

POLITICIZED CAPITALISM:  
DEVELOPMENTAL STATE AND THE FIRM IN CHINA

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Transformative institutional change relies not only on evolutionary processes but on formal action by the state. In transitions from communism to the market, the state must simultaneously dismantle the institutions of central planning and put in place the requisite rules of competition and cooperation of a market economy. The shift of control rights is often retarded, however, by mutually reinforcing interests which perpetuate a close relationship between the state and the firm. On the one hand, state actors are rarely willing to institute a new economic system that completely deprives them of direct control rights at the firm level (Nee 1992; Rona-Tas 1994; Walder 1995; Bian and Logan 1996). On the other hand, managers and workers often prefer the continuation of direct state-firm linkages to gain access to resources in a highly insecure and rapidly changing business environment. As a result, “there is still a much different atmosphere of interaction between government and individual economic agents in ex-socialist countries than in countries with a long tradition of free markets” (Murrell 1996: 32).

We call this type of economic order *politicized capitalism*, where state actors set the regulatory framework *and* remain directly involved in guiding transactions at the firm level. In transitions from state socialism, politicized capitalism is a hybrid economic order comprised of recombinant elements of preexisting and emergent economic institutions and organizational forms oriented to establishing a market economy (Stark 1996). It is a mixed economy where market liberalization and ownership reform are unfinished, preserving partial control rights by the state as both a redistributive allocator and an owner of productive assets. Although the new rules of a market economy impose formal limits on state interventions in the firm, the defining feature of politicized capitalism is the absence of clearly defined state-

firm boundaries and the overlap of economic and political spheres in the firm's decision-making.

[Figures 1 & 2 about here]

China's market transition has produced a prominent and much debated case of politicized capitalism (Parish and Michelson 1996; Szelenyi and Kostello; Zhou 2000; Walder 2004), where "the state-economy divide is blurred and there is a large intermediate terrain of hybrid activity which is hard to capture in terms of the usual 'state-market' characterizations" (White 1996:171).

Predictions on the expected efficiency and stability of such mixed systems with clear overlap of economic and political spheres inevitably refer to the centuries-old theoretical debate on the appropriate role of the state. Economic theory since Adam Smith's *Wealth of the Nation* (1776) asserts that only the full play of the market mechanism maximizes economic growth and social welfare. The state monitors and enforces the regulatory environment in which firms compete for survival and profits, but is not directly involved in firm-level decisions and transactions. Economic theory claims that state control over economic activity will inevitably lead to economic failure. Public choice theory calls particular attention to the self-interested behaviour of bureaucrats who seek to maximize their own budgets (Niskanen 1971) and politicians who give priority to securing political support (e.g., votes) in order to increase their chances for staying in power (Buchanan et al. 1980). Further, the rent-seeking activities of organized interest groups and politicians override the idea of a Benthamite welfare state as a neutral arbitrator (Krueger 1974; Shleifer and Vishny 1994). Another vein of the economic literature warns that direct involvement of state actors who impose on the firm multiple political interests (e.g., job creation) dilutes profit-making motives when social objectives collide with the firm's profit goals (Sappington and Stiglitz

1987). A weakening of profit motives may also result from the state's willingness to share entrepreneurial risks with the private economy. Risk-sharing by the state (via state ownership, state guarantees, or provision of preferential treatments) may easily lead to soft budget constraints, with the well-known negative effects on the firm's efficiency (Kornai 1980). Finally, informational asymmetry and uncertainty critically limits the effectiveness of government coordination of economic activity at the firm level. It is impossible, Hayek (1945) argues for central planners in the state bureaucracy to have the requisite information to plan and coordinate economic activities effectively. Although bureaucrats might be suitably chosen to command the best scientific knowledge available, this professional expertise will not suffice. Successful planning requires unorganized *knowledge of the particular circumstances of time and place* which "never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which the separate individuals possess" (1945:519). It is the market, through the price system, which serves as the only effective communication mechanism, coordinating relevant facts and promptly signaling changes in the economic structure and the emergence of new profit opportunities. To the extent that societal planning distorts the entrepreneurial-competitive discovery process, either on a society-wide scale or by means of discretionary intervention, "planners are at the same time both smothering the market's ability to transcend the basic knowledge problem and subjecting themselves helplessly to that very problem" (Kirzner 1984:416). In sum, standard economic theory asserts that political interference in the firm results in negative consequences on the firm's performance.

[Figure 2 about here]

By contradicting the expectations of such neo-utilitarian arguments, however, China's economic miracle has riveted attention on the positive role of the state in promoting

transformative economic development. As Stiglitz observes, “The contrast between Russia’s transition, as engineered by the international economic institutions, and that of China, designed by itself, could not be greater: While in 1990 China’s gross domestic product (GDP) was 60 percent that of Russia, by the end of the decade the numbers had been reversed. While Russia saw an unprecedented increase in poverty, China saw an unprecedented decrease” (2002:6). Per capita GDP grew from \$100 to \$944 (constant prices 1995) between 1978 and 2002. The market capitalization of firms listed on China’s stock exchanges increased from 1% of the GDP in 1992 to 37% by 2002. Exports increased from \$39 billion in 1978 to \$470 billion per annum in 2002 (constant prices 1995). Annual net foreign direct investments grew from \$386 million in 1982 to \$46.8 billion in 2002 (World Bank 2004). China thus becomes the latest entry in the pantheon of successful developmental states, along with South Korea, Taiwan and Japan (Stiglitz (2002). In light of China’s state-guided economic development, the long-standing debate in the social sciences as to whether the state can play a positive role in the development process has been largely settled. Now the focus of debate has shifted to specifying the conditions of effective state action to promote transformative economic growth. What is needed is a fuller clarification of these mechanisms.

Due to data limitations, developmental state theorists in the past have not examined the economic effect of state interventions at the critical firm level. The literature has relied principally on single-country case studies and cross-national studies using aggregate country-level variables to demonstrate support for the proposition that variations in the institutional structure of states correspond with the rate of economic growth (Evans 1989; Evans 1995). Single-country case studies have provided detailed historical accounts of the role of state bureaucrats in establishing the pre-conditions for modern economic growth elsewhere in East Asia: Japan (Johnson 1982), South Korea (Amsden 1989), and Taiwan (Wade 1990). Subsequent comparative institutional analyses have shed further insight by examining two cases (India and South Korea) in which the developmental state played a crucial role in

promoting economic growth (Evans 1995; Chibber 2003). In a recent quantitative study going beyond the case-study approach, Evans and Rauch (1999) developed a “Weberianness Scale” for 35 developing countries using country-level aggregate data. They found evidence consistent with a positive effect of “Weberian” characteristics of meritocratic recruitment and rewarding career ladders on the prospects for economic growth.

Overall, the literature convincingly supports a positive impact of the Weberian state bureaucracy on economic growth. However, developmental state theorists have not investigated a concern of neo-liberal economists since Adam Smith—the *mode* of state bureaucratic action. Does the “Weberianness” of the bureaucracy provide a sufficient condition for the state’s success in promoting economic growth? Evans’ (1989) conception of the developmental state slights the problems of information asymmetries, competing public goods objectives and disincentives of soft budget constraints stemming from the state’s risk-sharing with firms. While Evans criticizes mainstream economists for overlooking the role of state structures “in the rush to avoid the dangers of state intervention” (Evans 1989:749), we ask whether his own exclusive emphases on the influence of the internal structure of the state bureaucracy and its external ties with economic elites might be accompanied by a similarly serious overlooking of inefficiencies which arise from other dimensions of state involvement.

We therefore suggest a *state structure and developmental strategy approach* to specify the conditions that allow the state to play a positive developmental role. In particular, we engage in a micro-level study of state-guided economic development in China, investigating whether state interventions actually make a positive contribution to the economic performance of newly incorporated firms. Our study seeks to clarify whether China’s success in state-guided economic growth can be attributed to direct state interventions at the firm level or rather to the state’s role in building economic institutions that motivate and enable market-driven economic growth. In a broader context, our research seeks to contribute to the debate

on the role of the state in economic development by inspiring empirical research on the variety of growth strategies pursued by developmental states.

### **The Developmental State: The Strong and the Weak Versions**

In contrast to standard economic theory, sociologists since Max Weber's *Economy and Society* ([1904-1911] 1978) and Karl Polanyi's *The Great Transformation* ([1944] 1957) have generally viewed state intervention in economic life in a positive light. Weber argued that bureaucracy in its rational-legal form was a core institution of modern capitalism because it enabled the state to intervene to support markets with technical efficiency and rigorous calculation. Polanyi affirmed, "The road to the free market was opened and kept open by an enormous increase in continuous centrally organized and controlled interventionism" ([1944] 1957:140). Both Weber's and Polanyi's writings on the relationship between state and market have shaped the core assumptions of the sociological approach to state involvement in modern economic development. In his debate with economics on the effects of state intervention, Evans (1989) criticizes public choice theory for its neoutilitarian vision of the state as driven by self-interested maximizers. Such a one-sided focus on self-interest seeking of politicians cannot explain sustained long-term commitment to corporate goals by the state. Evans's own discussion of the developmental state integrates Weber's insights on the close positive relationship between bureaucracy and markets with central themes of development economics contributed by Gerschenkron (1962) and Hirschman (1958). While Evans does not rule out opportunistic behavior and the justified concerns of the public choice school, he points to specific features of the state bureaucracy which serve to constrain abuse of power and enable beneficial state involvement. In the strong version of the developmental state, as he conceives it, this bureaucracy has sufficient autonomy so that bureaucrats can pursue long-term objectives, while being connected enough to private capital to be responsive to how changing economic realities affect entrepreneurial interests (Evans 1995). This quality of

“embedded autonomy” enables state actors to inform long-term development goals with up-to-date information gained from direct involvement with key economic actors. Asserting that “entrepreneurial activity on the part of the state is a necessary part of economic transformation” (1989: 562), Evans underscores the positive effect of the state’s involvement in private sector enterprises. He calls attention to Japan’s Ministry of International Trade and Industry (MITI) to illustrate how a highly disciplined elite state bureaucracy can motivate and guide transformative economic development, with bureaucrats directly involved in the strategic action of firms. He refers, for example, to Okimoto’s (1989: 157) observation that the “deputy director of a MITI bureau may spend the majority of his time with key corporate personnel” (Evans 1989: 574).

In Japan (Johnson 1982), Korea (Amsden 1989) and Taiwan (Wade 1990)—case studies which Evans highlights as strong versions of the developmental state, politicized capitalism played a key historical role. Okazaki’s (1997) analysis of Japan’s industrialization strategy in the 1950s reveals that close government-firm relations were common and that the MITI actively and directly influenced strategic decisions at the firm level. Essentially, “the framework within which enterprises operated was formed by the relationship with the government, public agencies, and private financial institutions...” (Okazaki 1997: 90).<sup>1</sup> Similarly, the Nationalist party-state in Taiwan maintained direct control over large state-owned enterprises, which constituted the mainstay of Taiwan’s industrial base (Gold 1986). Even nowadays the Nationalist Party holds controlling shares in 155 large firms, and intervenes both directly and indirectly in firm management (Claessens et al. 1999: 23). In South Korea, the *chaebol* came into being through political transfers to prominent business families by the state. Consequently, “the new class of Korean entrepreneurs were essentially political capitalists who owed their fortunes to the favours of the President and followed his wishes” (Whitley 1999: 156). Moreover, twenty percent of the publicly traded companies are

controlled by the South Korean state (Claessens et al. 1999: 32). In these East Asian Tigers, politicized capitalism was historically rooted in the close and extensive direct ties between the state and a small number of elite families who own majority shares in publicly traded firms. This invited direct interference running in both directions, with elite families lobbying government for rents and government influencing firm decisions.

In describing a weaker version of the developmental state, Evans and Rauch (1999) focus on the “Weberianness” of the state bureaucracy—not its embeddedness—as providing the necessary condition to counter what political economists characterize as the “grabbing hand of the state.” To the extent that state officials intervene in economic life, political economists claim, they will seek to implement regulations over private-sector economic activity that maximize opportunity for receiving bribes. Evans and Rauch (1999) acknowledge that such rent-seeking is common in the developing world, but argue that the “Weberianness” of the state bureaucracy operates to limit such “predatory” behavior. In the rational-legal state bureaucracy, merit-based rules of recruitment and predictable career ladders offer long-term material and non-material rewards which reduce the attractiveness of rent-seeking and corruption. Additionally, rational-legal authority enables bureaucrats to act as a corporate group in pursuit of long-term development objectives. These structural features “contribute to a more competent, purposive, and cohesive bureaucracy” that complements market institutional arrangements and provides a necessary condition for transformative economic development (Evans and Rauch 1999: 752). This is not the activist state bureaucracy that intervenes at the firm level to shape entrepreneurial behavior, as in the strong version, but rather the organizational capacity of the state bureaucracy to provide public goods, reduce uncertainty and foster transparency in the institutional environment.

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<sup>1</sup> For illustration, Okazaki (1997) refers to the fact that MITI affected firms’ rationalization decisions by pre-

## China's Politicized Capitalism Examined

China's current economic system of politicized capitalism resembles Evans' strong developmental state. Direct state interference at the firm level is widespread, and the state's guiding hand in promoting national growth remains visible. Four mutually reinforcing institutional changes frame the interactions between the local state bureaucracy and firm-level economic actors:

### *Strengthening bureaucratic capacity after Mao*

Modernization of the state bureaucracy has been the government's priority throughout the reform period. The decade-long tumultuous upheaval of Mao's Cultural Revolution had demoralized and crippled China's state apparatus. At the outset of market-oriented reforms the leaders realized that modernization of the bureaucracy was essential to effectively implement their ambitious new policies. As a result of the administrative reforms carried out in the 1980s, local government regulations and procedural guidelines have gotten more and more precise and transparent (Yao 2001). This has increased the predictability of bureaucratic decisions and reduced uncertainty of economic planning.

As in other East Asian developmental states, the formulation and implementation of industrial policy is a central pillar of the state's development strategy. The first so-called industrial policy (*chanye zhengce*) guidelines were implemented in 1989<sup>2</sup>, when the government perceived that the old planning apparatus was no longer appropriate to steer economic—particularly industrial development—priorities in China's liberalized market environment. Since then, the government has frequently revised and reformulated industrial priorities in an effort to single out future winners and losers in the ongoing structural transformation of the economy. Common instruments such as market entry regulation,

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screening and (if necessary) revising restructuring plans for Japan Development Bank loans.

<sup>2</sup> The first industrial policy guideline was the “*Guowuyuan guanyu dangqian chanye zhengce yaodian de jue ding*,” released by the State Council on March 15, 1989.

taxation, and loan decisions are part of the state's tool-kit to influence the direction of structural transformation (Lu 2000).

In parallel, administrative reforms in the 1980s introduced strict retirement ages for government officials and a one-time buy-out strategy to retire old veterans as a means to push out Maoist bureaucrats who were impeding progress in market-oriented economic reforms. Reformers also sought to build a modernized bureaucracy by implementing merit-based entrance exams and promotion schemes (Nee 2000; Li 1998; Li and Lian 1999). A high turnover in bureaucratic personnel reduces the risk of bureaucratic inertia and commitment to the old planning mentality of state socialism (Lipton and Sachs 1990; Murrell 1996). Moreover, merit-based appraisal of government officials and performance-based incentive schemes reinforce incentives in the bureaucracy to improve local economic development (Chen 1999; Li and Lian 1999).

### *Fiscal federalism*

Building on Tiebout's (1956) findings on the effects of multi-jurisdictional competition, the theory of state and local finance has long stressed the disciplining effect of fiscal decentralization on government activities and the provision of public goods. Qian and Roland (1998) offer a model to analyze the relationship between the organization of the state, economic policies and the tightness of fiscal budget constraints. Two main mechanisms that may constrain political activities are identified. First, under the assumption of factor mobility, a federalist system introduces competition among local governments, which increases opportunity costs of bail-outs and any activities leading to inferior enterprise performance (Weingast 1995). If local government jurisdictions fail to provide a hospitable business environment, they face poor chances to attract resources needed to enhance economic prosperity. Competition in a federalist system eventually limits discretionary authority, predatory behavior and rent-seeking. Secondly, in federal systems, fiscal decentralization may

harden budget constraints of jurisdictions and provide incentives for efficiency-oriented local activities. Qian and Roland argue that their model of local federalism explains the emergence of institutionalized competition in which local governments compete to build a business environment favorable to private capital.

And indeed, China's policy of fiscal decentralization has constituted a key institutional innovation aimed at strengthening economic incentives of municipal and provincial governments to support market-oriented economic reform. According to the fiscal revenue-sharing system, lower-level governments have the obligation to submit a fixed proportion of fiscal revenues to their superior government unit, while retaining the residual for their own budget. Given that tax revenues are positively correlated with firms' performance, local bureaucrats have an incentive to do what they can to assure that local firms prosper (Montinola et al. 1995; Li 1998).

#### *Company Law of 1994*

In the 1990s, state-crafted institutional change established the framework for the conversion of state-owned enterprises into public corporations. The objective was to transform loss-making state enterprises into profit-making firms through corporatization and listing on stock-exchanges. Listed firms gained ready access to investment capital, and the legal status of public corporation confers legitimacy. With the Company Law (1994), the government sought to bring organizational standards in line with western-style corporate governance (Guthrie 1999). A vision of corporate governance clearly modelled after the modern corporation replaced the old state socialist model of party and government managerial control over the firm. As in the West, the board of directors and the CEO now play the crucial role in the company's management (Wong et al. 2004).

The implementation of the Company Law has altered both the quality and intensity of state intervention in the firm, depriving the government of its former unchallenged monopoly

rights and control over former state-owned enterprises. Corporatization and stock exchange listing has reduced the average state shareholding in firms listed on the Shanghai Stock Exchange to about one-third of the firms' total shares. Consequently, the bureaucrats representing the state's equity interest on the board of directors are members of a mixed committee representing diverse stakeholder interests, although minority shareholders are still underrepresented. Nonstate shareholders operate with harder budget constraints and hence have a stronger interest in strengthening the firm's profit orientation. Moreover, CEOs responding to nonstate shareholders' interests are increasingly disciplined by the company's market value (Opper 2004).

### *Reputational incentives*

The lure of lucrative career opportunities in the thriving market economy has led many government bureaucrats to seek jobs in local businesses after leaving the government. To enhance their post-retirement career chances, bureaucrats are eager to build a positive reputation for supporting the local business community (Li 1998). Consequently, bureaucrats often mimic the behavior of businessmen (Oi 1992). Although bribe-taking and other forms of malfeasance remain problematic in China's transition economy, bureaucrats tend to avoid actions that will negatively affect enterprise performance and their local reputations. Instead they strive to build up their reputations as entrepreneurially-oriented agents actively supporting local economic actors in promoting transformative economic development.

Through these post-Mao structural reforms, the Chinese state has evolved into a developmental state similar in its core features to its East Asian counterparts in Taiwan, South Korea and Singapore. However, it differs from these states insofar as the Chinese Communist Party retains coordination rights alongside the government bureaucracy. For this reason, it is imperative in an analysis of China's economic development to examine the effects of both government bureaucrats and party politicians' on the firms' behavior. And indeed, the co-

existence of these two types of state-actors provides a unique empirical opportunity to analyze whether differing organizational structures' intervention actually correspond with differing performance effects.

Bureaucrats are external to the firm, as they are based in state bureaus, but they maintain a direct tie to it through their participation in corporate governance as members of the board of directors representing state-owned shares in it. As such, they are entitled to represent the state's interests in the firm's strategic decisions, albeit within the framework of an advisory capacity as stipulated by the rules of corporate governance of the Company Law (1994). Thus while the firm's top executive—the CEO—has full control over its management, the state has a voice—the more so the larger its ownership share in the firm—and votes on strategic decisions.

Moreover, the state can exert influence and gain timely and accurate information on all aspects of the firm's activity through informal business-state networks. Informal vertical ties between enterprise and government bureaus help entrepreneurs and managers to evade or re-interpret existing rules, accelerate administrative procedures, secure favorable decisions and guarantee a relatively stable business environment. Even managers of foreign-funded enterprises in China regard good relations with official representatives as crucial for business success (Pearson 1997). In politicized capitalism, personal connections with government officials are important complements for business capabilities (Peng and Luo 2000).

State bureaucrats in local administration conform to Evans' conception of embedded autonomy. They serve as an elite screened through meritocratic recruitment in a bureaucracy that rewards long-term careers. Their role is to represent the government's economic interest in local prosperity as measurable by growth, employment growth and local tax revenues.

The party committee, in contrast, is in essence a network of political actors internal to the firm which the state can draw on to support its policy initiatives and to provide timely and detailed information about personnel and other matters. The party's involvement and interests

differ considerably from those of state bureaucrats responsible for overseeing the firm. Article 17 of the Company Law specifies “the activities of the local branch units of the CCP in a company shall be carried out in accordance with the Constitution of the CCP,” but this Constitution provides little additional clarification of the Party’s scope of involvement. It simply delegates the implementation of higher party decisions to local party committees and grants them the right to “supervise party cadres and any other personnel.” This provision (Article 31) formally confers on the local party committee the right to control personnel decisions in state-owned firms (Bian et al. 2001). In reality, however, party members usually succeed in remaining involved in almost all domains of the firm’s activity and generally exercise a stronger influence in the firm than government bureaus (see Appendix 1).

The Company Law offers no mechanism to align the party committee’s interests with the firm’s performance. The party committee neither has residual claims nor benefits from local tax revenues. Party members, moreover, are insufficiently insulated from patron-client ties, and may easily be “captured” by interest groups or be tempted to maximize their own self-interests. In sum, the party committee presides over a political network in the firm that can be used to mobilize informal opposition to reform policies which threaten vested interests in the firm. Figure 3 sketches the internal structure and persisting links between the “three old committees” [*lao san hui*, i.e. party committees, trade union and workers congress] and new decision-making bodies [board of directors, manager and board of supervisors].

[Figure 3 about here]

Overall, the party committee’s presence in the firm does not conform to Evans’ specification of embedded autonomy. First, the firm-level party committee lacks sufficient insulation from societal claims because it is too extensively enmeshed in interest-based networks of employees inside the firm. Second, since it lacks both financial interests in firm

prosperity (via tax income or residual claims of state shares) and interest alignment by performance-based contracts, it does not have the same incentive as state bureaucrats to the firm's profitability. Instead, the party committee is structurally positioned to lobby on behalf of constituents for redistribution of surplus, whether by fighting management's interest in laying off excess workers or by providing richer compensation packages for employees.

### **Hypotheses**

The strong and weak versions of the developmental state entail different explanations for a positive role of the state in economic development. The emphasis of the strong version is the capacity of the state for direct involvement at the firm level. It is tacitly assumed that without state connections with entrepreneurs in the firm, transformative economic development is not likely to proceed. The state would not have the requisite information for effective intervention. For this to be confirmed in our study of China, we would need to show a positive effect on economic performance of state involvement at the firm level.

***Hypothesis 1:** Interventions arising from the developmental state's structural capacity to be involved at the firm level ought to have a positive effect on performance.*

In particular, we would need to show

***Hypothesis 2:** The involvement of state bureaucrats in the firm's decision-making has a beneficial effect on the firm's performance.*

If our findings should fail to confirm a positive effect of direct state involvement at the firm-level, then we would infer from this that the weak version—the active development and provision of market institutions and a growth supporting business environment without direct

interference at the micro-level—accounts for why China’s developmental state has been so successful in guiding transformative economic development.

Further, for Evan’s assumption that the efficacy of state involvement depends on the “Weberianness” of the state bureaucracy and its external ties with economic elites to be supported, we would expect

***Hypothesis 3:** Communist party involvement in decision-making at the firm level weakens the firm’s performance.*

If our empirical findings fail to confirm clearly varying effects of bureaucratic and political involvement at the firm level, this would undercut Evans’ idea of a mono-causal linkage between organizational features of state actors and performance effects. Instead, it would suggest the need for a broader *state structure and developmental strategy approach*, to provide a clearer understanding of the developmental state’s role in promoting economic growth.

### **Data and Research Design**

We use data on corporate governance of firms listed on the Shanghai Stock Exchange, the commercialized and privatized former large-scale state-owned enterprises that comprise the core of China’s urban industrial economy. The Shanghai Stock Exchange distributed questionnaires to each of the 483 listed firms. Of these, 257 firms returned the questionnaires (response rate: 53.54%). To ensure data quality, we compared the survey data on basic firm characteristics, including listing age and industries, with those provided by annual firm reports. Of the 257 returned questionnaires, we excluded one because it contained inconsistent data. In line with our aim to provide an encompassing measure of direct state intervention at the firm-level, we decided to limit our sample to firms providing complete survey data,

reducing the total number to 72.<sup>3</sup> We then excluded 6 firms newly listed in 1999 which did not have lag performance data. Our final sample therefore consisted of 66 firms, or about 14% of the firms listed by the A-share market on the SSE.

Our data-set of listed firms provides detailed information on the relative involvement of managers, board members, shareholders, party officials, and government representatives in the firms' decision-making. In line with our definition of politicized capitalism, we examine the perceived degree of state intervention in such decision-making (Oppen et al. 2002; Wong et al. 2004).

At the end of 1999, 59.45% of the firms listed by the Shanghai Stock Exchange belonged to the manufacturing industries, 17.20% were conglomerates and 11.67% belonged to the wholesale and retail industries (see Appendix 2). The top three industries account for 79.61% of all the listed firms. Within our sample, 59.09% of firms belong to the manufacturing industry, 24.24% are conglomerates, and 9.09% belong to the wholesale and retail industries. Overall, our sample appears to comprise an acceptable representation of the overall industrial structure of the firms listed on the Shanghai Stock Exchange, without a critical response bias, although characterized by an overrepresentation of conglomerates, i.e. large business groups.<sup>4</sup> Since political intervention is assumed to be closely tied to industrial priorities, firm size, profitability, and financial leverage, there is strong reason to suppose that our sample does not suffer from a non-response bias in terms of political interventions at the firm level.

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<sup>3</sup> Detailed analysis of the response rates across decision types indicates no obvious pattern. We are therefore unable to determine why some respondents left some decisions unrated. However, we suspect that this may happen when they have not encountered that decision. This is based on our observation that the response rates for the two questions relating to external donation—an uncommon activity among listed firms—are the lowest. We therefore do not see any reason to believe that any form of self-censorship has led to the provision of incomplete questionnaires. Experiments with a larger sample inclusive of firms with incomplete questionnaires confirmed our results.

<sup>4</sup> Furthermore, the financial leverage (debt asset ratio), firm size (log of sales), ownership structure (percentage of state shares) and return on assets of our sample firms do not show any serious deviation from the mean values of the total population of listed firms at the Shanghai Stock Exchange (Appendix 3). Only the profitability measure Return on Equity shows an upward bias, with 0.9 compared to the total population with a mean value of 0.6. A comparison of the respective standard deviation of both measures suggests that our sample is characterized by a smaller proportion of outliers in terms of performance measured by ROE.

The questionnaire used by the Shanghai Stock Exchange's survey of listed firms asks respondents (secretaries to chairmen of the board of directors)<sup>5</sup> to rate the level of decision-making power (at end-1999) of shareholders (through shareholders' meetings), managers, boards of directors and state actors such as local party committees and the responsible bureaus of government administration in sixty three different types of firm decisions, including decisions on finance and investment, appointment and dismissal of key personnel, performance appraisal, organizational change, strategic planning, and external relationships. Responses are based on the following scale: 1 (no involvement), 2 (have some influence), 3 (have significant influence), 4 (have decisive influence) and 5 (complete control).<sup>6</sup>

In general, the survey confirms that the distribution of decision-making power among boards of directors, managers, and shareholders' meetings within China's listed firms actually resembles the corresponding distribution among Western-style firms. The board of directors is most heavily involved in decision-making (mean=3.61), followed by managers (mean=3.01), followed by shareholders' meetings (mean=2.66). Nonetheless, party committees (mean 1.65) and government bureaus (mean 1.25) remain directly involved in the decision-making, although state control is significantly weakened since the pre-reform era.

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<sup>5</sup> In the management structure of China's listed firms, the position of BoD secretary is similar to the position of managing director; such an individual is expected to be the most knowledgeable about a listed firm.

<sup>6</sup> As respondents' assessments are inherently subjective and may be plagued by inconsistency and biases, we tested for the internal consistency of our data when we constructed measures of state intervention. In addition to data on the involvement of various power holders in listed firms, we obtained data on shareholding structure and market prices from the *Taiwan Economic Journal*. Other data were obtained from the Shanghai WIND information Co., Ltd. (WIND).

*Measures of key variables*

Measures of state involvement: We use data on party and government involvement over 63 decisions to construct four measures of state intervention. For each firm, we construct an index of overall party ( $PI_A$ ) and government intervention ( $GI_A$ ) by averaging the level of involvement of the local party committee and the responsible government bureaus, respectively, in all decisions.

$$PI_{Ai} = \frac{\sum_{j=1}^n S_{ij}}{n} \qquad GI_{Ai} = \frac{\sum_{j=1}^n S_{ij}}{n}$$

$S_{ij}$  is the level of intervention of state actors of firm  $i$  in decision  $j$ , in all 63 decisions ( $n=63$ ). Nearly all major firm decisions are included, providing us with a comprehensive measure of state intervention.<sup>7</sup>

Our average measure, however, may conflate varying economic effects of different state interventions in the firm. Thus, to additionally investigate specific domains of such interventions, we grouped firm decisions into three broad clusters—personnel, financial, and strategic—all affecting mechanisms of corporate governance: the market for managers, the financial market, and the product markets, respectively.

Interventions in personnel decisions establish close networks between state and economic actors that allow other timely and direct interventions, whenever state involvement is deemed necessary, in order to realize industrial policy objectives or other types of development strategies. Our dataset confirms that China's local party committees actually exert the most control in personnel decisions, especially (1) selection of functional department managers, (2) selection of business department managers, (3) selection of branch managers, (4) selection of subsidiary managers, and (5) selection and dismissal of vice chief executive

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<sup>7</sup> We treat all decisions as equally important and thus assign them equal weightings. However, this may not be appropriate because some decisions (e.g. selection of CEO) are more important than others (e.g. selection of management consultant). But there is no reliable way to determine the relative importance of different decisions, because appropriate weightings depend on specific firm conditions. For example, the choice of a

officers (see Appendix 1). In essence, party involvement concentrates on human capital issues, which have been a central focus of the nomenklatura system for decades of socialist planning (Shirk 1992: 61). The fact that local party units tend to have a high level of involvement in decisions assigned *de jure* to the enterprise manager suggests that they may use the manager's office as their venue for interventionist activities. Personnel dependencies reinforce informal network ties with decision-makers within the firm, which can then easily be activated for further state interventions.

Similarly, interventions in financial decisions can be used to manipulate resource allocation in line with the state's industrial policy priorities and development objectives. Studies of the other Asian developmental states suggest that state interventions were particularly common in financial decisions, including those regarding loans, mergers and acquisitions, the issuing of new shares, and so on (Whitley 1999; Kang 2002). Our dataset confirms that China's government administration actually exerts more influence on financial decisions than other areas, with a mean of 1.407 (see Appendix 1). Four out of the top five decisions are related to financial issues, including (rank 1) decisions on being merged, (3) merging with other firms, (4) changes in shareholding structure, and (5) decisions on share placements and new issues.

Finally, a firm's strategic decisions, such as the entry into new markets and industries or the creation or abolition of new departments, branches and subsidiaries, critically affect market development and may therefore be closely screened by any state seeking to promote structural change. Although neither party nor bureaucracy has a particularly strong influence on strategic decisions, the party's mean value of involvement (1.77) is still above average. In contrast, government influence in strategic decisions is 1.236, about the same as the mean value of all 63 decisions.

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financial consultant may be of central importance for firms experiencing financial distress and undergoing strategic restructuring but may be unimportant for firms operating under normal conditions.

To investigate the performance effects of state intervention in these policy domains, we construct three measures to capture the level of state intervention in personnel decisions ( $PI_P$  and  $GI_P$ ), averaging overall 20 decision-types; in financial decisions ( $PI_F$  and  $GI_F$ ), averaging 18 decision-types; and in strategic decisions ( $PI_S$  and  $GI_S$ ) averaging 9 decision-types, respectively (see Appendix 1).<sup>8</sup>

$$PI_{Pi} = \frac{\sum_{j=1}^n S_{ij}}{n}$$

$$PI_{Fi} = \frac{\sum_{j=1}^n S_{ij}}{n}$$

$$PI_{Si} = \frac{\sum_{j=1}^n S_{ij}}{n}$$

$$GI_{Pi} = \frac{\sum_{j=1}^n S_{ij}}{n}$$

$$GI_{Fi} = \frac{\sum_{j=1}^n S_{ij}}{n}$$

$$GI_{Si} = \frac{\sum_{j=1}^n S_{ij}}{n}$$

Measures of economic performance: We evaluate the effects of state interventions through two indicators of a firm's profitability. Return on Asset (ROA) measures a company's net profit divided by its total assets including foreign capital, and Return on Equity (ROE) measures how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. Briefly, both measures indicate how well the company's management has performed with the total assets and with the resources provided by stockholders, respectively. Sceptics may have reservations about these measures owing to China's still-immature accounting standards. However, recent empirical work suggests that China has devoted serious efforts to making national accounting standards consistent with international standards (Lin et al. 2001).<sup>9</sup>

<sup>8</sup> We test the internal consistency of the ratings of 63 decisions for each decision maker, including BoDs, managers, shareholders' meetings, and local party committees. Results indicate that our data are highly consistent, with Cronbach's alpha exceeding 96% (the results are presented in Appendix 1). We also tested the internal consistency of ratings for each type of decisions for each decision maker. Results indicate that they are all consistent, with Cronbach's alpha exceeding 78.2% (the results are presented in Appendix 1).

<sup>9</sup> Alternative performance measures would actually provide inferior approaches. For instance, market valuation, such as the market-to-book value or Tobin's q would presuppose the existence of an efficient stock market. This assumption is certainly not justified in China's casino-style stock markets, which are highly distorted by heavy speculation. Particularly, risk evaluation is not in line with market-based assessment. Black (1986: 533) suggests that Tobin's q of about 2 signals the existence of an efficient stock

### *Control Variables*

We introduce the following control variables to isolate the performance effects of state intervention as exerted by party and government:

*INDUSTRY* The firms in our sample belong to various industries and therefore enjoy different profit-making opportunities. They may also be associated with different levels of state intervention because some industries are regarded as politically more important than others. Industrial dummies ( $INDUSTRY_i$ ) are therefore introduced.

*FIRM SIZE* Large firms may benefit from economies of scale and may have better access to financial resources, which could improve their performance (Fama and French 1995). They may be associated with a higher level of state intervention because they can deliver more benefits to politicians and bureaucrats (Lioukas et al. 1993). To capture the possible confounding effect of firm size, we control the natural logarithm of a firm's sales ( $SALES$ ).

*CAPITAL STRUCTURE* Qi et al. (2000) and Xu and Wang (1999) both find that financial leverage in China's listed firms is related to firm performance. On the other hand, financial leverage may be related to state intervention because state actors still provide an important network for obtaining bank loans in China (McGregor 2001). We therefore introduce the debt-to-asset ratio ( $DAR$ ) as a control variable.

*MEASURES OF ADMINISTRATIVE LEVELS* The administrative level of a firm's responsible government superiors ( $AS$ ) may affect performance due to differing budget constraints and competitive pressure. At the same time, the quality and intensity of state intervention may differ due to differing access to information, monitoring, and political priorities. We include three dummy variables indicating the existence of a central or provincial government, city or county government, and other authorities as administrative superiors.

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market. In China, Tobin's  $q$  reached values as high as 3.7 between 1996 and 1999 (Tenev und Zhang 2002: 106). Productivity measures actually suffer from data limitations as stock listed firms do not need to reveal the current number of employees.

LAG PERFORMANCE A high level of state intervention may affect firm performance, and conversely firm performance may affect the level of state intervention. To partially deal with this reverse-causality problem, we include lag performance variables (PL) as control variables. This allows us to capture potential interactions between state intervention and performance in the previous year.<sup>10</sup>

STATE OWNERSHIP According to property rights theory, state ownership should be negatively related to firm performance due to softer budget constraints, weak monitoring incentives and pronounced principal agent problems. At the same time, state ownership also invites state intervention in the capacity of shareholders. The maintenance of state ownership is not simply based on ideological reasons, but tightly connected with the state's desire to preserve its right to control and direct production. Indeed the preservation of a dominant ownership position of the state is a priority of state industrial policy.<sup>11</sup> State intervention via the ownership channel is facilitated by the current system of state asset management involving specialized state asset operating companies. This system was originally propagated as an effective tool to protect firms from direct state intervention. The independent decision-making power of these companies, however, is likely to be undermined by diverse structural and institutional deficiencies.<sup>12</sup> We use the percentage of state shares (PSTATE) as control variable.

DECISION-MAKING POWER OF SHAREHOLDERS, BOARDS OF DIRECTORS, AND MANAGERS A high level of shareholder, manager and BoD involvement in firm decision-making suggests the existence of active corporate monitoring and governance, which could in turn reduce agency

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<sup>10</sup> Testing our model without lag performance, however, shows no critical variations in our results. Signs and levels of significance remain unaffected, only the size of the slope coefficients changes.

<sup>11</sup> Art. 4 of the "Temporary methods to manage state-owned shares", November 3, 1994. „Gufen youxian gongsi guoyou guquan guanli zhanxing banfa“, in: Zhongguo Renmin Daxue jinrong yu Zhengquan yanjiusuo (Ed.) 2000.

<sup>12</sup> (1) Firms have the formal legal objective to realize the state's interests and not the general stakeholder interests. (2) The new agents suffer from a lack of independence from the state and remain embedded in a complex principal-agent system, being part of the administrative hierarchy. (3) The new agents have no material incentives to refuse political intervention, as they only enjoy control rights but no residual rights. They are also not responsible for operational losses. (4) Bureaucratic inertia is common, as the majority of bureaus are reorganised organs of the state administration, displaying a similar institutional and personal structure (Huchet and Richet 1999).

problems and lead to improved firm performance. At the same time it implies a lower relative level of state intervention. We therefore construct a set of three indices to measure the corporate governance involvement of shareholders' meetings (SI), BoDs (BI), and managers (MI) in decision-making. These indices are constructed in the same manner as the PI and GI index. The data are from SSES.

### Models

Our model seeks to measure the overall performance effect of party and government intervention. Each is estimated separately because of a risk of multicollinearity.<sup>13</sup> We construct the following regression model, where P denotes the performance measure of ROA and ROE, and  $PI_K$  and  $GI_K$  denote the four measures of decision-making power of party committees and government administration (namely  $PI_A$ ,  $PI_P$ ,  $PI_F$ , and  $PI_S$  and  $GI_A$ ,  $GI_P$ ,  $GI_F$  and  $GI_S$ ):

#### **Party Involvement**

$$P = \alpha + \sum_{i=1}^{12} \lambda_{K_i} INDUSTRY_i + \beta_{K1} SALES + \beta_{K2} DAR + \beta_{K3} Pstate + \beta_{K4} AS_i + \beta_{K5} PL + \beta_{K6} MI + \beta_{K7} BI + \beta_{K8} SI + \beta_{K9} PI_K + \varepsilon$$

#### **Government Involvement**

$$P = \alpha + \sum_{i=1}^{12} \lambda_{K_i} INDUSTRY_i + \beta_{K1} SALES + \beta_{K2} DAR + \beta_{K3} Pstate + \beta_{K4} AS_i + \beta_{K5} PL + \beta_{K6} MI + \beta_{K7} BI + \beta_{K8} SI + \beta_{K9} GI_K + \varepsilon$$

### *Regression Results*

Table 1 presents the ordinary least square (OLS) estimates on the overall performance implications of government and party intervention. For the government these estimates are insignificant, though the estimated coefficients have negative signs. Hence, hypothesis 2 specifying that involvement of bureaucrats in the firm's decision making has a positive effect

on the firm's performance is not supported. In contrast, the slope coefficient on party intervention ( $PI_A$ ) is actually negative and significant for both estimations on ROA and ROE. These results, consistent with those of Wong et al. (2004) and Chang and Wong (2003), suggest negative performance effects of party intervention in decision-making processes at the firm level, thereby supporting our hypothesis 3.

[Table 1 about here]

Tables 2a–c show the OLS estimates on the economic impact of state intervention in the domains of personnel, financial and strategic firm decisions. As to personnel decisions, estimates on performance implications of government interventions yield negative and significant coefficients, suggesting a detrimental impact. Hypothesis 2 is thereby clearly rejected for the field of personnel decisions. For party involvement, our estimates suggest that interference is not detrimental to firm performance (Table 2a). Although the estimated slope coefficient has a negative sign, the effect of party intervention on firm performance remains insignificant at conventional levels. Hypothesis 3 on the party's involvement is therefore not supported in the domain of personnel decisions. This finding is consistent with the widespread assumption in the literature that party committees have a comparative advantage in personnel matters (in comparison to other fields of intervention) due to the CCP's effective vertical command structure and long tradition of supervisory activities within the nomenclature system. Qian (1995) has suggested that party control may limit excessive managerial discretion and abuse of insider control, when effective corporate governance mechanisms are not yet in place. However, our estimates do not indicate any positive performance effects.

Our estimates on the economic effect of government interventions into financial decisions certainly deserve specific attention, as such interventionism undoubtedly serves as a

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<sup>13</sup> The Pearson Correlation matrix is presented in Appendix 3; the Variance Inflation Factor has been

central instrument to promote and steer economic development in China as in other East Asian economies (Table 2b). The high degree of regulation of China's financial and capital market actually provides convenient chances for the state bureaucracy to remain involved and to manipulate financial decision-making. First of all, the stock market is a pseudo-market due to over-regulation and heavy state intervention. Market entry and market exit are seriously politicized as both procedures are regulated by complex and opaque approval procedures, which usually involve intense political bargaining processes of the responsible government bureaus (OECD 2002). Similarly, new share issuance depends on government approval. Casual observation confirms that firms without reliable political networks have little chance to be listed at one of China's stock exchanges. Indeed only a small minority of private firms are currently listed. Furthermore, the market for mergers and acquisitions is regulated with unclear criteria, offering a wide leeway for government intervention. Finally, the state banking system has not undergone any property rights reforms and is still under intermittent pressure from the government to expand loans to rescue the ailing state-owned firms (Woo 2002). Though 'China's Law for Commercial Banking' stipulates that credit policy should be independent from state involvement (Zhu 1999, Leung and Mok 2000), a large number of loan decisions are influenced by political involvement, which banks can hardly escape, given the close networks between government, banks and enterprises (Park and Sehrt 2001).

In spite of the strong predisposition of financial and capital markets to invite government intervention, our estimates do not suggest that government involvement in capital allocation promotes the firm's development. Consistent with our estimates on overall government intervention, state involvement is not associated with a significant positive effect on firm performance. Instead we estimate negative (though statistically insignificant) slope coefficients for both ROE and ROA. Our estimates once again suggest the absence of a "helping hand" of the Chinese bureaucracy in firms' financial decision-making. As for party

intervention in financial decisions, our estimates yield a significant and negative effect for both performance measures. Hypothesis 3 is therefore supported.

For interventions in strategic decisions, our estimates are again mixed (Table 2c). We yield significant and negative performance effects for government involvement for both ROA and ROE, while the slope coefficients for party interference are negative but not significant at conventional levels (20% and 15%, respectively). Thus, for the field of strategic decisions neither Hypothesis 2 nor Hypothesis 3 is supported.

[Table 2a-c about here]

Overall, the surprising finding is that there is no difference between the economic effect of involvement in decision making between the state bureaucracy and the party committee. The clearly superior “Weberian” organizational features of the government bureaucracy compared with local party committees do not transform into superior outcomes, when it comes to direct involvement at the firm level. We infer from this finding that organizational features such as meritocracy-based recruitment and rewarding bureaucratic careers do not provide effective remedies to resolve information asymmetries and disincentives which are invariably connected with direct state interference at the micro-level. Evans’ claim that organizational features of state structures serve as a commensurate condition for beneficial state activities is not supported. Summarizing our findings, we find no support for hypothesis 1 that interventions arising from the developmental state’s structural capacity to be involved at the firm level have a positive effect on performance.

Skeptics might of course claim that our results pertaining to the negative performance effects of government administration and local party committees can be explained by a tendency of respondents in poorly performing firms to blame state actors for the firms’ economic failure. Although we cannot completely rule out such a possibility, such blame-

shifting is unlikely to have occurred. The survey includes 74 questions covering almost every aspect of firms' corporate governance. Therefore, it is unlikely that the respondents could have perceived the specific linkage between state intervention and firm performance. Some caveats apply, however. First, our empirical investigation is admittedly confined to a relatively small sample of firms due to the given data limitations. Broader studies will be needed to verify our findings. Second, our study exclusively focuses on China's listed firms, which are mostly large state-owned enterprises that only recently reformed their corporate governance in order to adapt to the market environment.

## **Discussion and Conclusion**

We have sought to examine the involvement of state actors in the firm's governance and to estimate their respective economic impact within China's transformative economic order of politicized capitalism. Our analysis details the characteristic features of politicized capitalism wherein state actors remain directly involved in guiding transactions at the firm level. Government bureaus motivated by material incentives stemming from fiscal federalism and performance-based contracts affect firm decisions through close state-firm relations and regulatory leeway in interpreting local development priorities. Party committees inside the firm provide a strategically located political network responsive both to the party's hierarchy and to a firm-based constituency.

We see some support for our hypothesis predicting that the party's involvement in management's decision-making has a negative effect on the firm's performance. Hypothesis 3 is confirmed for "all decisions" and interventions in "financial decisions", while estimates for "personnel decisions" and "strategic decisions" are negative though insignificant at conventional levels. Our results, however, do not offer support for the hypothesis predicting that the involvement of local state bureaucrats has a positive effect on the firm's performance. In contrast to the common view that close state-firm relations have actually contributed to

China's remarkable growth trajectory (Walder 1995, Frye and Shleifer 1997), our results suggest that politicized capitalism is not associated with beneficial effects on the firm's performance when state bureaucrats are directly involved in influencing decision-making in the firm. Even government intervention in financial decisions, undoubtedly China's most tightly regulated market and usually a major industrial policy instrument of Asian developmental states, is not associated with positive performance effects. For government interventions in personnel and strategic decisions, we estimated negative slope coefficients, which though statistically nonsignificant, suggest a possible negative performance effect.

Our results on China's politicized capitalism suggest the need to revitalize the discussion on the inner mechanics of a developmental state. We show that China's effectiveness is not due to its capacity to reach into the firm to intervene directly in shaping economic decisions. Whether as state bureaucrats or party politicians, interference of the state's representatives in the firm does not have a positive effect on the firm's performance.

Evans' (1989, 1995) strong version of the developmental state argues for beneficial effects of ongoing extensive contact and interaction between state actors and entrepreneurs, but is vague with respect to the requisite balance between insulation and firm-level direct intervention for the state to be effective in promoting transformative economic development, and does not adequately address possible negative consequences of embeddedness. Following the East Asian financial crisis of 1997, the negative consequences of close and extensive ties between state actors and entrepreneurs have come under critical scrutiny. Krugman (1998) focused attention on the problem of "crony capitalism" in his analysis of the causes of the financial crisis, asserting that "the success of too many Asian businessmen depended less on what they knew than on whom they knew" (Krugman 1998: 70). Similarly, McCormack (2001) emphasizes the close connections between government officials, the construction industry and financial institutions in analyzing the structural problems facing the Japanese economy after the crash of Japan's real estate bubble. Nee (2000) highlights the dilemma

posed by embeddedness when state-economy boundaries were wide-open and structurally vulnerable to rent-seeking and state capture in the early stages of China's economic reform.

In line with these observations, our results suggest that Weberian bureaucracy complemented by local embeddedness does not provide a commensurate condition for the economic success of the strong version of the developmental state. Instead, we infer from our results that such success stems from the competence and quality of the state bureaucracy to choose the most effective portfolio of indirect measures of developmental policies. Municipal governments compete by building supportive business environments to attract and retain private capital and facilitate the local entrepreneurs' competitive edge; by developing reputations for efficient and timely bureaucratic procedures; and through indirect incentives that do not interfere with the market mechanism (Yao 2001). They invest in the construction of industrial parks with the infrastructure and services that optimize their chances for attracting private investors and entrepreneurs. In other words, we suspect it is state bureaucratic capacity to set up and maintain an institutional environment which offers conditions favorable to private capital that explains the success of a developmental state in promoting transformative economic growth.

In sum, our analysis supports only the weak version of the developmental state, but with a caveat: it matters what policies the state bureaucracy actually pursues in its effort to promote economic development. The beneficial effect of the state results from its capacity to construct and maintain institutional environments that provide positive incentives to entrepreneurs and managers at the firm level to invest in economic growth. Judging from China's recent experience in sustaining high-speed transformative economic development, indirect state activity is more likely to play a supportive role and probably serves as a central determinant of economic success, while direct interventions into the free market mechanisms are likely to yield negative economic effects. Briefly, while Evans and Rauch (1999) emphasized the "Weberianness" of the state bureaucracy to explain beneficial behavior of bureaucrats and to

reconcile the conflict between the public choice school and sociologists, we wish to shift more attention to the government's choice of appropriate policy tools as a proximate cause of the developmental state's efficacy in promoting transformative economic development.

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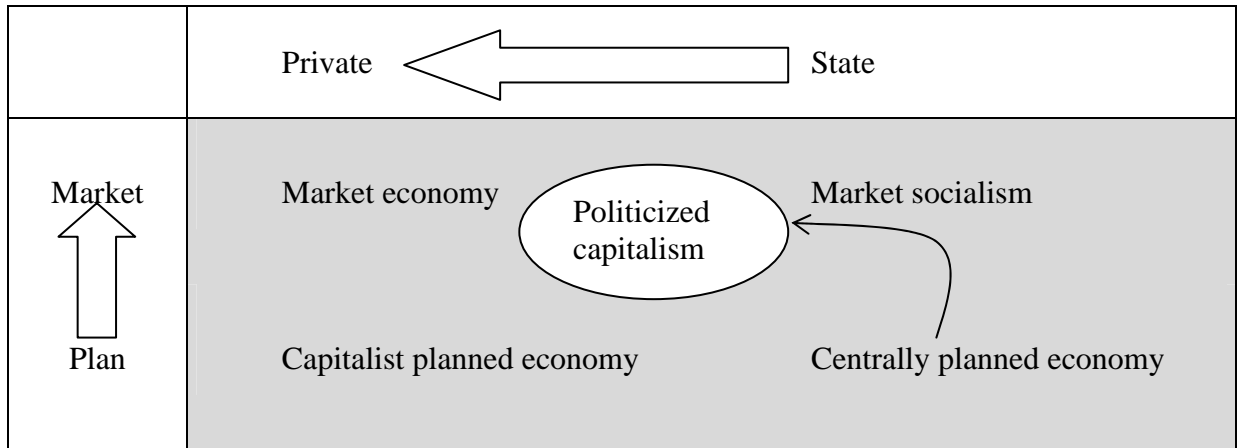
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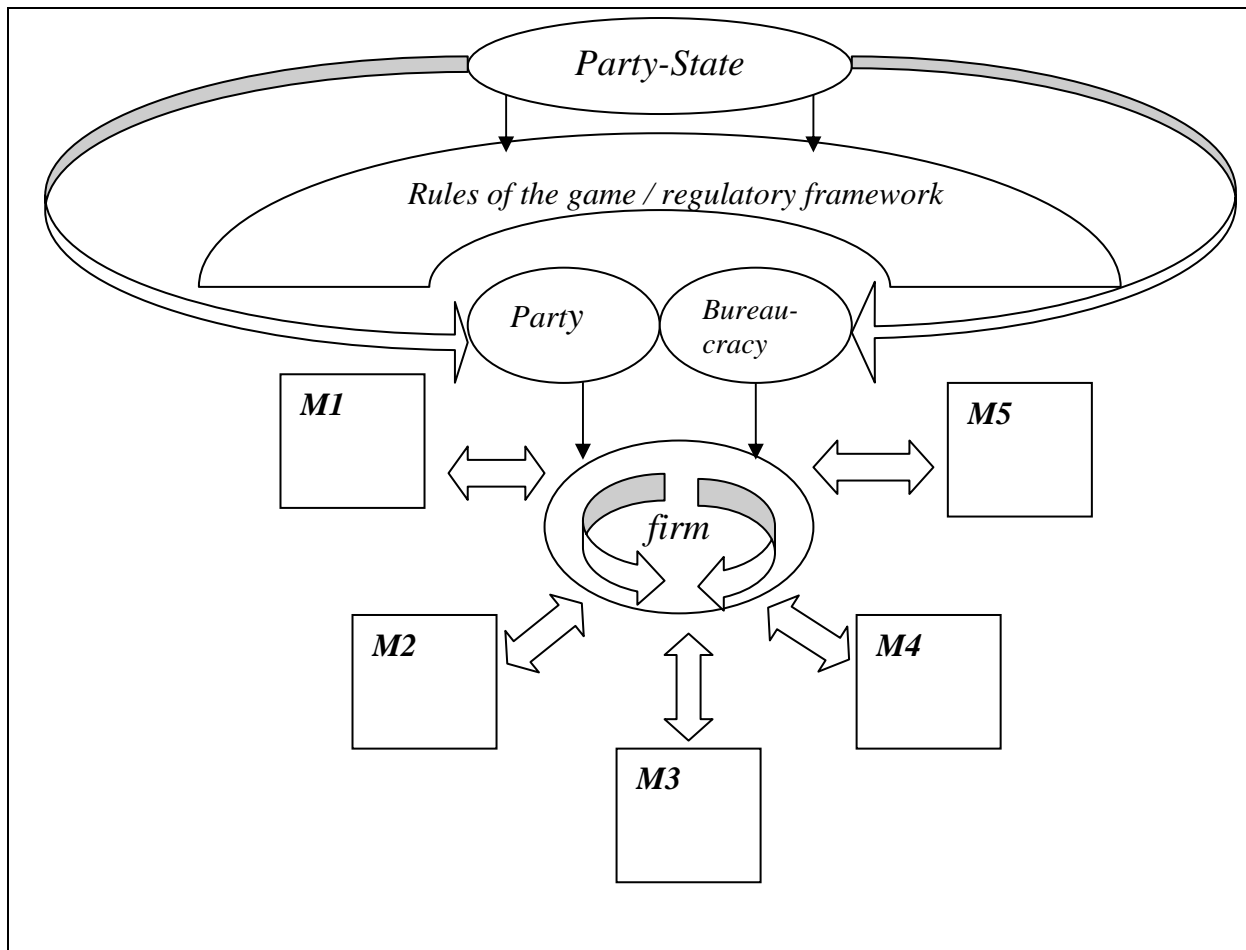
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**Figure 1: Politicized Capitalism as a Transformative Economic Order**



**Figure 2: Politicized Capitalism**



M1 to M5 identify different market types (i.e., labor, commodity, product and capital markets)

**Table 1: Overall Effect of State intervention on Economic Performance**

Independent Variables	ROA	ROE	ROA	ROE
	Coeff. (Std.Err.)	Coeff. (Std.Err.)	Coeff. (Std.Err.)	Coeff. (Std.Err.)
(Constant)	0.037 (0.093)	0.032 (0.204)	-0.014 (0.088)	-0.120 (0.202)
<b>Control Variables</b>				
Industry Dummy	NO	NO	NO	NO
Debt-to-Asset Ratio (DAR)	-0.022 (0.030)	0.090 (0.065)	-0.035 (0.028)	0.039 (0.061)
Logarithm of Sales (SALES)	0.004 (0.004)	0.008 (0.009)	0.006 (0.004)	0.014 (0.009)
Lag Performance	0.627*** (0.105)	0.568*** (0.118)	0.593*** (0.104)	0.547*** (0.122)
Decision-making Power of Board Of Directors (BI)	-0.034** (0.015)	-0.056 (0.034)	-0.034** (0.015)	-0.053 (0.033)
Decision-making Power of Shareholders (SI)	0.010 (0.008)	0.008 (0.017)	0.013 (0.008)	0.018 (0.018)
Decision-making Power of Managers (MI)	0.010 (0.009)	0.015 (0.020)	0.015 (0.010)	0.024 (0.022)
<b>Shareholding</b>				
Percentage of State-Shares (PSSHARES)	-0.002 (0.020)	-0.031 (0.043)	-0.005 (0.019)	-0.041 (0.042)
<b>Administrative Level</b>				
Central and Provincial	0.013 (0.011)	0.026 (0.024)	0.013 (0.010)	0.020 (0.023)
City and County	0.001 (0.013)	-0.004 (0.028)	0.001 (0.012)	-0.007 (0.027)
Other Authority	-0.008 (0.026)	-0.030 (0.058)	-0.003 (0.026)	-0.019 (0.058)
<b>Effect of Party Involvement</b>				
Government intervention (GI)	-0.017 (0.013)	-0.041 (0.028)		
Party intervention (PI)			-0.017** (0.008)	-0.033* (0.019)
Adj R Square	0.381	0.262	0.419	0.259
Observations	64	64	66	66

**Table 2a: Performance Effect of State Interventions in personnel decisions**

Independent Variables	ROA	ROE	ROA	ROE
	<u>Personnel</u> Coeff. (Std.Err.)	<u>Personnel</u> Coeff. (Std.Err.)	<u>Personnel</u> Coeff. (Std.Err.)	<u>Personnel</u> Coeff. (Std.Err.)
(Constant)	0.051 (0.093)	0.085 (0.200)	-0.011 (0.089)	-0.106 (0.198)
<b>Control Variables</b>				
Industry Dummy	NO	NO	NO	NO
Debt-to-Asset Ratio (DAR)	-0.005 (0.029)	0.120* (0.061)	-0.024 (0.028)	0.055 (0.060)
Logarithm of Sales (SALES)	0.002 (0.004)	0.004 (0.009)	0.004 (0.004)	0.011 (0.009)
Lag Performance	0.647*** (0.106)	0.599*** (0.117)	0.635*** (0.107)	0.595*** (0.122)
Decision-making Power of Board of Directors (BI)	-0.021* (0.011)	-0.038 (0.023)	-0.019* (0.011)	-0.031 (0.024)
Decision-making Power of Shareholders (SI)	0.002 (0.008)	-0.007 (0.016)	0.004 (0.008)	-0.002 (0.017)
Decision-making Power of Managers (MI)	0.009 (0.010)	0.019 (0.021)	0.013 (0.012)	0.027 (0.027)
Percentage of State-Shares (PSSHARES)	0.002 (0.020)	-0.020 (0.042)	-0.005 (0.019)	-0.036 (0.043)
<b>Administrative Level</b>				
Central and Provincial	0.014 (0.011)	0.028 (0.023)	0.011 (0.011)	0.017 (0.023)
City and County	0.005 (0.013)	0.006 (0.028)	0.001 (0.013)	-0.006 (0.028)
Other Authority	-0.003 (0.027)	-0.017 (0.057)	-0.001 (0.027)	-0.010 (0.060)
<b>Effect of Party intervention</b>				
Government intervention (GI)	-0.029* (0.015)	-0.070** (0.033)		
Party intervention (PI)			-0.010 (0.008)	-0.024 (0.017)
Adj R Square	0.388	0.304	0.378	0.245
Observations	66	66	66	66

Sources: SSES, Taiwan Economic Journal Data Bank (TEJ), Shanghai Wind Information Co., Ltd.

An asterisk denotes statistical significance at the 10% level; two at the 5% level; three at the 1 percent level.

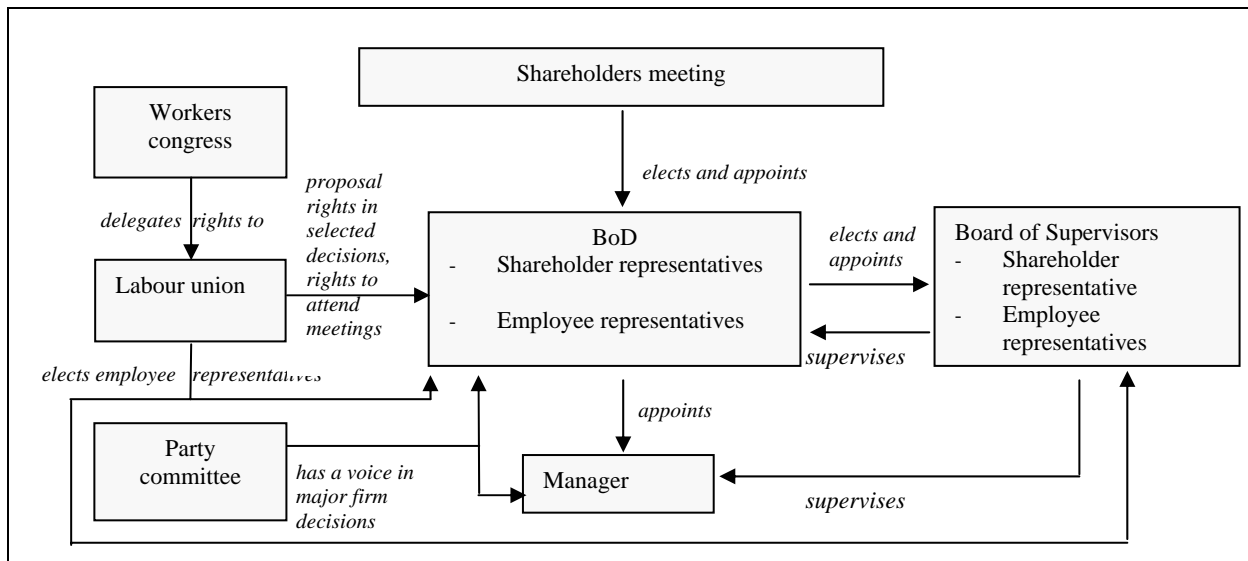
**Table 2b: Performance Effect of State Interventions in financial decisions**

Independent Variables	<u>ROA</u>	<u>ROE</u>	<u>ROA</u>	<u>ROE</u>
	<u>Financial</u>	<u>Financial</u>	<u>Financial</u>	<u>Financial</u>
	Coeff. (Std.Err.)	Coeff. (Std.Err.)	Coeff. (Std.Err.)	Coeff. (Std.Err.)
(Constant)	-0.041 (0.090)	-0.105 (0.196)	-0.101 (0.086)	-0.287 (0.194)
<b>Control Variables</b>				
Industry Dummy	NO	NO	NO	NO
Debt-to-Asset Ratio (DAR)	-0.025 (0.031)	0.085 (0.066)	-0.031 (0.028)	0.048 (0.061)
Logarithm of Sales (SALES)	0.005 (0.004)	0.011 (0.009)	0.008* (0.004)	0.018* (0.009)
Lag Performance	0.613*** (0.106)	0.550*** (0.120)	0.574*** (0.103)	0.521*** (0.120)
Decision-making Power of Board of Directors (BI)	-0.018 (0.014)	-0.023 (0.030)	-0.014 (0.013)	-0.014 (0.029)
Decision-making Power of Shareholders (SI)	0.009 (0.006)	0.007 (0.014)	0.011* (0.006)	0.016 (0.013)
Decision-making Power of Managers (MI)	0.002 (0.006)	-0.002 (0.014)	0.006 (0.006)	0.006 (0.015)
Percentage of State-Shares (PSSHARES)	-0.011 (0.020)	-0.047 (0.044)	-0.018 (0.019)	-0.063 (0.042)
<b>Administrative Level</b>				
Central and Provincial	0.012 (0.011)	0.025 (0.024)	0.012 (0.010)	0.019 (0.023)
City and County	-0.004 (0.013)	-0.014 (0.028)	-0.004 (0.012)	-0.014 (-0.027)
Other Authority	-0.012 (0.027)	-0.035 (0.060)	-0.009 (0.026)	-0.027 (0.058)
<b>Effect of State Involvement</b>				
Government intervention(GI)	-0.008 (0.010)	-0.020 (0.021)		
Party intervention (PI)			-0.017** (0.008)	-0.036* (0.019)
Adj R Square	0.345	0.221	0.404	0.257
Observations	64	64	66	66

**Table 2c: Performance Effect of State Interventions in strategic decisions**

Independent Variables	<u>ROA</u>	<u>ROE</u>	<u>ROA</u>	<u>ROE</u>
	<u>Strategic</u>	<u>Strategic</u>	<u>Strategic</u>	<u>Strategic</u>
	Coeff. (Std.Err.)	Coeff. (Std.Err.)	Coeff. (Std.Err.)	Coeff. (Std.Err.)
(Constant)	0.024 (0.091)	0.024 (0.191)	-0.014 (-0.088)	-0.122 (0.196)
<b>Control Variables</b>				
Industry Dummy	NO	NO	NO	NO
Debt-to-Asset Ratio (DAR)	-0.020 (0.030)	0.092 (0.063)	-0.024 (0.029)	0.042 (0.064)
Logarithm of Sales (SALES)	0.003 (0.004)	0.006 (0.009)	0.005 (0.004)	0.011 (0.009)
Lag Performance	0.640*** (0.103)	0.586*** (0.110)	0.638*** (0.104)	0.584*** (0.118)
Decision-making Power of Board of Directors (BI)	-0.021** (0.009)	-0.048** (0.019)	-0.018** (0.009)	-0.037* (0.019)
Decision-making Power of Shareholders (SI)	0.005 (0.006)	0.008 (0.012)	0.006 (0.006)	0.012 (0.013)
Decision-making Power of Managers (MI)	0.005 (0.009)	0.024 (0.019)	0.005 (0.009)	0.026 (0.021)
Percentage of State-Shares (PSSHARES)	-0.002 (0.019)	-0.024 (0.040)	-0.009 (0.019)	-0.044 (0.041)
<b>Administrative Level</b>				
Central and Provincial	0.017 (0.011)	0.036 (0.023)	0.013 (0.010)	0.020 (0.023)
City and County	0.000 (0.012)	-0.002 (0.026)	-0.002 (0.012)	-0.011 (0.027)
Other Authority	-0.008 (0.026)	-0.031 (0.054)	-0.003 (0.026)	-0.016 (0.058)
<b>Effect of State Involvement</b>				
Government intervention(GI)	-0.025* (0.014)	-0.071** (0.030)		
Party intervention (PI)			-0.009 (0.006)	-0.022 (0.014)
Adj R Square	40.3	34.4	39.3	26.9
Observations	66	66	66	66

**Figure 3: Corporate Governance of China's listed firms (according to Company Law)**



## APPENDIX 1

## Decision-Making Power of Various Power Holders in China's Listed Firms

	Shareholders Mean (Std.dev.)	BOD Mean (Std.dev.)	Manager Mean (Std.dev.)	Party Mean (Std.dev.)	Rank of Party Power	Government Mean (Std.dev.)	Rank of Gov. Power
<b>1. Involvement in Personnel Decisions</b>							
Selection of Functional Department Manager	1.352 (0.588)	3.028 (1.207)	4.310 (0.709)	2.127 (1.182)	1	1.056 (0.231)	61
Performance Appraisal of Functional Departments	1.394 (0.643)	2.718 (1.161)	4.324 (0.770)	1.986 (1.102)	6	1.069 (0.256)	60
Selection of Business Department Managers	1.338 (0.608)	2.606 (1.177)	4.338 (0.736)	2.113 (1.166)	2	1.070 (0.258)	58
Performance Appraisal of Business Department	1.324 (0.580)	2.549 (1.131)	4.310 (0.803)	1.986 (1.076)	7	1.070 (0.308)	58
Selection of Branch Manager	1.423 (0.647)	3.070 (1.280)	4.183 (0.867)	2.028 (1.183)	3	1.085 (0.280)	56
Performance Appraisal of Branch	1.394 (0.643)	2.944 (1.275)	4.183 (0.833)	1.831 (1.028)	15	1.085 (0.280)	56
Selection of Subsidiary Manager	1.493 (0.826)	3.408 (1.202)	3.915 (1.025)	2.000 (1.134)	4	1.099 (0.300)	50
Performance Appraisal of Subsidiaries	1.437 (0.732)	3.056 (1.286)	4.014 (0.978)	1.887 (1.049)	12	1.099 (0.300)	50
Election and Dismissal of Chairman of Board of Directors	3.352 (1.374)	4.042 (1.048)	1.465 (0.673)	1.620 (0.868)	36	1.681 (1.185)	1
Performance Appraisal of and Remuneration Enjoyed by Board Chairman	3.099 (1.406)	3.690 (1.103)	1.493 (0.694)	1.620 (0.763)	35	1.056 (0.231)	61
Election and Dismissal of Board Members	4.338 (1.041)	3.493 (0.876)	1.507 (0.734)	1.606 (0.819)	37	1.375 (0.813)	15
Performance Appraisal of and Remuneration Enjoyed by Board Members	3.535 (1.433)	3.718 (0.944)	1.549 (0.789)	1.634 (0.815)	30	1.292 (0.740)	24
Election and Dismissal of Board Secretary	2.563 (1.360)	4.437 (0.732)	1.873 (0.925)	1.648 (0.830)	29	1.139 (0.387)	43
Performance Appraisal of and Remuneration Enjoyed by Board Secretary	2.268 (1.309)	4.352 (0.880)	2.070 (1.087)	1.634 (0.849)	31	1.125 (0.373)	45
Selection of Supervisory Committee Members	4.282 (1.017)	2.239 (1.062)	1.634 (0.866)	1.746 (0.874)	22	1.250 (0.645)	28
Performance Appraisal of and Remuneration of Supervisory Committee	3.592 (1.498)	2.324 (1.168)	1.662 (0.925)	1.732 (0.910)	24	1.181 (0.513)	35
Selection and Dismissal of CEO	2.268 (1.183)	4.648 (0.563)	1.944 (1.068)	1.901 (1.016)	11	1.444 (0.948)	8
Performance Appraisal of and Remuneration Enjoyed by CEO	2.141 (1.138)	4.535 (0.651)	2.070 (1.073)	1.803 (0.935)	16	1.347 (0.754)	17
Selection and Dismissal of Vice-CEO	1.958 (1.101)	4.070 (1.046)	3.225 (1.289)	2.000 (1.056)	5	1.306 (0.705)	19
Performance Appraisal of and Remuneration Enjoyed by Vice-CEO	1.887 (1.090)	4.056 (1.068)	3.085 (1.307)	1.873 (1.027)	14	1.208 (0.529)	31
<b>Mean</b>	<b>2.322</b>	<b>3.449</b>	<b>2.858</b>	<b>1.839</b>		<b>1.211</b>	
<b>Alpha</b>	<b>0.918</b>	<b>0.833</b>	<b>0.853</b>	<b>0.977</b>		<b>0.924</b>	

**2. Involvement in Financial Decisions**

Change in Shareholding Structure	4.042 (1.088)	3.718 (0.796)	2.268 (1.133)	1.394 (0.665)	60	1.556 (0.977)	4
Change in Debt/Equity Ratio	3.592 (1.348)	3.930 (0.617)	2.577 (1.091)	1.366 (0.591)	62	1.431 (0.853)	10
Formulation of Dividend Plan	4.282 (1.098)	3.845 (0.624)	2.366 (1.018)	1.338 (0.584)	63	1.181 (0.589)	35
Determining Share Placement and New Issue	4.296 (1.088)	3.789 (0.754)	2.493 (1.054)	1.366 (0.615)	61	1.556 (1.005)	5
New Investment in Technology	3.239 (1.347)	4.014 (0.548)	3.268 (1.041)	1.437 (0.732)	47	1.486 (0.934)	7
New Investment in Infrastructure	3.239 (1.336)	4.000 (0.609)	3.169 (1.014)	1.437 (0.732)	48	1.528 (0.949)	6
Financial Investment	3.141 (1.323)	4.042 (0.572)	3.042 (1.034)	1.394 (0.665)	58	1.375 (0.830)	15
Investment in Other Stock Firms	3.549 (1.285)	3.958 (0.685)	2.944 (1.120)	1.423 (0.710)	52	1.306 (0.725)	19
Sale of Assets	3.394 (1.368)	4.000 (0.697)	2.901 (1.097)	1.465 (0.842)	43	1.431 (0.853)	10
Determining Loans for Fixed Asset Investment	2.648 (1.425)	3.915 (0.732)	3.423 (1.051)	1.437 (0.751)	49	1.403 (0.816)	13
Determining Loans for Liquidity Fund	2.296 (1.269)	3.563 (0.967)	3.676 (1.079)	1.394 (0.727)	59	1.292 (0.740)	24
Determining Loans Through Mortgaging of Assets	3.366 (1.407)	3.972 (0.717)	2.986 (1.035)	1.465 (0.808)	42	1.319 (0.784)	18
Serving as Guarantee for Other Firms' Large-Scale Loans	3.549 (1.318)	3.944 (0.773)	2.845 (1.064)	1.437 (0.751)	50	1.264 (0.650)	27
Determining Amount of External Donation	2.577 (1.461)	3.944 (0.791)	3.042 (1.224)	1.690 (0.950)	25	1.306 (0.762)	19
Determining External Donation Plan	2.352 (1.395)	3.521 (1.067)	3.197 (1.203)	1.761 (1.007)	19	1.306 (0.762)	19
Contracting of Large-Scale Construction Project	2.366 (1.355)	3.718 (1.017)	3.423 (1.078)	1.535 (0.790)	41	1.306 (0.664)	19
Merging with Other Firms	4.042 (1.061)	3.887 (0.522)	2.944 (0.969)	1.549 (0.842)	40	1.597 (0.944)	3
Being Merged By Other Firms	4.028 (1.230)	3.718 (0.848)	2.732 (1.068)	1.620 (0.962)	34	1.681 (1.032)	1
<b>Mean</b>	<b>3.333</b>	<b>3.860</b>	<b>2.961</b>	<b>1.473</b>		<b>1.407</b>	
<b>Alpha</b>	<b>0.928</b>	<b>0.865</b>	<b>0.953</b>	<b>0.982</b>		<b>0.967</b>	

**3. Involvement in Strategic Decisions**

Organizational Change	2.239 (1.247)	3.915 (0.841)	3.535 (0.939)	1.944 (1.013)	10	1.181 (0.513)	35
Creation and Abolition of Functional Departments	1.648 (0.864)	3.662 (1.082)	3.986 (0.802)	1.986 (1.021)	8	1.097 (0.342)	53
Creation and Abolition of Business Departments	1.437 (0.712)	2.930 (1.257)	4.310 (0.748)	1.887 (1.022)	13	1.099 (0.300)	50
Creation and Abolition of Branch	2.028 (1.219)	3.676 (1.025)	3.775 (0.898)	1.746 (0.982)	23	1.127 (0.335)	44
Creation and Abolition of Subsidiaries	2.310 (1.369)	3.831 (0.926)	3.535 (1.012)	1.761 (1.007)	20	1.155 (0.364)	40

Formulation of Long-Term Development Plan	3.493 (1.297)	4.141 (0.639)	3.268 (0.999)	1.662 (0.925)	27	1.417 (0.727)	12
Formulation of Strategic Plan	3.113 (1.410)	4.197 (0.710)	3.296 (0.932)	1.634 (0.930)	32	1.444 (0.748)	8
Establishment of Long-Term Relationship With Other Firms	2.423 (1.359)	3.775 (1.017)	3.592 (0.935)	1.634 (0.960)	33	1.222 (0.481)	30
Change of Direction, Entry into New Industry and Market	3.761 (1.213)	3.901 (0.759)	3.268 (0.970)	1.662 (0.985)	28	1.403 (0.685)	13
<b>Mean Alpha</b>	<b>2.495</b> <b>0.822</b>	<b>3.781</b> <b>0.782</b>	<b>3.618</b> <b>0.791</b>	<b>1.768</b> <b>0.963</b>		<b>1.236</b> <b>0.891</b>	

#### 4. Other Decisions

Call of Shareholder Meeting	3.225 (1.475)	4.070 (0.781)	2.141 (0.780)	1.437 (0.649)	46	1.208 (0.409)	31
Agenda Setting in Shareholder Meeting	3.465 (1.371)	4.028 (0.810)	2.155 (0.856)	1.408 (0.599)	55	1.153 (0.362)	40
Call of Board Meeting	2.141 (1.073)	4.521 (0.734)	2.324 (0.907)	1.408 (0.599)	57	1.181 (0.422)	35
Agenda Setting in Board Meeting	2.113 (1.049)	4.493 (0.843)	2.352 (0.912)	1.423 (0.601)	53	1.153 (0.399)	40
Call of Supervisory Committee Meeting	1.958 (0.992)	1.887 (0.871)	1.732 (0.925)	1.563 (0.712)	39	1.125 (0.373)	45
Agenda Setting in Supervisory Committee Meeting	2.000 (1.028)	1.859 (0.867)	1.732 (0.940)	1.563 (0.732)	38	1.125 (0.373)	45
Call of Manager's Office Meeting	1.634 (0.832)	2.676 (0.982)	4.535 (0.673)	1.789 (0.827)	17	1.167 (0.375)	39
Agenda Setting in Manager's Office Meeting	1.592 (0.748)	2.577 (0.981)	4.549 (0.672)	1.789 (0.827)	18	1.194 (0.399)	33
Selection of Representatives Attending Manager's Office Meeting	1.423 (0.730)	2.324 (1.066)	4.507 (0.826)	1.662 (0.861)	26	1.083 (0.278)	57
Making Amendments to Firm's Charter	4.113 (1.248)	3.620 (0.744)	2.211 (0.773)	1.451 (0.628)	44	1.292 (0.740)	24
Selection of Accounting (Auditing) Firm	3.972 (1.298)	3.817 (0.867)	2.592 (1.154)	1.408 (0.748)	56	1.111 (0.316)	48
Selection of Law Firm	2.972 (1.576)	3.972 (0.956)	2.831 (1.242)	1.423 (0.768)	54	1.111 (0.358)	48
Selection of Financial Consultant	2.479 (1.482)	3.915 (1.038)	2.986 (1.259)	1.437 (0.806)	51	1.097 (0.342)	53
Selection of Management Consultant	2.211 (1.383)	3.930 (1.060)	3.268 (1.207)	1.451 (0.842)	45	1.097 (0.342)	53
Training and Education for Board Members and Higher Management	1.775 (0.944)	4.169 (0.941)	2.986 (1.213)	1.746 (1.079)	21	1.239 (0.643)	29
Training and Education for Middle Management	1.507 (0.754)	2.944 (1.319)	4.225 (0.814)	1.958 (1.188)	9	1.194 (0.597)	33
<b>Mean of all decisions</b>	<b>2.658</b>	<b>3.608</b>	<b>3.018</b>	<b>1.653</b>		<b>1.247</b>	
<b>Alpha of all decisions</b>	<b>0.967</b>	<b>0.923</b>	<b>0.967</b>	<b>0.990</b>		<b>0.977</b>	

## APPENDIX 2

## Industrial Structure of Firms, 1999

	All Firms listed at SSE (ALL <sub>99</sub> )	Sample Firms	Respondents with incomplete questionnaires
	Number (percentage)	Number (percentage)	Number (percentage)
Finance	3 (0.64)	0 (0.00)	1 (0.55)
Public	40 (8.49)	5 (7.58)	16 (8.79)
Real Estate	12 (2.55)	0 (0.00)	4 (2.20)
Conglomerate	81 (17.20)	16 (24.24)	22 (12.09)
Manufacturing	280 (59.45)	39 (59.09)	119 (65.38)
Wholesale and Retail	55 (11.67)	6 (9.09)	20 (10.99)
Total Observations	471	66	182

Source: China Securities Regulatory Commission.

## APPENDIX 3

**Fundamental Data of Firms, 1999**

	All Firms listed at SSE (ALL <sub>99</sub> )	Sample Firms
	Mean (Std. Dev.)	Mean (Std. Dev.)
Return on Assets	0.04 (0.09)	0.05 (0.04)
Return on Equity	0.07 (0.46)	0.09 (0.09)
Debt to Asset Ratio	0.44 (0.23)	0.44 (0.17)
Log. of Sales	19.92 (1.19)	19.97 (1.21)
Percentage of State Shares	0.32 (0.28)	0.33 (0.27)
Total Observations	471	66

Source: China Securities Regulatory Commission.

## APPENDIX 4

### Descriptive Statistics of Key Variables and Pearson Correlation Matrix (N=66)

Variables	MeanSample99	S.D.Sample99	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1 Return on Asset (ROA)	0.046	0.042														
2 Return on Equity (ROE)	0.087	0.083	0.851**													
3 Market to Book Value (MB)	4.450	2.424	0.262*	0.351**												
4 Percentage of State Shares (PSTATE)	0.319	0.470	-0.010	-0.046	-0.119											
5 Debt-to-Asset Ratio (DAR)	0.433	0.168	-0.249*	0.084	0.413**	0.045										
6 Logarithm of Sales (SALES)	19.944	1.162	0.164	0.219	-0.308*	0.175	0.100									
7 Central and Province Administration	0.292	0.458	0.087	0.142	0.004	0.128	0.178	0.271*								
8 City and County Administration	0.208	0.409	-0.004	-0.058	0.103	0.148	-0.030	-0.092	-0.327**							
9 Other Authority	0.028	0.165	-0.034	-0.003	0.094	-0.188	0.069	-0.079	-0.117	-0.088						
10 Party intervention (PI <sub>A</sub> )	1.623	0.688	-0.209	-0.173	0.030	0.164	0.081	0.184	0.229	0.021	-0.092					
11 Party intervention in Personnel Decision (PI <sub>P</sub> )	1.802	0.831	-0.183	-0.136	0.066	0.177	0.112	0.140	0.229	0.013	-0.092	0.950**				
12 Party intervention in Financial Decision (PI <sub>F</sub> )	1.452	0.664	-0.214	-0.204	-0.062	0.092	0.044	0.228	0.188	-0.005	-0.095	0.939**	0.813**			
13 Government intervention (GI <sub>A</sub> )	1.252	0.410	-0.196	-0.152	0.182	0.277	0.201	0.041	0.134	0.175	-0.116	0.634**	0.632**	0.544**		
14 Gov. Intervention in Personnel Decision (PG <sub>P</sub> )	1.199	0.345	-0.255	-0.196	0.233	0.310	0.251	-0.004	0.154	0.202	-0.110	0.637**	0.647**	0.520**	0.959**	
15 Gov. Intervention in Financial Decision (PI <sub>F</sub> )	1.283	0.507	-0.171	-0.152	0.114	0.285	0.155	0.049	0.107	0.122	-0.106	0.572**	0.570**	0.489**	0.966**	0.866**

\*\*P < 0.01; \*P < 0.05

## APPENDIX 5

### Data and Sources

Variable	Definition	Source
ROA	Return on assets is measured as net income over assets.	Shanghai Wind Information Co., Ltd.
ROE	Return on equity is measured as net income over equity.	Shanghai Wind Information Co., Ltd.
DAR	Debt asset ratio is measured as total debt over assets.	Shanghai Wind Information Co., Ltd.
SALES	Amount of sales is the total volume of sale measured by million yuan (RMB).	Shanghai Wind Information Co. Ltd.
INDUSTRY	Dummy indicating industrial sector (energy, transportation, wholesale and retail, real estate, social services, manufacturing, conglomerates).	China Securities Regulatory Commission
AS	Dummy indicating the identity of the administrative superior of the firm.	SSES
PSTATE	Percentage of state shares = number of state shares over total number of shares.	Shanghai Wind Information Co., Ltd.
BI (SI, MI)	Decision-making power of BoDs (shareholders meeting and managers) is the average decision-making power of the BoD (shareholder meeting / managers) in a specified range of decisions (all, personnel, financial).	SSES
PI / GI	Party intervention / Government intervention is the average decision making power of the local Party Committee / responsible government bureaus in a specified range of decisions (all, personnel, financial)	SSES