approaches to measure factional ties. Combining the

two approaches, I define a provincial leader P as a factional member of the CCP's incumbent general secretary G if and only if all of the following conditions are met:

1. G served as the head of a ministerial or province-level unit, including minister, provincial party secretary or governor.
2. While G was working in the unit, P was transferred into G's work unit or out of G's work unit, except when P was transferred out to the Party Congress or the Chinese People's Political Consultative Conference.
3. Before or after such transfer, P and G have shared working experiences in that unit for over one year within four administrative steps of one another.

Past research on provincial leadership ties tends to focus on the effects of provincial party secretaries because they are the most powerful leading figures in the provincial-level unit (Sheng 2007). But party secretaries are often focused on personnel management, while governors may have more direct responsibility for economic policy (An et al. 2016). Thus, the governors should be taken into consideration for their potential influence on private investment growth. In order to combine the two, I coded the provincial independent variable value as 1 if the factional variable value of either the party secretary or the governor was 1, and 0 otherwise.

### **3.3.3 Control Variables**

To isolate the confounding effects of provincial economic performance from the key factional effects, I introduced a vector of economic control variables capturing provincial economic conditions. They are *GDP* (annual provincial GDP value), *GDP growth* (annual provincial GDP growth rate value), *Per Capital GDP* (annual provincial GDP per capita),

*Manufacturing/GDP*, and *Service/GDP* (provincial manufacturing and service industries added values as a percentage of provincial GDP). To isolate the confounding effects of certain key characteristics on leader competence and policy preferences, I include the *Age*, college *Education*, and *Tenure* length of the provincial leaders. I also control for *CYL*, career experiences in the Communist Youth League, and *EXP*, career experiences in some prosperous provinces (Beijing, Tianjin, Shanghai, Jiangsu, Zhejiang, Fujian, and Guangdong).

### 3.3.4 Data Sources

The data for this study come from several sources. The economic statistics were from the National Bureau of Statistics of China website and the annually published China Statistical Yearbooks. I changed the current economic statistics to the constant value of the year 1997 because the data of Chongqing begin in that year. The biographical information was manually collected from Jiang's (2018) Chinese political elite database.

### 3.3.5 Baseline Specifications

The hypothesis above presumes that the effects of personal connections to supreme leaders on private investment do not change with regions and time. In this case, a two-way fixed-effects regression makes it possible to control for unobservable heterogeneity across provinces and years. The model equation takes the following form:

$$Private\ Investment\ Growth_{p,t+1} = \alpha_0 + \alpha_1 Personal\ Connection_{p,t} + \alpha_2 Z_{p,t} + \gamma_t + \eta_p + \varepsilon_{p,t}$$

where *Private Investment Growth*<sub>p,t+1</sub> indicates the growth rate of private investment in province p at time t+1. I set the dependent variable at t+1 to mitigate time lag and reverse effects. *Personal Connection*<sub>p,t</sub> reflects affiliation of the provincial leaders with the currently

ruling supreme leader at time  $t$ .  $Z$  is the vector of controls, including provincial economic attributes and provincial leaders' demographic characteristics. Time-related terms  $\gamma_t$  are included to capture omitted country-wide economic and policy shocks. Province dummies  $\eta_p$  capture time-invariant heterogeneity among different provinces. To avoid correlation of the residuals with the province-level clusters, I applied clustered standard errors to estimate the significance of the coefficients.

Table 6 Baseline Models

	(1)	(2)	(3)	(4)
Dependent Variable	Private Investment Growth (t+1)	Private Investment Growth (t+1)	Private Investment Growth (t+1)	Private Investment Growth (t+1)
Personal Connection	0.167*** (0.061)	0.156*** (0.046)	0.156** (0.061)	0.150*** (0.047)
Constant	0.079 (0.054)	-0.480* (0.258)	0.181 (0.280)	-0.326 (0.314)
Economic Attributes	NO	YES	NO	YES
Demographic Characteristics	NO	NO	YES	YES
Province Fixed-effects	YES	YES	YES	YES
Year Fixed-effects	YES	YES	YES	YES
Number of Provinces	31	31	31	31
Number of Observations	680	680	680	680
R-squared	0.579	0.587	0.578	0.583

Notes: Independent variables are one year lagged. Robust standard errors clustered at province level are reported in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

### 3.4 Empirical Results

Table 6 presents the effects of personal ties on the province-level private investment growth rate from 1993 to 2017. Model 1 show the most parsimonious results without control variables. Model 2 and Model 3 add the economic attributes and demographic characteristics respectively. Model 4 includes all of the variables in my baseline specification. They provide remarkably similar results. Personal connections with the CCP's incumbent supreme leader, whether held by the province party secretaries or the province governors, produce positive and statistically significant effects on the growth of private investment. Model 4 estimates

that, all else equal, the growth rate of fixed-asset investment by private firms in the provinces having a close relationship with the top is about 15.0% higher than in other provinces. This is a considerable performance premium. The private investment for each province in this study is 171.7 billion yuan (24.2 billion US dollars) on average. Every year, a personal connection with the top provides an additional 25.8 billion yuan (3.6 billion US dollars) of private investment.

As robustness checks, I use several procedures to modify my models. First, I apply alternative coding strategies for age and tenure controls by designating age dummies for over 65 years old (less than or equal to 65 years old being the reference group) and tenure length dummies for one year, one to three years, and three to five years (more than five years being the reference group). Second, I use alternative time-related trend terms to replace the year fixed-effects. They are *Hu Era* from 2002 to 2012 and *Xi Era* from 2013 to 2017. Third, I adopt the Arellano-Bond Generalized Methods of Moments procedure to estimate the coefficients (Arellano and Bond 1991). Fourth, I follow Meyer, Shih and Lee's (2016) broad tie measurement to assess whether a provincial leader is connected with the CCP's general secretary. Here, two officials sharing a native place and institutions of higher education are also coded as factional allies. In Table 7, Models 1-4 exhibit all these empirical results, which are consistent with the main results in Table 6. I also regress the effects of provincial party secretaries and governors in Model 5. It shows that, while the factions of both party secretaries and governors have some positive effects on private investment, the effects of governors are much more significant than those of party secretaries. Overall, my hypothesis is strongly supported.

Table 7 Robustness Checks

	(1)	(2)	(3)	(4)	(5)
	Alternative Age and Tenure Control	Alternative Time-related Trend Control	GMM Regression	Broader Personal Connection	Separate Personal Connection
Dependent Variable	Private Investment Growth (t+1)	Private Investment Growth (t+1)	Private Investment Growth (t+1)	Private Investment Growth (t+1)	Private Investment Growth (t+1)
Personal Connection	0.148*** (0.046)	0.137*** (0.030)	0.170*** (0.066)		
Personal Connection (Broad)				0.056** (0.027)	
Personal Connection (Sec)					0.066 (0.061)
Personal Connection (Gov)					0.166** (0.076)
Hu Era (2003<=year<=2012)		0.006 (0.039)			
Xi Era (2013<=year<=2017)		-0.421*** (0.061)			
Constant	-0.492 (0.299)	-0.788** (0.347)		-0.313 (0.310)	-0.230 (0.308)
Economic Attributes	YES	YES	YES	YES	YES
Demographic Characteristics	YES	YES	YES	YES	YES
Province Fixed-effects	YES	YES	YES	YES	YES
Year Fixed-effects	YES	NO	YES	YES	YES
Number of Provinces	31	31	31	31	31
Number of Observations	680	680	558	680	680
R-squared	0.584	0.256		0.577	0.584

Notes: Independent variables are lagged one year. Robust standard errors clustered at the province level are reported in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

### 3.5 Conclusions

This article discusses the relationship between the CCP's patronage networks and the growth rate of provincial private investment. Based on a quantitative research design, I find that the provincial leaders' personal connections with the CCP's incumbent general secretary significantly increase the growth rate of private investment. This might happen through several channels, all of which can be outlined as areas for further research. First, due to career promotion incentives, the cronies of the supreme leaders may have stronger incentives to promote economic development by fostering the private economy. Second, cooperation with the connected provincial leaders may foster private investment by reducing private sector

political risks. If these causal mechanisms do exist, future research should investigate in detail the specific favorable treatments and privileges that the connected provincial leaders provide for private investors. Case studies may offer details regarding these open or clandestine transactions, while data analyses may show the extent to which these additional benefits, along with the reduced political risks, stimulate private investment. In addition, firm-level analyses may help to decipher how the factional ties interact with other individual characteristics to affect private sector investment behavior.

China's market-oriented reform is not a matter of expediency, but a long-term strategy for the survival of the CCP. Due to the elites' consensus on marketization, the CCP's economic reform intentions have been coherent since at least the mid-1990s. However, because the party is not willing to fundamentally transform the authoritarian regime, its efforts to establish market-oriented, rule-of-law institutions are greatly constrained. Thus, the institutions underlying the development of the private economy are still weak. Nevertheless, informal institutions seem to provide a sub-optimal alternative for privatization reform (Dickson 2008).

Under these conditions, the implications of the informal institutions for the broader system are of growing interest to scholars. More recent studies disagree on whether political connections affect corporate investment efficiency and profitability of private firms. Some of them find that political connections help to protect private firm equity values. This is because seeking new and strong political connections may enhance private sectors' relatively weak position, given China's weak legal infrastructure and discretionary, preferential treatments and policies (Wang et al. 2018), as compared to SOEs (Chen et al. 2011). However, the

uncertainty of political turnover may reduce investment and profitability of private firms (An et al. 2016). The results of this study offer some additional support for the hypothesis that, in reform-era China, informal institutions may provide a partial, sub-optimal substitute for traditional rule-of-law institutions.

### 3.6 Appendix

This appendix provides complementary information that is not shown in my research note. The information includes descriptive statistics on the measures of personal connections and the demographic characteristics of provincial leaders, models addressing potential endogeneity problems, and additional analyses on provincial reform performance. I also test the association between informal politics and prospects for future GDP growth. Finally, a firm-level analysis is provided to strengthen the empirical evidence.

#### 3.6.1. Descriptive Statistics

I manually collected demographic characteristics of provincial leaders from the Chinese political elite database. As this dataset ends in 2015, I supplement missing demographic information for 2016 and 2017 through other websites, including China Vitae, Wikipedia, and Baidu Baike. I build a panel of data on provincial leadership. It takes the province-year as the unit of analysis, incorporating the provincial party secretaries and governors from 1993 to 2017. The panel is composed of 771 valid observations, including 166 provincial party secretaries and 212 governors. The observations of Chongqing before 1997 are excluded, because it was not until 1997 that Chongqing became a provincial unit. The descriptive statistics are in Table 8. Panel A reports the sample means. It shows that about 9% of all observations have at least one provincial leader who has working ties with the CCP's incumbent general secretary. About 26% of observations have at least one provincial leader who has broad ties with the CCP's incumbent general secretary. Panel B reports sample distributions by year. Panel C reports sample distributions by province.

Table 8 Descriptive Statistics

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Panel A: Overall statistics	(1)	(2)	(3)
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	Secretary or Governor	Secretary	Governor
<i>Measures of personal connections</i>			
Working Ties	0.09	0.06	0.05
Birth Province	0.15	0.10	0.06
Alumni	0.03	0.02	0.02
Broad Ties	0.26	0.16	0.13
<i>Demographic Characteristics</i>			
Age		59.70	57.87
Tenure Length		3.35	3.09
College Education		0.83	0.88
Served in CLY		0.20	0.23
Served in Prosperous Provinces		0.30	0.37
Observations	771	771	771

Panel B: connection variables by year

Year	Secretary or Governor		Secretary		Governor	
	working ties	broad ties	working ties	broad ties	working ties	broad ties
1993	0.03	0.27	0.03	0.20	0.03	0.13
1994	0.03	0.27	0.03	0.20	0.03	0.13
1995	0.03	0.30	0.03	0.17	0.03	0.20
1996	0.03	0.30	0.03	0.17	0.03	0.20
1997	0.03	0.26	0.03	0.19	0.03	0.13
1998	0.03	0.29	0.03	0.19	0.03	0.16
1999	0.03	0.29	0.03	0.16	0.03	0.19
2000	0.03	0.39	0.03	0.19	0.03	0.23
2001	0.06	0.42	0.06	0.26	0.03	0.19
2002	0.06	0.35	0.06	0.19	0.03	0.19
2003	0.13	0.29	0.10	0.19	0.03	0.10
2004	0.13	0.29	0.10	0.19	0.03	0.10
2005	0.13	0.29	0.10	0.19	0.03	0.10
2006	0.13	0.32	0.10	0.23	0.03	0.10
2007	0.10	0.26	0.06	0.23	0.03	0.03
2008	0.10	0.23	0.00	0.13	0.10	0.10
2009	0.10	0.23	0.00	0.13	0.10	0.10
2010	0.06	0.19	0.03	0.13	0.03	0.06
2011	0.06	0.19	0.03	0.13	0.03	0.06
2012	0.06	0.19	0.06	0.16	0.00	0.03
2013	0.10	0.13	0.03	0.03	0.10	0.13
2014	0.10	0.13	0.03	0.03	0.10	0.13
2015	0.13	0.16	0.10	0.10	0.10	0.13
2016	0.19	0.26	0.13	0.13	0.13	0.19
2017	0.23	0.32	0.13	0.13	0.10	0.19

Panel C: Connection variables by province

province	Secretary or Governor		Secretary		Governor	
	working ties	broad ties	working ties	broad ties	working ties	broad ties
Beijing	0.04	0.20	0.04	0.04	0.00	0.16
Tianjin	0.16	0.40	0.08	0.08	0.16	0.40
Hebei	0.08	0.44	0.00	0.36	0.08	0.08
Shanxi	0.04	0.20	0.00	0.16	0.04	0.04
Inner Mongolia	0.12	0.40	0.12	0.40	0.00	0.00
Liaoning	0.12	0.24	0.12	0.24	0.00	0.00
Jilin	0.20	0.88	0.12	0.48	0.08	0.40
Heilongjiang	0.00	0.04	0.00	0.00	0.00	0.04
Shanghai	0.44	0.48	0.40	0.44	0.44	0.44

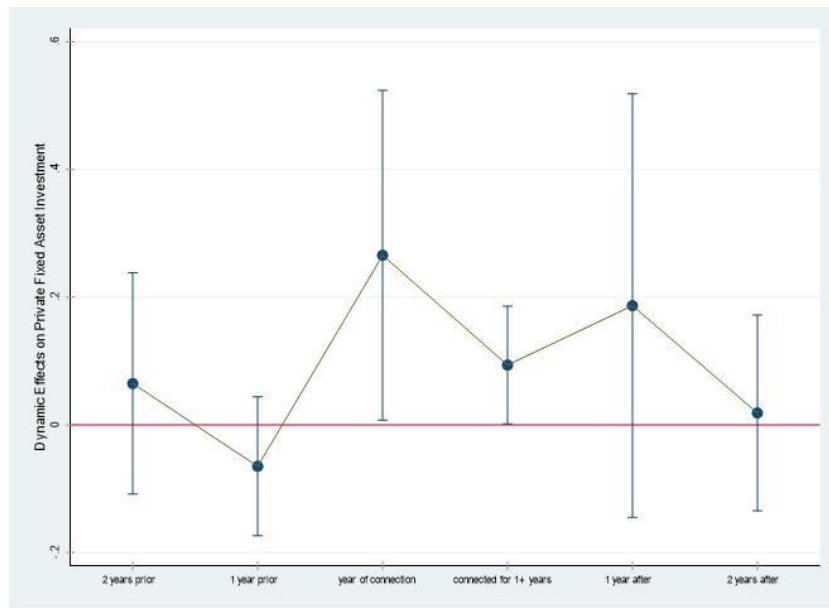
Jiangsu	0.28	0.68	0.28	0.56	0.00	0.40
Zhejiang	0.16	0.48	0.16	0.32	0.16	0.32
Anhui	0.16	0.28	0.00	0.00	0.16	0.28
Fujian	0.08	0.36	0.00	0.16	0.08	0.20
Jiangxi	0.12	0.12	0.08	0.08	0.04	0.04
Shandong	0.00	0.00	0.00	0.00	0.00	0.00
Henan	0.08	0.08	0.08	0.08	0.00	0.00
Hubei	0.00	0.28	0.00	0.04	0.00	0.24
Hunan	0.00	0.20	0.00	0.20	0.00	0.00
Guangdong	0.00	0.20	0.00	0.20	0.00	0.00
Guangxi	0.00	0.08	0.00	0.08	0.00	0.00
Hainan	0.12	0.12	0.04	0.04	0.08	0.08
Chongqing	0.00	0.29	0.00	0.10	0.00	0.19
Sichuan	0.16	0.48	0.16	0.48	0.00	0.00
Guizhou	0.00	0.00	0.00	0.00	0.00	0.00
Yunnan	0.00	0.16	0.00	0.00	0.00	0.16
Tibet	0.28	0.36	0.00	0.08	0.28	0.28
Shaanxi	0.00	0.20	0.00	0.00	0.00	0.20
Gansu	0.04	0.04	0.04	0.04	0.00	0.00
Qinghai	0.00	0.16	0.00	0.00	0.00	0.16
Ningxia	0.00	0.36	0.00	0.36	0.00	0.00
Xinjiang	0.00	0.00	0.00	0.00	0.00	0.00

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### 3.6.2. Endogeneity Issues

The CCP's supreme leaders have the arbitrary power to appoint their cronies to provinces with distinctive economic features. Therefore, the provinces exhibiting the trends of fast growth in private investment may be systematically assigned a crony from the top, which would create endogeneity. In order to investigate whether this problem exists, I designate a series of dummies showing statuses ranging from two years prior to forming a connection to two years after losing such connection. Figure 1 shows the dynamic effects of personal connections on private investment. There is a rise of private investment precisely after appointment of leaders connected to the top. Then it deteriorates back to the bottom two years after these connected officials leave. It is evident that the growth rate of private investment is significantly stimulated only when the province is connected with the top. As a result, endogeneity does not appear to be a severe problem.

Figure 1 Dynamic Effects of Personal Connection



### 3.6.3 Additional Analyses on Reform Performance Incentives

This article assumes that informal political connections may encourage provincial leaders to promote growth by fostering private investment. One way to achieve this is to reduce the political risks of private investors in anti-corruption campaigns. In this section, I provide additional evidence on the effects of informal politics on reform performance, which proves that the provincial leaders who have personal connection with the CCP's incumbent general secretary perform better in supporting the private economy.

Arguably, the inflow of private investment indicates the investors' assessment of their policy environment. Under weak institutions, private investors have a low status in the political pecking order of Chinese firms. They are inclined to seek political protection (Huang 2003). One way of doing this is to cooperate with the state-owned sectors through mixed or even ambiguous property ownership. Haggard and Huang (2008) claim that regulatory and other policy barriers lead to the rise of mixed property firms. Namely, private sectors register

their firms as red-hat firms to access economic resources that are exclusively reserved for state-controlled sectors. Therefore, the ratio of private investment to state-owned investment should be lower when the policy environment is not good for private sectors. In contrast, if some provincial leaders improve the policy environment by liberalizing business entry and reducing biases against the private sector, this may increase private investment. The public sector, by contrast, may be less sensitive to the provincial leaders' factions. Also, public sector investment may decline because of privatization policies. I thus assume that the ratio of private investment to public investment should be higher when the policy environment is good for the private sector.

To verify this argument, I create two indicators for the changes of policy environment. One is *PFA/SFA Growth*, the annual growth rate of the ratio of private investment to state-owned investment. The other one is *PFA/SCFA Growth*, the annual growth rate of the ratio of private investment to state-owned and collective investment. I control for the economic attributes of each province and the demographic characteristics of the provincial leaders. From Table 9, we can see that, regardless of which control variables are included, the estimated effects of connected provincial leaders on policy environment are positive and statistically significant at 1%. This implies that provincial leaders who have personal connections with the CCP's incumbent general secretary may perform better than other leaders in improving the policy environment for the private economy.

Table 9 Reform Performance Incentives

	(1)	(2)	(3)	(4)
Dependent Variable	PFA/SFA Growth (t+1)	PFA/SFA Growth (t+1)	PFA/SCFA Growth (t+1)	PFA/SCFA Growth (t+1)
Personal Connection	0.211*** (0.073)	0.185*** (0.064)	0.205*** (0.071)	0.179*** (0.065)
Constant	0.129	-0.254	0.136	0.048

	(0.083)	(0.455)	(0.082)	(0.459)
Economic Attributes	NO	YES	NO	YES
Demographic Characteristics	NO	YES	NO	YES
Province Fixed-effects	YES	YES	YES	YES
Year Fixed-effects	YES	YES	YES	YES
Number of Provinces	31	31	31	31
Number of Observations	680	680	679	679
R-squared	0.169	0.169	0.267	0.263

Notes: Independent variables are one year lagged. Robust standard errors clustered at province level are reported in parentheses. Economic attributes include GDP, GDP growth, Per Capital GDP, Manufacturing/GDP, and Service/GDP. Demographic characteristics include the provincial party secretaries' and governors' age, college education, tenure length, career experiences in the Communist Youth League and in some prosperous provinces.

PFA = private fixed asset investment; SFA = state-owned fixed asset investment; SCFA = state-owned and collective fixed asset investment

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

### 3.6.4 Personal Connection, Private Investment and Prospects for Future GDP Growth

This article argues that the provincial leaders' personal connections may assist China's private economy by partially compensating for the weaknesses of formal rule-of-law institutions. Moreover, the CCP's factionalism does not necessarily result in increased overall inefficiency. This may be because the CCP makes efforts to select new leaders from the cadres having past experience working in some developed coastal provinces, which enables these prosperous areas to establish closer relations with the party center. This is conducive for the party to control economic resources and makes the economic resources tilt toward these coastal provinces, which in turn may be one of the driving forces to reform the planned distribution of economic resources to some inefficient northeast and western inland provinces. Namely, the party's factions may be actively reallocating economic resources to some highly efficient eastern coastal areas. In this sense, the CCP's informal politics seem not to conflict with efficiency of resource allocation. Additionally, the private sector may be more prone to adapt to the party's factional politics than the state-owned sector, which helps the connected provinces to attract private investment while avoiding crowding-out effects of state investment on private investment. These connected provinces thus become the areas with a stronger private economy.

Nevertheless, empirical evidence with regard to these arguments is still rare. In this case, I design a two-stage regression to test these points. First, I regress the private investment growth at the year  $t+1$  on personal connection at the year  $t$ . Column (1) in Table 3 shows that, after including the control variables of provincial *GDP*, *GDP per capita*, *Manufacturing/GDP* and *Service/GDP*, personal connection can significantly promote private investment. Second, I regress the provincial GDP growth at the year  $t+1$  on private investment at the year  $t$ . Column (2) in Table 3 shows that private investment growth can significantly promote economic growth. Third, I regress the provincial GDP growth at the year  $t+1$  on personal connection of the provincial leaders at the year  $t$ . Column (3) in Table 10 shows that personal connection has no expected effects on GDP growth in the next year. This indicates that the CCP's factionalism may promote growth through fostering private investment. But factionalism seems to have no direct effects on growth.

### 3.6.5 Firm-Level Evidence

This study shows the effects of provincial leaders' personal connections on overall private investment at the provincial level. Thus it uses the growth rate of provincial level private fixed-asset investment as the dependent variable. In this section, I strengthen the argument by using a firm-level analysis. It examines how personal connections of provincial leaders affect corporate investment for private enterprises. In this analysis, both provincial-level factors and firm-level characteristics can be controlled for.

Table 10 Connections, Investment and Prospects for Future GDP Growth

Dependent Variable	(1) PFA Growth (t+1)	(2) GDP Growth (t+1)	(3) GDP Growth (t+1)
Personal Connection	0.153*** (0.047)		-0.067 (0.408)
Private Investment Growth		0.784* (0.430)	
GDP	0.014*	-0.456***	-0.603***

	(0.007)	(0.164)	(0.172)
GDP per capita	-0.046	-5.285***	-4.440***
	(0.145)	(1.649)	(1.573)
Manufacturing/GDP	0.701*	-2.444	-0.518
	(0.352)	(3.567)	(3.031)
Service/GDP	0.906	-7.309	-3.989
	(0.648)	(6.518)	(6.004)
Constant	-0.331	14.918***	14.286***
	(0.267)	(2.967)	(2.374)
Province FE	YES	YES	YES
Year FE	YES	YES	YES
N of Province	31	31	31
Obs.	680	649	740
Adjusted R <sup>2</sup>	0.584	0.648	0.614

Notes: Independent variables are one year lagged. Robust standard errors clustered at province level are reported in parentheses.

PFA = private fixed asset investment

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

I obtained firm-level accounting data from the Chinese Industrial Enterprises Database. This contains data on all Chinese industrial firms with sales of over RMB 5 million from 1998 to 2013. I only included private firms that met the following criteria: (1) it is not reported as bankrupt, merged, nor closed; (2) total assets, total fixed assets and depreciation expenses are greater than zero; (3) total debt and total sales are greater than zero; and (4) it was established after 1900. The dependent variable is *Corporate Investment* at the year  $t+1$ , which is calculated as the firm's net fixed assets at the year  $t+1$ , minus its net fixed assets at the year  $t$ , plus depreciation at the year  $t+1$ , divided by its total assets at the year  $t$ . The independent variable is the provincial leaders' *Personal Connection* with the CCP's incumbent general secretary. I control for firm-level corporate investment, industrial output, sales growth rate, gross profits and corporate age at the year  $t$ . I also control for provincial *GDP*, provincial *GDP per capita*, provincial *GDP Growth* and the ratio of provincial total fixed asset investment to provincial *GDP*. Age and tenure of the provincial leaders, as well as firm and year fixed effects, are also included in the regressions. I regress all of the enterprises and the enterprises with total sales greater than RMB 30 million separately.

Table 11 Firm-Level Evidence

Dependent Variable	(1)	(2)
	All sample	Total sales greater than RMB30 million
	Corporate Investment (t+1)	Corporate Investment (t+1)
Personal Connection	0.129*** (0.023)	0.098*** (0.022)
Corporate Investment	-0.005 (0.019)	0.001 (0.029)
Industrial Output	0.000 (0.000)	-0.000 (0.000)
Sales Growth Rate	-0.000*** (0.000)	-0.000*** (0.000)
Gross Profits	-0.000** (0.000)	-0.000 (0.000)
Corporate Age	0.001 (0.001)	-0.000 (0.001)
GDP	0.000*** (0.000)	0.000*** (0.000)
GDP per capita	0.000** (0.000)	0.000 (0.000)
GDP Growth	0.035*** (0.012)	0.024** (0.010)
Total Fixed Asset Investment/GDP	0.074 (0.075)	0.132* (0.072)
Constant	-4.407*** (1.477)	-3.252*** (1.176)
Age and Tenure of the Provincial Leaders	YES	YES
Firm Fixed Effects	YES	YES
Year Fixed Effects	YES	YES
Obs.	288743	190869
Adjusted R <sup>2</sup>	0.002	0.003

Notes: Independent variables are one year lagged. Robust standard errors clustered at province level are reported in parentheses.  
\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

Table 11 shows that the estimated coefficients of *Personal Connection* are significantly positive at the 1% level, which suggests that the provincial leaders' connection with the top may positively affect corporate investment of private enterprises. The estimated coefficient of *Personal Connection* for all the enterprises in this database is -0.129, shown in column (1). The estimated coefficient of *Personal Connection* for the enterprises with total sales greater than RMB 30 million is 0.098, shown in column (2). These findings provide further evidence that investment of private enterprises may be driven by the CCP's informal politics.

## **Chapter 4: Factional Politics and Foreign Direct Investment in China**

**Abstract.** This article uses quantitative analyses to discuss the effects of the Chinese Communist Party's factional politics on the regional distribution of foreign direct investment inflows from 1993 to 2017. Empirical evidence shows that provincial leaders' personal connections with the CCP's incumbent general secretary had positive and statistically significant effects on the annual growth rate of provincial foreign direct investment inflows. These effects were more salient in inland provinces and during Xi era. These findings challenge the conventional wisdom about the evolution of institutions under the leadership of the Chinese Communist Party and demonstrate the importance of informal politics in promoting China's economic reform and prosperity.

## 4.1 Introduction

China is known to have benefited from reformist policies, which have opened the country to foreign investment since the 1970s. Arguably, the combination of regional economic advantages and, more importantly, advanced formal institutions help governments attract foreign investment (Henisz and Delios 2001; Li and Resnick 2003; Li and Filer 2007; Pajunen 2008; Pajunen 2008). Legal and other regulations conducive to growth have been regularly enacted, despite the nation's weak institutional foundations (Ang 2016). These newly established formal institutions could reduce the uncertainty surrounding economic activities in China by standardizing transactions and maintaining uniformity of treatment, encouraging foreign investors to take an optimistic view of China's long-term prospects for growth and profitability (Gao 2017). Some scholars thus have argued that China's long-term competitiveness in attracting foreign investment can be explained by studying the gradual improvement of its institutional framework (Fu 2000).

Despite improvements, however, other scholars point out that institutional barriers still hinder China's long-term development (Xia 2018). Even after political and economic reforms, formal institutions remain very weak. Inefficient state-owned enterprises often monopolize China's economic opportunities. The government frequently intervenes in economic transactions, ignoring established rules and principles. Collusive corruption is rampant and widespread. All of this breaks down political accountability and undermines social trust. Recent developments in China's domestic politics, such as the anti-corruption movement, may further erode the code of civility and the institutional environment (Pei 2006).

In this situation, the fact that China lacks checks and balances, transparency, and the rule

of law should have dimmed its hopes of achieving economic prosperity and discouraged foreigners from investing in China (Acemoglu and Robinson 2012). However, China's seemingly immature institutions still induce international enterprises to make large, long-term investments. China has maintained rapid growth for many decades and continued to attract international business. This raises the following questions. What are the roles of the weak institutional foundations in attracting foreign direct investment inflows in China? Do informal institutions to some extent compensate for the weaknesses of China's formal legal system in promoting foreign investment? Specifically, does the Chinese Communist Party's factional politics at the top affect the provincial allocation of foreign direct investment?

A recent study has argued that many private firms rely on special deals to circumvent the obstacles presented by formal rules, thereby obtaining scarce resources and illegal benefits from a political monopoly (Hallward-Driemeier and Pritchett 2015). In particular, Chinese informal institutions, usually involving a patronage network within the bureaucracy, seem to compensate for the deficiencies of formal institutions by providing special deals (Bai et al. 2020). Based on the arguments above, this study contends that factional politics within the Chinese Communist Party may influence the extent to which foreign corporations engage with China's economy, generating regional discrepancies in foreign direct investment inflows. CCP factions informally monopolize control over China's economic resources and influence the commercial prospects of foreign investors. The pre-reform planning system augmented the Chinese Communist Party's resource-mobilization capability. Since the 1970s, market-oriented reforms have helped to promote economic liberalization while maintaining China's authoritarian regime. These intact political institutions influence the way in which the

economy functions and create incentives for local bureaucracies to shape the economy's spatial configuration (Chan et al. 2008). Beyond their political rank in formal institutions, local cadres who show allegiance to the top can form political factions to maintain influence over economic resources. The factions attract foreign investors via economic resources they control because foreign companies naturally prefer to invest in provinces run by trusted leaders.

The present study creates a provincial-year panel and designs regression models to verify the arguments above. After controlling for various factors that past researchers considered influential in the regional distribution of FDI, this study shows that, from 1993 to 2017, personal connections between provincial leaders and the current CCP general secretary significantly increased FDI inflows to particular provinces. Factional connections have had more influence over FDI inflows in inland, as opposed to coastal, provinces. The variation over time indicates that factional politics became important in attracting foreign investment during the Hu Jintao era. By demonstrating that factional coalitions can increase the growth rate of provincial FDI inflows in China, this research stresses the role of informal institutions in stimulating FDI inflows (Boisot and Child 1996; Peng 2002; Seyoum 2011; Jr et al. 2013; Zhao et al. 2013; Munasib and Tian 2015). This paper also suggests that China's rapid economic growth over the past three decades may not have fundamentally changed weak institutions. Under these conditions, foreign investors may prefer to continue to seek informal political protections through factional politics.

The remainder of the article proceeds as follows. The next two sections summarize past research on regional allocation of FDI inflows and then offer new theory about how informal

politics have determined Chinese foreign direct investment. The fourth section covers methodology, data, variables, model building, and descriptive statistics. The fifth section presents the empirical evidence including the baseline results and robustness checks. The sixth section further discusses the geography and time differences in the effects of informal institutions. The final section presents conclusions.

#### **4.2 Neoliberal Theories of FDI**

There is a vast literature on the factors that determine the regional distribution of FDI inflows (Faeth 2009). The Heckscher-Ohlin-Samuelson model of neoclassical trade theory views FDI as a component of international capital trade, linked to the surplus in capital returns between capital-abundant countries, such as the U.S., and labor-abundant countries, such as China (Aliber 1970). To obtain these extra benefits, foreign firms must overcome multiple difficulties, including a different culture, an unfamiliar commercial environment, legal uncertainty, and even political risk (He 2002). They use several strategies to address these problems. First, multinational enterprises with market power may capitalize on their monopolistic advantages, such as product differentiation, managerial expertise, and new technologies, to balance out the risks associated with competing with local firms in China (Dunning 2015). Second, multinational firms are essentially products of market internalization across national borders. Through hierarchical institutions with cohesive force, they can avoid market deficiencies caused by ambiguous rules, opportunistic behavior, and increased transaction costs (Buckley and Casson 2002). Third, the geographical and sectoral diversification of some large countries may enable multinational enterprises to reduce their investment risks. Foreign investors can circumvent the sectors where state-owned enterprises

enjoy preferential treatment and invest in market-oriented, labor-intensive industries (Lin and Kwan 2011).

While these theories parsimoniously account for the broad profile of FDI inflows across the world, more recent research has turned to explain why and how foreign investment flows into certain newly emerging economies, such as China. For instance, Sun, Tong, and Yu (2002) argue that location theory helps to explain the determinants of foreign investment across China. They have identified eight important factors that affect China's FDI distribution: market size and demand, concentration of economic activities, labor quality, labor costs, scientific-research development, economic openness, political stability, and financial competition. Their findings are supported by other quantitative research (Wei et al. 1999; Hon et al. 2005). However, some of these economic explanations may be effects, rather than causes, of foreign investment. For example, the inflows of foreign investment help to diffuse advanced technologies, promoting the economic development of host countries (Hermes and Lensink 2003). Financial deregulation has been shown to accelerate FDI technology diffusion, which, in turn, helps to expand market size, develop scientific research, and elevate labor quality (He et al. 2012). By contrast, economic concentration, openness, and political stability are often functions of political institutions and industrial policies.

Thus, private investment behavior may not be shaped by market forces alone (Mudambi and Navarra 2002; Fan et al. 2009). Economists have highlighted the role of institutions in sustaining long-term growth (North 1990; Rutherford 1995), and scholars now discuss the nexus between investments and non-market institutions. Institutions are rules and procedures enforced through official channels. In this sense, institutions encompass formal rules, laws,

and regulations that are pro-competition, predictable, and transparent. They are designed to protect property rights and reduce transaction costs, thus promoting FDI in specific locations. According to Fu (2000), the case of FDI in China converges with this argument. The bloom of foreign investment across China has been based on gradual reform and the solidification of market-oriented institutions (Gao 2017). Domestic legal institutions have been established to check sovereign discretion, improve dispute resolution, protect intellectual-property rights, broaden market access, promise the free repatriation of profits, offer preferential taxation, and generate other fiscal incentives. This process has boosted the confidence of foreign investors, making them believe that their interests were sufficiently guaranteed in the long run.

#### **4.3 Informal Politics and China's FDI Inflows**

Overall, transnational corporations view China as an attractive place to locate their businesses, because of its large internal market, abundant low-cost workforce, improved physical infrastructure, and easy access to capital goods (Yi et al. 2004; Liu et al. 2012). In turn, such corporations contribute funds, advanced technologies (via capital goods), managerial experience, and professional training for employees, all of which help to make China one of the largest emerging economies in the world (Buckley et al. 2002; Branstetter and Lardy 2008).

In this case, conventional theories provide holistic explanations of the surge in foreign direct investment in China (Sethi et al. 2011). They claim that regions with greater economic advantages and better institutions should have attracted greater FDI inflows. However, many of them often ignore informal institutions. In comparison to formal institutions, informal institutions are defined as unwritten rules, usually based on shared culture and values, created

and enforced outside officially sanctioned channels (Helmke and Levitsky 2006). According to Wang (2001), such informal institutions generally consist of intimate interpersonal connections among economic elites and influential local bureaucrats. Arguably, such social ties can reduce information costs and alleviate commitment problems by increasing mutual trust between foreign investors and their hosts (Lu et al. 2018). For example, scholars have observed that investment from Hong Kong and Taiwan makes up a large proportion of the total foreign investment in China; it is also geographically concentrated in Guangdong and Fujian. This shows that linguistic and cultural connections among these coastal regions can foster mutual financial flows (Wei 1995; Naughton 1996).

Moreover, the scope of such informal factors, affecting the regional distribution of FDI in China, may go beyond linguistic and cultural ties, ultimately involving the core characteristics of the Chinese Communist Party's economic and political rules. Despite decades of reforms, China's authoritarian regime has not changed fundamentally. Although the reforms have allowed more space for local economic autonomy (Huang 1996; Landry 2008), the party center still monopolizes the authoritative distribution of political resources. After the 1980s, the CCP tried to replace informal rules with consolidated regulatory rules through a bureaucratic reshuffle (Su and Yang 2000; Huang 2008; Miller 2008). However, the effectiveness of these reforms should not be overstated. Within the hierarchical bureaucracy of the CCP, the informal distribution of power did not change fundamentally. Outside established formal political institutions, lower-level officials form political factions, exchanging their personal allegiance for various resources (Nathan and Tsai 1995). In other words, the power and economic resources held by lower officials depend not only on their

formal political rank within the party and government, but also on the degree to which they are trusted by their superiors (Dittmer 1978).

This system has produced at least two political outcomes. First, trusted officials, who often have personal connections with people at the top, are strongly encouraged to follow the economic goals of higher-level officials and to implement policies that favor growth (Jiang 2018). In this way, the political connections of local officials influence their policy preferences (Tung 2014; Jiang and Zeng 2019). Second, a lower cadre with informal ties to a powerful leader may obtain preferential treatment through network-based policy coordination (Jiang and Zhang 2020). The preferential treatment may reduce the political risks of investment projects and improve investors' expectations of earnings. Investors can hedge their risks by colluding with local leaders who have informal connections with CCP top leaders. Thus, interpersonal connections with local officials can compensate for the institutional risks associated with a weak legal system (Wang 2001). Merchants can hedge their risks by colluding with local leaders who have informal connections with CCP top leaders. Foreign investors may thus prefer to invest in provinces that have closer political connections with power center. This strategy better ensures good relationships with both local government and the center of power.

This study therefore posits that the political networks of provincial leaders generate privileges that appeal to foreign investors. First, provincial leaders with good connections have a substantial advantage when it comes to obtaining scarce resources controlled by central government; various kinds of resources tilt in their direction (Shih 2004). Most importantly, their political backing seems to give them more discretionary power to use these resources to

attract foreign investors, possibly by circumventing institutional barriers to investment. For example, connected officials can help foreign investors circumvent performance requirements, including export ratios and compulsory technology transfer requirements (Fu 2000). Under fiscal decentralization, they can capitalize on special channels outside established rules to help foreign investors avoid land-conflict-related policy risks (Wu and Heerink 2016). Second, provincial leaders linked to party heads are less likely to be defeated in political struggles and more likely to be promoted in the next five or ten years (Jiang and Xu 2015; Opper et al. 2015). Their ability to protect investors' property rights thus seems stable enough to guarantee long-term returns. This prospect of preserving long-term personal power provides more certainty for investors for the foreseeable future. For all of these reasons, provincial leaders' personal links to top officials make their provinces more attractive to foreign investors. On this basis, the following hypothesis is proposed:

*H: Provincial leaders' personal connections with the incumbent supreme leader should increase the growth rate of FDI inflows.*

## **4.4 Methodology**

### **4.4.1 Panel Data**

To test the theories and hypotheses above, this study has gathered panel data, including factors related to the regional distribution of FDI inflows into China, between 1993 and 2017. This time frame is ideal because it covers the main period of economic reform and development in China. The time-series, cross-sectional data cover 30 provinces, each of which provides diverse incentives for foreign investors and receives vastly different levels of foreign investment. In a country with obvious geographical differences and vast market size,

these data provide a good sample for analyzing FDI distribution. Tibet has been excluded from the research sample because insufficient data were available. Chongqing did not become a provincial-level administrative zone until 1997. For this reason, the data from 1993 to 1996 includes 29 provinces only.

To examine the hypothesis above, provincial leaders are the appropriate units of analysis, because they provide the main pathways through which the CCP's supreme leadership work with their high-level bureaucracies to promote FDI inflows. Party secretaries and governors are the most powerful leaders in provincial governments. Party secretaries are in charge of political issues, including general strategies, ideological control and personnel management. Governors often take responsibility for economic-development policies and promoting growth. In this sense, both types of provincial leader should have influence on FDI distribution. In the study panel, each provincial observation was matched with one party secretary and one governor; there were 164 party secretaries and 206 governors in total. Provincial leaders who had held office for less than a year were excluded, because they were unlikely to be sufficiently influential.

#### **4.4.2 FDI Inflow Growth**

The main dependent variable I use in this study is the annual growth rate of provincial FDI inflows. Specifically, foreign investment inflow is measured using actual foreign direct investment, which includes the actual capital and loans provided by foreign investors. As this study concerns the provincial distribution of realized FDI, annual FDI inflows are collected from provincial statistical yearbooks from 1993 to 2017. FDI is measured in millions of U.S. dollars. The annual reference exchange rate is used to calculate its RMB values.

#### 4.4.3 Patronage Ties

In this case, shared working experiences serve as an affective clientelist bond, since working in the same organization increases the probability of knowing each other and establishing steady patronage networks. Intimate factional ties are likely to be built on hierarchical relationships within a regional or departmental bureaucracy. Apart from that, previous studies also claim that factional ties may appear between officials who share birthplaces or between officials who graduate from the same universities (Shih et al. 2012; Meyer et al. 2016). The biography of each provincial leader was therefore analyzed to identify any personal relationships with the CCP's top leaders. The Personal Connection was coded as 1 if such relationships occur between a provincial party secretary or governor and a CCP supreme leader—and otherwise 0. When a top leader leaves office, the patronage connection disappears. This study posits that both party secretaries and governors influence provincial reform policies. Thus, the value of the independent variable *Personal Connection* was coded as 1 if the factional variable value of either a party secretary or a governor was 1, and 0 otherwise.

#### 4.4.4 Control Variables

*Demographic Characteristics.* It is assumed that some personal features of the provincial leaders may affect their personal competence and policy preferences. For example, due to promotion incentives, younger cadres, who are in the early stages of their careers, may be more active in promoting investment policies. The officials with work experiences in the Communist Youth League or in prosperous provinces may be more liberal-minded. To control for the effects of these key demographic characteristics, I include the provincial leaders' age,

tenure length, and career experiences in the CYL and in some prosperous provinces (Beijing, Tianjin, Shanghai, Jiangsu, Zhejiang, Fujian, and Guangdong). Biographical data on provincial leaders came from Jiang's (2018) Chinese Political Elite Database, and was double-checked using independent data sources.

*Previous Performance.* The previous economic performance of provinces is included to account for the possibility that provincial leaders with informal connections to the top may be systematically assigned to the provinces that perform better in terms of key economic indicators, including GDP, GDP per capita, and GDP growth. All of these variables are measured in the final year of the party secretaries' and governors' predecessors' terms.

*Economic Controls.* Past researchers have shown that several economic and institutional factors may influence the regional distribution of foreign investment inflows. Based on available data, the factors included below were market size, labor costs, economic decentralization, institutional strength, openness policy, and basic infrastructure. The given province's current GDP and GDP per capita capture the market-size effect. The average wage of employees in urban units in each province has been used to capture labor costs. Economic decentralization delegates power to local governments, which facilitates regional reform experiments and more liberalized policies designed to attract foreign investors. I measure this via the ratio of provincial fiscal revenue to GDP. I measure the quality of formal institutions by using the ratio of private investment to state-owned investment. This is because greater relative private investment may indicate a better environment for non-public economies, including deregulation of investment projects, easy access to bank loans, rule of law and property rights protection (Huang 2003). The number of special economic zones is used as a

proxy to measure provincial economic openness policy. Finally, highways per square kilometer is used to capture the quality of basic infrastructure. Original data for the economic variables are collected mainly from the NBS website, supplemented by China's annual statistical yearbooks. Current economic statistics were changed to constant values in 1997 prices, when the Chongqing data begin. The list of SEZs come from China's National Development and Reform Commission.

#### **4.4.5 Descriptive Statistics**

Table 12 displays the basic summary statistics of the main quantities of interest. Panel A shows that the average growth rate of FDI inflows is about 16.50% and that about 30% provinces are assigned at least one top official having a personal connection with the top. Panel B shows that, on average, the provincial FDI growth rate was about 15.08% during Jiang era, 23.90% during Hu era, and 4.38% during Xi's first term. Thus, the Hu Jintao era saw the greatest increase in inflows of foreign investment, which is consistent with the proliferation of factional politics at that time. Panel B also shows that, albeit on the secondary status, the inland provinces have absorbed an increasing share of foreign investment inflows.

#### **4.4.6 Model Building**

Based on the panel data, a multiple regression analysis was carried out. The two-way fixed effects regression captured both province and year effects, testing the determinants of FDI inflows into different regions. Many previous studies lagged location determinants by one year to allow for the delayed effects of economic factors and to avoid the endogeneity problem (Liu et al. 2012). The present study has assumed that international investment decisions are handled more cautiously than other investments. Foreign investors may need

more time to collect information about the frequently changing patronage networks among provincial bureaucracies and to accommodate any changes they encounter. Thus, the location determinants in this model were lagged by two years to allow more time to elapse. This made it possible to test whether foreign investment growth was influenced by informal connections. The regression model specified for this study is as follows:

$$FDI\ Inflow\ Growth_{p,t+2} = \alpha_0 + \alpha_1 Personal\ Connection_{p,t} + \alpha_2 Z_{p,t} + \alpha_3 X_{p,t+1} + \gamma_t + \eta_p + \varepsilon_{p,t}$$

In this model, FDI and the personal connections of provincial leaders are the most important variables. FDI Inflow Growth<sub>p, t+2</sub> is the growth rate of foreign investment inflow into province p at time t+2. Personal Connection<sub>p, t</sub> indicates the political affiliation of province p with the CCP supreme leader at time t. Z is the vector of demographic characteristics and previous performance. X is the vector of economic and political factors that are associated with FDI inflows, including GDP, GDP per capita, labour cost, economic decentralization, institutional strength, openness policy and basic infrastructure. All of the economic variables are standardized for comparison. The year dummies  $\gamma_t$  and province dummies  $\eta_p$  were included to capture any unobservable shocks during different time periods or among different regions. As a statistical strategy to avoid correlation between the residuals with the province-level clusters, clustered standard errors were applied to estimate the significance of the coefficients.

Table 12 Descriptive Statistics

Panel A: Overall statistics					
	Observation	Mean	Std. Dev.	Min	Max
	(1)	(2)	(3)	(4)	(5)
<i>Measures of Foreign Investment</i>					
Provincial FDI Inflows (100 Million RMB)	746	296.06	421.51	0.69	3825.35
Provincial FDI Growth Rate (%)	717	16.50	0.48	-80.92	427.93
<i>Measure of Political Faction</i>					
Personal Connection	746	0.30	0.46	0	1
<i>Demographic Characteristics</i>					
Age (Sec)	746	59.80	4.04	47	70
Tenure Length (Sec)	746	3.35	2.30	1	15

Working in CYL (Sec)	746	0.20	0.40	0	1
Working in Prosperous Provinces (Sec)	746	0.31	0.46	0	1
Age (Gov)	746	57.83	3.98	43	66
Tenure Length (Gov)	746	3.08	2.03	1	13
Working in CYL (Gov)	746	0.22	0.42	0	1
Working in Prosperous Provinces (Gov)	746	0.39	0.49	0	1
<i>Economic Controls</i>					
GDP (100 M RMB)	746	10119.75	12825.44	157.7838	95383.77
GDP per capita (RMB)	746	24027.32	24751.26	1875.23	168527.5
Labour Costs	741	26334.96	23788.99	2747.73	143758.9
Revenue/GDP (%)	746	8.50	0.03	0.03	0.26
Private/State-Owned Investment (%)	717	70.07	0.69	0.02	3.98
Total Number of SEZs	746	38.68	38.29	0	174
Highways Per Square Kilometer	746	0.50	0.40	0.01	1.71

Panel B: Main variables by year

Year	Broad Ties	FDI Growth Rate (%)	FDI Inflows			
			Total (100 M RMB)		Distribution by region (%)	
			(1)	(2)	(3)	(4)
1993	0.31		2216.32	18.03	81.97	
1994	0.28	67.57	3558.30	16.82	83.18	
1995	0.31	-1.52	3331.19	16.78	83.22	
1996	0.31	0.94	3553.27	16.12	83.88	
1997	0.33	18.50	3861.46	19.05	80.95	
1998	0.33	6.09	3946.76	18.31	81.69	
1999	0.33	-3.12	3943.11	17.77	82.23	
2000	0.40	7.87	4047.55	18.57	81.43	
2001	0.40	7.75	4530.96	19.02	80.98	
2002	0.37	31.62	5557.44	19.80	80.20	
2003	0.23	24.46	6949.35	20.17	79.83	
2004	0.23	13.51	6681.14	22.93	77.07	
2005	0.23	23.71	7347.90	21.89	78.11	
2006	0.30	26.56	8676.99	24.52	75.48	
2007	0.23	31.54	9881.24	27.62	72.38	
2008	0.23	7.66	10002.31	30.47	69.53	
2009	0.23	5.34	10638.11	33.11	66.89	
2010	0.20	14.25	11739.84	36.22	63.78	
2011	0.20	138.94	25532.81	39.99	60.01	
2012	0.23	-47.01	13646.59	39.53	60.47	
2013	0.27	2.92	13949.66	42.18	57.82	
2014	0.27	1.94	14227.60	42.63	57.37	
2015	0.33	9.45	13862.70	37.62	62.38	
2016	0.43	3.26	13921.13	39.42	60.58	
2017	0.43	4.35	15259.97	38.30	61.70	
Sum	0.30	16.50	220863.70	32.29	67.71	

Table 13 Baseline Models

Dependent Variable	FDI Growth (t+2)					
	(1)	(2)	(3)	(4)	(5)	(6)
Personal Connection	0.084*	0.116**	0.116**	0.112**	0.115**	0.118**
	(0.048)	(0.053)	(0.054)	(0.052)	(0.053)	(0.053)
GDP (t+1)			-0.029	-0.034	-0.028	-0.033
			(0.032)	(0.032)	(0.030)	(0.031)
GDP Per Capita (t+1)			-0.013	-0.013	-0.014	-0.018
			(0.053)	(0.055)	(0.057)	(0.058)
Labour Cost (t+1)				-0.029	-0.028	-0.028

				(0.022)	(0.026)	(0.026)
Economic Decentralization (t+1)					-0.015	-0.026
					(0.047)	(0.047)
Institutional Strength (t+1)					-0.001	-0.010
					(0.025)	(0.025)
Openness Policy (t+1)					-0.020	-0.026
					(0.044)	(0.043)
Basic Infrastructure (t+1)						0.032
						(0.044)
Constant	-0.038	0.692	0.643	0.615	0.536	0.511
	(0.041)	(0.443)	(0.469)	(0.467)	(0.552)	(0.543)
Demographic Characteristics	No	Yes	Yes	Yes	Yes	Yes
Previous Performance	No	Yes	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N of Province	30	30	30	30	30	30
Obs.	686	686	686	681	652	652
Adjusted R <sup>2</sup>	0.424	0.427	0.426	0.429	0.431	0.430

Notes: Robust standard errors clustered at province level are shown in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

## 4.5 Empirical Evidence

### 4.5.1 Baseline Results

Table 13 presents the baseline results. Overall, the empirical evidence shows that, regardless of variation in which control variables are included, provincial leaders' personal connections with the CCP top leader had positive and statistically significant effects on the growth of FDI inflows into their regions. In particular, the final model in Column (6) shows that, after including fixed effects and other controls, FDI inflow growth rates in well-connected provinces are about 11.8 percentage points higher than those in other provinces, at a significance level of five per cent. In this sample, the average annual FDI inflow in a province is about 29.6 billion yuan (about 4.60 billion U.S. dollars). The well-connected provinces receive an additional 3.49 billion yuan (about 0.54 billion U.S. dollars) in annual FDI inflows. Personal connections have not only a statistically significant effect but also a substantively significant economic effect on FDI distribution. Thus, the

hypothesis is strongly supported.

#### 4.5.2 Sensitivity Analyses

As a robustness check, an Arellano-Bond Generalized Methods of Moments estimator is adopted to account for the effects of the lagged variables. Table 14 shows that the positive effects of personal connection remain statistically significant when adopting GMM regressions.

Table 14 Sensitivity Analyses

Dependent Variable	FDI Growth (t+2)		
	(1)	(2)	(3)
Personal Connection	0.144* (0.082)	0.186** (0.091)	0.187** (0.090)
Demographic Characteristics	No	Yes	Yes
Previous Performance	No	Yes	Yes
Economic Controls	No	No	Yes
Province FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N of Province	30	30	30
Obs.	627	627	561

Notes: Robust standard errors clustered at province level are shown in parentheses.

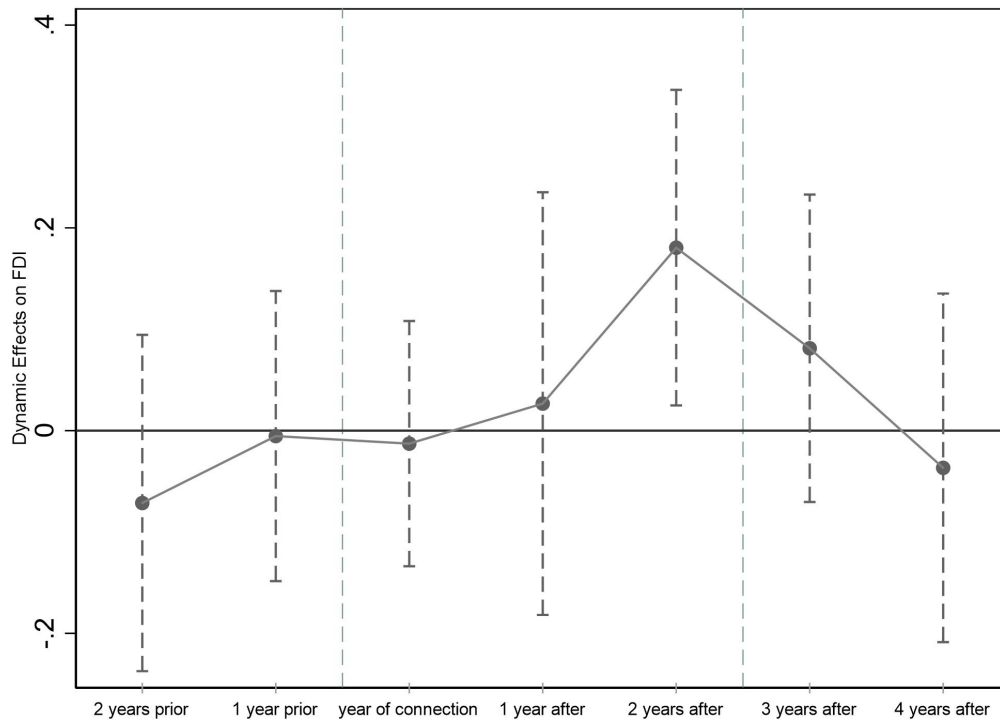
\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

#### 4.5.3 Endogeneity Issues

One possible concern about the above results is that there may be an endogeneity problem. The CCP's leadership may assign their trusted followers to the provinces that are more favorable for high FDI growth. These well-connected officials thus may appear to have better performance in attracting foreign investment and promoting economic growth simply because they are assigned to more desirable provinces. In order to test whether such endogeneity issues exist, I apply three strategies. First, I conduct an event study to test the parallel trend assumption. I make several dummies from 2 years prior to the occurrence of connection to 4 years after the connection. The dynamic effects of connection on FDI inflows are presented visually in Figure 2. It shows that the FDI performance premium slightly

increases only after a connected provincial leader is appointed. The performance premium reaches its peak 2 years after connection and begins to decrease 3 years after connection.

Figure 2 Event Analysis



Second, I conduct a series of placebo tests. I change the periodicity of the dependent variable FDI from  $t-3$ ,  $t-2$ ,  $t-1$ ,  $t$  to  $t+1$  and finally  $t+2$ . Table 15 displays the results. The coefficient of personal connection is only significantly positive when the dependent variable is FDI  $t+2$ , and not in prior years. This also shows that two years is the appropriate lag in the regression.

Third, I directly test whether selective appointment is present. Several connection indicators at  $t+1$  are regressed by a series of socioeconomic variables. They are the three-year moving average of FDI growth, GDP growth, revenue growth, and the growth of the total number of SEZs. I also include other controls in the final model. Table 16 shows that

connection status does not appear to be significantly associated with a province's prior growth rates of FDI, GDP, fiscal revenue and the number of SEZs. All three tests provide reassuring evidence that strategic appointment is not what drives the observed premium of the FDI growth rate.

Table 15 Placebo Tests

Dependent Variable	FDI Growth (t-3)	FDI Growth (t-2)	FDI Growth (t-1)	FDI Growth (t)	FDI Growth (t+1)	FDI Growth (t+2)
	(1)	(2)	(3)	(4)	(5)	(6)
Personal Connection	0.020 (0.037)	0.002 (0.027)	0.031 (0.035)	0.008 (0.033)	0.032 (0.030)	0.118** (0.053)
Constant	2.473** (0.936)	1.618** (0.642)	-0.131 (0.596)	1.803** (0.729)	1.121* (0.563)	0.511 (0.543)
Demographic Characteristics	Yes	Yes	Yes	Yes	Yes	Yes
Previous Performance	Yes	Yes	Yes	Yes	Yes	Yes
Economic Controls	Yes	Yes	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N of Province	30	30	30	30	30	30
Obs.	593	623	624	653	682	652
Adjusted R <sup>2</sup>	0.448	0.441	0.443	0.432	0.418	0.430

Notes: Robust standard errors clustered at province level are shown in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

## 4.6 Regional and Periodic Divergence

### 4.6.1 Inland and Coast Provinces

By showing the effects of factional connections on provincial FDI inflows, this study highlights that the CCP's informal politics may partially compensate for the weaknesses of formal institutions. Also, The relative importance of potential FDI-inflow determinants may vary across different regions in China (Liu et al. 2012). There are reasons to expect some geographic discrepancies in the effects of CCP factional politics on foreign investment. Relative to the interior regions, China's coastal provinces have inherent advantages in attracting foreign investment. These advantages are reflected not just in highly developed economies, larger market size, better education, more skilled workers, and a relatively mature

rule of law, but also in locational advantages and closer cultural ties with Hong Kong and Taiwan. Such factors make coastal developed provinces more attractive to foreign capital. By contrast, inland provinces have corresponding natural disadvantages when it comes to competing for foreign investment. They may therefore be more likely to resort more to informal political ties and adopt temporary preferential policies to attract foreign investors (Ang 2016).

Table 16 Prior FDI Growth Trends and Connection

Dependent Variable	FDI Growth (t+2)		
	(1)	(2)	(3)
FDI Growth (3-year avg)	0.041 (0.136)	0.034 (0.172)	0.016 (0.164)
GDP Growth (3-year avg)		0.043 (0.035)	0.056 (0.037)
Revenue Growth (3-year avg)		0.221 (0.573)	0.226 (0.595)
SEZ Growth (3-year avg)		0.058 (0.075)	0.093 (0.095)
Constant	0.563*** (0.086)	-4.533 (3.854)	-5.858 (4.182)
Economic Controls	No	No	Yes
Year FE	Yes	Yes	Yes
Province FE	Yes	Yes	Yes
N of Province	30	30	30
Obs.	628	349	348
R-squared	0.146	0.149	0.159

Notes: Robust standard errors clustered at province level are shown in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

To test these arguments, the following regional model is applied:

$$FDI\ Inflow\ Growth_{p,t+2} = \alpha_0 + \alpha_1 PC_{p,t} * Region + \alpha_2 Z_{p,t} + \alpha_3 X_{p,t+1} + \gamma_t + \eta_p + \varepsilon_{p,t}$$

where Region indicates the coastal and inland provinces. The interaction terms, of personal connections with region, were used to test whether the effects of provincial leaders' patronage networks vary significantly with regional differences.

As Table 17 shows, personal connections were more effective in inland provinces than they were in coastal provinces. In particular, Model 3 suggests that, on average, a patronage connection with the CCP's top leader increases the FDI growth rate by 17.2 per cent in inland

provinces; this result is statistically significant at 5per cent. By contrast, the patronage connections have almost no effect in coastal provinces.

Table 17 Regional Models

Dependent Variable	FDI Growth (t+2)		
	(1)	(2)	(3)
Personal Connection*	0.118*	0.159**	0.172**
Inland Provinces	(0.069)	(0.072)	(0.071)
Personal Connection*	0.033	0.043	0.019
Coast Provinces	(0.040)	(0.041)	(0.043)
Constant	-0.015	0.619	0.400
	(0.048)	(0.453)	(0.572)
Demographic Characteristics	No	Yes	Yes
Previous Performance	No	Yes	Yes
Economic Controls	Yes	No	Yes
Year FE	Yes	Yes	Yes
Province FE	Yes	Yes	Yes
N of Province	30	30	30
Obs.	686	686	652
R-squared	0.424	0.428	0.433

Notes: Robust standard errors clustered at province level are shown in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

#### 4.6.2 Periodicity of Informal Politics

Past studies have suggested that China's economic institutions evolved over time (Fu 2000). According to this logic, interpersonal connections should have become less important as formal institutions developed. During the Jiang Zemin era, rampant corruption may have forced foreign investors to seek informal political protection. Although corruption remained a serious problem after Hu Jintao came to power, China's membership of the WTO strengthened formal institutions designed to attract foreign investment. As a result, it can be argued that the role of informal institutions in attracting foreign investment would be expected to decline. After 2012, Xi Jinping's anti-corruption movement moved a step further, strengthening the established rules and weakening the power of informal connections. All of these factors would have helped Xi-era China attract even more foreign investment without recourse to personal connections.

To examine this line of argument, consider the following regional model:

$$FDI\ Inflow\ Growth_{p,t+2} = \alpha_0 + \alpha_1 PC_{p,t} * Periodicity + \alpha_2 Z_{p,t} + \alpha_3 X_{p,t+1} + \gamma_t + \eta_p + \varepsilon_{p,t}$$

where Periodicity indicates the Jiang, Hu, and Xi eras. The interaction terms of personal connection with these three periods of supreme rule are included to test whether the effects of provincial leaders' patronage networks depend on the tenures of CCP top leaders.

As Model 3 in Table 18 shows, after including control variables, the personal connections of provincial leaders are effective in influencing FDI inflows only during the Hu era. Specifically, personal connections increase provincial FDI inflows by 23.5 per cent during the Hu era. These results are statistically significant at 5 per cent. This factor is not important in determining FDI inflows during the Jiang or Xi eras. Thus the argument of China's evolution of institutions may be challenged. The development of China's market-oriented rule-of-law institution may be nonlinear but fluctuant. China has not yet established a real market economy. In this case, informal politics can make up for institutional weaknesses in promoting economic development.

Table 18 Periodic Models

Dependent Variable	FDI Growth (t+2)				
	All Samples (1)	All Samples (2)	All Samples (3)	Inland Samples (4)	Coast Samples (5)
Personal Connection*Jiang Era	-0.010 (0.053)	0.014 (0.048)	0.002 (0.046)	0.077 (0.071)	-0.040 (0.079)
Personal Connection*Hu Era	0.179** (0.080)	0.226** (0.092)	0.235** (0.095)	0.311*** (0.097)	0.069 (0.042)
Personal Connection*Xi Era	0.098 (0.089)	0.115 (0.111)	0.113 (0.114)	0.207 (0.132)	0.067 (0.090)
Constant	0.011 (0.046)	0.443 (0.399)	0.196 (0.500)	1.144 (1.655)	0.374 (0.326)
Demographic Characteristics	No	Yes	Yes	Yes	Yes
Previous Performance	No	Yes	Yes	Yes	Yes
Economic Controls	No	No	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	No	No
N of Province	30	30	30	19	11
Obs.	686	686	652	412	240
R-squared	0.427	0.431	0.435	0.421	0.619

Notes: Robust standard errors clustered at province level are shown in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

Do the results differ between coastal and inland provinces? One way of answering this question is to combine the regional and periodicity models; the periodicity models are regressed using sub-samples. One sample contains data from coastal provinces, while the other contains data from inland provinces. Models 4 and 5 in Table 18 present the results. In inland provinces, personal connections have a positive effect on the growth rate of provincial FDI inflows during the Hu eras. In coastal provinces, personal connections have almost no effect on the growth rate of provincial FDI inflows during the whole period.

#### **4.7 Conclusion**

Previous studies have generally argued that greater prevalence of informal rules fundamentally undermine the conditions for long-term development. Based on this argument, one must assume that the massive influx of FDI into China cannot rely on informal institutions forever. However, the present study challenges this traditional wisdom by showing that China's informal rules may indeed drive foreign investment and lead to regional discrepancies in FDI inflows. Empirical evidence proves that provincial leaders' personal connections with the CCP general secretary have both positive and statistically significant effects on the growth rate of provincial FDI inflows. These effects were more salient in inland provinces and during the Hu era. Given the increasing volume of FDI inflows that go to inland provinces, factional ties indeed have great effects on the Chinese foreign investment environment. The periodic effects of factional politics also coincide with the peak of FDI growth. The influence of factional politics on the regional distribution of FDI was mostly significant during Hu era, which had the fastest growth rate of FDI inflows.

From the perspective of institutional evolution, China's economic reforms and

development have a weak institutional base, which appeared to prompt foreign investors, during the Jiang era, to seek informal political protection. One might therefore assume that the development of an institutional framework would decrease the effects of informal rules during the Hu and Xi eras. However, here the empirical findings of this research present a different picture. They show that personal connections had more effects on provincial FDI inflows during the Hu era than the other eras. One possible explanation involves the policy changes adopted by the CCP's leadership. Jiang Zemin adapted macroeconomic policies that were conducive to centralization and greater efficiency (Lardy 2014). Apart from strengthened national banking system, reformed taxation, controlled inflation, and reduced SOE inefficiencies and bloat, Jiang utilized Shanghai Pudong New Area to offer preferential treatments to foreign investors, including the liberalized laws and policies for attracting and regulating foreign participation in the country's economy (Fu 2000). All of these, arguably, improved the overall institutional environment for foreign investors. In comparison to Jiang Zemin and Xi Jinping, Hu Jintao was a weak political leader. Under this interpretation, within the constraints of the CCP's factional balance, Hu lacked the political influence to promote additional liberalizing policies. Stagnation of SOE reforms, proliferation of governmental intervention, and pervasive corruption weakened the investment environment (Hsueh 2011). Thus, foreign investors relied more on local factions to obtain preferential treatment. Xi's anti-corruption campaign strengthened the rule of the party and consolidated his personal influence. It may also have deterred corruption and weakened the influence of factional politics (Fabre 2017). Xi also initiate a comprehensive reform plan in 2013 to support market-oriented development (Rosen 2014). Foreign investors may rely less on factions to

protect their commercial interests. I understand that this explanation is easily challenged. Jiang's liberalization policies were indeed associated with rampant corruption, while Xi's campaigns were far from establishing real rule-of-law institutions (Chen 2017). These issues must be left for future research.

Future research can also examine the scope conditions of the theory. I conjecture that the influence of factional ties on FDI is likely to extend downward to lower-level leaders. As many city leaders are active in courting FDI, it is important to conduct research on prefecture-level units. City-level leaders who have personal connections with the incumbent provincial leaders may perform better in attracting FDI, especially when the provincial leaders belong to a strong faction at the party center. This is mainly because factional leaders may encourage their followers by providing better opportunities for career promotion. But this hypothesis remains to be tested.

In past decades, China's authoritarianism has successfully developed a globalized economy. However, China has not established institutions that promote the long-term development of a market economy. In sharp contrast to the viewpoints of classical economists, this paper argues that the political foundations of China's economic reforms are still very weak. The Chinese Communist Party has preserved a strong and effective form of authoritarianism. This regime has been able to capitalize on its massive economic resources to deal effectively with international capitalists. It has traded China's huge market and cheap labor for the funds and technology needed to develop its economy. Essentially, the rules of this commercial transaction are part of China's informal politics. As the economic prosperity driven by this transaction does not necessarily lead to institutional evolution, the

sustainability of this development model remains questionable. If the Western world develops a general suspicion of and aversion to the CCP regime, China may need to reform its institutions to retain its favorable position in a globalized world. In other words, China may need to establish a market economy that conforms to Western standards, incorporating respect for the rule of law, property-rights protection, and labor security, to create a more stable basis for developing its long-term economic prosperity.

## Chapter 5: Conclusion

The term “institution” refers to a platform providing rules influencing the incentives of agents and helping to coordinate their activities. Institution constrains the behavior of political and economic actors when they maximize their interests (Hall and Taylor 1996). Well-established formal institutional arrangements can reduce the uncertainty of economic activities, reduce the costs of transactions, induce entrepreneurship and private investment, and thus increase economic efficiency and promote long-term development. Thus, institutionalists often ascribe national economic growth to development-oriented formal institutions. Accordingly, they believe that China’s success in reform and opening up policies depends on formal institutional evolution that results in rule of law, high efficiency, and transparency. In sharp contrast with these thoughts, the CCP continues to monopolize political power and govern the state through its patronage network. In order to maintain growth, the party should have pushed forward substantial formal institutional reforms. But such efforts are obstructed by its lag in political reform. Although constantly adapting and innovating to ensure success in a growing market, the CCP has never transformed its authoritarian ruling system, which blocks China from fully building market-oriented rule-of-law institutions. In this dissertation, several quantitative analyses are conducted to prove that informal politics may still dominate China’s provincial bureaucracy and to some extent compensate for the weaknesses of formal institutions in attracting non-public economic investment.

By analyzing panel data from 1993 to 2017, this study testifies to a controversial causal link running from patronage networks with the top to increased career promotion chances. Specifically, the provincial leaders' personal connections with the CCP's incumbent general secretary, mainly measured using shared working experiences, significantly increase their opportunities for postings to higher bureaucratic positions. But connections with other important top leaders do not have similar effects. Except for the general secretary, membership in the Politburo Standing Committee members' patronage networks appears to reduce the likelihood of promotion. Moreover, meritocracy plays a less important role than previously thought, at least for positions at the provincial level or above. Empirical evidence implies that the positive effects of provincial leaders' previous economic performance and seniority may be exaggerated in previous studies.

These findings indicate the dominance of the CCP's supreme leaders in making provincial personnel arrangements. Based on career promotion incentives, connected provincial leaders may actively promote reform policies favorable for the private sector as a strategy to increase economic efficiency. They also increase the confidence of private investors with regard to long-term profits. This study further shows that provincial leaders' patronage linkages with the top significantly promote the private and foreign investment within their jurisdictions. Empirical evidence also implies that policy inclinations in support of market-oriented reform are consistent among the major factions. There are no salient ideological divergences in market reform orientations among the political leaders. It is worth noting that this situation differs from that of the 1980s, when political factions within the party center fell into the conflicts over economic reform goals. At that time, the conservative

factions attempted to block market-oriented reform policies, whereas their political rivals utilized reform policies to improve the efficiency of regional economic growth and thus reap advantages in political struggles (Cai and Treisman 2006). Since then, reform consensus has dominated the CCP's top leadership. Factional cooperation facilitates the implementation of reform policies. In turn, these political elites share the economic benefits of reform through factional cooperation. Therefore, unless and until there are fundamental changes among the CCP's top leadership cadres, it seems that market-oriented reform has become an irreversible trend in China.

This study tells us that the reform-era Chinese economic system combines market-friendly development with the dominant position of government in a unique way. The centrally managed state-owned enterprises, entrepreneurial local governments, and powerful planning institutions have jointly influenced the state-market nexus (Zheng and Huang 2018). But in contrast with the East Asia development model, which also incorporates a strong role for government, China's state apparatus uses political factions to cooperate with entrepreneurs in an informal way. Even though China's rule of law institutions are not full-fledged, the CCP's top leaders are still able to exploit their personal factional ties to fulfill their market-oriented economic goals. Rampant corruption caused by informal institutions and factional politics have never undermined rapid growth of China's national economy. This differentiates China from other new emerging countries, such as Russia, where the stagnation of political reform contributes strongly to the stagnation of economic growth. This might be because the Chinese government has a stronger developmental

ideology and can deliver its developmental priorities from above to the bottom mainly through informal factional connections.

Apart from showing the uniqueness of China's model, this study also enlarges our understanding of the general roles of institutions in sustaining authoritarian regimes. Some scholars argue that whether a authoritarian regime is strong enough seemingly depends on the extent to which it can monopolize political resources (Reuter 2017). When dictators monopolize power, they tend to exclude the political participation of other forces. If the authoritarian leaders are relatively weak in resources to defect from bargaining with the ruling elite groups and compel them to relinquish their own autonomy, they have to share their political power in exchange of the assistance of the elites, or even politicize social resources to buy the support of the public in authoritarian elections (Greene 2010). However, institutional arrangements can provide more stable support for the survival of authoritarianism in the long run (Boix and Svobik 2013). Apparently, a formidable party system may be more durable than other kinds of authoritarianism (Geddes 1999; Magaloni 2008; Reuter and Robertson 2015). This is because strong authoritarian parties are effective vehicles to facilitate cooperation and prevent factionalism. Svobik (2012) argues that, for these parties, three functions are important. They are hierarchical assignment of service and benefits, political control over appointments, and selective recruitment and repression. They effectively exploit their members' opportunism and career aspirations to create a stake in the perpetuation of the regime among the most productive and ideologically agreeable segments of the population.

In China's case, the main purposes of authoritarian institutions are to simultaneously maintain economic development and political stability. The dictatorship is legitimized via its market-oriented reform and brilliant economic performance (Ang 2016). The Chinese Communist Party needs to avoid the inefficiency caused by the rigid political system on the one hand and prevent economic development from threatening its dictatorship on the other. Therefore, at least during the early stages of reform and opening up, the CCP had to give up its one-sided pursuit of the lower cadres' political loyalty and encourage professional bureaucrats to develop the economy. Under these conditions of transitioning to market-oriented reform, the party elites developed the exchange of concrete rewards and punishments through chains of actual acquaintance, rather than relying on abstract, impersonal principles. Thus, it is the functioning of power-sharing mechanisms, rather than ideological commitments, that inspires the loyalty of inferior officials to their leaders (Kung and Chen 2011). But the party leaders still fear that allowing a group of technocrats who have economic talents and uncertain political disloyalty to hold power may threaten the party's dominant position. Therefore, the party does not select senior officials according to the meritocratic principles used to select grassroots cadres. The party leaders tend to select their trusted acquaintances to enter the party leadership. These promoted cadres formed a ruling elite coalition with their leaders.

China's informal institutions manifest both flexibility and authority. But this multilevel appointment strategy may also result in rampant corruption. Once grassroots cadres realize the ceiling effect of career promotion, they may give up their pursuit of local economic performance and participate in corruption for personal gains. The incentives of career

advancement are likely to be less effective in influencing marginalized or disconnected cadres, because these cadres are outside the factional networks of the top party leaders and less likely to be promoted even with outstanding working performance. Therefore, Chinese experts should not be surprised by the CCP's selective anti-corruption campaigns and should not necessarily view them as a strategy to suppress rivals in political struggles. An alternative explanation seems to be that the officials without high-level factional connections are more motivated to engage in corruption. Not coincidentally, they also lack factional protection when facing anti-corruption investigations.

Given the detrimental effects of corruption on economic growth, the Chinese Communist Party should seek to completely eradicate the roots of corruption. Formal institutions should be established to ensure checks and balances of power, maintain judicial independence, tolerate press freedom and supervision by public opinion, and solidify private property protections. DeLisle (2008) argues that, essentially, China indeed has rule-by-law institutions, in the sense of governmental tools to effectively and consistently regulate economic, political and social behaviour of its citizens. In China, economic laws are implemented to cultivate the private sector; and perhaps even more importantly, to attract foreign investors who can provide markets, capital and techniques, yet require a legal system with familiar contents. Relying on these formal institutions, China's authoritarian regime successfully established a framework for market-oriented reform and economic growth. However, the Chinese legal system differs fundamentally from conventional rule-of-law institutions. It merely allows institutions with hierarchical constraints on the bottom, yet falls short of any substantial restrictions on the rulers themselves. Thus, corruption cannot be eradicated in China.

Economic reform requires the party leaders to enfranchise economic and political actors outside the established system. This is a good strategy to release social innovation. Along with economic development, however, anti-establishment camps, often including private entrepreneurs, economic bureaucrats, liberal intellectuals and even political dissidents, can get around the obstructions of a conservative system to obtain economic and political resources and gradually marginalize the ruling party power. The expansion of such independent and autonomous social groups may erode the basis of the CCP's authoritarian regime. One day, these groups may demand power-sharing with the party's ruling elites. Thus, formal rule-of-law institutional advancement is bound to accompany the decline of ruling party power. Such a threat to China's authoritarian regime is unacceptable to the CCP's dictators. Therefore, China cannot establish a real Western-style legal system.

However, the party does not react to this threat by tightly monopolizing economic power at the costs of undermining economic efficiency. One way to maintain a balance is to distribute economic resources via informal institutions. The party still can promote economic growth through factional politics. In this way, it also makes private investors cooperate with powerful local officials to seek additional protection. Factional politics become a viable means for party leaders to strengthen their control over economic resources. The development of the private economy thus cannot be separated from the party-state (Wei 2020). Due to their dependence on informal institutions and factional politics, private entrepreneurs cannot easily become a threat to the party's leadership (Dickson 2008).

In the near future, the CCP will not give up its authoritarian control. Thus, at least in the short run, informal politics will retain its dominant role in China's economic reform because

it helps the party to resist the political risks of economic reform. But, in the long run, the immaturity of formal institutions may hinder economic reform and development. Especially in the case of China's rise and conflicts with the Western World, the attractiveness of Chinese political and economic systems may gradually decrease. In this case, I think that it will become more difficult for China to maintain long-term economic growth by relying on a party-state that strengthens individual dictators. Those dictators will then have to choose between continued economic dynamism and political stability.

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- Zhou, X., Ai, Y., Ge, J., Gu, H., Li, L., Lu, Q., . . . Zhu, L. 2018. Zhongguo Difang Zhengfuguan yu de Kongjianliudong: Cengjifenlie moshi yu jingyanzhengju (Stratified Mobility in Chinese Bureaucracy: A Model and Empirical Evidence). *Shehui*, 38: 1-45.
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- Zhu, J., and Zhang, D. 2017. Weapons of the Powerful: Authoritarian Elite Competition and Politicized Anticorruption in China. *Comparative Political Studies*, 50(9): 1186-1220.

## Curriculum Vitae

### Jingnan Liu

Place of Birth: Chongqing, People's Republic of China

### Education

Ph.D., Political Science, University of Wisconsin-Milwaukee, May 2021

*Exam Fields: Comparative Politics and International Relations*

*Dissertation Title: The Political Economy of Factionalism in Reform-era China: Informal Institutions and the Regional Distribution of Non-Public Investment*

*Committee: Shale Horowitz (chair), Natasha Borges Sugiyama, Steven Redd, Ora John Reuter*

M.A., Religious Studies, Chinese University of Hong Kong, June 2013

B.L., Political Science and Public Administration, Wuhan University, June 2012

### Research Experience

#### *Published Articles*

Liu, Jingnan. 2022. "Selection of China's Top Leadership Cadre: The Roles of Supreme Leaders, Factional Networks, and Candidate Attributes," *Journal of Current Chinese Affairs*: forthcoming.

Liu, Jingnan. 2022. "Supreme Leaders, Provincial Leaders, and Factional Competition in China's Anti-Corruption Enforcement: Regional- and City-Level Evidence." *Journal of Chinese Political Science*: 71, 1:133-153.

Liu, Jingnan. 2021. "Informal Political Coalitions and Private Investment in China," *Journal of East Asian Studies*: 21, 3:515-525.

Liu, Jingnan. 2021. "Factional Politics and Foreign Direct Investment in China," *Review of International Political Economy*: forthcoming.

Liu, Jingnan. 2012. "Jidu zongjiao yu zhongguo zhengzhi yanjiu de wenxian juli fenxi (Analysis of Literature on the Christian Religion and China's Political Research)," *Journal of Postgraduates in Wuhan University (Humanities & Social Sciences Edition)*. 28, 3: 128-135

Liu, Jingnan. 2011. "Shuineng chaoyue ziyou minzhu-dongxifang wenhua yishi de xiandai zaoyu yu jiazhi chongsu (Who are Beyond Liberal Democracy: The Modernity Encounter and Value Reconstruction of Eastern and Western Cultural Ideology)," *Journal of Postgraduates in Wuhan University (Humanities & Social Sciences Edition)*. 27, 3: 140-146

#### *Conference Papers and Participation*

*International Studies Association Midwest St Louis, 2021, St Louis, MO: "Globalization,*

Relative Power, and Post-Cold-War Democratization.”

*International Studies Association Midwest St Louis, 2020, Virtual: “Communist Legacy, Democratization and Economic Globalization: An Empirical Analysis.”*

*Chicago Area Comparative Historical School Sciences Conference at Northwestern University, 2018, Evanston, IL: “Economic, Political, and Cultural Causes of Ethnic Conflicts: An Empirical Contemplation about Minority Group Protest and Rebellion in China.”*

#### *Invited Talks and Presentations*

*Wuhan University International Forum For Interdisciplinary Sciences and Engineering, April 7, Virtual: “Debates on the Political and Economic Development Model in East Asia.”*

*MAPSS Session, March 4, at University of Wisconsin Milwaukee: “China’s New Era in Foreign Policy: Explaining Changes and Continuities under Xi Jinping.”*

#### *Paper under Review*

Horowitz, Shale and Jingnan Liu. “China’s Changing Foreign Policy under Xi Jinping: Theories and Evidence.”

#### *Works in Process*

Liu, Jingnan. “Selection of China’s Top Leadership Carder: The Roles of Supreme Leaders, Factional Networks, and Candidate Attributes.”

Liu, Jingnan. “Globalization, Relative Power, and Post-Cold-War Democratization.”

Liu, ingnan. “Institutional Evolution, Factional Politics and Economic Reform in China.”

Liu, Jingnan. “Institutional Competition: Free Trade, Democracy and Economic Growth.”

#### *Referee for Journals*

Referee, *American Review of China Studies*

### **Research Interests**

Comparative Authoritarianism, Democratization, Nationalism and Ethnic Conflicts, International Political Economy, Chinese politics and Foreign Policy

Subfields: Comparative Politics and International Relations

### **Teaching Experiences**

Spring 2021 Guest Lectures in **POL 314 Chinese Politics and Foreign Policy**

Fall 2021 Guest Lectures in **POL 106 Politics of the World’s Nations**

Fall 2021 Guest Lectures in **POL 312 The Politics of Authoritarian Regimes**

Fall 2021 Guest Lectures in **POL 340 Politics of Nuclear Weapons**

Spring 2022 Guest Lectures in **POL 371 Nationalism and Ethnic Conflict**

### **Computer Skills**

Statistical Packages: Stata, R, SAS, Python

Applications: EXCEL, Word

### **Language Skills**

Chinese (Mandarin): Native Speaker

English: Reading, Listening, Writing and Speaking