Between Developmental and Clientelist States

Local State-Business Relationships in China

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Before the Asian Financial Crisis of 1997, the idea of the developmental state was in vogue to explain what the World Bank once called the East Asian Miracle.[1] The broader theoretical debate in comparative political economy recognized the pivotal role of the state in guiding the market and attaining economic growth.[2] This large body of literature on the developmental state consisted predominantly of studies of either single nation-states or cross-country comparisons of national states.[3]

The role of the state, particularly the local states, has received enormous attention in explaining the spectacular rural industrialization in China, a process that jumpstarted the country's economic take-off in the early 1980s and pulled hundreds of millions of people out of poverty during the first fifteen years of economic reform.[4] Conventional wisdom among political scientists holds that local governments in China have played an instrumental role in developing collectively owned enterprises and spearheading rural industrialization. Local states have been described as corporatist,[5] entrepreneurial,[6] or developmental,[7] denoting the interventionist and instrumental roles they have played in rural industrialization.

The central government has provided policy incentives to encourage industrial promotion by local governments, even though it is not directly involved in local industrialization. Since the implementation of fiscal decentralization polices in the 1980s, local governments have been given the prerogative to impose and collect taxes as well as to retain a certain portion of tax revenues. Local governments are also given the financing responsibilities of public goods and service provision. Given the fiscal incentive and responsibility, developing tax-contributing industries becomes a critical objective of local governments.[8] Hence, it is appropriate to restrict the current study of the role of the state to that of local states.

I question the validity of the conventional wisdom in light of recent empirical developments. The literature on local states in China was written in the 1980s and early 1990s, when collectively owned township and village enterprises (TVEs) were expanding rapidly; since then, the TVE sector has been drastically transformed. Beginning in the mid–1990s, local governments either privatized these collective enterprises or shut down the extremely unprofitable ones. There is ample evidence pointing to pervasive stripping of collectively owned assets during the privatization process. Various studies on privatization have pointed to massive undervaluation of collectively owned assets by local governments, and to transaction prices set significantly below the collective enterprises' net worth. Consequently, a majority of the collectively owned assets were simply sold to private individuals at heavily discounted prices. This contradicts the very notion of developmental states. If the local governments were indeed acting in the interests of the communities, as developmental states do, why did they allow such stripping of collective assets?

To explain this empirical puzzle, this article draws on the theoretical literature on effective state intervention, but brings the analysis to a subnational level. While there are a number of studies on privatization, none has gone beyond merely depicting the process. The implications of the massive ownership transformation and the concomitant asset stripping for local governance remain underanalyzed. Popular understanding of local governments remains stagnant in the paradigm of "local developmental states" and "local corporatist states." The intention of this article is not to uncover the privatization process, which has been done previously. Instead, its primary contribution is to conceptualizing the role of local states, in light of developments in the last decade. No doubt multiple local-state models coexist. However, the popular "Sunan" model and its variants that laud the role of local government in development, theorized during the 1980s and early 1990s, are due for a fundamental reassessment.

In *Bringing the State Back In*, Peter Evans, Dietrich Reuschemeyer, and Theda Skocpol contend that the prerequisites of effective state intervention are strong "state capacity" and the state's "relative autonomy" from dominant societal interests.[9] But two decades of market liberalization, including the development of input markets and material resources and the relaxation of administrative controls, eroded the local state's relative autonomy vis-à-vis the economic elite. Over this period, local political leaders, upon whom enterprise managers used to rely, lost their monopoly control of and access to key economic resources. In the context of privatization, state capacity refers to the state's competence in establishing and enforcing the rules of the game for the market to function. A useful contrast is Russia's weak versus Hungary's strong regulatory capacity, which resulted in a negative privatization outcome in the former but a positive outcome in the latter.[10] The institutional capacity of the state to supervise and monitor market transactions, which was less essential in a controlled system, became critical when the economy liberalized. But the Chinese state increasingly lacked that capacity when privatization was carried out. In the context of the effective state intervention theory, state capacity declined. The diminution of both relative autonomy and state capacity transformed developmental local states into clientelistic states, enabling local political leaders to collude with the empowered economic elite to act against the interests of the communities in the privatization process. This is symbolic of the larger trend in the state-business relationship that has emerged in China since the mid–1990s.

The Role of the State in Economic Development

Evans, Rueschemeyer, and Skocpol contend that the state is not a "black box," as it is treated in the neo-utilitarian approach. Though the state has an important role to play in economic development,[11] not all states are effective in their intervention in the economy. Strong state capacity and relative autonomy from dominant interests in society are the two conditions necessary to make state intervention effective.[12]

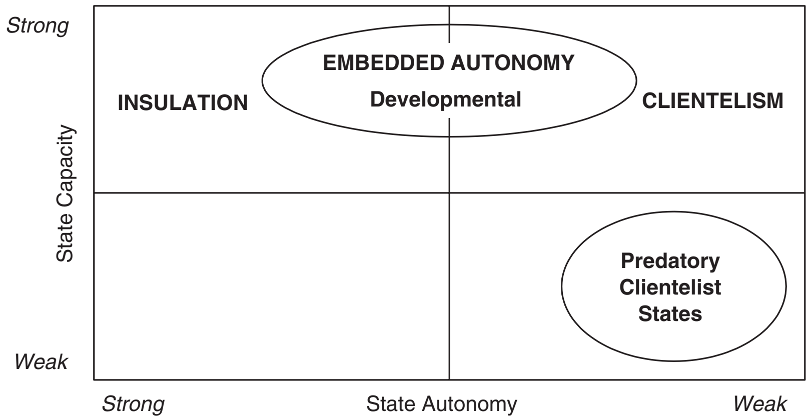
In the context of this article, state capacity is defined as the ability of the state to set and enforce the rules of the game for the market to function. State capacity is traditionally defined as a "well-developed bureaucratic apparatus" that is selected based on merit, and is sturdy and competent to carry out the state's goals. Among the newly industrializing countries, Japan, South Korea, and Singapore are most often lauded as having a competent and uncorrupt bureaucratic apparatus that has contributed to their economic success. However, in the process of enterprise ownership transformation, an efficient bureaucratic apparatus on its own is insufficient. It is critical for the state to be an independent arbiter of the rules, which include fair asset evaluation, buyer selection, and transparent auctions or sales. The massive asset stripping in Russia during the 1990s took place precisely because the state lacked the capacity to enforce the rules of the game. As Andrew Barnes notes,

> "the approach of the Yeltsin regime was to let the market do most of the restructuring of the system… he (Yeltsin) gathered a team of radical reformers to implement a rapid freeing of prices followed by a mass, voucher-based privatization program that aimed to put as much property in private hands as quickly as possible. There was no effort to de-monopolize, to regulate banks, to impose transparency requirements on financial transactions, or to establish conflict-of-interest rules, despite the fact that prominent Russian politicians had been advocating just such restrictions for some time."[13]

The second condition for effective state intervention is the state having a *certain degree* of autonomy from society. As shown in Figure 1, along the scale of state autonomy, there is "insulation" or "absolute autonomy" on one end, and "capture" or "clientelism" on the other. Absolute autonomy can be superior if the state has close-to-perfect knowledge and enormous resources that enable effective policy formulation and implementation. Conversely, if the state relies heavily on its alliance with the dominant classes to implement its policies to such an extent that it loses most of its autonomy for independent thinking and execution, it is being captured by dominant societal groups and interests.[14] What lies in between the two extremes is an alliance between the state and the dominant class of society that makes state intervention most effective.

While the developmental states could play a handmaiden role in economic transformation, "predatory clientelist states" that have weak capacity and little autonomy often move the countries toward the path of "collective disasters" instead of "collective goals."[15] The essential ingredient of the developmental states—a term that has been used to describe Japan in the 1970s and 1980s, South Korea under Park Chung-Hee's regime, and Taiwan under Chiang Kai-Shek's Kuomintang's rule—is "embedded autonomy," which "combines Weberian bureaucratic insulation with intense connection to the surrounding social structure … (and) connection means increased competence instead of capture."[16] In Evans's description, predatory states are exemplified by Zaire under Mobutu, where plundering and looting of state resources took place at the top of the

Figure 1 Developmental States vs. Predatory States



government echelon. Despite the façade of a modern state, Zaire was marked by an absence of rules-based bureaucratic structure and officials disciplined by career advancement [or pursuant] of coherent corporate goals.

Local State-Driven Development in China

There are two major local-state models in China's economic development. The more popular of the two and the one that has more widespread application is the "Sunan" model, where local governments play an indispensable role in spearheading local economic development. The model refers to control of economic and physical resources by local governments in southern Jiangsu and their channeling of resources to develop government-owned enterprises.[17] Massive explosion of collective township and village enterprises (TVEs) throughout the country during the 1980s and early 1990s was seen as vindication of the instrumental role of local governments in jump-starting rural industrialization.[18]

The other is the "Wenzhou" model that lauds the role of private enterprises in steering economic development.[19] Compared to the former, Wenzhou government is more laissez faire, allowing private entrepreneurs to set up their own firms and leaving the task of spearheading economic growth to the entrepreneurs. The Wenzhou model has relatively limited application in the rest of the country because of the city's unique conditions that enable and facilitate the growth and mushrooming of private enterprises. Prior to communist rule in the late 1940s, Wenzhou people were known for their risk-taking and entrepreneurial spirit, while the local government had a reputation of playing a minimal role in the economy. Even during the heyday of collectivization of the 1950s and 1960s, private enterprises did not completely die out, unlike what happened in the rest of the country. These historical and anthropological factors are widely believed to have given rise to the unique Wenzhou phenomenon.[20]

While the local-state models vary in China's economic development, the Sunan model and its variants are far more widespread than the Wenzhou model. It is the local developmental state-type Sunan model—which has influenced the thinking of a generation of scholars on the role of local states—that this article addresses.

The majority of studies lauding the role of local states in rural industrialization were conducted during the 1980s and the first half of the 1990s when the TVEs were booming and rapidly expanding. In a study of Zouping county in Shandong province on the east coast of China, Andrew Walder observes that the local government operates like a profit-oriented multinational corporation with the county government as the corporate headquarters, and the township governments as the subsidiaries reporting to the head office.[21] Following a similar logic, Jean Oi uses the term "local state corporatism" to describe the role of local government's corporate-like behavior in running enterprises, and attributes the take-off of rural industrialization to local government's action.[22]

Other authors have also written on the interventionist role of local governments, and how it has advanced the interests of rural communities. In a study of real estate and commerce government agencies in Tianjin municipality, Jane Duckett labeled local states "entrepreneurial" because state bureaus were observed to be engaging in profit-seeking businesses that are productive but not rent-seeking.[23] The work of Marc Blecher and Vivienne Shue in a municipality in Hebei province suggests the local state is more "developmental" than "entrepreneurial" since they find local government officials to be working for the "collective good" rather than merely maximizing profits for themselves.

Nevertheless, beginning in the second half of the 1990s, development of the TVEs took a downturn—a significant number of the collective enterprises experienced losses, and the problem worsened to such an extent that the enterprises became financial liabilities, instead of cash cows, to the local states. From the mid–1990s, financial performance of many rural collective enterprises began to deteriorate, which added to the dismal outlook vis-à-vis the private sector in terms of job creation and revenue contribution to the local government's coffers.[24] A study based in rural Sichuan province suggests that local government debt owing to township enterprise financing in the impoverished regions accounted for as much as forty times a township government's annual budgetary revenue.[25] In southern Jiangsu province, the region where the collective TVEs were initially born and bred, local governments began selling off their stakes in these enterprises to existing management, employees, or private individuals, or they shut down the enterprises to wind up their losses.

The central government began encouraging TVE privatization by the mid–1990s. Having seen how divestment of local government ownership had provided a solution for the growing financial losses and indebtedness of the collective enterprises in southern Jiangsu, the central government encouraged all local governments to divest their stakes in collective enterprises, calling for a separation of business from politics, or *zhengqi fenkai*.[26]

Governance Problems in the Ownership Reform of Collective Enterprises

As market competition became keener, growth of the collective enterprises started to lose steam, and many were in the red in the mid–1990s. The initial recipes for their success—their agility and offers of consumer products to fill the market gap unmet by the state-owned enterprises—had gradually eroded.[27] As Barry Naughton notes,

> "with increased market integration and competition, TVEs lost their protected position. There were few, if any, empty niches for TVEs to exploit. Moreover, as incomes, especially urban incomes, rose, consumers increasingly demanded higher quality products than those that the traditional TVEs, with their outdated technologies, could provide. TVEs seemed to lose their special role in the economy."[28]

The number of rural enterprises had grown to such a scale that they competed vigorously among themselves. Further, as more private enterprises were being set up during the 1990s, they posed competitive pressure that reduced the collective enterprises' profitability.[29]

The TVEs were heavily in debt by the mid–1990s. Among various enterprise types, township-based TVEs had the highest average debt-asset ratio of 0.68, while village-based TVEs had a ratio of 0.55, compared to 0.25–0.35 for private firms.[30] A research report produced by the Jiangsu Chinese Academy of Social Sciences (CASS) indicates the average debt-to-asset ratio of the firms in southern Jiangsu were as high as 0.75 prior to the ownership transformation.[31] From the perspective of local governments, the collective TVEs had become financial liabilities, rather than "cash cows" when enterprises were making money.[32] As a corollary, local governments were eager to divest their stakes in the enterprises to rid themselves of the financial burdens.[33] By the end of 2000, 93 percent of 85,000 TVEs in Jiangsu province had been privatized.[34]

Scholars have observed that significant items were not taken into account in the valuations, resulting in gross undervaluation of collective assets.[35] As the notable Chinese agricultural specialist Tiejun Wen pointed out, land occupied by the collective TVEs was collectively owned, and that had been cost-free for the enterprises.[36] Rural land had registered manifold price increases in recent years, simply because rapid industrialization and urbanization had raised the demand for land, particularly in densely populated areas.[37]

Research indicates an overwhelming proportion of buyers had paid prices that were grossly less than the collective enterprises' net worth. Of the eighty-eight firms investigated by Li and Rozelle, 70 percent were sold at prices less than their net worth, and close to 40 percent were transacted at prices less than half their net worth (see Table 1, column 3).[38] If the firms that had negative net asset value were excluded from the sample, more than 50 percent of the remaining firms were transacted at prices half their net worth, as indicated in Table 1.[39]

Hui Qin's case study illustrates how local party bosses have pocketed proceeds from the inherently nontransparent ownership reform process.[40] A collective enterprise X in southern Jiangsu was valued at 8.6 million *yuan* in net equity (of which 4.1 million were fixed assets), the total asset value net of its debt. The private firm it was merging

Table 1 Buyout Prices and the Net Worth of Collective Firms

Ratio of buyout price to net worth (%)	No. of firms	% of firms	Asset value (mil yuan)[c]	Buyout price (mil yuan)[a]	Net worth (mil yuan)[b]	Payment premium (mil yuan)[d]
0–20	21	23.9	18.06	0.78	7.16	−6.39
21–50	14	15.9	11.67	1.48	4.56	−3.17
51–75	13	14.8	6.80	1.57	2.39	−0.82
76–100	13	14.8	16.61	3.09	3.80	−0.70
Greater than 100	20	22.7	10.88	3.24	2.58	0.93
Less than 0[e]	7	7.95	6.22	0.20	−0.69	0.89

Notes:
[a]The buyout price is the price paid by the new owner to the local government at the time of privatization.
[b]The net worth is the book value of equity, that is the difference between the book value of assets and that of debt.
[c]The asset value is the book value of assets.
[d]The payment premium is the difference between the buyout price and firm's net worth.
[e]The ratio is negative when the net worth is negative (debts are greater than assets).
Source: Li and Rozelle (2003, p.993)

with had a net worth or equity of 3.0 million yuan (of which 1.2 million was fixed assets). Thus, the private firm was about a third the size of the collective firm. However, when the new joint stock company was formed, the private firm became the majority shareholder, holding 3.0 million yuan worth of shares, or 60 percent stake in the new firm. The collective enterprises held only 2.0 million yuan share, or 40 percent stake. What happened to the rest of the collective enterprise assets? Its 8.6 million in net equity was said to consist of 3.5 million yuan worth of fixed assets and 2.0 million yuan worth of inventories. The remaining 3.2 million yuan was said to have been reallocated (*diaobo chuli*) by the township authority. After deducting the reallocated amount, the collective enterprise still had a net equity of 5.5 million yuan. Why did it invest only 2.0 million yuan into the new enterprise? It turned out that, of the 5.5 million yuan in net equity, the township authority had claimed creditor rights to 3.5 million yuan. However, the value of net equity (8.6 million yuan) is the total asset value minus the amount of debt, which means any debt owed to debtors should have been taken into account. The amount that lined the pockets of local officials could be as much as 6.6 million yuan in a sale transaction of a collective firm valued at 8.6 million yuan.

For the collective enterprises that were "auctioned off" (*paimai*), no competitive bidding was involved—in contrast to what the term implies. It was almost always the case that bids submitted by the existing managers were the only offers accepted by the sellers or local governments. Moreover, there was no public notice issued to solicit competitive bidding. Of the eleven enterprises investigated by Qin, only two had competitive bidding. Seven of the eleven firms were sold to the existing managers—the so-called insider privatization.[41]

Another study conducted in Jiangsu and Shandong provinces by Xiao-yuan Dong, Paul Bowles, and Samuel Ho reaffirms the phenomenon of insider privatization. Close to 80 percent of the firms' shares were sold to the existing managers and board members, while 18 percent were sold to ordinary employees. They found that local governments imposed "significant limits" on the ability of ordinary employees to purchase shares. Employees were typically required to pay cash for their shares, while managers were allowed to finance their purchases in installments or use working capital and retained profits. Local workers were refused the opportunity to buy shares in some enterprises; migrant workers were simply not eligible in most cases.[42]

How Does State Theory Explain the Governance Problem?

Why were the insiders able to buy collective enterprises at heavily discounted prices? What does it tell us about the relationship between local states and enterprise managers? A comparison of the pre- and post-reform relationship between the two parties suggests that the local state's capacity has declined and its relative autonomy from the enterprise managers in the pre-reform era has transformed into a destructive clientelistic relationship.

Pre-Mid–1990s: Embedded Autonomy of Local States Prior to the mid–1990s, though local political leaders maintained a less-than-arm's-length relationship with enterprise managers, it was a relationship in which the local leaders had the upper hand, because the managers had to rely on the political elite for access to various economic resources and political protection. In other words, enterprise managers may have had a degree of independence in running the firms, but the autonomy was embedded within the local state.

Local leaders typically appointed their protégés to become enterprise managers when the enterprises were first established.[43] At the township level, it was commonplace for the township party secretary to appoint people whom he trusted to manage the enterprises since a township could own as many as a dozen collective firms. At the village level, where there were fewer firms, it was not uncommon for village leaders to become managers themselves. Though the managers were the people whom local party leaders trusted, they could not manage the enterprises independent of local officials. In the early reform days, enterprise managers had to rely on the political leverage of local leaders to secure essential resources.

When the banks and nonbanking institutions were still in an embryonic stage of development during the 1980s and early 1990s, they lent only to the state-owned firms and government-linked enterprises.[44] Until the early 2000s, bank officers could lose their jobs if the loans they had approved to private enterprises went sour, while the same could not be said about lending to state-owned or collective firms because of the local government connection.[45] Access to formal bank financing was highly restricted and it forced private entrepreneurs to turn to informal sources of credit, ranging from rotating credit associations, underground money houses, and illegal usurious moneylenders.[46]

These informal lenders who charged exorbitant interest rates significantly raised the cost of financing for those enterprises that failed to secure formal credit.

Access to capital of the TVEs was greatly enhanced by guarantees provided by local governments. As Naughton notes, "local government officials acted as intermediaries and guarantors, reassuring local agents of the banking system that their loans would ultimately be repaid."[47] Many local authorities ended up with huge debt burdens owed to financial institutions as a result of failed TVE developments in some locales.[48] Some local government officials went a step further to actively pressure local banks to provide loans to their firms.[49]

To lower the political and business risks associated with private ownership, private entrepreneurs employed creative practices to forge alliances with local governments.[50] Though the actual size is unknown, it is commonly noted that a significant proportion of the official "collective rural enterprises" were in fact *guahu* (hang-on) and *daihongmao* (red hat) firms, which were private enterprises in disguise.[51] On the one hand, guahu firms were private enterprises that paid a fee to collective firms for the use of their names, bank account numbers, receipt books, and income taxes; on the other hand, daihongmao private firms paid a management fee to the village or township government in exchange for registration as collectively owned entities.[52] Until the early 1990s, many household enterprises also had to register themselves as "collective firms" to circumvent the illegal status as private entities and to guard against the institutional discrimination against private ownership. Not only did private firms have difficulty obtaining formal finance, they also faced higher tax rates than the state-owned and collective enterprises. In addition, private entrepreneurs also faced threats of property seizure and had to deal with being hassled by local officials.

Apart from financial capital and legal protection, local governments also controlled access to other key industrial inputs, such as land.[53] Since all rural land is collectively owned, land usage—critical for industrial development—is decided by village and township leaders. In the early days of reform, political connections with local officials were also needed to secure access to industrial inputs, such as electricity and other raw materials, because procurement for the TVEs, unlike the state-owned enterprises, was not included in the state plans.[54] In other words, local states maintained a certain degree of autonomy, though not absolute autonomy, from enterprise managers, in the early reform period.

Post-Mid–1990s: Diminishing Autonomy of Local States With market liberalization and economic reform, the embedded autonomy of the local state in the initial period diminished over time. With increased liberalization in the input markets and financial industry, local political leaders lost their monopoly power as the gatekeepers to these essential resources. Though political connection was still helpful to the entrepreneurs, it was not as indispensable as it had been previously. Put simply, the economic elite had gained autonomy vis-à-vis the local political leaders.

The central government's recentralization of the banking industry in the mid–1990s made it more difficult, though not impossible, for local leaders to use political persuasion to channel loans to favored enterprises. To reduce local government interference in loan allocations, the central government recentralized the state-owned banking system in the areas of loan-making decisions and personnel appointment in the mid–1990s.[55] Loan approval decisions were recentralized from managers in township branches to the county, a level above the township. For loans exceeding a certain amount, the decisions had to be referred to the prefecture level, a higher level than the county. This trend of recentralizing loan decisions continued into the 2000s, to such an extent that in 2012 county-level branches of the state-owned banks do not have much leverage over loan approval. Most loan decisions are made at the prefectural level and above.[56]

Further, local government influence on personnel appointment in local branches of the state-owned banks was also curbed as part of the recentralization efforts in the mid–1990s. Bank managers are now subject to two sets of personnel management systems—that of the Communist Party system, as party members, and that of the banking system. Prior to the banking reform in the mid–1990s, the party system took priority over the personnel system in the bank— local party bosses appointed bank managers and determined their career prospects.[57] The state banking sector reform in the mid–1990s reduced the power of local party secretaries in personnel control. Although bank managers still report to local party bosses on party-related matters, their appointment and career decisions are now made by their functional superiors in the hierarchies of banks.[58]

By the early 1990s, the collective TVEs could apply for financing directly—in the absence of any guarantee or political backing by the local government—by using their enterprise, machinery, and equipment as collateral. This was not possible in the early days of collective TVE development because most of the physical resources were remnants of the commune and brigade enterprises that were tightly controlled by the collectives or local political elite. The nature of access to other industrial inputs had also changed by the mid–1990s to alter the relationship dynamics between local political leaders and the economic elite. When markets developed over time, enterprise managers could secure industrial supplies, such as steel, iron, and electricity, directly from the market.

Official attitudes toward private enterprises had become less antagonistic by the early 1990s, which in turn enhanced their access to economic resources. In 1988 the National People's Congress approved the establishment of "private enterprises" with more than eight employees.[59] The official recognition of private entities, however, suffered a brief setback during 1989–1992, following the Tiananmen incident. Private capitalists were criticized by the Communist Party for their alleged role in supporting the Tiananmen demonstrators.[60] However, Deng Xiaoping's southern tour in 1992 sent a strong message that liberal economic reform would continue and provided much-needed support for private entrepreneurs, though it was not until the early 2000s that private property rights were officially recognized and the Communist Party's representation of the "most advanced forces of production" or private entrepreneurs was officially recognized in Jiang Zemin's Theory of the Three Represents.[61]

The more favorable official attitude had raised the political status of private enterprises and improved their access to resources. Even though the number of red hat firms was not officially recorded, available data on the township and village enterprises indicate the increased prominence of noncollective TVEs after 1992. As Table 2 shows, the number of private and household-owned TVEs and their production value increased at significantly faster rates than those of the collective firms after 1993, after the sharp decline during 1989–1992. This is partly attributable to the fact that some red hat firms had felt secure enough to take off their "red hats" following the official reendorsement of private enterprises. As indicated in Table 3, bank loans allocated to noncollective TVEs also rose significantly after 1993—their percentage share increased from 3 percent to 10 percent from 1986 to 1989, then fell to 6 percent during the Tiananmen interlude, but rose to over 10 percent after 1993.

While on the one hand local political leaders' control over the enterprises has diminished, on the other hand existing enterprise managers have gained autonomy. Having intimate knowledge about the firms also provided the existing enterprise managers with a greater degree of autonomy from local party leaders. The existing managers had superior information of the true value of an enterprise's assets, its profitability, and future prospects. This was true in townships more than in villages, because a township could run up to a dozen enterprises, significantly more than a village, which made it more challenging for township political leaders to keep track. The existing managers' insider knowledge of the firms gave them an inherent advantage in their negotiations with local political leaders.

Post-Mid–1990s: Declining Local State Capacity In the context of privatization, state capacity is best understood as the state's competence in establishing and enforcing the rules of the game for the market to function effectively. The capacity of the Chinese state in regulating the ownership transformation of collectively owned enterprises had declined in relative terms in the mid–1990s. In the semicontrolled economy of the 1980s, the regulatory capacity of the state mattered less, because most transactions were determined not by market forces but by state directives. State capacity had not declined in absolute terms, but the need for the state to step in to regulate the market was heightened in the age of privatization.[62] There was no regulatory body to oversee the privatization of collectively owned firms. A regulatory body similar to the State-owned Assets Supervision and Administration Commission (SASAC) that has the mandate of realizing the government's role as the investor and owner of key central-level state-owned enterprises (SOEs) would have been useful in mitigating the negative outcome in the TVE sector.[63]

With privatization taking place exclusively at the township and village levels, there was no supervision of the process by higher level governments or from any third party. As local governments–which were the asset owners–conducted the valuation of enterprise assets,[64] they became both the valuer and the seller. The absence of an oversight body also contributed to lack of transparency in the auctions and in the other transactions, which became tainted by the underhanded accounting tricks described earlier.

Comparing privatization among several Eastern European countries, Barnes attributes the positive asset development outcome in Hungary to the hands-on regulatory

Table 2 Indicators of Township and Village Enterprises, 1978–2006

	No of enterprises ('000)			Percentage Change (YoY)			Total Production Value (RMB million)			Percentage Change (YoY)		
	Collective-owned	Private-owned	Household-owned	Collective-owned	Private-owned	Household-owned	Collective-owned	Private-owned	Household-owned	Collective-owned	Private-owned	Household-owned
1978	1,524	-	-	-	-	-	51,438	-	-	-	-	-
1979	1,480	-	-	-	-	-	56,073	-	-	-	-	-
1980	1,425	-	-	-	-	-	67,833	-	-	-	-	-
1981	1,338	-	-	-	-	-	76,726	-	-	-	-	-
1982	1,362	-	-	-	-	-	89,233	-	-	-	-	-
1983	1,346	-	-	-	-	-	101,931	-	-	-	-	-
1984	1,650	-	-	-	-	-	142,084	-	-	-	-	-
1985	1,569	533	10,123	-	-	-	198,780	18,550	5,551	-	-	-
1986	1,728	1,093	12,332	*10%*	*105%*	*22%*	260,549	32,866	78,290	*31%*	*77%*	*1310%*
1987	1,583	1,189	14,731	*−8%*	*9%*	*19%*	343,190	45,610	116,698	*32%*	*39%*	*49%*
1988	1,590	1,200	16,092	*0%*	*1%*	*9%*	504,914	71,273	174,057	*47%*	*56%*	*49%*
1989	1,535	1,069	16,082	*−3%*	*−11%*	*0%*	558,226	68,203	213,752	*11%*	*−4%*	*23%*
1990	1,454	979	16,302	*−5%*	*−8%*	*1%*	653,327	77,265	247,443	*17%*	*13%*	*16%*
1991	1,442	849	16,796	*−1%*	*−13%*	*3%*	802,037	80,325	298,696	*23%*	*4%*	*21%*
1992	1,527	902	18,491	*6%*	*6%*	*10%*	1,199,059	121,452	467,484	*50%*	*51%*	*57%*
1993	1,685	1,039	21,806	*10%*	*15%*	*18%*	2,064,991	214,415	933,826	*72%*	*77%*	*100%*
1994	1,641	786	22,517	*−3%*	*−24%*	*3%*	2,481,473	668,799	1,462,132	*20%*	*212%*	*57%*
1995	1,620	960	19,446	*−1%*	*22%*	*−14%*	3,725,762	1,098,827	2,132,278	*50%*	*64%*	*46%*
1996	1,549	2,264	19,550	*−4%*	*136%*	*1%*	4,113,614	1,290,502	2,273,649	*10%*	*17%*	*7%*
1997	1,292	2,332	16,524	*−17%*	*3%*	*−15%*	4,384,414	1,905,893	2,699,753	*7%*	*48%*	*19%*
1998	1,066	2,222	16,751	*−18%*	*−5%*	*1%*	4,329,773	2,129,861	3,209,731	*−1%*	*12%*	*19%*
1999	941	2,076	17,692	*−12%*	*−7%*	*6%*	4,278,897	2,610,211	3,953,499	*−1%*	*23%*	*23%*
2000	802	2,061	17,984	*−15%*	*−1%*	*2%*	4,027,852	3,234,697	4,352,478	*−6%*	*24%*	*10%*
2001	669	2,007	18,480	*−17%*	*−3%*	*3%*	3,840,843	3,968,999	4,794,846	*−5%*	*23%*	*10%*
2002	732	2,629	18,297	*9%*	*31%*	*−1%*	1,975,673	6,968,490	5,099,287	*−49%*	*76%*	*6%*
2003	292	2,944	18,615	*−60%*	*12%*	*2%*	1,571,629	8,426,865	5,237,578	*−20%*	*21%*	*3%*
2004	241	3,231	18,661	*−17%*	*10%*	*0%*	1,214,948	10,053,258	5,983,467	*−23%*	*19%*	*14%*
2005	175	5,230	17,091	*−27%*	*62%*	*−8%*	1,096,456	14,099,307	6,586,097	*−10%*	*40%*	*10%*
2006	157	5,542	17,447	*−10%*	*6%*	*2%*	1,110,640	16,809,022	7,061,133	*1%*	*19%*	*7%*
Average (1986–88)				*1%*	*38%*	*17%*				*37%*	*57%*	*470%*
Average (1989–92)				*−1%*	*−7%*	*4%*				*25%*	*16%*	*29%*
Average (1993–2006)				*−13%*	*18%*	*0%*				*3%*	*48%*	*24%*

Source: China's Township & Village Enterprise Statistics, Ministry of Agriculture, various years.
NB: The series for private and household firms started in 1985.

Table 3 Bank Loans to Collective and Noncollective TVEs

	Collective		Non-collective	
	RMB million	% of total	RMB million	% of total
1985	27780	*96%*	1020	*4%*
1986	51993	*97%*	1841	*3%*
1987	57713	*97%*	2043	*3%*
1988	73238	*93%*	5265	*7%*
1989	86522	*90%*	9491	*10%*
1990	105606	*94%*	7221	*6%*
1991	135183	*94%*	9226	*6%*
1992	184933	*89%*	22159	*11%*
1993	279028	*90%*	31694	*10%*
1994	267228	*87%*	38613	*13%*
1995	379321	*85%*	64781	*15%*
1996	445253	*84%*	86398	*16%*
1997	457174	*83%*	93900	*17%*
1998	456816	*79%*	122791	*21%*
1999	453745	*72%*	175105	*28%*
2000	410877	*65%*	217330	*35%*
2001	376821	*58%*	273437	*42%*
2002	327846	*47%*	362688	*53%*

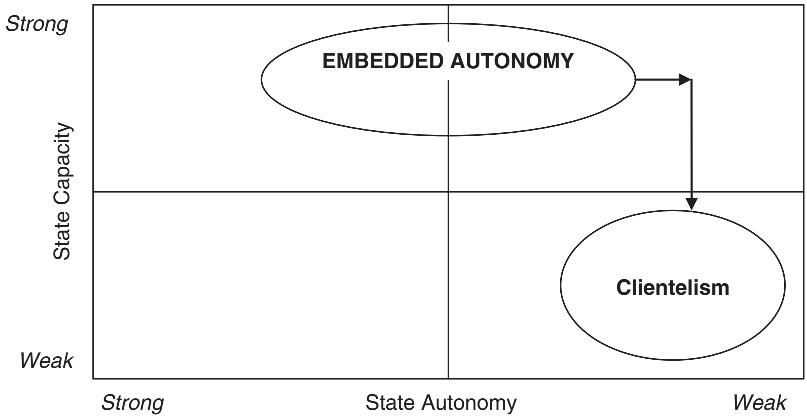
Source: China's Township and Village Enterprise Statistics, Ministry of Agriculture, various years.
Note: The bank loan series was discontinued in 2003.

capacity of the state as opposed to the laissez-faire approach in Russia that contributed to rapid expropriation of assets by private industrialists.[65] To swiftly abolish the former Soviet apparatus, the Yeltsin government made no attempt to establish transparency rules on privatization or to regulate banks or financial transactions. The consequence was that insiders ended up usurping majority shares in state enterprises at very favorable terms, and eventually the demise of the former state-owned economy was replaced by an oligarchy of business empires.[66]

In the lexicon of the statist theory, the diminution in the local state's relative autonomy coupled with the decline in the state's capacity turn embedded autonomy into clientelism. This is represented by a shift to the right and to the south in Figure 2. In a clientelistic relationship, the patron and client are locked in a symbiotic relationship, serving each other's interests. The patron (the local political leader or the seller) derives his power from the ability to offer lower-than-market prices, favorable to the client or the enterprise buyer, based on his de facto ownership of the collective enterprise, in an institutional environment where the state is weak in regulatory capacity to enforce fair rules of the game. However, the patron also relies on the client's insider position to benefit from the deal. Each party needs the other to extract benefits from the transactions, though the patron has marginally greater power.

Empirical studies provide evidence of enterprise managers colluding with local political leaders to gain from the privatization process, and bribing local leaders for lower prices. Some managers went one step further in deploying financial resources to cultivate cozy relationships with higher level political officials to obtain their backing and blessing, to enhance their bargaining power vis-à-vis local political leaders.[67]

Figure 2 From Developmental to Clientelist Local States



Conclusion: Local State-Business Relations in China

This article employs the analytical framework of statist literature to explain the pervasive governance problem in the privatization outcome of local government-owned firms in China. It challenges the conventional wisdom of the positive role of local states in China's economic development, which was fashioned mainly at the peak of the TVE development. The relative decline in the state's regulatory capacity and autonomy vis-à-vis enterprise managers have transformed embedded autonomy into a clientelistic relationship between local political leaders and capitalists that accounts for the massive asset stripping of firms.

Insider privatization and asset stripping are not exclusive to the local government-owned firms; similar governance issues are also widespread in the privatization of SOEs. In the 15th Chinese Communist Party's National Party Congress in 1997, then-Premier Zhu Rongji pronounced that the Chinese government will divest its stake in the SOEs by adopting the policy of "grasping the large, and letting the small go." While the central government retains majority stake and reorganizes the nation's largest state-owned firms in industries such as energy and natural resources, all other SOEs were restructured. Since 1997, various levels of government, ranging from municipal, provincial, prefectural, to county, have sought to sell off hundreds of thousands of SOEs under their ownership or shut down them. Massive governance problems ensued. Officials who embezzled and seized state assets accounted for close to half the total number of public officials investigated for corruption during 2001–2005.[68] Ting Gong and Huangao Shi observe similar phenomena as in the TVE cases, such as underpricing of assets and lack of competitive bidding, which led to loss of state assets during the ownership transformation.[69] Xueliang Ding details numerous strategies used to usurp state assets, such as setting up bloated organizations and faked joint ventures.[70] Keun Lee and Donghoon Hahn contend that insider control of SOEs is due to collusion between firm managers and the supervisory state officials.[71] These studies point to the fact that this analysis of the relations between the incumbent managers or economic elites and local states is also applicable and germane to the state-owned firms.

The analysis of changing state-business relations provides a more nuanced understanding of cronyism in the relationship between the Chinese Communist Party and capitalists. Bruce Dickson has coined the term "crony communism" to describe the characteristics of cronyism in China that are decentralized at the local level, diffuse and widespread among a large number of small and medium-sized private firms, which stand in contrast to corruption in the elite ruling families observed in Marcos's Philippines and Suharto's Indonesia and in the handful of oligarchies in Russia.[72] Minxin Pei also observes decentralization of corruption and the rise of decentralized predatory states to the extreme case of emerging local mafia states.[73] The present study provides a powerful explanation for these noteworthy characteristics of corruption. Compared to the pre-reform era, local governments have increased fiscal resources and enhanced capacity in managing local officials resulting from fiscal and administrative decentralization policies implemented since the 1980s. Nevertheless, the governance capacity of the local states, such as their ability to police market transactions and investigate potential malfeasance—has not necessarily improved even though the need for more effective local states has heightened owing to greater decentralization of power from center to local and increasing number of market activities. Concomitantly, emerging economic elites, such as managers of TVEs and SOEs as well as private entrepreneurs, are less dependent upon local political leaders who used to be the gatekeepers to resources such as bank loans and industrial raw materials. As a result, they have acquired more autonomy from local political elites. The combination of declining governance capacity and relative autonomy thus gives rise to predatory local states. When interests of local political and economic elites coincide, they collude and engage in symbiotic activities, of which state asset stripping is a prime example. The majority of local states in China are no longer "developmental" or "corporatist" as they once were.

NOTES

I would like to thank the participants of the University of Toronto Politics at Noon Workshop and Harvard University's Postcommunist workshop and two anonymous reviewers for helpful comments and suggestions. All remaining errors are mine, of course.

1. World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York: Oxford University Press, 1993); Chalmers Johnson, *Miti and the Japanese Miracle: The Growth of Industrial Policy, 1925–1975* (Stanford, CA: Stanford University Press, 1982); Meredith Woo-Cumings, ed., *The Developmental State* (Ithaca, NY: Cornell University Press, 1999).

2. Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton, NJ: Princeton University Press, 1995); Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge, UK: Cambridge University Press, 1985); Atul Kohli, *State-Directed Development: Political Power and Industrialization in the Global Periphery* (New York: Cambridge University Press, 2004).

3. Examples of a single nation-state study and cross-country national studies, respectively, are Robert. Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press, 1990); and Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989). A notable exception is Assema Sinha, "Rethinking the Developmental State Model: Divided Leviathan and Subnational Comparisons in India," *Comparative Politics*, 35 (July 2003): 459–76.

4. Al Nyberg and Scott Rozelle, *Accelerating China's Rural Transformation* (Washington, DC: The World Bank, 1999); World Bank, *World Development Report 1996: From Plan to Market* (New York: Oxford University Press, 1996).

5. Jean C. Oi, *Rural China Takes Off* (Berkeley: University of California Press, 1999); Oi, "The Role of the Local State in China's Transitional Economy," *China Quarterly*, 144 (December 1995): 1132–49.

6. Jane Duckett, *The Entrepreneurial State in China: Real Estate and Commerce Departments in Reform-Era Tianjin* (London and New York: Routledge, 1998).

7. Marc Blecher and Vivienne Shue, *Tethered Deer: Government and Economy in a Chinese County* (Stanford, CA: Stanford University Press, 1996).

8. Justin Yifu Lin and Liu Zhiqiang, "Fiscal Decentralization and Economic Growth in China," *Economic Development and Cultural Change*, 49 (October 2000): 1–21; Oi, 1999.

9. Evans, Rueschemeyer, and Skocpol; Peter Evans, "Predatory, Developmental, and Other Apparatuses: A Comparative Political Economic Perspective on the Third World State," *Sociological Forum*, 4 (December 1989): 561–87. These concepts are further refined in subsequent studies by Peter Evans and Atul Kohli.

10. This point made in Andrew Barnes's study of privatization in Eastern Europe is explored further below. Barnes, "Comparative Theft: Context and Choice in the Hungarian, Czech, and Russian Transformations, 1989–2000," *East European Politics and Societies*, 17 (August 2003): 533–65.

11. Evans, Rueschemeyer, and Skocpol.

12. The two conditions are laid out and discussed in Dietrich Rueschemeyer and Peter B. Evans, "The State and Economic Transformation: Toward an Analysis of the Conditions Underlying Effective Intervention," in Evans, Rueschemeyer, and Skocpol. Along the Weberian line of analysis, the idea of a "well-developed bureaucratic apparatus" refers to a state bureaucracy that is coherent, meritocratic, and disciplined. Widely cited examples include the bureaucratic machinery in Japan, South Korea, and Taiwan that are prestigious, recruited based on merit, relatively well compensated (at rates comparable to those of the private sector), and aspire to pursue coherent organizational/bureaucratic goals. The epitome of a strong "state capacity" is Chalmers Johnson's characterization of Japan's Ministry of International Trade and Investment (MITI) as a "powerful, talented, and prestige-laden economic bureaucracy." See Johnson, *Miti and the Japanese Miracle: The Growth of Industrial Policy, 1925–1975*, p. 26.

13. Barnes, 2003, p. 556. For further elaboration on this concept of state capacity, see Andrew Barnes, *Owning Russia: The Struggle over Factories, Farms, and Power* (Ithaca, NY: Cornell University Press, 2006).

14. There is a huge body of literature on state capture and rent-seeking; for instance, see Robert D. Tollison, "Rent Seeking: A Survey," *KYKLOS*, 35 (November 1982): 575–602, Gordon Tullock, "Efficient Rent Seeking," in James M. Buchanan, Robert D. Tollison, and Gordon Tullock, eds., *Toward a Theory of the Rent-Seeking Society* (College Station, TX: Texas A & M Press, 1980); Anne O. Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review*, 64 (June 1974): 291–303.

15. I am grateful to an anonymous reviewer for pointing out that "predatory states" can be autonomous in the sense that they are acting on their own, independent of the social elite. Nonetheless, in this instance, I am most interested in "predatory clientelistic states" which are predatory states that are not shielded from the social elite.

16. Evans, 1995, p. 50.

17. Hsiao-Tung Fei, *Rural Development in China: Prospect and Retrospect* (Chicago, IL: University of Chicago Press, 1989).

18. To be sure, not all local state literature has cast the role of local governments in a positive light. In the literature on peasant burdens, local governments that face many "unfunded mandates" have been said to prey upon the revenue of collective enterprises. See Thomas Bernstein and Xiaobo Lü, *Taxation without Representation in Contemporary Rural China* (Cambridge: Cambridge University Press, 2003). Lü has argued that the weak capacity of the bureaucracy in China has contributed to widespread corruption. See

Xiaobo Lü, "Booty Capitalism, Bureau-Preneurs, and the State in Transition: Organizational Corruption in China," *Comparative Politics*, 32 (April 2000): 273–94.

19. Wenzhou is a city located in the south of Zhejiang province. Historically it had received little central government's financial assistance due to its proximity to Taiwan.

20. Alan P. L. Liu, "The 'Wenzhou Model' Of Development and China's Modernization," *Asian Survey*, 32 (August 1992): 696–711; Chris Bramall, "The 'Wenzhou' Miracle: An Assessment," in Peter Nolan and Fureng Dong, eds., *Market Forces in China: Competition and Small Business - the Wenzhou Debate* (London and New Jersey: Zed Books Ltd, 1989).

21. Andrew G. Walder, "Zouping in Perspective," in Andrew G. Walder, ed., *Zouping in Transition: The Process of Reform in Rural North China* (Cambridge, Massachusetts: Harvard University Press, 1998).

22. Oi, 1999. Nan Lin has carried the concept of local state corporatism further to illustrate how local sociocultural institutions can help coordinate state actions for achieving the objectives of "local market socialism." See Lin, "Local Market Socialism: Local Corporation in Action in Rural China," *Theory and Society*, 24 (June 1995): 301–54.

23. Duckett.

24. Hongbin Li and Scott Rozelle, "Privatizing Rural China: Insider Privatization, Innovative Contracts and the Performance of Township Enterprises," *China Quarterly*, 176 (2003): 981–1005; James Kung and Yi-Min Lin, "The Decline of Township-and-Village Enterprises in China's Economic Transition," *World Development*, 35 (April 2007): 569–84.

25. Lynette Ong, "The Political Economy of Township Government Debt, Township Enterprises and Rural Financial Institutions in China," *The China Quarterly*, 186 (2006): 377–400.

26. Although privatization of collective township and village enterprises was a central government policy, it started at the grassroots level in southern Jiangsu where the enterprises were born and developed, and were also among the first to encounter financial difficulties. Zheng Chang, Yi Shi, and Xiaojian Zhao, "Tell-Tale Signs from Sunan *(Sunan De Yuyan)*," *Finance and Economics*, *(Caijing)*, August 5, 2001.

27. Peter Ping Li, "The Puzzle of China's Township-Village Enterprises: The Paradox of Local Corporatism in a Dual-Track Economic Transition," *Management and Organization Review*, 1 (July 2005): 197–224.

28. Barry J. Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge, MA: MIT Press, 2007), p. 285.

29. Kung and Lin, "Decline of Township-and-Village Enterprises in China's Economic Transition." This process is similar to the emergence of the TVEs in the early 1980s which posed competitive challenges to the state-owned enterprises, and forced state firms to embark on restructuring and reforms. For more details, see John McMillan and Barry Naughton, "How to Reform a Planned Economy: Lessons from China," *Oxford Review of Economic Policy*, 8 (1992): 130–43.

30. The debt-asset ratio for joint-household firms was 0.35, 0.25 for individual household firms, and 0.66 for industrial SOEs. Laixing Sun, "Ownership Reform in China's Township and Village Enterprises," in Stephen Green and Guy S. Liu, eds., *Exit the Dragon: Privatization and State Control in China* (Hoboken, NJ: Wiley-Blackwell, 2005).

31. This means that for every 100 yuan of TVE asset, 75 yuan were debt.

32. Chang, Shi, and Zhao, "Tell-Tale Signs from Sunan (Sunan De Yuyan)." have reported some incidents of rural protests as collective enterprise workers lost the "investments" they were forced to make by the local governments when the enterprises were performing well.

33. In the beginning, reform of the collective enterprises in southern Jiangsu was carried out without the provincial government's approval. Endorsements from the provincial and central governments only came in 1997, after the pilot reform that took place in parts of Jiangsu and Zhejiang.

34. Chang, Shi, and Zhao.

35. Fair valuation of enterprise assets is an essential first step in the sale of an enterprise as the procedure serves to ensure the transacted price reflects the true value of assets.

36. Tiejun Wen, "Sources of Collective Enterprise Assets and the Principles in the Reform," *Zhejiang Social Sciences (Zhejiang Shihui Kexue)*, 3 (1998): 39–42. Though the ownership of collective land is not transferable, land use rights, which can be legally transferred, were not usually taken into consideration in asset valuations.

37. In my field studies in rural Jiangsu and Zhejiang provinces during 2004–2006, the land prices had increased by as many as 50- to 100-fold since the economic reforms were first introduced in the early 1980s.

38. Though Li and Rozelle go on to show that privatized firms have shown improved performance, the fact that an overwhelming proportion of the collective firms were sold at a significant discount was beyond dispute.

39. Economists have argued that the existing manager may have paid a discounted price initially but had to share future profits with the local government seller. It has been argued that this served as a screening mechanism that helped government sellers obtain information about the firms' future profitability. While this explanation may have accounted for a proportion of the firms bought at low buyout prices, it is simply illogical that 40 percent of the sampled firms were transacted at prices that were half of firms' net worth for the reason of economic signaling alone.

40. Hui Qin, "Case Studies of Township and Village Enterprise Reform in Jiangsu and Zhejiang," in *USC Seminar Series* (Hong Kong: Hong Kong Institute of Asia-Pacific Studies, Chinese University of Hong Kong, 1998).

41. Three of the 11 collective firms were not sold to the existing managers or "insiders," and there was no information available for any of them. Again, insider privatization has also characterized the privatization of state-owned enterprises in China. See Xueliang Ding, "The Illicit Asset Stripping of Chinese State Firms," *China* Journal, 43 (January 2000): 1–28; Ross Garnaut et al., *China's Ownership Transformation: Process, Outcomes, Prospects* (Washington, DC: The International Finance Corporation, 2005).

42. Xiao-yuan Dong, Paul Bowles, and Samuel P. S. Ho, "The Determinants of Employee Ownership in China's Privatized Rural Industry: Evidence from Jiangsu and Shandong," *Journal of Comparative Economics*, 30 (2002): 415–37.

43. Li and Rozelle, p. 990; James Kung, "The Evolution of Property Rights in Village Enterprises: The Case of Wuxi County," in Jean Oi and Andrew Walder, eds., *Property Rights and China's Economic Reform* (Stanford, CA: Stanford University Press, 1999).

44. Loren Brandt, Hongbin Li, and Joanne Roberts, "Banks and Enterprise Privatization in China," *Journal of Law, Economics, and Organization*, 21 (2003): 524–46.

45. Albert Park, Loren Brandt, and John Giles, "Giving Credit Where Credit Is Due: The Changing Role of Rural Financial Institutions in China," (Ann Arbor, MI: William Davidson Institute at the University of Michigan Business School, 1997).

46. For more on informal credit, see Kellee S. Tsai, *Back-Alley Banking: Private Entrepreneurs in China* (Ithaca, New York: Cornell University Press, 2002).

47. Naughton, 2007, p. 278.

48. Ong, "Political Economy of Township Government Debt."

49. Naughton, 2007, p. 278.

50. In Tsai's terminology, these creative practices are known as "adaptive informal institutions." See Kellee Tsai, *Capitalism without Democracy: The Private Sector in Contemporary China* (Ithaca, NY: Cornell University Press, 2007).

51. Many scholars have made this observation. For instance, see Tsai, 2002; Kristen Parris, "Local Initiative and National Reform: The Wenzhou Model of Development," *China Quarterly*, 134 (June 1993): 242–63; Liu, "The 'Wenzhou Model'"; Peter Nolan and Fureng Dong, eds., *Market Forces in China: Competition and Small Business the Wenzhou Debate* (London and New Jersey: Zed Books Ltd, 1989).

52. Yia-Ling Liu, "Reform from Below: The Private Economy and Local Politics in the Rural Industrialization of Wenzhou," *China Quarterly*, 130 (June 1992): 293–316.

53. Sun, p. 94.

54. Fei, p. 90.

55. Yasheng Huang, *Inflation and Investment Controls in China: The Political Economy of Central-Local Relations During the Reform Era* (Cambridge: Cambridge University Press, 1996); Eric Girardin, *Banking Sector Reform and Credit Control in China* (Paris: Organization for Economic Co-operation and Development, 1997).

56. The author's interviews with managers at county and prefectural level state-owned banks in June–July 2004 and November–December 2005.

57. For further elaboration on how this works in the state-owned banks and the rural credit cooperatives respectively, see Victor Shih, *Factions and Finance in China: Elite Conflict and Inflation* (Cambridge; New York: Cambridge University Press, 2008), Lynette Ong, "The Political Economy of Credit in Rural China: The Rural Credit Cooperatives" (Australian National University, Ph.D. thesis, 2007).

58. In the lexicon of "tiao–kuai" (vertical–horizontal) accountability system termed by Kenneth Lieberthal, the power of the "tiao" (vertical or functional) system has taken priority over the "kuai" (horizontal or local party) system. For elaboration on this concept, see K. G. Lieberthal, *Governing China: From Revolution through Reform*, 2nd ed. (New York and London: W. W. Norton & Company, Inc., 2004), pp. 186–88.

59. Tsai, 2007, p. 50.

60. As cited in Dickson, after the Tiananmen incident, the Fourth Plenum of the 13th Central Committee criticized "individual and private entrepreneurs who use illegal methods to seek huge profits and thereby

create great social disparity and contribute to discontent among the public." See Bruce J. Dickson, *Wealth into Power: The Communist Party's Embrace of China's Private Sector* (New York, NY: Cambridge University Press, 2008), p. 36.

61. As discussed in Tsai, 2007, p. 67, the first session of the Eighth National People's Congress amended Article 15 of the Constitution to "the state practices a socialist market economy" from "a planned economy on the basis of socialist public ownership" previously.

62. A similar argument is made by Prosser that privatization in Britain during the Thatcher years had created the need for a regulatory state to curb the power of business by controlling monopoly and enforcing competition. See Tony Prosser, *Law and the Regulators* (Oxford: Clarendon Press, 1997).

63. This is not to say that asset stripping does not occur in the state-owned firms. Insider privatization and illicit asset stripping was in fact rampant among the state-owned enterprises. The State-owned Assets Supervision and Administration Commission (SASAC) set up in the early 2000s was in fact a response to the massive loss of state assets during the ownership transformation in the late 1990s. The argument advanced here is not inconsistent with Yang's argument of increased prominence of regulatory agencies since the late–1990s. As Yang as acknowledged, the capacity of regulatory agencies at local level is seriously challenged by local protectionism and the vertical-horizontal accountability system. See Dali Yang, *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China* (Stanford, CA: Stanford University Press, 2004), pp. 96–109.

64. Sun, p. 102.

65. Barnes, 2003.

66. David Hoffman, *The Oligarchs: Wealth and Power in the New Russia* (New York, NY: Public Affairs, 2003).

67. Li, 2005.

68. Ting Gong and Huangao Shi, "Management Corruption in China's Industrial Restructuring: How and Why State Assets Get Lost," *China Information*, 23 (2009), p. 415.

69. Ibid.

70. Ding, pp. 1–28.

71. Keun Lee and Donghoon Hahn, "From Insider-Outsider Collusion to Insider Control in China's Soes," *Issues & Studies*, 40 (June 2004): 1–45.

72. Dickson.

73. Minxin Pei, *China's Trapped Transition: The Limits of Developmental Autocracy* (Cambridge, MA: Harvard University Press, 2006).