

# **From Political Power to Personal Wealth: Privatization, Elite Opportunity, and Social Stratification in Post-Reform China**

Duoduo XU, Xiaogang WU

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## Abstract

The impact of market transition on the changing order of social stratification in post-socialist regimes has been a highly prominent topic in sociology in recent decades. However, the debate has yielded no concrete conclusions, due in part to the lack of substantive institutional analysis. In this article, we aim to provide new answers to this age-old question by specifically examining how the economic opportunities available to former political elites have been shaped by the process of privatization. Based on firm-level data from a national representative survey on Chinese private enterprises, we show that nomenclatures in some regions successfully converted their political power into personal wealth by acquiring privatized firms, and the extent to which they could exploit the opportunities available to them was contingent upon how the privatization process was structured and regulated in a local context. Further analysis reveals important institutionalized inequality among private entrepreneurs, with former nomenclatures at the top of the social hierarchy in post-reform China.

## Author's contact information

### **Duoduo Xu**

Division of Social Science & Institute for Advanced Studies (IAS)  
The Hong Kong University of Science and Technology  
Clear Water Bay, Kowloon  
Hong Kong  
E: [ddxu@ust.hk](mailto:ddxu@ust.hk)

### **Xiaogang Wu**

Division of Social Science  
The Hong Kong University of Science and Technology  
Clear Water Bay, Kowloon  
Hong Kong  
E: [sowu@ust.hk](mailto:sowu@ust.hk)

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# **From Political Power to Personal Wealth: Privatization, Elite Opportunity, and Social Stratification in Post-Reform China**

## **Introduction**

As a rapidly evolving country undergoing tremendous socioeconomic transformations, post-reform China has been of significant interest to social scientists on social change and social inequality (Bian 2002). In particular, a generation of scholarly work has been devoted to the social consequences of market transition in China as well as other former socialist countries in Eastern and Central Europe. The major theme of this line of research is to investigate the winners and losers during a transition from a redistributive to a market-oriented economy, and the socioeconomic prospects of former political elites in post-socialist regimes have been at the center of the debate.

While earlier controversies were mainly centered on whether economic returns to political power decreased or increased during the market transition (Bian and Logan 1996; Cao and Nee 2000; Nee 1989; Rona-Tas 1994), scholars have now reached a consensus that, given the complexity and variability of the transformation, the direction of its impact cannot be predicted without specifying concrete conditions and institutional circumstances (Parish and Michelson 1996; Walder 1996; Wu 2002; Wu 2006; Zhou 2000b). They also advocate substantive institutional analysis venturing beyond a binary distinction between the state and the market (Zhou 2000b) and call for new attention to be paid to important institutional changes that marked the nature of the transition, such as the reallocation of assets, a fundamental change in ownership structure, and the political processes by which market economies were established (Walder 1996). Inspired by their

insightful and visionary critiques, this study aims to provide a broad perspective on social stratification in transitional economies by specifically examining how former political elites' economic opportunities were shaped by the process of privatization.

The privatization of publicly-owned enterprises is regarded as one of the key steps in the transformation of planned economies into market economies. Although it was widely implemented in most transition economies, China's was by far the largest in human history in terms of scale. Close to 100,000 firms with assets worth 11.4 trillion RMB (US\$1.63 trillion) were privatized between 1995 and 2005 (Gan 2009). This massive privatization process brought fundamental changes in the ownership of and control over Chinese corporations and also created a new elite class composed of private entrepreneurs (Walder 2011). Unsurprisingly, many members of this "new middle class" were advantageously-placed *nomenclature* members who took advantage of this institutional change and transformed their political privilege into economic benefits (Ding 2000; Kung 1999; Li and Rozelle 2003). However, the extent to which they seized the opportunity to acquire public assets may have been deeply influenced by how the privatization process was structured and regulated (Walder 2003).

Investigating the opportunities as well as constraints faced by these elite insiders in the process of privatization is therefore of particular importance to understanding China's changing socioeconomic structure. However, despite its importance, related empirical evidence has been surprisingly scarce. One main obstacle is that individual or household-based social surveys rarely capture a sufficient number of political elites,<sup>2</sup> let alone

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<sup>2</sup> Although it is a common practice for scholars to use party membership or cadre status to measure political power, ordinary party members and junior cadres are intrinsically

details on their social origins, the value of assets they controlled or owned, and political connections after economic restructuring, while ethnographic studies usually suffer from limited representativeness and cannot adequately evaluate how the influence of privatization varies based on social context. Taking advantage of firm-level data from a nationwide sampling survey on Chinese private enterprises and corresponding owners, we explicitly demonstrate the process and mechanisms through which Chinese political elites converted their control power into personal wealth and how this process created and stratified a new economic elite class. Furthermore, to more deeply understand regional and temporal variations in China's economic transition, we also attempt to integrate theories and new evidence from both economics and political science on the underlying dynamics and mechanisms of privatization initiated and dominated by local governments.

Our analysis comprises three interrelated steps. We first systematically examine how local governments' decisions on the timing and mode of privatization varied by specific social context. We then further investigate how these contextual factors facilitated or limited the opportunities available to elite insiders to acquire public firms through privatization and accumulate personal wealth. Lastly, we uncover the institutionalized inequality between these former political elites and other private entrepreneurs by analyzing their political connections and status perceptions.

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different from “political elites” or so-called *nomenclatures*, who enjoy many privileges due to their strategic positions. In this paper, we refer to political elites (or elite insiders) as a much more exclusive group of people who held direct control of public assets or exerted a direct influence on redistributive orders.

The rest of this article is organized as follows. Section 2 reviews previous literature on economic returns to political power in transition economies. Section 3 sketches the historical background of China's privatization and its implications for political elites' economic opportunities. Section 4 assesses how specific privatization strategies were influenced by local governments' economic and political considerations. Section 5 describes the data and variables. Section 6 demonstrates the empirical findings. Lastly, Section 7 draws conclusions.

### **Economic Returns to Political Power in Transition Economies**

The late 20<sup>th</sup> century witnessed large-scale market transitions in former state socialist countries. This dramatic socioeconomic transformation has inspired many scholars to examine the relationship between economic mode and social stratification. In Polanyi's seminal work (1944) and the further elucidation by Szelenyi (1978), it is argued that a society's stratification mechanism is based on the dominant economic integration mode within it. Political power and loyalty are important factors affecting social inequality in a redistributive economy, whereas the transition from a redistributive economy to a market economy may fundamentally alter the ways in which political elites are rewarded.

Accordingly, Nee (1989)'s market transition thesis predicts the decline of the former elite class as the transfer of power favors direct producers over redistributors.

This prediction has nevertheless been challenged by contradictory empirical findings, leading to a heated debate on the fate of former political elites in transition economies (Bian and Logan 1996; Bian and Zhang 2002; Gerber 2000; Rona-Tas 1994; Walder

2002; Walder 2003; Wu 2006; Xie and Hannum 1996; Zhou 2000a). For instance, based on panel survey data from Hungary, Rona-Tas (1994) shows that former cadres were able to convert their past political power into an economic advantage by adopting new positions in the private sector as entrepreneurs (i.e., the power conversion thesis). Using retrospective data from a major Chinese city of Tianjin, Bian and Logan (1996) found that the income advantage of workers in occupations with high redistributive power had actually increased since the reform in 1978 (i.e., the power persistence thesis). Other studies from a different perspective have questioned whether the change in the economic returns to political power may be attributed to co-evolving socioeconomic changes such as economic expansion (Walder 2002) and structural changes in the labor market (Gerber 2002) rather than to the changes in the economic mode.

This debate has yielded no definite answers, as a consensus has emerged among scholars that given the complexity and variability of market transition, “the conditions under which, and the reasons why, markets lead to a relative decline, or increase, in cadre power or income” must be identified (Walder 1996), and it is unrealistic to predict the impact of market transition without specifying its concrete conditions and institutional circumstances (Parish and Michelson 1996; Walder 1996; Wu 2002; Wu 2006; Zhou 2000b). In other words, instead of asking generally *whether* economic returns to political power decreased or increased during a market transition, we should ask *why* and *how* the shift occurred and, moreover, *which* social contexts facilitated or hindered these changes.

More importantly, researchers have also observed that some key institutional changes that marked the nature of transition have been largely neglected, such as the reallocation of assets, the fundamental change in ownership structure, and the political process

through which market economies were established (Walder 1996). The privatization of public firms in many transition economies particularly influenced the changing order of social stratification. However, only limited sociological endeavors have been made to systematically examine its origins, process, variations, and subsequent consequences for socioeconomic inequality.

### **Privatization and Elite Opportunities**

As one of a few studies focusing specifically on the implications of privatization for social stratification in post-socialist regimes, Staniszkis (1991) points out that in the process of privatizing and restructuring state-owned enterprises, strategically-located cadres took advantage of their positions when acquiring state property. Specifically, cadres turned their limited control over state property into quasi- or real ownership through their access to valuable business information and credit. Eyal, Szelenyi and Townsley (1998), on the other hand, offer conflicting evidence showing that most state-owned enterprise (SOE) managers acquired some property during the privatization process in Central Europe, but this was typically a relatively small stake. Instead, they were more willing to set up small subcontracting firms owned by themselves or by their family members. Walder (2003) claims that although privatization created unprecedented opportunities for elite insiders, these opportunities largely depended on the extent of regime change and barriers to asset appropriation. For instance, it was an important prerequisite for the conversion of political power that the Communist Party maintained its ability to appoint officials in public institutions and enterprises before the launch of



market reforms, and different policy and regulatory environments also imposed different constraints on embezzlement.

China's privatization process provides an ideal setting to further investigate unresolved questions on the economic prospects of political elites during a market transition, characterized by a fundamental shift in the relative dominance of the public and private sectors in the economy. As shown in Figure 1, while 1978 marked the beginning of China's economic reforms, it was not until the mid-1990s that a sharp decline in the employment of state- and collectively-owned work units could be observed, accompanied by a rapid increase in the employment of privately-owned work units. One of the major reasons for this dramatic change was the massive privatization of public firms. It is well known that the development of the Chinese private sector entailed a combination of the establishment of new private firms and the privatization of public firms. What is less frequently mentioned is that the new elite class of private entrepreneurs may not be entirely "new" at all. Table 1 outlines the social origins of Chinese private business owners and clearly shows a strikingly high proportion of former political elites among the ranks of private entrepreneurs compared to the general population.

As Walder (2003) points out, redistributive economies gave political elites administrative control and material privilege but severely restricted money income and private wealth. Before the transition, elite insiders had control of public firms but no property rights to them. However, the privatization process created unprecedented opportunities for them to convert their control power into personal wealth. This was particularly true in China, where the most commonly practiced form of privatization was insider privatization (Li and Rozelle 2003). Nevertheless, the specific process and

strategies of privatization varied substantially between regions, the reasons for which are explained in the next section. Hence investigating the opportunities as well as constraints faced by elite insiders in the process of privatization is of vital importance to understanding China's changing socioeconomic structure.

[Figure 1 about here]

[Table 1 about here]

### **Incentives and Privatization Strategies**

Suffering from the soft budget constraint syndrome (SBC),<sup>3</sup> ailing SOEs posed serious financial burdens on governments in all centralized economies (Kornai 1986; Kornai, Maskin and Roland 2003; Maskin and Xu 2001), and privatization was carried out as one of its major remedies. However, in sharp contrast to other transition economies, the Chinese economy was privatized predominantly by subnational governments rather than the central government. This was because the *de facto* ownership of most public firms and the power to make privatization decisions were in the hands of local governments (Gan, Guo and Xu 2010; Garnaut, Song and Yao 2006; Li and Rozelle 2003).

Privatization was not the favored choice of the Chinese leadership at the beginning of the transition and was thus long postponed due to ideological and political resistance. Nevertheless, after initial reforms without explicit changes in ownership (e. g. the

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<sup>3</sup> The concept was originally formulated by Kornai (1986) to describe situations when a funding source (e.g., a bank or government) fails to keep an enterprise to a fixed budget.

strengthening of managerial incentives through the contract responsibility system) failed to solve the SBC problem, most SOEs were facing considerable financial difficulties and heavy indebted by the early 1990s. As a result, local governments started to sell off loss-making public enterprises when without official permission from the central government (Gan, Guo and Xu 2010; Garnaut, Song and Yao 2006; Kung 1999; Li and Rozelle 2003; Lin and Zhu 2001; Xu 2011). After 1997, the central government launched a policy of “grasping the large and letting go of the small” (*zhuada fangxiao*), retaining ownership of 500 to 1,000 large state firms while allowing smaller firms to be leased or sold. This green light officially relaxed constraints on privatization<sup>4</sup> and provided political incentives for local officials to broaden its scope (Cai 2002a).

In terms of specific modes of privatization, local governments adopted various privatization strategies depending on local economic circumstances, including public offering, internal restructuring, bankruptcy and reorganization, joint ventures and mergers, employee shareholding, open sales, and leasing to management, employees, outside private firms, and other SOEs (Garnaut et al. 2005). Although fiscal revenue remained the primary incentive for local governments to privatize and restructure firms (Gan, Guo and Xu 2010; Kung 1999), to maintain social stability, priority was usually given to the redeployment of workers who had become redundant as a result of privatization. Gan, Guo and Xu (2010) observe that local governments of cities with more developed private sectors tended to opt for full (e.g., management buyout, or MBO) rather than partial privatization (e.g., share issue privatization). On the other hand, local governments of cities with less developed private sectors needed to be more cautious in

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<sup>4</sup> Usually euphemistically referred to as “restructuring (*gaizhi*)”

initiating full privatization to prevent rapid and massive layoffs, which risked creating mass unemployment and leading to social unrest (Cai 2002b). Under these circumstances, they may have been inclined to privatize more conservatively, retaining a majority stake in the public sector. On the contrary, more developed private sectors provided greater potential to absorb large numbers of laid-off workers, reducing pressure for radical privatization in employment, which helped to gather support of local governments for private ownership prior to the onset of privatization. Such institutional circumstances thus provided opportunities for elite insiders such as SOE and COE (collectively-owned enterprise) managers and advantageously-placed government officials to acquire public assets because completely privatized firms with explicit ownership change were usually sold to insiders rather than outsiders such as through MBOs (Gan 2009; Gan, Guo and Xu 2010; Li and Rozelle 2003). Hence, we expect to observe larger incumbent advantages in provinces with more *ex ante* developed private sectors, since they were more likely to undertake MBO privatization.

The timing of privatization may also have been influenced by local governments' economic and political considerations. While some researchers argue that localities with a booming private sector privatized SOEs and COEs more aggressively (Garnaut et al. 2005), others find that local officials in public sector-dominated regions were most highly motivated to undertake rapid privatization. This was because when privatization became a political target at the national level, higher levels of government set timetables for local SOE restructuring and incorporated the speed of restructuring as a performance criterion for cadre evaluation (Zeng 2013).

In sum, the different privatization strategies adopted by local governments based on their economic conditions and social context imply considerable regional and temporal variations in the privatization process in China.

## **Data, Measures, and Descriptive Statistics**

### *Data*

The Chinese government started to conduct a nationwide random sampling survey on private enterprises in 1993.<sup>5</sup> The survey collects detailed information on both firms and their owners, providing an ideal dataset for studying the impact of privatization on the accumulation of wealth by former political elites during the economic transition.

The survey sample contains mainly large firms with a small portion of individual and household businesses drawn from all 31 provinces, autonomous regions and municipalities in Mainland China, generating significant regional variations in local institutional setting. This repeated cross-sectional survey is conducted over a regular two- or three-year cycle. The empirical analyses in this paper are based on data from three rounds (2002, 2004, and 2006), which were the only rounds containing detailed information on firms' restructuring history. We pooled all three waves of data together to increase the sample size and expand the period analyzed. The pooled sample comprises

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<sup>5</sup> This survey was implemented by the Department of United Front of the Central Committee of Chinese Communist Party, in collaboration with the National Federation of Industry and Commerce of China and the Chinese Society of Research on Private Economy.

more than 9,000 private enterprises that were established or privatized during the period from 1985 to 2005, over 20 percent of which were privatized former state enterprises.

This therefore also offered ample temporal variation to evaluate the privatization process.

Figure 2 displays the geographic distribution of both *de novo* private firms and privatized firms in our sample. Surprisingly, although both types of firm were more prevalent in traditionally well-developed eastern provinces than in others, some provinces (e.g. Jiangsu, Zhejiang) had much larger proportions of privatized firms than others (e.g. Shanghai, Guangdong). Figure 3 shows the temporal distribution of the privatization of former SOEs and COEs in our sample. Consistent with previous observations, although nationwide and legally mandated restructuring did not start until the mid-1990s, small-scale regional experiments in privatization were implemented by local governments as early as the 1980s to reduce the heavy financial burden of local public enterprises. However, it was only after 1997, when political constraints were completely relaxed, that massive SOE restructuring started to take place. Privatization peaked around 2000, after which it gradually declined before stalling completely in the mid-2000s.<sup>6</sup>

[Figure 2 about Here]

[Figure 3 about Here]

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<sup>6</sup> Another distinctive feature shown in Figure 2 is that compared to SOEs, more urban and rural COEs were privatized at an earlier stage. This may be due to the fact that local governments held greater decision-making power over local COEs and strategically chose to experiment with firms first by selling them to private owners. It could also have been because local COEs were usually of a smaller scale and could thus be more easily privatized at a lower economic and political risk than larger SOEs.

## *Variables and Measures*

### (1) Individual-level variables

The key independent variable, *insider*, is defined as the advantageously-placed political elites who held direct control over public assets at the launch of privatization, including former directors of public enterprises, former tenants and contractors of public enterprises, and former directors of government agencies and institutions or senior cadres with a rank equivalent to or higher than *chuji*. Individuals who did not belong to any of these three categories are thus labeled “outsiders.” To justify the use of this definition, we predict the effect of private entrepreneurs’ previous occupation or post on the probability of being the owner of a privatized firm and report the results in Appendix Table A1. Consistent with our expectations, *insiders* are far more likely to own a privatized firm after controlling for other factors.

We measure the status hierarchy of private entrepreneurs from three different perspectives: their perceived economic status, social status, and political status compared to other social groups on a scale of 1 to 10. We also measure private entrepreneurs’ political connections based on their sources of startup funds when they established the firms (1 indicating that they used personal accumulation, bank loans or private loans), as well as their political positions at government (1 indicating membership of the National People’s Congress or Chinese People’s Political Consultative Conference).

Other individual-level control includes Chinese Communist Party (CCP) membership (both at the time the firm was established/privatized and at the time the survey was conducted), years of schooling, gender (male = 1), age (both at the time the firm was

established or privatized and at the time the survey was conducted), and current personal annual income.

## (2) Firm-level variables

The key dependent variable is the logarithm of initial assets (net liabilities) at the time when a firm was established or privatized. We use this measure as a proxy of private entrepreneurs' personal wealth, with more valuable firms implying wealthier owners. We use initial value instead of current value because it can more accurately reflect the phenomenon of public asset embezzlement during privatization as well as rule out the confounding impacts of subsequent management efficiency and firm performance.

Firms that were restructured from former SOEs or COEs are referred to as "privatized firms," while others are called "*de novo* private firms." For privatized firms, we also measure the timing of privatization (year registered as a private business) and mode of privatization (1 representing a management buyout). Other firm-level controls include the year of establishment or restructuring and the primary industry in which the firm was engaged (both at the time the firm was established or privatized and at the time of the survey).

## (3) Provincial-level variables

Following previous literature, we adopt two provincial-level indicators to capture regional variations in local governments' incentives for privatization, namely the development of the private sector and the severity of SBC syndrome. The development of the private sector is measured by the share of industry output contributed by SOEs, with larger values indicating a less developed private sector in a province. Soft budget constraints are



measured by the ratio of fiscal revenue to expenditure, with larger values indicating fewer fiscal transfers from the central government to provincial governments, or harder budget constraints. These provincial-level economic data are drawn from the State Statistical Bureau of China and merged to firm-level data by year of establishment or restructuring.

We also adopt two year dummies to capture the potential period effect due to critical policy changes. One of the policy changes was the implementation of the tax reform in 1994. The new fiscal system fundamentally changed the way in which revenues were shared between the central and provincial governments by shifting from a negotiated system of general revenue sharing to a mix of tax assignments and tax revenue sharing. The other was the aforementioned 15<sup>th</sup> CCP Congress in 1997, which officially granted local governments the authority to privatize local SOEs and COEs and to decide the timing and mode of privatization independently (Cai 2002a). Other provincial-level controls include the logarithm of GDP per capita and its lagged form. Province dummies are incorporated in models where appropriate.

### *Descriptive Statistics*

We construct a typology comprising four categories based on the origins of the firms and their owners: *de novo* private firms owned by outsiders and insiders, and privatized firms owned by outsiders and insiders.

Figure 4 shows the composition of the firms in terms of these criteria in three waves of the survey. More than half of the firms were *de novo* private firms established by individuals with no political privileges. It is worth noting that about one-third of the firms were owned by former political elites, although they only accounted for a very small

portion of the general population. Some of these insiders left their political posts and entered the private sector to start their own businesses (“jump into the sea” or “ ”) (Wu 2010), whereas others took advantage of the privatization process and became the owners of privatized firms. Over time, the proportion of privatized firms slightly declined as the privatization process reached an end but became increasingly owned by elite insiders. In the 2006 survey, for example, over 60 percent of the privatized firms were owned by insiders.

Table 2 separately summarizes the firm and owner’s characteristics of the four groups and shows a distinct hierarchy among these private business owners. We can easily observe a consistent pattern in that private entrepreneurs who took over privatized firms were generally better-off than others who started from scratch, while insiders always outperformed outsiders, irrespective of the firm type. The most advantaged group, unsurprisingly, were insiders who owned privatized firms. They accumulated massive personal wealth through privatization, exhibited higher perceived status, were more likely to be members of the CCP, NPC (National People’s Congress), and CPPCC (Chinese People’s Political Consultative Committee), and had greater access to loans from state banks.

[Figure 4 about Here]

[Table 2 about Here]

## Results

### *Regional and Temporal Variations in the Implementation of Privatization*

The first step in understanding the opportunities and constraints faced by political elites during the economic transition involves investigating the specific social contexts of privatization. As many studies have shown, local SOEs and COEs are *de facto* owned by local governments, which are granted considerable autonomy to make their own decisions on privatization (Gan, Guo and Xu 2010; Garnaut, Song and Yao 2006; Li and Rozelle 2003). In this regard, local governments' incentives and strategies for privatization have arguably defined the extent to which insiders were able to take advantage of their political positions to acquire state property. In this section, we explicitly investigate how these incentives were shaped by local economic conditions and the political considerations of government officials, which consequently affected when and how public firms were privatized.

Intuitively, provinces with larger public sectors and suffering more from soft budget constraints are expected to be more economically and politically motivated to privatize loss-making SOEs and COEs. Nevertheless, in reality, local governments' reactions may differ due to two main reasons. On one hand, local SOEs and COEs are important contributors to their local economies and to tax revenue. Thus local governments in poorer provinces that rely heavily on fiscal transfers from the central government or have softer budget constraints are less incentivized to give up their control over public enterprises. It can be reasonably assumed that when the fiscal balance (ratio of fiscal

revenue to expenditure) is small, local governments are more likely to delay the privatization process and less likely to choose full privatization.

On the other hand, SOEs and COEs are also crucial institutions that provide large numbers of jobs and various welfare and benefits to their employees (*danwei*) (Wu 2002). A major concern that may have deterred local governments from privatizing public firms is that rapid and massive layoffs are likely to create significant unemployment and potential social conflict as a result. However, resistance to restructuring may have been weaker in provinces with booming private sectors, where laid-off workers could be redeployed much more easily. We would therefore expect that when the share of output contributed by SOEs was large, local governments were likely to delay privatization and more reluctant to choose full privatization as it typically results in substantial layoffs. Our preliminary description of the relationship between SOE output share and the timing and mode of privatization, shown in Figure 5, appears to support this conjecture. Provinces with *ex ante* more developed private sectors, such as Jiangsu and Zhejiang, were the pioneers that undertook privatization more rapidly and radically.

[Figure 5 about Here]

Nevertheless, this two-way association can be affected by many confounding factors. To rigorously examine the aforementioned hypotheses, we first use OLS models to predict the impacts of the provincial share of industry output by SOEs and the fiscal balance on the timing of privatization. Results are presented in Table 3. We then use binary logit models to predict their impacts on the probability of carrying out MBOs (full

privatization) among privatized firms.<sup>7</sup> Table 4 shows the estimates of the models. Provincial-level economic development on and before the year of privatization are controlled for in all models, along with the survey year dummies and industry dummies. For both Table 3 and 4, in Model 1, we only include the share of industry output by SOEs, to which we then further add the fiscal balance in Model 2. To capture the potential period effect due to critical policy changes, the fiscal reform in 1994 and its interaction term with the fiscal balance are included in Model 3, and finally, the relaxation of political constraints on privatization in 1997 and its interaction term with the SOE output share are also included in Model 4.

[Table 3 about Here]

[Table 4 about Here]

As suggested by the model estimations in Table 4, private sector development has no systematic relationship with the timing of privatization before 1997, but local governments of provinces with more developed public sector became eager to start privatizing SOEs and COEs after privatization gained its legitimacy. This finding contradicts our expectations, and is likely due to pressure on local government officials to meet the timetables of restructuring set by the central government (Zeng 2013). In terms of the means of privatizing public firms, as Table 5 shows, the larger size of public sector in a province indeed significantly reduces local government's tendency of full

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<sup>7</sup> Although MBO is not the only means for insiders to acquire public assets, it is a signal of relatively weak policy restrictions on embezzlement, which provide favorable institutional circumstances for elite insiders to acquire public assets and transform their control rights into ownership rights.

privatization, due to the risk of large-scale layoffs and consequent social unrests. However, this negative association between public sector development and MBO probability diminished after 1997, when privatization was regarded as an irresistible trend. Figure 6 illustrates these differential patterns in the relationship between local economic conditions and the timing and mode of privatization.

[Figure 6 about Here]

In addition, softer budget constraints were associated with significant delays in the timing of privatization, particularly after the fiscal reform in 1994. It also reduced the likelihood of a public firm being privatized through an MBO after 1994, although the effect is only marginally significant at the 10-percent level. These findings are consistent with previous narratives on the transition process in China.

#### *Regional Variations in In Advantages during Privatization*

Given the substantial regional and temporal variation in privatization strategies between provinces, our next objective is to examine the extent to which insiders' advantages were fueled or restricted by social context. We strategically focus on two provincial-level indicators, namely the share of industry output contributed by SOEs and the fiscal balance, as they have been demonstrated to be important factors affecting local governments' decisions on the timing and mode of privatization. The latter is of particular importance because whereas the government continues to hold a significant stake following partial privatization, full privatization such as MBOs may provide a greater opportunity for political elites to acquire public assets as it typically involves insider privatization. Accordingly, we expect that under circumstances in which local

governments are more positively inclined toward full privatization (e.g. a large fiscal balance, or a small share of industry output contributed by SOEs), insiders are more likely to acquire large amounts of public assets through MBOs.

Table 5 presents the OLS regression models predicting the initial assets of the firms. From Model 1, we can observe that holding all else constant, privatized firms usually hold considerably more initial assets than *de novo* private firms, and firms owned by elite insiders are also more valuable than those owned by outsiders. In Model 2, we include the interaction term of the privatized firm dummy and insider dummy. The coefficient is insignificant, suggesting that insider-owned privatized firms enjoy no further advantages on average after controlling for individual- and provincial-level characteristics. We then further include the two contextual variables indicating local government incentives for full privatization (i.e. share of industry output by SOEs and fiscal balance), as well as their interaction terms with the other three variables (the privatized dummy, the insider dummy, and their interaction term) in Models 3 and 4. Although we do not find evidence that insiders' advantages systematically varied with a province's fiscal condition, we find that the *ex-ante* development of the local private sector significantly influenced the assets of privatized firms owned by insiders. The two-way interaction between the privatized firm dummy and insider dummy in Model 4 becomes positive and significant, suggesting a net advantage in initial assets for insiders who took over privatized firms. Furthermore, the three-way interaction between the privatized firm dummy, insider dummy, and share of industry output contributed by SOEs is negative and significant, indicating that the net advantage enjoyed by this group of insiders varies with local institutional circumstances. Specifically, insiders enjoyed a more substantial advantage where the local private sector

was more developed, presumably because local governments were more likely to choose full privatization strategies such as MBOs, thus offering greater opportunities for insiders to acquire public assets. These findings are consistent with our previous speculations.

[Table 5 about Here]

For clarity, Figure 7 depicts results for the three-way interaction in Model 4 in Table 5. It shows that the provincial-level share of SOE output is positively correlated with insiders' advantage among *de novo* private firms but negatively correlated with insiders' advantage among privatized firms. Net of the other factors, insiders benefitted most from buying out public firms in provinces where the share of industry output contributed by SOEs was less than 40 percent, but local governments in provinces with a share of industry output contributed by SOEs of over 40 percent were less incentivized to fully privatize, and thus insiders were better off launching their own businesses.

[Figure 7 about Here]

We replicate the analysis using a different indicator of personal wealth, namely the logarithm of initial firm equities, an instrument that signifies an ownership position in a corporation and represents a claim to its proportionate share in the corporation's assets and profits. In short, it indicates the value of assets that are actually "owned" by private entrepreneurs. The patterns we identified remain robust to such an alternative specification (see Appendix Table A2 and Figure A1).



China's economic transition was accompanied by a rapid expansion of the private sector and the emergence of a "new middle class" stratum comprising private business owners (Glassman 1991). However, based on an in-depth study, Tsai (2005) concludes that class formation has not occurred among Chinese private entrepreneurs, primarily due to their significant diversity in terms of both occupational and political backgrounds. In this section, we systematically examine social stratification among private entrepreneurs. A four-group typology is constructed based on the origin of the firms (*de novo* private firms vs. privatized firms) and their owners (outsiders vs. insiders).

We first investigate the key determinants of the acquisition of political connections by private entrepreneurs. Specifically, two sets of indicators are used as proxies of political connections. The first is respondents' ability to raise funds from various sources when they first established or bought their firms, and the other is their membership of political institutions such as the NPC or CPPCC. We focus on the sources of startup funds because previous studies have shown access to bank credit by private entrepreneurs in China to be severely limited (Tsai 2002), and insiders who in charge of former public firms may have enjoyed greater access to financing due to their political connections (Li et al. 2008). Table 6 reports a logit model predicting private entrepreneurs' political connections. Apart from the macro-level controls used in previous models, individual characteristics such as party membership, number of years of education, sex, and age are also controlled for in all of the models.

In terms of sources of startup funds, we find that outsiders who started their own businesses were more likely to rely on personal accumulation, whereas owners of privatized firms were more likely to gain access to bank and private loans. This was likely because privatized firms were larger firms that required substantial external funding to be bought out. Surprisingly, we notice that insider-owned privatized firms were much more likely to be funded by state banks than by other groups. Holding factors constant, they were 67 percent ( ) more likely to have secured loans from state banks. Some case studies (Kung 1999; Tsai 2002) find that local authorities may have assisted incumbent managers in borrowing from credit institutions to raise the necessary capital to buy out privatized firms, since these managers were unlikely to have the financial resources to do so themselves. Our findings are consistent with this observation, and it is thus safe to conclude that insiders were able to take over these public assets not because of their personal wealth accumulation but because of their privileged positions as former political elites.

We also observe significant net advantages enjoyed by former political elites in the acquisition of membership in political institutions. In particular, insiders who took over privatized firms were linked most closely with government authorities. They were 1.7 (( )\*100) times more likely to be NPC members, and 0.2 (( )\*100) times more likely to be CPPCC members.

[Table 6 about Here]

We now focus on status stratification among private entrepreneurs. Three different dimensions of self-perceived status are examined here including economic status, social

status, and political status. Estimations based on ordinal logit models are presented in Table 7. In the first model, we include the four-type variable along with other controls. Unsurprisingly, insiders who owned privatized firms were the single most privileged group, as they demonstrated significantly higher perceived status in all three aspects. However, when we further control for business owners' economic capital (measured by current firm assets and their personal annual income), their advantage in terms of economic status is fully explained (or mediated), and their advantages in terms of social and political status are also reduced to an extent. In the final model, which also includes business owners' political capital (as measured by NPC and CPPCC membership) to further explain their higher perceived status, the coefficients remain statistically significant at the 0.05 level. In sum, these advantageously-placed *nomenclature* members were much higher in the status hierarchy than other private entrepreneurs.

[Table 7 about Here]

## **Conclusions and Discussion**

Sociologists have intensively investigated the socioeconomic impacts of China's economic transition in recent decades. Although the scholarly debate has largely waned over the past decade, many critical issues remain unanswered (Zhou 2000b). In this article, we revisit the question of the economic opportunities available to former political elites in transitional economies, with an explicit focus on the privatization process in China.

The massive privatization of public firms has featured China's market transition since the mid-1990s and has been one of the key institutional changes that has fundamentally shifted the order of social stratification in post-reform China. Using firm-level data from a nationwide survey of Chinese private enterprises, matched to provincial-level economic statistics, we have examined the essential role of local governments in determining specific privatization strategies, which in turn defined the opportunities and constraints faced by elite insiders in converting their political advantages into personal wealth. By focusing on the institutional transformation of control rights and the ownership structure of the corporate sector and incorporating regional variations into the analytic framework, our research defies an oversimplified theoretical logic of the relationship between the economic mode and stratification order. Our empirical results largely lend support to our hypotheses.

We find that *ex ante* more developed private sectors at the start of the privatization process greatly alleviated the potential issues of large-scale layoffs and social instability and hence increased the probability of full-scale privatization strategies such as MBOs being adopted by local governments. On the other hand, such institutional arrangements may also have delayed privatization by enabling government officials to rely on a booming private sector to meet performance criteria stipulated in the cadre evaluation system (Zeng 2013). Provinces with softer fiscal constraints should have been highly motivated to restructure loss-making SOEs and COEs, but in reality, they are less willing to completely give up the control rights over these firms in order to fulfill local revenue targets and social responsibilities. Officials in these provinces were thus more likely to have delayed privatization and been more reluctant to carry out full-scale privatization.

These contextual variations considerably influenced the economic opportunities available to political elites. While elite insiders performed quite well in the private sector in general, their specific advantages varied depending on local context. Insiders who relinquished public office and established their own firms (“*xiahai*”) (Wu 2010) enjoyed the greatest net advantage in firm assets in provinces where the public sector played a dominant role in the local economy, likely due to a less competitive market and their own selectivity as “later entrants” (Wu and Xie 2003). However, insiders who took over privatized firms enjoyed the greatest net advantage in provinces with *ex ante* more developed private sectors in which local governments were more likely to adopt a strategy of insider privatization (i.e. MBO). These findings suggest that former *nomenclatures* successfully adapted to socioeconomic changes and actively pursued new opportunities in the growing private sector by either acquiring restructured firms or establishing their own.

A further analysis of social stratification among private entrepreneurs reveals that insiders who took over privatized firms attained positions at the top of the hierarchy of China’s “new middle class.” They not only acquired considerable economic benefits through insider privatization and increased access to bank loans but also maintained their political connections even after entering the private sector, which potentially contributed to their higher social and political status compared to other private business owners. Our results also lend strong support to Tsai’s (2005; 2007) argument that despite similarities in their economic activities, private entrepreneurs in China cannot be viewed as a single class since they differ substantially in their political identities and attitudes.

Despite accounting for less than 1 percent of the general population, former political elites now own up to one-third of private firms in post-reform China. Crucially, many of these firms were in fact privatized from former SOEs and COEs with much higher value than *de novo* private firms. These elite insiders successfully converted their political power into economic benefits and transformed public assets into personal wealth through the privatization process. They also successfully maintained their political privileges thereafter, maintaining a significantly higher social and political status than other private business owners.

Our findings offer new evidence to support Rona-Tas' (1994) power conversion thesis that the new elites will substantially overlap with the old ones during the transition from redistributive economy to a market economy. Moreover, the regional variations we have identified in the net advantage enjoyed by elite insiders are also consistent with Walder's (2003) proposition that elite opportunities in transitional economies are constrained by the extent of regime change and barriers to asset appropriation. Finally, our investigation on the impact of local economic conditions on the timing and mode of privatization also contributes to related literature on this topic in economics and political science (Garnaut et al. 2005; Zeng 2013).

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**Current Firms (%), China Private Enterprises Survey 1993-2002**

***Panel A. Last Occupation***

|   | 1993   | 1995   | 1997   | 2000   | 2002   | Total  |
|---|--------|--------|--------|--------|--------|--------|
| Professionals                             | 11.19  | 11.48  | 4.24   | 9.74   | 6.37   | 8.57   |
| Director of government agency/institution | 6.25   | 8.21   | 2.56   | 3.85   | 3.15   | 4.73   |
| Director of public enterprise             | 13.37  | 13.18  | 4.73   | 14.59  | 12.07  | 11.96  |
| Director of private enterprise            | 1.96   | 1.55   | 19.21  | 20.67  | 43.99  | 20.07  |
| Self-employed                             | 8.79   | 10.27  | 27.53  | 18.06  | 15.13  | 15.91  |
| Others                                    | 58.43  | 55.32  | 41.73  | 33.09  | 19.27  | 38.75  |
| Total                                     | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| <i>N</i>                                  | 1,376  | 2,717  | 1,838  | 2,907  | 3,139  | 11,977 |

***Panel B. Last Post***

|  | 1993   | 1995   | 1997   | 2000   | 2002   | Total  |
|--|--------|--------|--------|--------|--------|--------|
| Junior cadre                           | N/A    | N/A    | 8.73   | 10.05  | 7.38   | 5.63   |
| Senior cadre                           | 7.43   | 5.07   | 5.44   | 10.12  | 8.48   | 7.50   |
| Village cadre                          | 6.11   | 6.19   | 1.93   | 3.31   | 2.54   | 3.90   |
| Tenant/contractor of public enterprise | 2.92   | 2.38   | 13.92  | 17.15  | 14.90  | 10.80  |
| Others                                 | 83.54  | 86.36  | 70.99  | 59.37  | 66.70  | 72.17  |
| Total                                  | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| <i>N</i>                               | 1,440  | 2,602  | 1,765  | 2,717  | 2,994  | 11,518 |

***Panel C. Last Work Unit***

|                    | 1993   | 1995   | 1997   | 2000   | 2002   | Total  |
|--------------------|--------|--------|--------|--------|--------|--------|
| State-owned        | 33.23  | 29.80  | 7.54   | 20.88  | 15.10  | 20.73  |
| Collectively-owned | 25.84  | 24.68  | 8.20   | 22.84  | 14.50  | 19.14  |
| Others             | 40.93  | 45.52  | 84.26  | 56.28  | 70.40  | 60.12  |
| Total              | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| <i>N</i>           | 1,339  | 2,711  | 1,830  | 2,864  | 3,125  | 11,869 |

**Table 2. Descriptive Statistics on Selected Variables, by Type of Private Entrepreneur**

|  | <i>de novo</i> Private Firm |                   |           | Privatized Firm   |                   |           |
|--|-----------------------------|-------------------|-----------|-------------------|-------------------|-----------|
|  | Outsider                    | Insider           | T-value   | Outsider          | Insider           | T-value   |
| <b><i>Personal Wealth</i></b>            |                             |                   |           |                   |                   |           |
| Ln(assets) (before)                      | 4.245<br>(1.603)            | 4.673<br>(1.698)  | 8.523***  | 4.925<br>(1.707)  | 5.223<br>(1.557)  | 3.685***  |
| Ln(assets) (current)                     | 5.191<br>(1.715)            | 5.653<br>(1.754)  | 8.419***  | 5.736<br>(1.740)  | 6.063<br>(1.634)  | 3.837***  |
| Ln(income)                               | 1.854<br>(1.395)            | 2.037<br>(1.377)  | 4.647***  | 1.840<br>(1.434)  | 1.980<br>(1.350)  | 2.146*    |
| <b><i>Individual Characteristics</i></b> |                             |                   |           |                   |                   |           |
| Party member (before)                    | 17.3%                       | 39.9%             | 19.757*** | 38.5%             | 65.4%             | 12.379*** |
| Party member (current)                   | 22.5%                       | 44.4%             | 17.938*** | 44.2%             | 69.7%             | 11.780*** |
| Years of schooling                       | 12.973<br>(2.729)           | 13.733<br>(2.568) | 10.459*** | 13.297<br>(2.691) | 13.692<br>(2.602) | 3.348***  |
| Male                                     | 84.2%                       | 90.1%             | 6.297***  | 89.1%             | 93.4%             | 3.446***  |
| Age (before)                             | 35.465<br>(8.017)           | 38.669<br>(7.744) | 14.891*** | 38.000<br>(8.632) | 42.130<br>(7.776) | 11.291*** |
| Age (current)                            | 42.322<br>(8.095)           | 45.621<br>(7.646) | 15.273*** | 44.065<br>(8.000) | 47.613<br>(7.281) | 10.418*** |
| <b><i>Perceived Status</i></b>           |                             |                   |           |                   |                   |           |
| Economic status (1-10)                   | 5.869<br>(1.805)            | 6.072<br>(1.748)  | 4.165***  | 6.049<br>(1.866)  | 6.235<br>(1.800)  | 2.262*    |
| Social status (1-10)                     | 6.001<br>(1.983)            | 6.209<br>(1.908)  | 3.880***  | 6.295<br>(2.002)  | 6.574<br>(1.969)  | 3.117**   |
| Political status (1-10)                  | 5.216<br>(2.329)            | 5.614<br>(2.199)  | 6.342***  | 5.648<br>(2.240)  | 6.122<br>(2.146)  | 4.801***  |
| <b><i>Political Positions</i></b>        |                             |                   |           |                   |                   |           |
| NPC member                               | 13.2%                       | 18.7%             | 5.778***  | 23.5%             | 36.8%             | 6.546***  |
| CPPCC member                             | 29.3%                       | 34.9%             | 4.535***  | 26.5%             | 29.7%             | 1.585     |
| <b><i>Sources of startup Funds</i></b>   |                             |                   |           |                   |                   |           |
| Personal accumulation                    | 91.3%                       | 88.6%             | -3.436*** | 86.5%             | 81.2%             | -3.197**  |
| Bank loans                               | 28.6%                       | 33.4%             | 3.813***  | 38.3%             | 46.3%             | 3.624***  |
| Private loans                            | 23.3%                       | 26.4%             | 2.687**   | 33.4%             | 42.1%             | 4.009***  |
| <i>N</i>                                 | 5228                        | 1861              |           | 920               | 1111              |           |

Note: Standard deviations in parentheses; \*\*\*  $p < 0.001$ , \*\*  $p < 0.01$ , \*  $p < 0.05$ . “Before” indicates status when the firm was established; “current” indicates status when the survey was conducted. “Insiders” include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.

**Table 3. OLS Models Predicting the Timing of Privatization among Privatized Firms**

|  | <b>DV.: Year of Privatization</b> |                        |                        |                        |
|--|-----------------------------------|------------------------|------------------------|------------------------|
|  | (1)                               | (2)                    | (3)                    | (4)                    |
| <b><i>Provincial government incentives</i></b> |                                   |                        |                        |                        |
| Share of industry output by SOEs               | 3.234***<br>(0.294)               | 0.589*<br>(0.239)      | -1.293***<br>(0.259)   | -0.012<br>(0.426)      |
| Ratio of fiscal revenue to expenditure         |                                   | -7.143***<br>(0.198)   | -3.746***<br>(0.318)   | -2.674***<br>(0.275)   |
| 1994 Fiscal Reform                             |                                   |                        | 7.005***<br>(0.409)    | 5.879***<br>(0.383)    |
| 1994*Ratio                                     |                                   |                        | -9.384***<br>(0.510)   | -7.864***<br>(0.461)   |
| 1997 15 <sup>th</sup> Party Congress           |                                   |                        |                        | 4.535***<br>(0.220)    |
| 1997*Share                                     |                                   |                        |                        | -1.681***<br>(0.467)   |
| <b><i>Provincial economic controls</i></b>     |                                   |                        |                        |                        |
| Ln(PGDP)                                       | -9.639***<br>(0.968)              | -6.515***<br>(0.755)   | -7.091***<br>(0.705)   | 6.808***<br>(0.786)    |
| Lagged Ln(PGDP)                                | 12.819***<br>(0.940)              | 9.669***<br>(0.734)    | 10.726***<br>(0.702)   | -4.135***<br>(0.807)   |
| <b><i>Other controls</i></b>                   |                                   |                        |                        |                        |
| Survey year dummies                            | YES                               | YES                    | YES                    | YES                    |
| Industry dummies (before)                      | YES                               | YES                    | YES                    | YES                    |
| <b><i>Constant</i></b>                         | 1969.000***<br>(0.854)            | 1975.219***<br>(0.684) | 1968.749***<br>(0.744) | 1971.688***<br>(0.728) |
| <i>N</i>                                       | 1994                              | 1994                   | 1994                   | 1994                   |
| <i>R</i> <sup>2</sup>                          | 0.5987                            | 0.7591                 | 0.7963                 | 0.8527                 |

Note: Standard deviations in parentheses; \*\*\* p < 0.001, \*\* p < 0.01, \* p < 0.05. “Before” indicates status when the firm was established.

**Table 4. Logit Models Predicting the Mode of Privatization among Privatized Firms**

|  | <b>DV.: Whether MBO</b> |                      |                      |                      |
|--|-------------------------|----------------------|----------------------|----------------------|
|  | (1)                     | (2)                  | (3)                  | (4)                  |
| <b><i>Provincial government incentives</i></b> |                         |                      |                      |                      |
| Share of industry output by SOEs               | -1.127***<br>(0.253)    | -1.216***<br>(0.265) | -1.028***<br>(0.311) | -2.798***<br>(0.643) |
| Ratio of fiscal revenue to expenditure         |                         | -0.249<br>(0.224)    | -0.170<br>(0.395)    | -0.317<br>(0.426)    |
| 1994 Fiscal Reform                             |                         |                      | -0.095<br>(0.509)    | -0.826<br>(0.583)    |
| 1994*Ratio                                     |                         |                      | 0.552<br>(0.630)     | 1.236+<br>(0.684)    |
| 1997 15 <sup>th</sup> Party Congress           |                         |                      |                      | -0.668*<br>(0.317)   |
| 1997*Share                                     |                         |                      |                      | 2.221**<br>(0.698)   |
| <b><i>Provincial economic controls</i></b>     |                         |                      |                      |                      |
| Ln(PGDP)                                       | -3.613***<br>(0.841)    | -3.512***<br>(0.847) | -3.362***<br>(0.857) | -3.392**<br>(1.131)  |
| Lagged Ln(PGDP)                                | 3.878***<br>(0.818)     | 3.778***<br>(0.824)  | 3.522***<br>(0.854)  | 3.467**<br>(1.161)   |
| <b><i>Other controls</i></b>                   |                         |                      |                      |                      |
| Survey year dummies                            | YES                     | YES                  | YES                  | YES                  |
| Industry dummies (before)                      | YES                     | YES                  | YES                  | YES                  |
| <b><i>Constant</i></b>                         | -1.799*<br>(0.745)      | -1.601*<br>(0.768)   | -1.072<br>(0.918)    | 0.565<br>(1.068)     |
| <i>N</i>                                       | 1990                    | 1990                 | 1990                 | 1990                 |
| <i>Pseudo R2</i>                               | 0.0615                  | 0.0620               | 0.0625               | 0.0664               |

Note: Standard deviations in parentheses; \*\*\* p<0.001, \*\* p<0.01, \* p<0.05. "Before" indicates status when the firm was established.

**Table 5. OLS Models Predicting the Initial Assets When Firms were Established**

|  | DV.: Logarithm of Initial Assets |                     |                     |                     |
|--|----------------------------------|---------------------|---------------------|---------------------|
|  | (1)                              | (2)                 | (3)                 | (4)                 |
| Privatized firm                            | 0.494***<br>(0.048)              | 0.510***<br>(0.064) | 0.802***<br>(0.192) | 0.151<br>(0.149)    |
| Insider                                    | 0.096*<br>(0.043)                | 0.106*<br>(0.050)   | 0.351*<br>(0.142)   | -0.079<br>(0.122)   |
| Privatized firm*insider                    |                                  | -0.036<br>(0.091)   | -0.230<br>(0.285)   | 0.521*<br>(0.216)   |
| Ratio of fiscal revenue to expenditure     |                                  |                     | 0.278*<br>(0.140)   |                     |
| Ratio*privatized firm                      |                                  |                     | -0.400<br>(0.252)   |                     |
| Ratio*insider                              |                                  |                     | -0.340<br>(0.187)   |                     |
| Ratio*privatized firm*insider              |                                  |                     | 0.256<br>(0.385)    |                     |
| Share of industry output by SOEs           |                                  |                     |                     | -0.205<br>(0.146)   |
| Share*privatized firm                      |                                  |                     |                     | 0.798**<br>(0.300)  |
| Share*insider                              |                                  |                     |                     | 0.407<br>(0.242)    |
| Share*Privatized firm*Insider              |                                  |                     |                     | -1.246**<br>(0.440) |
| <b><i>Provincial economic controls</i></b> |                                  |                     |                     |                     |
| Ln(PGDP)                                   | 1.782**<br>(0.623)               | 1.783**<br>(0.623)  | 1.753**<br>(0.624)  | 1.741**<br>(0.638)  |
| Lagged Ln(PGDP)                            | -1.805**<br>(0.628)              | -1.806**<br>(0.628) | -1.806**<br>(0.628) | -1.771**<br>(0.640) |
| <b><i>Individual characteristics</i></b>   |                                  |                     |                     |                     |
| Party member (before)                      | 0.104*<br>(0.045)                | 0.104*<br>(0.045)   | 0.103*<br>(0.045)   | 0.103*<br>(0.045)   |
| Years of education                         | 0.113***<br>(0.007)              | 0.113***<br>(0.007) | 0.113***<br>(0.007) | 0.113***<br>(0.007) |
| Male                                       | 0.246***<br>(0.058)              | 0.246***<br>(0.058) | 0.245***<br>(0.058) | 0.243***<br>(0.058) |
| Age (before)                               | 0.003<br>(0.003)                 | 0.003<br>(0.003)    | 0.003<br>(0.003)    | 0.003<br>(0.003)    |
| <b><i>Other controls</i></b>               |                                  |                     |                     |                     |
| Survey year dummies                        | YES                              | YES                 | YES                 | YES                 |
| Establishment year dummies                 | YES                              | YES                 | YES                 | YES                 |
| Industry dummies (before)                  | YES                              | YES                 | YES                 | YES                 |
| <b><i>Constant</i></b>                     | 1.716**<br>(0.636)               | 1.708**<br>(0.637)  | 1.674**<br>(0.645)  | 1.848**<br>(0.668)  |
| <i>N</i>                                   | 6528                             | 6528                | 6528                | 6528                |
| <i>R2</i>                                  | 0.1936                           | 0.1936              | 0.1946              | 0.1947              |

Note: Standard deviations in parentheses; \*\*\* p < 0.001, \*\* p < 0.01, \* p < 0.05. “Before” indicates status when the firm was established. “Insiders” include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.

Table 6. Logit Mo

## Political Connections

|   | DV.: Sources of Startup Funds |                      |                      | DV.: Political Positions |                      |
|---|-------------------------------|----------------------|----------------------|--------------------------|----------------------|
|   | Personal accumulation         | Bank loans           | Private loans        | NPC member               | CPPCC member         |
|   | (1)                           | (2)                  | (3)                  | (4)                      | (5)                  |
| <i>Type of private entrepreneurs (ref. outsider-owned private firm)</i> |                               |                      |                      |                          |                      |
| Insider-owned private firm  | -0.207*<br>(0.098)            | 0.097<br>(0.065)     | 0.047<br>(0.072)     | 0.128<br>(0.084)         | 0.160*<br>(0.070)    |
| Outsider-owned privatized firm  | -0.251*<br>(0.121)            | 0.296***<br>(0.081)  | 0.487***<br>(0.088)  | 0.499***<br>(0.101)      | -0.121<br>(0.095)    |
| Insider-owned privatized firm   | -0.581***<br>(0.112)          | 0.512***<br>(0.080)  | 0.728***<br>(0.086)  | 0.997***<br>(0.094)      | 0.193*<br>(0.093)    |
| <i>Individual characteristics</i>                                       |                               |                      |                      |                          |                      |
| Party member (before/current)   | -0.576***<br>(0.083)          | 0.269***<br>(0.058)  | 0.411***<br>(0.062)  | 0.547***<br>(0.068)      | -0.506***<br>(0.063) |
| Years of education  | -0.074***<br>(0.015)          | -0.002<br>(0.010)    | -0.039***<br>(0.011) | 0.029*<br>(0.012)        | 0.095***<br>(0.011)  |
| Male  | 0.019<br>(0.115)              | 0.275***<br>(0.078)  | 0.177*<br>(0.086)    | -0.119<br>(0.104)        | 0.167+<br>(0.086)    |
| Age (before/current)  | -0.006<br>(0.005)             | 0.002<br>(0.003)     | -0.004<br>(0.004)    | 0.012**<br>(0.004)       | 0.028***<br>(0.004)  |
| <i>Other controls</i>   |                               |                      |                      |                          |                      |
| Survey year dummies   | YES                           | YES                  | YES                  | YES                      | YES                  |
| Establishment year dummies  | YES                           | YES                  | YES                  | YES                      | YES                  |
| Industry dummies (before/current)                                       | YES                           | YES                  | YES                  | YES                      | YES                  |
| Province dummies  | YES                           | YES                  | YES                  | YES                      | YES                  |
| <i>Constant</i>   | 4.273***<br>(0.587)           | -1.731***<br>(0.365) | -1.761***<br>(0.408) | -2.685***<br>(0.470)     | -2.309***<br>(0.402) |
| <i>N</i>  | 8235                          | 8214                 | 8235                 | 7897                     | 7880                 |
| <i>Pseudo R2</i>  | 0.0541                        | 0.0353               | 0.0911               | 0.1229                   | 0.1325               |

Note: Standard deviations in parentheses; \*\*\* p < 0.001, \*\* p < 0.01, \* p < 0.05. “Before” indicates status when the firm was established; “current” indicates status when the survey was conducted. “Insiders” include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.

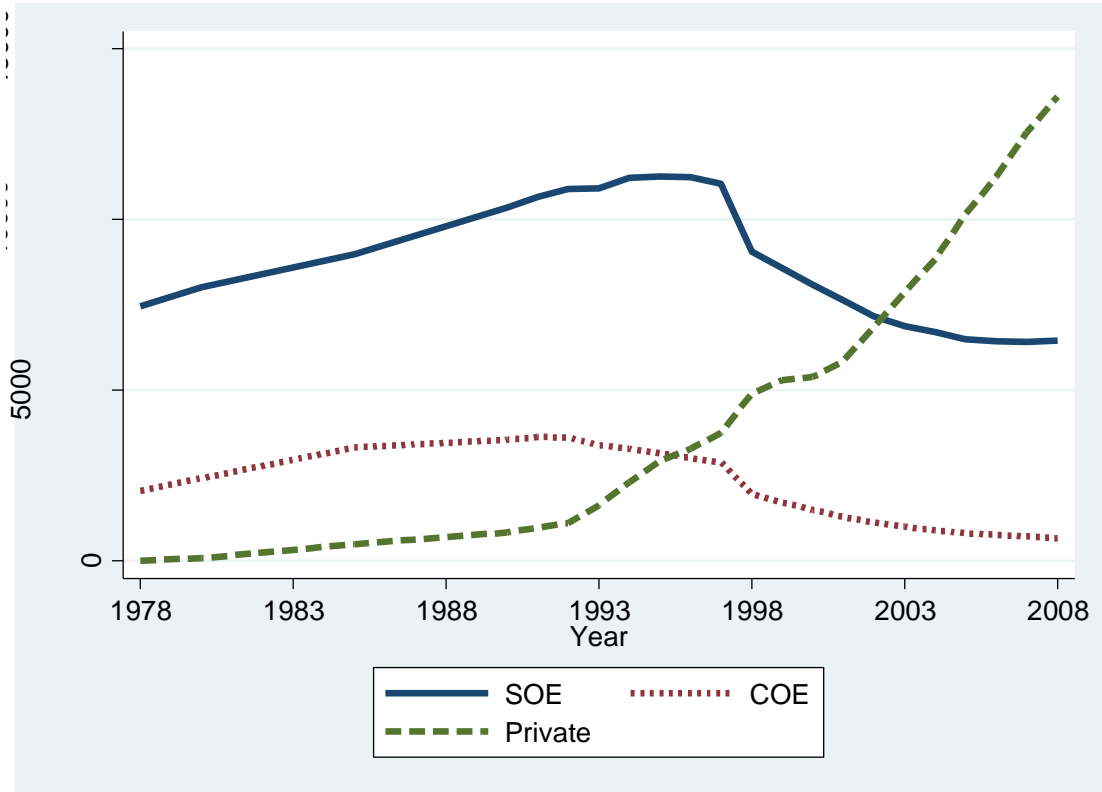


**Table 7. Ordinal Logit Models Predicting**

|   | DV.: Perceived Status (1-10) |                     |                      |                     |                     |                     |                     |                     |                     |
|---|------------------------------|---------------------|----------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
|   | Economic Status              |                     |                      | Social Status       |                     |                     | Political Status    |                     |                     |
|   | (1)                          | (2)                 | (3)                  | (4)                 | (5)                 | (6)                 | (7)                 | (8)                 | (9)                 |
| <i>Type of private entrepreneurs (ref. outsider-owned private firm)</i> |                              |                     |                      |                     |                     |                     |                     |                     |                     |
| Insider-owned private firm  | 0.117<br>(0.064)             | 0.068<br>(0.064)    | 0.056<br>(0.064)     | 0.071<br>(0.064)    | 0.037<br>(0.064)    | 0.016<br>(0.064)    | 0.087<br>(0.063)    | 0.055<br>(0.063)    | 0.014<br>(0.063)    |
| Outsider-owned privatized firm  | 0.015<br>(0.082)             | -0.093<br>(0.083)   | -0.099<br>(0.083)    | -0.020<br>(0.082)   | -0.095<br>(0.082)   | -0.104<br>(0.082)   | 0.050<br>(0.081)    | -0.006<br>(0.081)   | 0.007<br>(0.082)    |
| Insider-owned privatized firm   | 0.258**<br>(0.082)           | 0.082<br>(0.082)    | 0.031<br>(0.083)     | 0.364***<br>(0.082) | 0.239**<br>(0.082)  | 0.163*<br>(0.083)   | 0.373***<br>(0.081) | 0.282***<br>(0.081) | 0.180*<br>(0.082)   |
| <i>Economic capital</i>   |                              |                     |                      |                     |                     |                     |                     |                     |                     |
| Ln(assets) (current)  |                              | 0.258***<br>(0.018) | 0.233***<br>(0.018)  |                     | 0.188***<br>(0.017) | 0.145***<br>(0.017) |                     | 0.153***<br>(0.017) | 0.074***<br>(0.017) |
| Ln(income)  |                              | 0.333***<br>(0.023) | 0.323***<br>(0.023)  |                     | 0.167***<br>(0.021) | 0.153***<br>(0.021) |                     | 0.073***<br>(0.021) | 0.053**<br>(0.020)  |
| <i>Political capital</i>  |                              |                     |                      |                     |                     |                     |                     |                     |                     |
| NPC member  |                              |                     | 0.378***<br>(0.065)  |                     |                     | 0.587***<br>(0.065) |                     |                     | 0.904***<br>(0.066) |
| CPPCC member  |                              |                     | 0.261***<br>(0.057)  |                     |                     | 0.460***<br>(0.057) |                     |                     | 1.044***<br>(0.058) |
| <i>Individual characteristics</i>                                       |                              |                     |                      |                     |                     |                     |                     |                     |                     |
| Party member (current)  | 0.056<br>(0.055)             | 0.066<br>(0.055)    | 0.056<br>(0.055)     | 0.166**<br>(0.054)  | 0.177**<br>(0.054)  | 0.164**<br>(0.055)  | 0.374***<br>(0.054) | 0.380***<br>(0.054) | 0.398***<br>(0.055) |
| Years of education  | 0.023*<br>(0.010)            | -0.031**<br>(0.010) | -0.033***<br>(0.010) | 0.024*<br>(0.010)   | -0.014<br>(0.010)   | -0.015<br>(0.010)   | 0.027**<br>(0.010)  | 0.001<br>(0.010)    | -0.007<br>(0.010)   |
| Male  | 0.203**<br>(0.075)           | 0.044<br>(0.076)    | 0.058<br>(0.076)     | 0.016<br>(0.074)    | -0.100<br>(0.075)   | -0.071<br>(0.075)   | -0.092<br>(0.074)   | -0.178*<br>(0.075)  | -0.147*<br>(0.075)  |
| Age (current)   | -0.006<br>(0.003)            | -0.006<br>(0.003)   | -0.007*<br>(0.003)   | 0.007*<br>(0.003)   | 0.007*<br>(0.003)   | 0.004<br>(0.003)    | 0.019***<br>(0.003) | 0.018***<br>(0.003) | 0.015***<br>(0.003) |
| <i>Other controls</i>   |                              |                     |                      |                     |                     |                     |                     |                     |                     |
| Survey year dummies   | YES                          | YES                 | YES                  | YES                 | YES                 | YES                 | YES                 | YES                 | YES                 |
| Establishment year dummies  | YES                          | YES                 | YES                  | YES                 | YES                 | YES                 | YES                 | YES                 | YES                 |
| Industry dummies (current)  | YES                          | YES                 | YES                  | YES                 | YES                 | YES                 | YES                 | YES                 | YES                 |

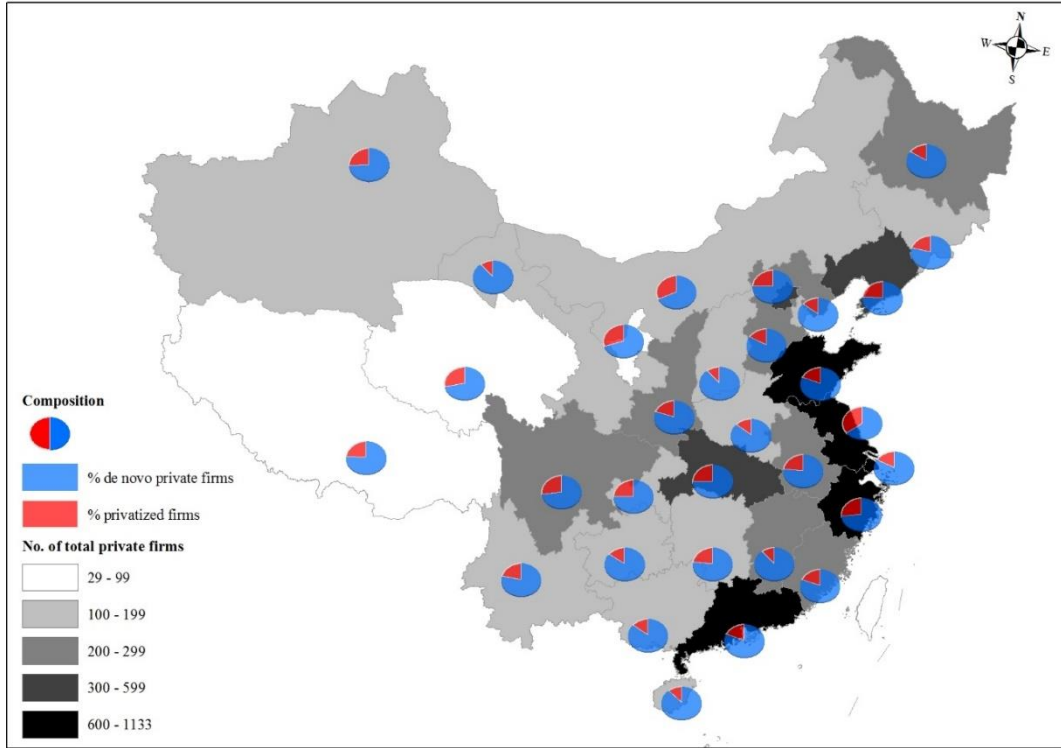
| Province dummies | YES    | YES    | YES    | YES    | YES    | YES    | YES    | YES    | YES    |
|------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| <i>N</i>         | 5700   | 5700   | 5700   | 5698   | 5698   | 5698   | 5689   | 5689   | 5689   |
| <i>Pseudo R2</i> | 0.0269 | 0.0563 | 0.0587 | 0.0442 | 0.0559 | 0.0619 | 0.0339 | 0.0391 | 0.0593 |

Note: Standard deviations in parentheses; \*\*\*  $p < 0.001$ , \*\*  $p < 0.01$ , \*  $p < 0.05$ . “Current” indicates status when the survey was conducted. “Insiders” include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.



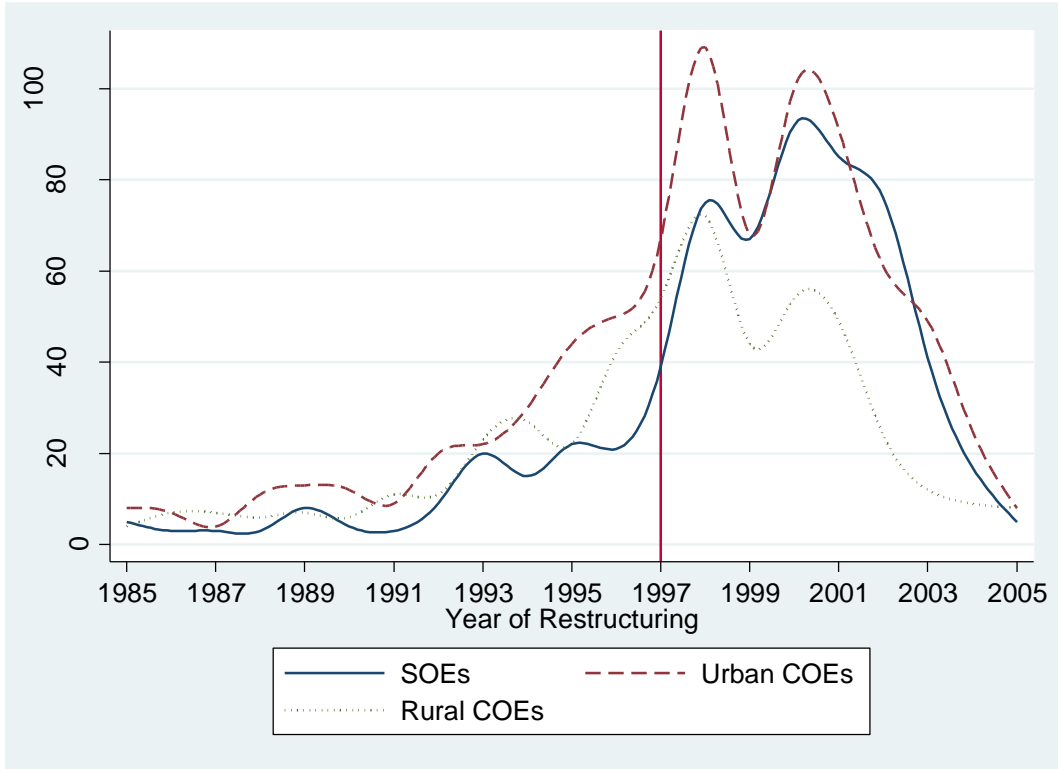
Source: China Statistical Yearbook 2009.

**Figure 1. Changes in Employment Numbers in Urban China, by Ownership, 1978-2008**



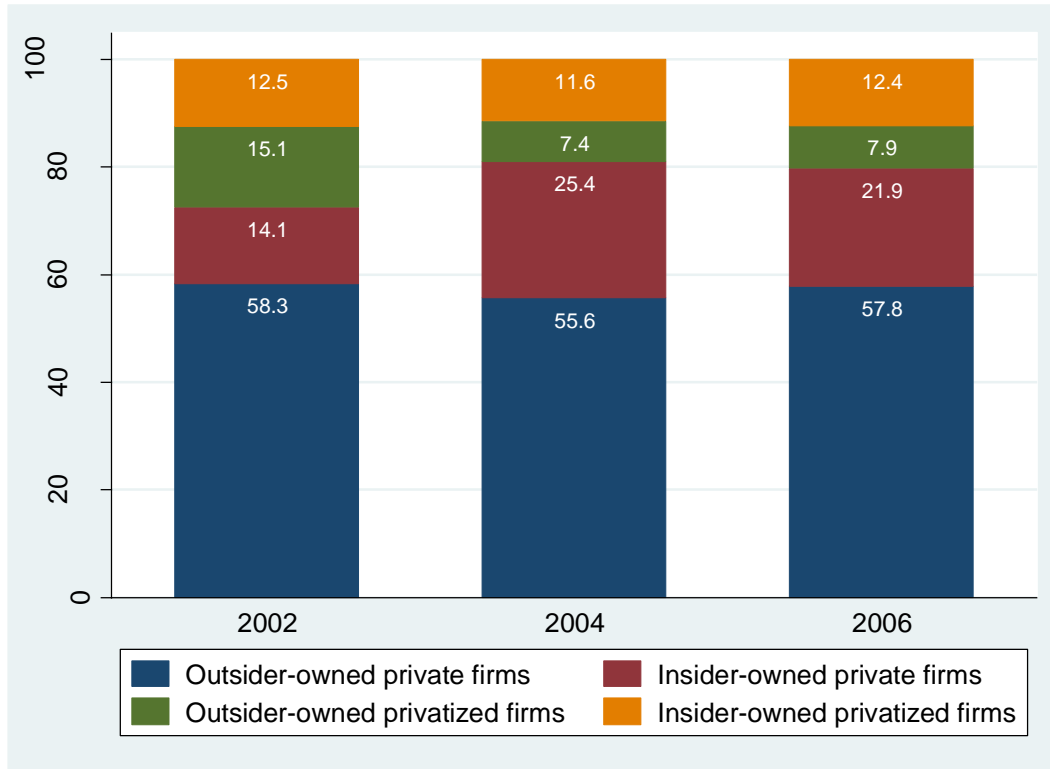
Source: China Private Enterprises Survey Data 2002, 2004, 2006.

**Figure 2. Geographic Distribution of *de novo* Private Firms and Privatized Firms**



Source: China Private Enterprises Survey Data 2002, 2004, 2006.

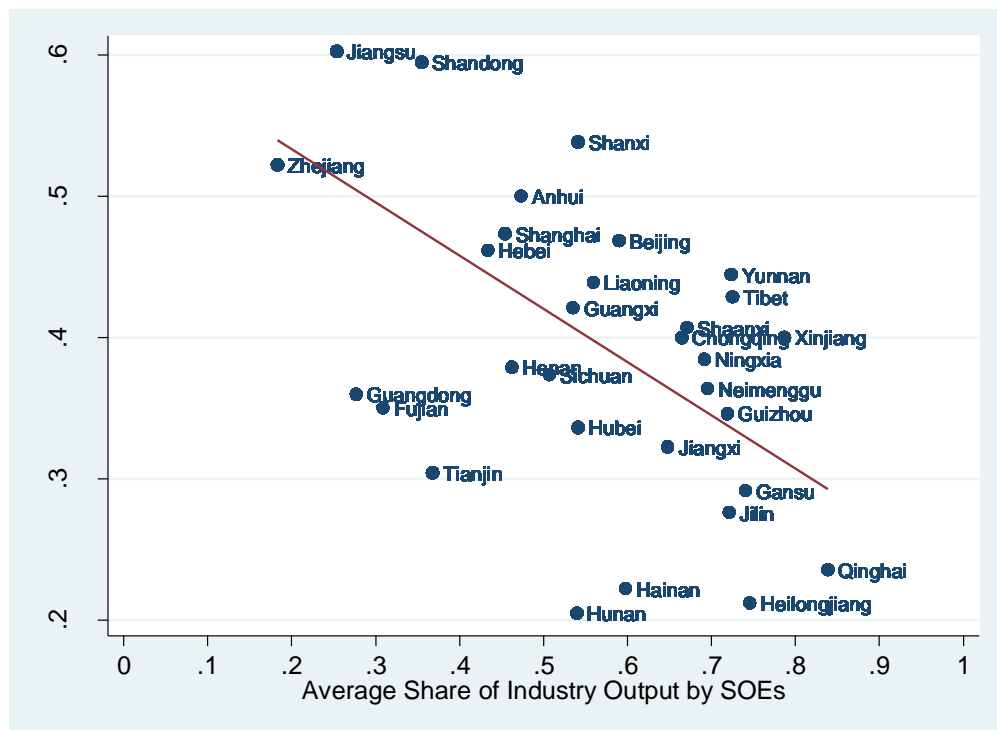
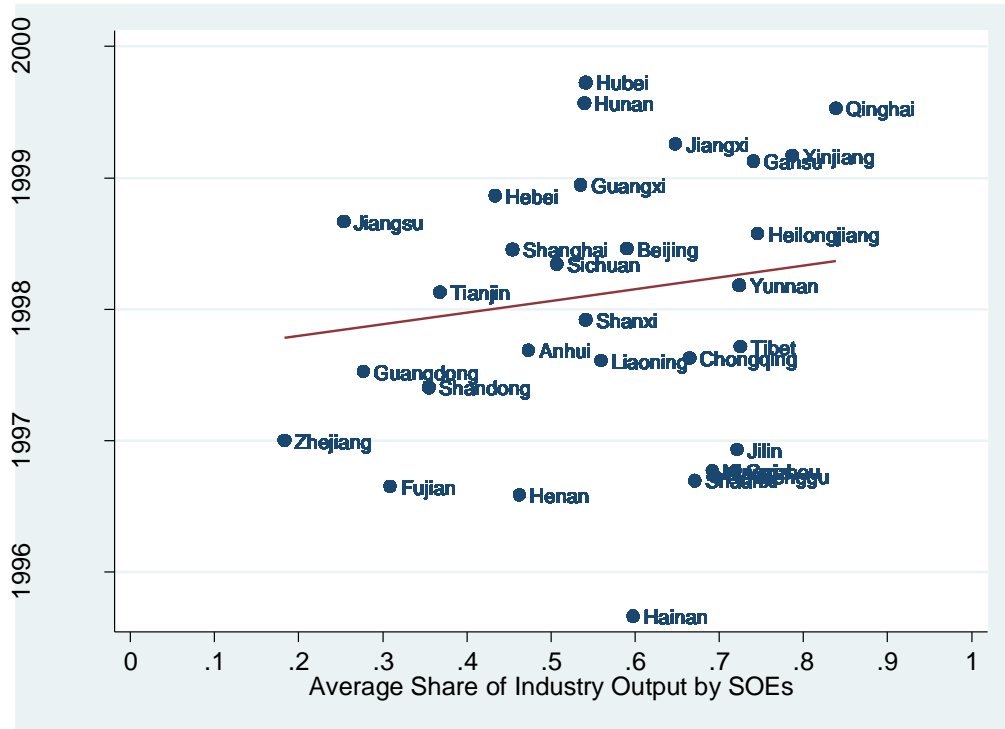
**Figure 3. Temporal Distribution of Restructuring, by Ownership**



Source: China Private Enterprises Survey Data 2002, 2004, 2006.

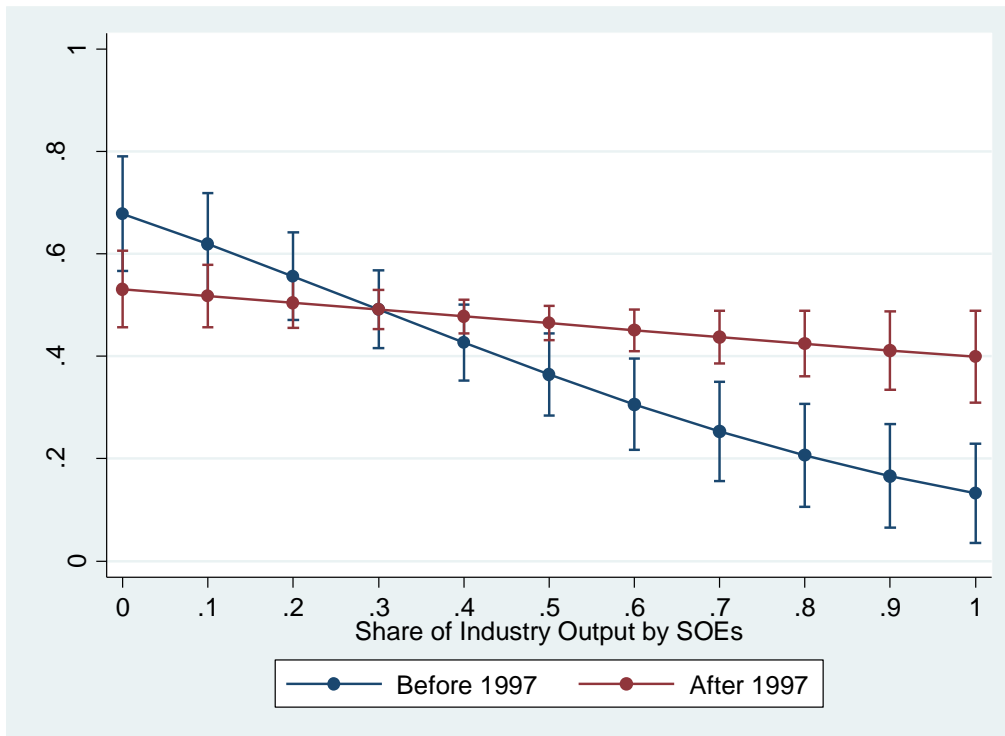
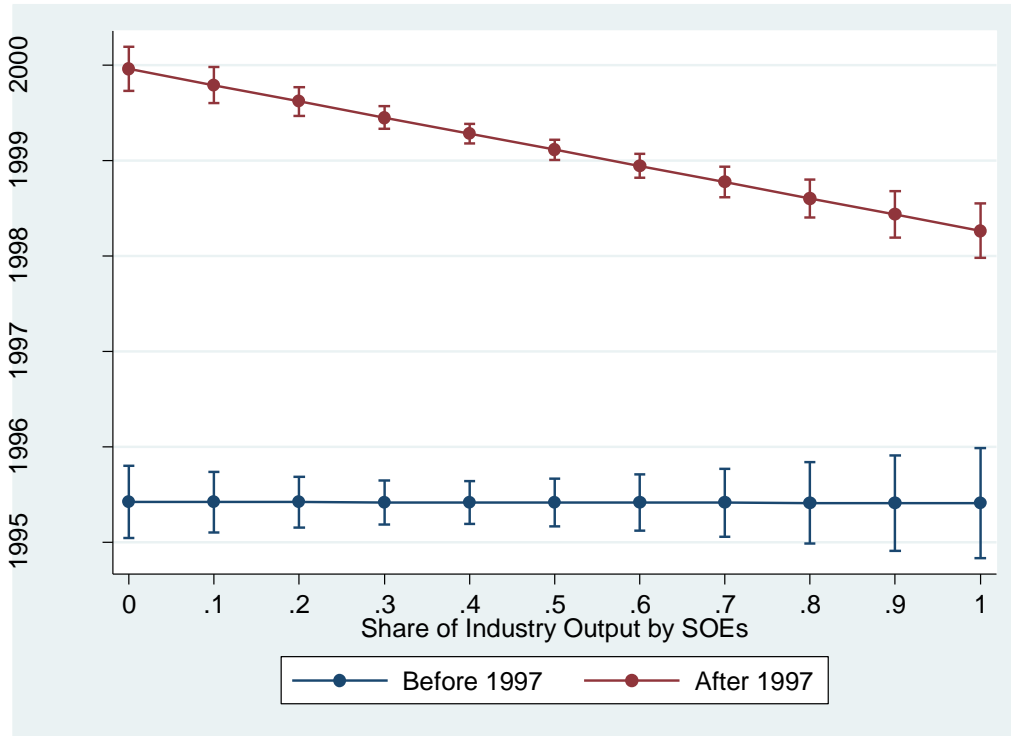
Note: “Insiders” include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.

**Figure 4. Composition of Chinese Private Enterprises, by Survey Year**



Source: China Private Enterprises Survey Data 2002, 2004, 2006.

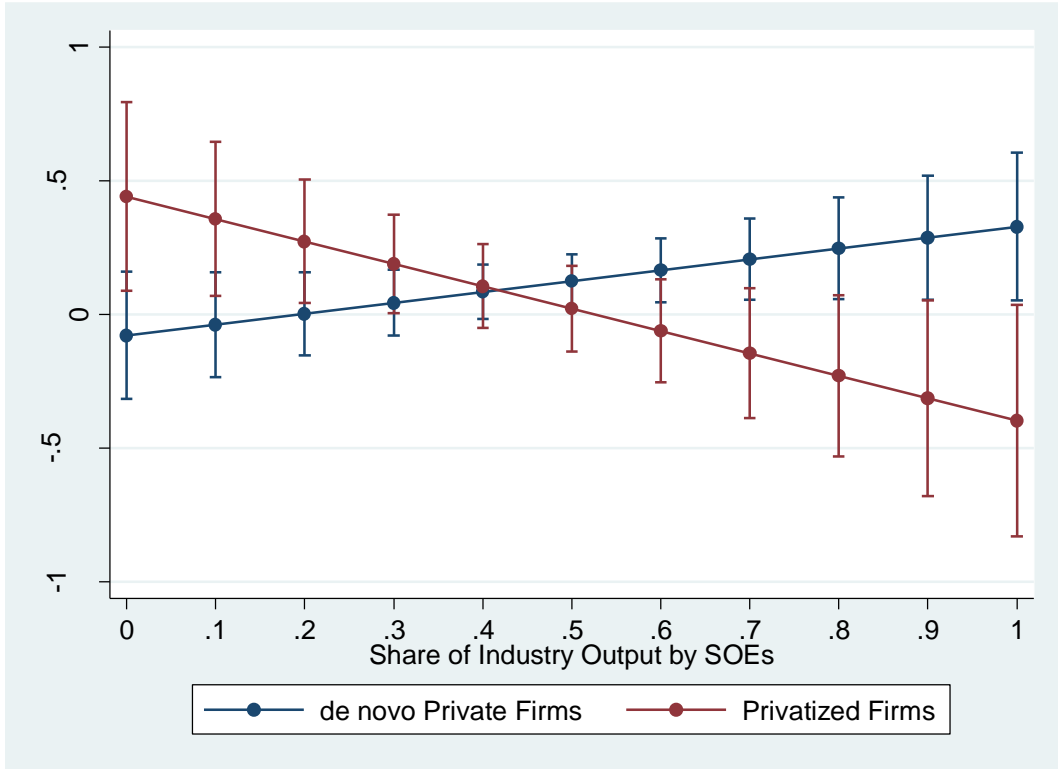
**Figure 5. The Descriptive Relationships between Share of Industry Output by SOEs and Timing and Mode of Privatization**



Source: China Private Enterprises Survey Data 2002, 2004, 2006.

**Figure 6. Model-Predicted Relationships between Share of Industry Output by SOEs and Timing and Mode of Privatization, by Period**





Source: China Private Enterprises Survey Data 2002, 2004, 2006.

Note: “Insiders” include: former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.

**Figure 7. Model-**

**Net Advantage on Initial Assets, by Firm Type**

## Appendix

Table A1. Logit Models Predicting the Probability of Owning a Privatized Firm

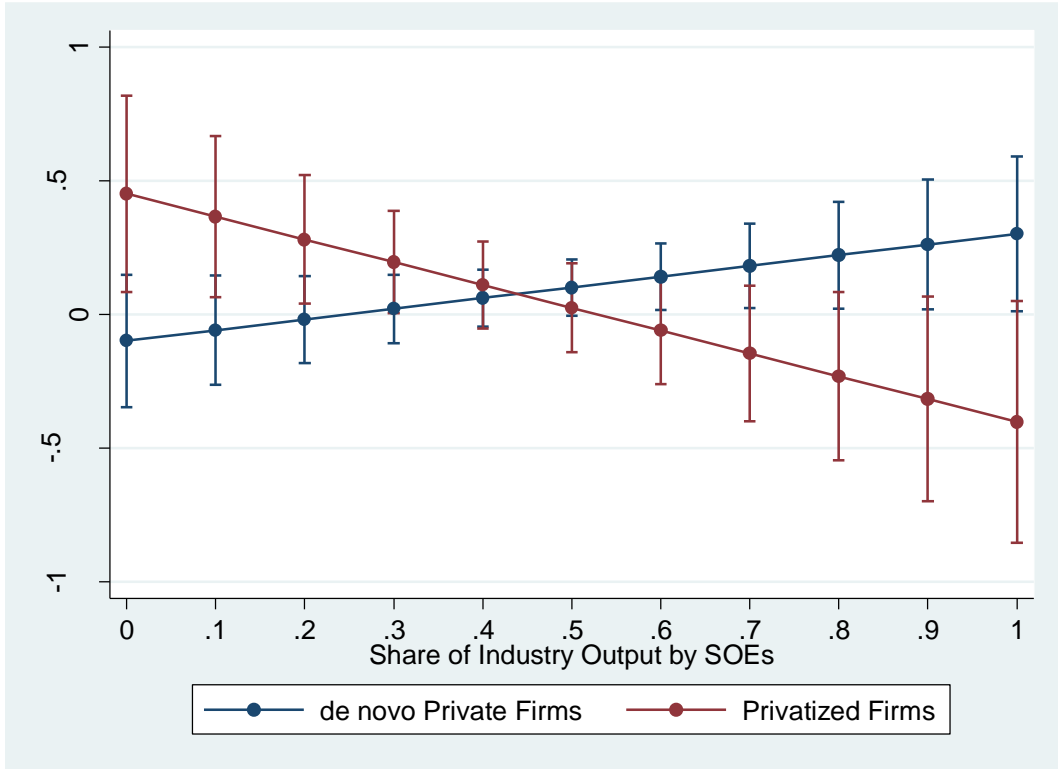
|   | DV.: Owner of a Privatized Firm |                      |                      |                      |                      |
|---|---------------------------------|----------------------|----------------------|----------------------|----------------------|
|   | (1)                             | (2)                  | (3)                  | (4)                  | (5)                  |
| <i>Former director of public enterprise</i>             | 0.790***<br>(0.111)             | 0.573***<br>(0.118)  | 0.575***<br>(0.118)  |                      |                      |
| <i>Former tenant/contractor of public enterprise</i>    |                                 | 0.666***<br>(0.123)  | 0.676***<br>(0.123)  |                      |                      |
| <i>Former director of government agency/institution</i> |                                 |                      | 0.371*<br>(0.173)    |                      |                      |
| <i>Insider</i>  |                                 |                      |                      | 0.796***<br>(0.106)  | 0.819***<br>(0.062)  |
| <i>Individual characteristics</i>                       |                                 |                      |                      |                      |                      |
| Party member (before)                                   | 0.880***<br>(0.106)             | 0.889***<br>(0.107)  | 0.860***<br>(0.108)  | 0.849***<br>(0.107)  | 0.903***<br>(0.064)  |
| Years of education                                      | 0.077***<br>(0.018)             | 0.078***<br>(0.019)  | 0.073***<br>(0.019)  | 0.070***<br>(0.019)  | 0.050***<br>(0.012)  |
| Male  | -0.002<br>(0.158)               | -0.031<br>(0.159)    | -0.045<br>(0.159)    | -0.022<br>(0.159)    | 0.238*<br>(0.099)    |
| Age (before)  | 0.025***<br>(0.006)             | 0.023***<br>(0.006)  | 0.022**<br>(0.007)   | 0.022***<br>(0.006)  | 0.026***<br>(0.004)  |
| <i>Other controls</i>                                   |                                 |                      |                      |                      |                      |
| Survey year dummies                                     | --                              | --                   | --                   | --                   | YES                  |
| Establishment year dummies                              | YES                             | YES                  | YES                  | YES                  | YES                  |
| Industry dummies (before)                               | YES                             | YES                  | YES                  | YES                  | YES                  |
| Province dummies  | YES                             | YES                  | YES                  | YES                  | YES                  |
| <i>Constant</i>   | -3.533***<br>(0.658)            | -3.478***<br>(0.655) | -3.398***<br>(0.657) | -3.394***<br>(0.659) | -3.129***<br>(0.435) |
| <i>N</i>  | 2757                            | 2757                 | 2757                 | 2757                 | 8340                 |
| <i>Pseudo R2</i>  | 0.1681                          | 0.1769               | 0.1783               | 0.1697               | 0.1684               |

Note: Standard deviations in parentheses; \*\*\* p < 0.001, \*\* p < 0.01, \* p < 0.05. "Before" indicates status when the firm was established. "Insiders" include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.

**Table A2. OLS Models Predicting the Initial Equities When Firms were Established**

|  | <b>DV.: Logarithm of Initial Equities</b> |                     |                     |                     |
|--|---|---------------------|---------------------|---------------------|
|  | (1)                                       | (2)                 | (3)                 | (4)                 |
| Privatized firm                            | 0.334***<br>(0.050)                       | 0.337***<br>(0.067) | 0.405*<br>(0.200)   | 0.069<br>(0.156)    |
| Insider                                    | 0.082<br>(0.045)                          | 0.083<br>(0.052)    | 0.263<br>(0.148)    | -0.099<br>(0.127)   |
| Privatized firm*insider                    |   | -0.005<br>(0.095)   | -0.118<br>(0.297)   | 0.551*<br>(0.225)   |
| Ratio of fiscal revenue to expenditure     |   |                     | 0.188<br>(0.147)    |                     |
| Ratio*privatized firm                      |   |                     | -0.091<br>(0.263)   |                     |
| Ratio*insider                              |   |                     | -0.252<br>(0.195)   |                     |
| Ratio*privatized firm*insider              |   |                     | 0.153<br>(0.401)    |                     |
| Share of industry output by SOEs           |   |                     |                     | -0.171<br>(0.152)   |
| Share*privatized firm                      |   |                     |                     | 0.594<br>(0.313)    |
| Share*insider                              |   |                     |                     | 0.401<br>(0.253)    |
| Share*Privatized firm*Insider              |   |                     |                     | -1.255**<br>(0.460) |
| <b><i>Provincial economic controls</i></b> |   |                     |                     |                     |
| Ln(PGDP)                                   | 1.372*<br>(0.649)                         | 1.372*<br>(0.649)   | 1.342*<br>(0.651)   | 1.328*<br>(0.666)   |
| Lagged Ln(PGDP)                            | -1.394*<br>(0.654)                        | -1.394*<br>(0.654)  | -1.392*<br>(0.654)  | -1.360*<br>(0.667)  |
| <b><i>Individual characteristics</i></b>   |   |                     |                     |                     |
| Party membership (before)                  | 0.003<br>(0.047)                          | 0.003<br>(0.047)    | 0.003<br>(0.047)    | 0.000<br>(0.047)    |
| Years of education                         | 0.089***<br>(0.008)                       | 0.089***<br>(0.008) | 0.089***<br>(0.008) | 0.090***<br>(0.008) |
| Male                                       | 0.207***<br>(0.060)                       | 0.207***<br>(0.060) | 0.206***<br>(0.060) | 0.204***<br>(0.060) |
| Age (before)                               | 0.001<br>(0.003)                          | 0.001<br>(0.003)    | 0.001<br>(0.003)    | 0.001<br>(0.003)    |
| <b><i>Other controls</i></b>               |   |                     |                     |                     |
| Survey year dummies                        | YES                                       | YES                 | YES                 | YES                 |
| Establishment year dummies                 | YES                                       | YES                 | YES                 | YES                 |
| Industry dummies (before)                  | YES                                       | YES                 | YES                 | YES                 |
| <b><i>Constant</i></b>                     | 2.030**<br>(0.660)                        | 2.030**<br>(0.661)  | 2.035**<br>(0.670)  | 2.166**<br>(0.694)  |
| <i>N</i>                                   | 6432                                      | 6432                | 6432                | 6432                |
| <i>R2</i>                                  | 0.1422                                    | 0.1422              | 0.1426              | 0.1433              |

Note: Standard deviations in parentheses; \*\*\* p < 0.001, \*\* p < 0.01, \* p < 0.05. “Before” indicates status when the firm was established. “Insiders” include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.



Source: China Private Enterprises Survey Data 2002, 2004, 2006.

Note: “Insiders” include former directors of public enterprises, former tenants/contractors of public enterprises, and former directors of government agencies and institutions.

**Figure A1. Model-**  
**Net Advantage on Initial Equities, by Firm Type**