

## **Betting on a Princeling**

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### **Abstract**

An event study of the removal of two Chinese Politburo members shows that firms were strategically betting on promising politicians in hopes of receiving favors in return. The surprising removals of these politicians generated significant drops in the values of the connected firms. Using fine-grained data on firms' board composition, I report evidence that political connections are endogenous to leadership change, firms tend to build super-majoritarian coalitions rather than minimal-winning coalitions, and connections with the government are more vulnerable than connections with parliament or the military confronting a partial regime change. I further show that regulatory capture is the most important mechanism through which connections help businesses.

On March 15, 2012, the Chinese official media announced the removal of Bo Xilai—the son of a revolutionary veteran, a “princeling”<sup>1</sup>—from his post as Party chief in Chongqing. Around five days of the event, Chongqing-based firms that were connected with the *national* government<sup>2</sup> had a significant cumulative abnormal return of -2.91%, which created a \$311 million financial market shock (0.17% of Chongqing’s 2012 gross domestic product, GDP). However, Bo’s fall barely affected Chongqing firms that were connected with the *local* government.<sup>3</sup> The five-day cumulative abnormal return for locally connected firms was -1.66% and statistically insignificant. How should we interpret these results?

The downfall of politicians often produces political earthquakes that break existing state-business ties in countries that have prevalent clientelism.<sup>4</sup> In China, where “[P]rivate business operated in networks of personal ties centered on the local government,”<sup>5</sup> a local politician’s career is usually associated with local firms’ (mis)fortune. In 2006, when Shanghai’s Party boss Chen Liangyu fell from grace, firms that were connected with the Shanghai local government experienced a significant five-day cumulative abnormal return of -2.29%. The magnitude of the connection-induced shock to the Shanghai economy (-0.64% of the city’s GDP) is comparable to how much Hitler’s rise added to the value of firms associated with the Nazi movement in Germany in 1933.<sup>6</sup> Interestingly, this time, Shanghai firms that were connected with the national government were not negatively affected.

How come that the downfall of Bo and Chen—both provincial Party chiefs—has differential effects on firms that had different types of connections? The results are unlikely to be a fluke of the data or a result of mismeasurement. I consistently use the

same measures of political connections in both cases, and the results are robust when using different event windows and considering confounding events.

My preferred explanation is a *politician's career shapes political connections* hypothesis, which states that politicians serve as brokers between certain political organizations and firms, and politician's career path determines to whom firms are connected. While Chen Liangyu spent his whole career in Shanghai as a local official, Bo Xilai was a central minister before becoming Chongqing's Party chief. By collecting fine-grained panel data on firms' board composition, I report evidence that most firms that were affected by Bo's removal built their connections with the national government after he was appointed Chongqing's Party chief, and that it is no coincidence that Bo, before arriving in Chongqing, worked in the national government as Minister of Commerce. This suggests that Bo served as a bridge between Chongqing firms and the national government, and that companies were betting on Bo—a political rising star—hoping that he would become a top leader in the Chinese Communist Party (CCP)'s 18th Congress. Unfortunately, Bo was purged right before the 18th Party Congress due to a murder scandal, and the firms that betted on him lost the most in market values.

Much recent research on political connections has focused on people elected to the legislature.<sup>7</sup> I, however, find no evidence that the removals had any effects on firms that had connections with either the national legislature or local legislatures. This finding might be China specific in that people in the executive branch are the real power holders, and the seat on the legislature is not the major source of power.<sup>8</sup> In many other autocracies, parliamentarians are more powerful than members of the state bureaucracy.<sup>9</sup> The weaker findings for parliamentary connections might also be the result of the limited

scope of the events: both events might only affect linkages in the Party-state but not in the legislature.

Last, taking advantage of the detailed working history data of board members, I am able to identify mechanisms through which connections help businesses. I show strong evidence that the firms that were most affected were the ones that hired a former regulator from the related government branch (“revolving door”). The evidence reveals “capture” in an authoritarian state.<sup>10</sup>

This study goes beyond previous exercises in three significant ways. First, I extend the time frame of most existing studies, which only examine the period of the exogenous shock, to investigate the political economy in each city prior to the shock, providing evidence that in Chongqing in particular, firms responded to the arrival of centrally-connected “princeling” Bo Xilai as Party boss by rapidly adding central-government-linked members to their boards. Politicians’ role as brokers adds a new dimension to the clientelism literature, which often treats politicians as one end of the clientelist ties rather than a link between two ends.<sup>11</sup>

Second, I analyze a wider set of possible connections and provide comparisons among them. Rather than asking whether a specific connection or kind of connection matters, I investigate different types of connections. In addition, while most prior studies have focused on connections at the national level,<sup>12</sup> I examine the hierarchy of connections.

Third, I utilize the richness of the board composition data to explore what kinds of state-linked board members they had, identifying the causal mechanism through which connections affect business.

### **Prior Studies on Political Connections**

Connections between politics and business are a global phenomenon. Dick Cheney, before elected America's forty-sixth Vice President, was chairman and CEO of Halliburton Company, one of the world's largest oilfield services companies. Silvio Berlusconi had built a property-and-media empire and reinvigorated one of the world's greatest soccer clubs, AC Milan, before elected Italy's Prime Minister. Political connections exist everywhere around the globe from Hitler's Germany,<sup>13</sup> Suharto's Indonesia,<sup>14</sup> Mahathir's Malaysia<sup>15</sup> to Great Britain<sup>16</sup> and United States<sup>17</sup>. In a cross-national study of politically connected firms, Faccio found connections to exist in thirty-five of the forty-seven countries in her sample.<sup>18</sup> Cultures from the east to the west designate specific terms—*Amakudari* (descent from heaven) in Japanese and *pantouflage* in French—to describe senior civil servants taking cushy corporate positions.

It is beyond doubt that political connections are important for firms: after their political patrons lose power through death or purge, connected firms often experience drops in market value<sup>19</sup>; conversely, when their patrons rise in power, connected firms reap the benefits<sup>20</sup>. Political connection is usually viewed as an inevitable precondition or consequence of corruption. As Faccio showed, connections are particularly common in countries that are perceived as being highly corrupt. She suggested that corruption and connection are complements, and when corruption is not helpful enough to obtain significant benefits, firms need to become personally involved in politics to “squeeze the state.”<sup>21</sup>

Theoretically, connections with politicians can be seen as a form of political

coalition.<sup>22</sup> Firms build coalitions with powerful politicians for political insurance against uncertainties<sup>23</sup>, to seek protections<sup>24</sup> or to eliminate competition<sup>25</sup>. And as many studies have shown, as political uncertainties and competition intensify, it is more efficient for interest groups to build “supermajorities” rather than “minimal winning coalitions” to win<sup>26</sup>. Applying this logic to political connections, it is expected that firms build broad connections across types and levels to achieve the most effective outcome.

A typical research design for the study of political connections often follows three steps: (1) construct some measure of political connectedness of listed firms (X), (2) identify some surprising events that could influence connected firms such as a leader’s death or exit and estimate the cumulative abnormal returns of firms around the event date (Y), and (3) regress Y on X.

This routine methodology has generated three characteristics of the political connection literature. First, few studies have asked where political connections come from. In a path-breaking analysis, Fisman constructed a Suharto Dependency Index developed by a consulting firm to measure firms’ connections with Suharto. However, he never explored how these connections were formed in the first place.<sup>27</sup> Second, most studies have only examined one level or one type of connections. Nearly all cross-national research only collected data on connections with national leaders or organizations. In the most systematic study of political connections to date, Faccio analyzed connections with ministers and the national parliament, and she admitted, “connections with local officials may be more important than connections with central government office-holders.”<sup>28</sup> In addition, nearly all studies have merely examined one type of connection, be it with members of parliament<sup>29</sup> or bureaucrats in the

government<sup>30</sup>. Third, most analyses stop after estimating the marginal effect of connections on firm value without further exploring the causal mechanisms.<sup>31</sup> We are left wondering whether connections help business via regulatory favors, tax benefits, bank loans or lax law enforcement.

### **Uncovering Connections Through an Event Study in China**

I move the literature forward by studying political connections in China, the country with prevalent connections between politicians and corporations.<sup>32</sup> I will first show that firms in China tend to build supermajoritarian coalitions by hiring former politicians or bureaucrats across types of political organizations and levels of government. I then estimate the rate of return by conducting an event study of two significant political events in China in the last decade: the removals of Chen Liangyu and Bo Xilai.

Firms are expected to lose their investment once there is a regime change. Firms' market values drop after a leadership change for various reasons other than political connections. It might be because the outgoing leader is a good leader and is being replaced by a bad leader, which depresses investors' confidence in the economy. Or a sudden leadership change might reveal the system's political uncertainties or volatilities, leading investors to update their prior beliefs about politics with this new information. A promising empirical strategy should be able to tease out these "noises" and isolate the effect of political connections. As Khwaja and Mian suggested, we need to move away from simply "single differences" to more elaborate comparisons that involve "double differences."<sup>33</sup>

Imagine that a leader's removal leads to a domino effect of regime reshuffle, and

firms located in the leader's jurisdiction experience negative returns for various reasons discussed above (first difference). However, if politically connected firms lose more market values than unconnected firms, the "additional difference" is more likely to be created by connections between firms and the regime. This strategy's strength relies on arguing (1) that I have indeed correctly identified situations in which political connections create an additional difference, and (2) that these situations arise from factors that are exogenous.<sup>34</sup>

The fall of both Chen Liangyu and Bo Xilai involved decisions made by people at the very top. The available evidence shows that Chen Liangyu misallocated social security funds, and that Bo Xilai was involved in a murder case, neither of which was related to firms hiring former politicians.

### ***Data***

A total of 133 companies registered in Shanghai and 35 companies registered in Chongqing were listed on the Shanghai Stock Exchange or the Shenzhen Stock Exchange in 2006 and 2012, respectively. I obtained the biographical information of all 3,029 board members of these companies (chairperson, president, vice-president, CEO, executive director, non-executive director or secretary) from Wind Info, a leading integrated service provider of financial data based in Shanghai.<sup>35</sup> I then checked the reliability and consistency of the Wind data using public information found in a random sample of companies' annual reports to verify its accuracy.<sup>36</sup> I then manually coded the career information of each board member in each firm to determine whether a member was politically connected.<sup>37</sup> This "board" approach is consistent with the identification of

political connections in the literature.<sup>38</sup>

Unlike prior studies that only examine one level or one type of connection, I distinguish between seven types of connections. I first differentiate connections with national institutions from those with local institutions. Studies have shown different incentive structures for politicians under a decentralized vs. centralized systems<sup>39</sup>, and as Shleifer and Vishny showed, “decentralized corruption” is more costly for society than “centralized corruption.”<sup>40</sup>

The Chinese reforms have transitioned from “decentralization”<sup>41</sup> to “recentralization”<sup>42</sup>, and many marked the 1994 fiscal reform as a turning point<sup>43</sup>. In addition, the Chinese bureaucracy is fragmented by conflicting goals and functions between departments, interlocking directorate, and complex vertical versus horizontal responsibilities.<sup>44</sup> These institutional characteristics incentivize firms to build broad coalitions. It is, therefore, unwise to assume that China is “federalism: Chinese style”<sup>45</sup> and therefore to expect firms to build connections only with local governments. As Yang pointed out, this focus on decentralization has “gone too far.”<sup>46</sup> We expect to see a broader coalition built by firms with both the national and local governments.

I also distinguish connections with the government from those with the legislature, while most existing studies have fused them.<sup>47</sup> The logics are different. Political connections with the government can be supplied by politicians who “descend from heaven” through retirement. In China, Deng Xiaoping carefully and gradually enforced policies and norms of cadre retirement in the late 1970s.<sup>48</sup> Many officials also resign from public office to take a corporate job for two reasons.<sup>49</sup> One is simply that not everyone gets promoted to the top in the bureaucracy.<sup>50</sup> The second is the differential

salaries of public and private sector jobs.<sup>51</sup>

Another way to establish political connections is for business people to enter politics (“wealth into power”).<sup>52</sup> Legislatures in autocracies have intentionally incorporated opposition forces including the business class into politics to co-opt potential threats to the regime.<sup>53</sup> In China, the CCP has aggressively involved private entrepreneurs in politics by making them Party members or People’s Congress representatives. These “red capitalists” are shown to be more sympathetic than non-Party members to the authoritarian regime.<sup>54</sup>

A board member could be connected with one of the following organizations: the national government, a local government (from province to township), the national parliament (including the National People’s Congress (NPC) and the Chinese People’s Political Consultative Conference), a local parliament (including local People’s Congress and local People’s Political Consultative Conference), the National CCP Congress, a local CCP Congress, or the People’s Liberation Army (PLA). For local connections, I also determine whether the connection was in the province in which the company was registered or not.

A board member is considered to be connected with one of these organizations if she was previously or currently an employee or member. I define government connections very strictly, excluding any semi-governmental organizations such as research institutes affiliated with a government organization.<sup>55</sup> A company is connected if one of its board members is connected.<sup>56</sup>

Following this procedure, I find that firms in Shanghai and Chongqing had a wide range of connections across the board that showed signs of “supermajorities” rather than

“minimal-winning coalitions.”<sup>57</sup> And firms were more connected with the government than parliament, which is a more common form of connection in democracies.<sup>58</sup> Table 1 summarizes the data.

**Table 1: Politically Connected Firms in Shanghai (2006) and Chongqing (2012)**

Type	Shanghai 2006		Chongqing 2012	
	Frequency	%	Frequency	%
Connected to the national government	22	16.54	7	20.00
Connected to the local governments	55	41.35	25	71.43
Connected to the national Parliament	6	4.51	10	28.57
Connected to local parliaments	21	15.79	21	60.00
Connected to the National Party Congress	0	0.00	0	0.00
Connected to local Party Congresses	0	0.00	1	2.86
Connected to the People's Liberation Army	7	5.26	6	17.14
<b>Total</b>	<b>133</b>	<b>100.00</b>	<b>35</b>	<b>100.00</b>

*Notes:* These categories are not mutually exclusive. A firm can have connections, say, with both the national government and the national parliament.

I have different theoretical expectations about how these connections would impact firm values confronting a leadership change. I expect government connections to be the most vulnerable because of prevalent “factionalism” in the appointment of officials<sup>59</sup>. As political winds shift, a partial regime change often follows a major official’s removal. For example, after Bo stepped down, at least 21 bureau-level officials were removed.<sup>60</sup> In a systematic study of political clientelism, Ang estimated that when a provincial leadership transition occurs, it will cause a change of 0.51 public employees per 1,000 residents or 22,813 positions in the bureaucracy, on average.<sup>61</sup> Parliament connections, however, are less vulnerable to leadership change, because firms rely on the reputation they build through serving in parliament,<sup>62</sup> and the fall of a regional leader does not affect the reputation of a firm. Military connections, I predict, are the most robust because China’s civilian government is separate from the army, so a civilian’s

removal should not affect the PLA. So I expect firms connected with the government to be most negatively affected by the political events.

Two caveats are in order. My measure of connections is far from comprehensive. First, in some instances, politicians' families may control firms through share-holding, nominee accounts, or shell entities. As a New York Times article shows, China's former Premier Wen Jiabao's mother was a large shareholder of Ping An Insurance.<sup>63</sup> However, there is no comprehensive and accurate disclosed financial information for Chinese politicians. Nonetheless, my "board" approach can produce results that resonate well with unobserved connections. For example, using this procedure, Ping An Insurance is coded as a highly connected firm: two board members are connected with the national government, five with local governments, and one with the national parliament. Second, there are many ways to build a connection, such as friendship, marriage, and bribery. I only focus on a direct measure that is observable for all firms.

### *An Event Study*

I conduct an event study to estimate the rate of return for political connections to Chinese firms. Event studies use financial market data to measure the impact of a specific event on the value of a firm. The rationale of such a study is based on the "efficient market" assumption that, "given rationality in the marketplace, the effects of an event will be reflected immediately in security prices."<sup>64</sup> Event studies have been widely applied to a variety of economic events, and have recently gained popularity in the study of political events.<sup>65</sup>

### *The Events*

I study two significant political events in China: the removal of two Politburo members (Shanghai Party secretary Chen Liangyu in September 2006 and Chongqing Party secretary Bo Xilai in March 2012).<sup>66</sup>

Chen Liangyu worked in Shanghai for his entire public life, serving as mayor from 2001 to 2003. He was elected to the Politburo in November 2002. From February 2003 to September 2006, he was the Party chief of Shanghai. In contrast, Bo Xilai came to prominence through his tenures as the mayor of Dalian and then the governor of Liaoning Province. From 2004 to November 2007, he served in the central government as Minister of Commerce. Between 2007 and 2012, he served as a member of the Politburo and as the Party chief of Chongqing. The son of Bo Yibo, one of the “Eight Elders” of the Communist Party, Bo Xilai is one of the “princelings” of Chinese politics.

On September 25, 2006, the Chinese official media announced the dismissal and detention of Chen Liangyu because of his involvement in the Shanghai social security fund scandal.<sup>67</sup> Chen made his last public appearance as the Shanghai Party boss on the evening of September 23, and the purge was kept strictly confidential until September 25.<sup>68</sup>

On February 9, 2012, the Chinese media reported that Chongqing’s police chief Wang Lijun traveled to the U.S. consulate in the nearby city of Chengdu, and as was later revealed, Wang brought evidence implicating Bo Xilai and his wife in the murder of a British businessman. Bo’s political career was largely unaffected until mid-March, and many observers believed that he would merely have a soft-landing because of his prominent princeling status and wide support among the Chinese leftists.<sup>69</sup> Bo later

appeared in NPC meetings from March 5 to 14 and held a high-profile press conference on March 9. He made his last public appearance as the Chongqing Party boss in the closing ceremony of the NPC on the morning of March 14. However, later that day, during then-Premier Wen Jiabao's press conference, Bo was reprimanded: Wen urged the Chongqing leadership to "engage in diligent reflection and draw lessons from the [Wang Lijun] incident."<sup>70</sup> On March 15, 2012, the Chinese official media announced the removal of Bo Xilai from his post as Party chief in Chongqing.<sup>71</sup>

Please note that my measures of connections do not indicate firms' personal connections with Chen Liangyu or Bo Xilai, but rather connections with the "regimes" under Chen and Bo. The focus on ties with a regime distinguishes this study from some earlier studies that examine ties with individual politicians.<sup>72</sup> If I could find significant results using regime ties, then the implications of this study are more profound because it implies that informal institutions, such as political connections, have subverted formal institutions, and businesses have indeed "squeezed the state."

### *Procedure*

I follow the standard event study procedure to estimate the market-adjusted cumulative abnormal return for the five-day period (event window) around the event dates (days -2 to +2).<sup>73</sup> The event date for Chen's removal is straightforward: September 25, 2006, the day of the announcement and the first trading day after his last public appearance. The event date for Bo's removal is tricky because there were many confounding events. I decide to use March 14, 2012 as the event date because Wen Jiabao's remarks signaled the collective decision of the Chinese leadership that Bo should be responsible for the Wang

Lijun incident, and Bo still appeared in public right before the press conference. To stock market investors, Wen’s rebuke was more of a surprise, and by the time of the removal, most people were prepared. One concern might be that the event should be dated much earlier, to the Wang Lijun incident. I will, however, later show that the Wang incident had little impact on the stock market.

I included in the analysis all the listed firms that were registered in Shanghai as of 2006 and Chongqing as of 2012 that have daily return data.<sup>74</sup> Firms’ political connections were measured in 2006 for Shanghai and 2012 for Chongqing. This criterion gave me 121 firms in Shanghai and 27 firms in Chongqing.<sup>75</sup>

I then estimate the abnormal return and cumulative abnormal return during the event window [-2, 2] using the standard event study methodology. Normal return is the expected return without conditioning on the event taking place. Abnormal return (AR) is defined as the actual ex post return of security during the event window [-2, 2] minus the normal return of the firm during the event window [-2, 2]. I use the estimation window [-110, -10] to estimate the normal return based on the “market model.”<sup>76</sup>

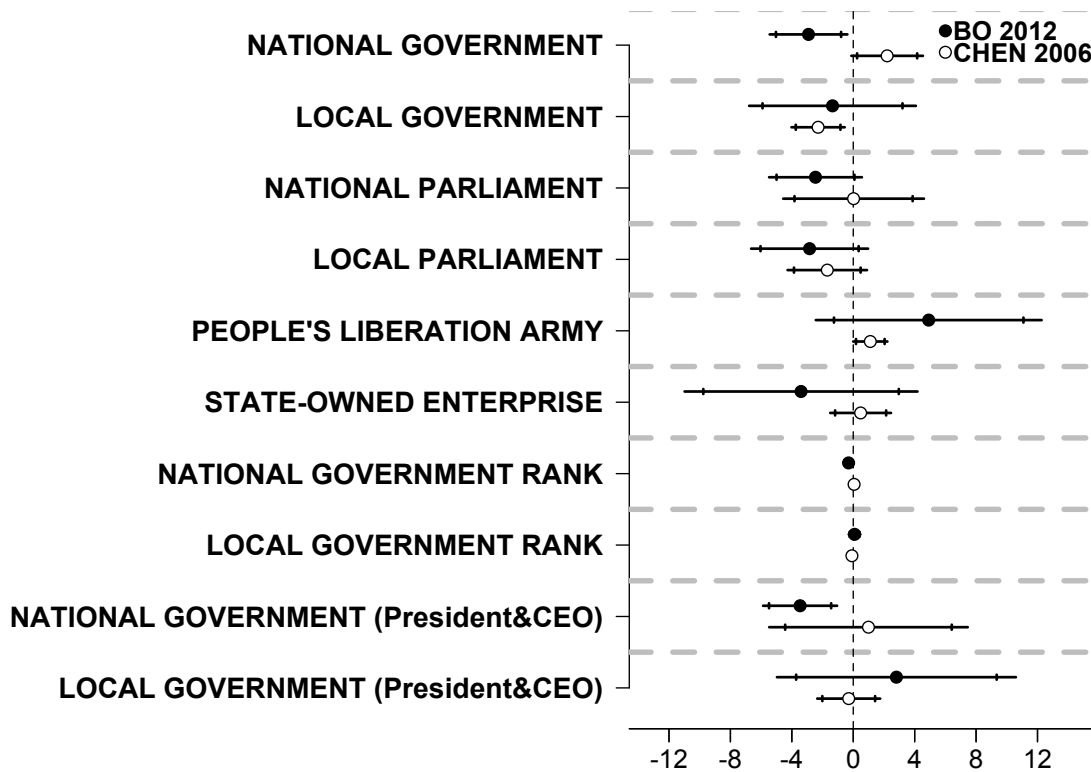
The following specification is estimated using OLS to test the argument that political connections determine firm value:

$$CAR_{i\tau} = \alpha + \beta CONNECTION_i + XB + \varepsilon_{i\tau}, \quad (1)$$

where  $CAR_{i\tau}$  is the estimated cumulative abnormal return of firm  $i$  during event window  $\tau$  ([-2, 2]),  $CONNECTION_i$  is one of the seven measures of political connections (all indicators), and  $X$  includes a number of controls, such as AGE, to consider the maturity of a firm and industry fixed effects to control for sectoral variations<sup>77</sup>. Robust standard errors are estimated to tackle heteroskedasticity.

*Results*

Figure 1 summarizes the results. Each line representing a separate regression, the black dots are the estimated coefficients for the Bo Xilai 2012 event, and the white dots represent the same for the Chen Liangyu 2006 event.<sup>78</sup> The lines represent the 95% confidence intervals, and the small bars the 90% confidence intervals. As the figure shows, around the time when Bo was removed, connected firms experienced a five-day cumulative abnormal return of -2.91% compared to firms not connected with the national government, and this difference is significant at the 0.05 level. Surprisingly, firms' connections with the Chongqing local government did not make a difference to their cumulative abnormal returns. Other types of connections, including connections with parliament and the PLA, did not matter as much.<sup>79</sup>



**Figure 1: The Value of Political Connections**

*Notes:* Each line represents a separate regression. The dependent variable is the five-day cumulative abnormal return. NATIONAL GOVERNMENT, LOCAL GOVERNMENT, NATIONAL PARLIAMENT, LOCAL PARLIAMENT, and PEOPLE'S LIBERATION ARMY are all dummy variables that indicate whether a firm is connected with these organizations. STATE-OWNED ENTERPRISE is a dummy variable measuring whether the state was the ultimate shareholder of a firm. NATIONAL GOVERNMENT RANK and LOCAL GOVERNMENT RANK are continuous variables measuring the ranks of positions according to the fifteen-level hierarchy specified in China's Civil Service Code. NATIONAL GOVERNMENT (President & CEO) and LOCAL GOVERNMENT (President & CEO) are indicators measuring whether the firm's Chairman or CEO used to work in the national or local government. Every regression controls for AGE and industry fixed effects. The black dots are estimates using the Chongqing sample; the white dots are estimates using the Shanghai sample. Lines represent the 95% confidence intervals, and the small bars 90% confidence intervals, both of which are based on robust standard errors. The results that generate this graph are presented in Tables 13 and 14 in the web appendix.

Conversely, around the time when Chen was removed, it was locally connected firms that were affected: firms connected with the Shanghai local government experienced a five-day cumulative abnormal return of -2.29%, and this effect is significant at the 0.05 level. Other types of connections are not significant using 0.05 as a bar.<sup>80</sup>

How big are the effects substantively? Taking into account the market capitalization of the affected firms and the size of the local economies, during the five trading days around Bo's removal, the Chongqing economy experienced a negative connection-induced shock of \$311 million, which was 0.17% of the city's GDP. In Shanghai in 2006, during the five days around Chen's removal, connected firms lost \$829 million, which was 0.64% of the city's GDP. The magnitude of the shock is almost equal to how much Hitler's rise added to the value of firms connected with the Nazi movement in 1933<sup>81</sup>. These numbers are not, however, the full value of connections, the estimation of which would require a complete regime change.

To test whether state-owned enterprises (SOEs) were affected disproportionately, I also regress CUMULATIVE ABNORMAL RETURN on STATE-OWNED

ENTERPRISE, an indicator measuring whether the state was the ultimate shareholder of a firm.<sup>82</sup> As Figure 1 shows, that variable does not have a significant effect at the 0.05 level on firm value. As some earlier studies suggest, political connection might play a different role in SOEs and private companies. For example, Fan and his coauthors argued that SOE managers appointed by the government oversee the operation of the company and, therefore, bring in negative effect on firm performance. In contrast, connections benefit private companies by “greasing the wheels.”<sup>83</sup> To test this possibility, I interact my connection variables with SOE, but I don’t find an interactive effect of political connections and SOE.<sup>84</sup>

Does it matter if a board member was a high-ranking official? I coded the connected board members’ rank according to the Chinese Civil Service Code.<sup>85</sup> NATIONAL GOVERNMENT RANK and LOCAL GOVERNMENT RANK measure the total ranks of all the connected board members of each firm.<sup>86</sup> As Figure 1 shows, NATIONAL GOVERNMENT RANK is significantly negative in Chongqing but not in Shanghai, and LOCAL GOVERNMENT RANK is insignificant everywhere. In Chongqing, a firm with, say, a former minister would experience a greater -0.30% cumulative abnormal return than a firm with a deputy minister, holding everything constant. This suggests that the power associated with the position can also make a difference to firm value.

Some recent studies also use the political connections of major managers (a “leader” approach), such as President and CEO, rather than board members to measure a firm’s connectedness.<sup>87</sup> I argue that the “board” approach is a more accurate measure in the Chinese context, because many retired officials become independent directors (board

members but not major managers), but they play a very important role in bridging their firms and their former governmental organizations. To test whether the events affected firms that had politically connected Presidents or CEOs, I create two new variables—NATIONAL GOVERNMENT (President & CEO) and LOCAL GOVERNMENT (President & CEO)—to measure whether a firm’s President or CEO used to work in the national or local government. This new set of connected firms is a subset of firms that was coded using the “board” approach. The last two rows in Figure 1 show the results using these two new variables as independent variables. The only significant result is that firms in Chongqing that had Presidents or CEOs who used to work in the national government were affected by Bo’s downfall, which is consistent with earlier findings. Shanghai firms that had connected Presidents or CEOs were not affected.

### ***The Betting***

How should we interpret the opposite findings—national connections mattered in Chongqing, whereas local connections mattered in Shanghai? There are three possible explanations: (1) national connections were more important to firms in Chongqing than in Shanghai (regional variation), (2) national connections were more important to firms in 2012 than in 2006 (temporal variation), and (3) Bo Xilai had central government experience, while Chen Liangyu spent all his career in Shanghai (individual variation).

To sort out these possibilities that mix time, space, and individuals, I collected panel data of listed firms in Shanghai and Chongqing from 2000 to 2012.<sup>88</sup> I followed the same procedure of coding the biographies of board members to identify connected firms. The data enable me to rule out the first possibility: if national connections were more

important to firms in Chongqing than in Shanghai, we should expect to see more nationally connected firms in Chongqing. However, Shanghai (26%) had more nationally connected firms than Chongqing (22%) in 2012.<sup>89</sup> For explanations (2) and (3), I find that from 2006 (one year before Bo's arrival) to 2012 (the year of his removal), Chongqing experienced an abnormally rapid increase in firms connected with the national government (100% growth rate) compared to Shanghai (41% growth rate). However, during the same period, the percentage of firms connected with the Chongqing local government only increased by 20%, whereas in Shanghai this percentage grew by 51%. Chongqing's change is not only abnormal compared to Shanghai; it is also unprecedented: in 2000, Chongqing had 0.09% firms connected with the national government, and the growth rate from 2000 to 2006 was 50%.<sup>90</sup>

Considering the many differences between Chongqing and Shanghai, such as geographic, historic, economic structure, and population, this comparison might not be insightful. I thus conduct a "most similar system design" to compare Chongqing with its neighboring province Sichuan. Several facts make this comparison more convincing: both Chongqing and Sichuan are located in Southwest China,<sup>91</sup> both regions share a similar history and culture, and more importantly, Chongqing, before becoming a provincial-level city in 1997, was a municipality within Sichuan Province. I then collected a panel data set of listed firms in Sichuan from 2006 to 2012.<sup>92</sup> The percentage of nationally connected firms in Sichuan increased by only 15% in these six years. Table 2 summarizes all the comparisons.

**Table 2: Comparisons of Chongqing, Shanghai, and Sichuan**

<b>Region</b>	<b>Period</b>	<b>Growth in the # of firms that had a local government connection</b>	<b>Growth in the # of firms that had a national government connection</b>
Chongqing	2000-2006	50%	50%
	2006-2012	20%	100%
Shanghai	2006-2012	51%	41%
Sichuan	2006-2012	0%	15%

These results cannot completely rule out possibility (2), because in all three provinces the number of nationally connected firms increased. However, the abnormal growth in Chongqing makes possibility (3) more sensible: Bo’s prior job as Minister of Commerce and his family connections might make him a bridge between Chongqing firms and the national government. There is some anecdotal evidence suggesting that this is the case. A recent corruption scandal involving Jiang Jiemin—the former director of the State Assets Commission—revealed that Jiang helped Bo obtain licenses for Chongqing firms and establish oil plants in Chongqing while Bo was the Party chief.<sup>93</sup> Bo’s removal broke the ties between Chongqing firms and Beijing, which caused the stock market reaction.<sup>94</sup>

The findings suggest that some firms in Chongqing were betting on Bo Xilai, hoping that he would be promoted to the Politburo Standing Committee—the peak of China’s power hierarchy—in 2012 during the Party’s 18th Congress. And Bo was indeed a very ambitious political star because of his charismatic personality and princeling status.<sup>95</sup> However, the odds turned against him, and against the political “gamblers.”

### ***Mechanisms***

What are the mechanisms through which connections help businesses? I first employ an

*ad hoc* approach to identify causal mechanisms by collecting information on what exactly these former bureaucrats did while in government, and then subject the data to regression analysis to compare firms with and without a particular sort of bureaucrat.

To identify possible mechanisms, I focus on firms that experienced negative cumulative abnormal returns during these two events and collected information about their business activities. I then coded their connected board members' previous governmental positions into eight categories: GENERALIST, REGULATOR, BANKER, TAX COLLECTOR, LAW ENFORCER, LICENSER, LABOR OFFICIAL, and OTHER.<sup>96</sup> GENERALIST is an official who has broad contacts in the political system, including Party chiefs and executives (governors, mayors, heads of Party organization departments). REGULATOR is an official who previously worked in a government organization that directly regulates the industry in which the firm conducts business (“revolving door”), for example, a former land bureau official working in a real estate company. BANKER is an official who worked in the People’s Bank of China—China’s central bank—and its local branches or finance departments that coordinate loans. TAX COLLECTOR is an official who worked in the tax or audit bureau. LAW ENFORCER is an official who worked in one of the following organizations: public security, court, procuratorate, or legal bureau.<sup>97</sup> LICENSER is an official who worked in the industry and commerce administration that is responsible for issuing licenses and permits for new businesses. LABOR OFFICIAL is someone who worked in the labor bureau. OTHER includes officials who do not belong to any of the above categories.<sup>98</sup>

Table 3 lists the percentages of these categories in Shanghai and Chongqing, respectively. Obviously, “revolving door”—a regulator taking a position in a regulated

firm—is the most common form of connection. A “captured” regulator can do various things to help a firm, including granting exclusive entry, making favorable policies, sanctioning competitors, approving new projects, and manipulating prices.<sup>99</sup> Second is GENERALIST, who can provide an “umbrella” to protect business. BANKER, TAX COLLECTOR, and LAW ENFORCER are also important. I did not find roles played by LICENSER and LABOR OFFICIAL, but this does not mean that they are not important. Connections with licensing authorities are critical for investors who want to open a new business; the zero appearance in my data is probably because these firms are already well established. Connections with labor officials are important when a collective labor dispute occurs, but most labor disputes are settled internally within the firm<sup>100</sup>.

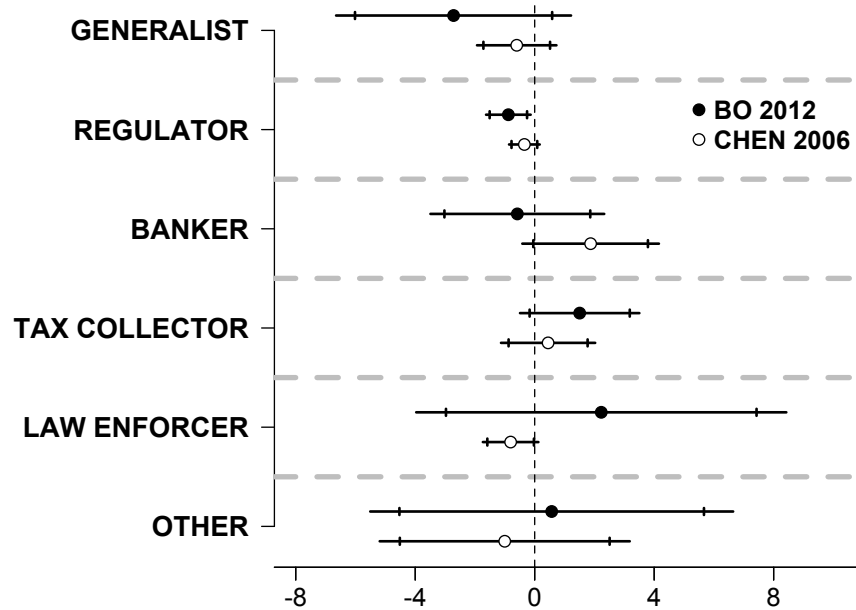
**Table 3: Positions of Former Government Officials in Affected Firms**

Position	Shanghai 2006		Chongqing 2012	
	Frequency	%	Frequency	%
GENERALIST	26	24.53	10	11.49
REGULATOR	62	58.49	40	45.98
BANKER	3	2.83	7	8.05
TAX COLLECTOR	5	4.72	10	11.49
LAW ENFORCER	3	2.83	9	10.34
LICENSER	0	0.00	0	0.00
LABOR OFFICIAL	0	0.00	0	0.00
OTHER	7	6.60	5	5.75
TOTAL	106	100.00	81	100.00

I then conduct regression analysis to compare the cumulative abnormal returns of firms with and without a particular type of former bureaucrat. Each line represents a separate regression; Figure 2 presents the result. The regressions confirm the findings in the descriptive analysis: firms with former generalists and regulators experienced higher negative returns two days before and after the event date, although the effect of GENERALIST is insignificant in both events, and the effect of REGULATOR is

insignificant in Shanghai. The effects of other mechanisms are not significant, except that firms with former law enforcers had significantly negative returns in Shanghai.<sup>101</sup>

These results are only suggestive, because they are strongly associated with the feature of the event (for example, Chen’s dismissal might only have affected the legal organizations but not the Bureau of Labor in Shanghai). The wide range of “captured” agencies resonates well with the “buying supermajorities” argument<sup>102</sup> and the “fragmented authoritarianism” argument<sup>103</sup> that firms must build over-sized coalitions.



**Figure 2: Testing Causal Mechanisms**

*Notes:* Each line represents a separate bi-variate regression. The dependent variable is the five-day cumulative abnormal return. GENERALIST, REGULATOR, BANKER, TAX COLLECTOR, LAW ENFORCER, and OTHER are all continuous variables measuring how many of these former bureaucrats a firm has. The black dots are estimates using the Chongqing sample; the white dots are estimates using the Shanghai sample. Lines represent the 95% confidence intervals, and the small bars 90% confidence intervals, both of which are based on robust standard errors. The results that generate this graph are presented in Tables 15 and 16 in the web appendix.

***Robustness Checks***

I conduct five robustness checks. First, one might be concerned that the information about the purges might be leaked before the event dates, or one might wonder what happened to the firms after the event window. I extend the event window to [-10, 10], and see how the results change every day using daily ABNORMAL RETURN as the dependent variable. No significant results are found outside the original [-2, 2] event window. The results also imply that these shocks were transient.<sup>104</sup>

Second, one might worry that the Wang Lijun incident (visiting the U.S. consulate in February), which predated Bo's removal, might "suppress" part of the Bo effect. To see whether the Wang incident had any impact in Chongqing, I specify February 9, 2012—the date of the first official report of Wang's treason—as a new event date and conduct an event study following the same procedure. Nothing significant happened.<sup>105</sup>

Third, one might think that there were some confounding events going on near the time they were purged. I searched major newspapers to see whether there were major national or local events around September 25, 2006 or March 14, 2012.<sup>106</sup> No major events happened in Shanghai. However, on March 14, 2012, since it was then-Premier Wen's press conference, he announced to tighten control of the real estate market.<sup>107</sup> It is possible that this remark influenced the stock prices of real estate companies. I therefore excluded all the real estate companies in the Chongqing sample, and the results did not change much, except that the effect of NATIONAL GOVERNMENT became less significant, but it still passes the 0.1 level. This implies that Wen's remark might be counted in the overall effect, but it does not change my basic conclusions.<sup>108</sup>

Fourth, one might ask, whether—since Bo Xilai spent his early political career in Liaoning Province, first in the city of Dalian (1985-2000) and then appointed governor of

Liaoning (2000-2004)—his downfall had any impact on Liaoning? To answer this question, I collected data of firms registered in Liaoning Province and tested whether they were affected by Bo’s removal. Neither firms connected with the national government (coefficient = -0.03, robust standard error = 1.64) nor those connected with the Liaoning local government (coefficient = 1.16, robust standard error = 1.39) were affected by this event. A dummy variable indicating firms registered in Dalian—the “launch pad” of Bo’s political career—has no significant effect either (coefficient = 0.37, robust standard error = 1.60).

Last, one interesting extension would be to investigate whether firms connected with the “winners” of the purges experienced positive returns. While there was no obvious winner in the Chen event, some pundits believed that Wang Yang—then Party chief of Guangdong Province—was Bo’s political rival and might benefit from Bo’s purge.<sup>109</sup> I collected the information of all the 247 listed firms in Guangdong, but I do not find any significant effects of any types of connections in Guangdong using the same event study procedure.<sup>110</sup>

## **Conclusion**

The study generates three observations that differ from findings in prior studies. First, I show that connections are not exogenous, as previous studies have suggested. Firms strategize about when and with whom to build connections, and this strategy is endogenous to the career prospects of politicians. Second, not all types or levels of connections matter. Aggregating connections (as prior research did) fails to detect the nuances of different connections. And there is a qualitative difference between

connections in democracies and autocracies: while it is important to connect with members of parliament in democratic settings<sup>111</sup>, it is crucial to connect with the government in autocracies. Disaggregating types and levels of connections shows that firms prefer to buy “supermajorities” rather than “minimal-winning coalitions” to tackle political uncertainties and competitions. Third, the most important mechanism through which connections facilitate businesses is distorting regulations.

Some broader implications can be drawn from this research. Many high-performing authoritarian regimes have been characterized as “developmental states” that are highly embedded but not captured in the economy.<sup>112</sup> However, a theory about high-performing autocracies needs to explain two interrelated phenomena simultaneously: the rapid growth in the early stages and the stagnation afterwards. Indeed, “embeddedness” has benign effects on a “backward” economy<sup>113</sup>. However, the “lost decades” of Japan, the Asian Financial Crisis that hit most Southeast Asian nations in 1997, and the recent slowdown of China’s economy pose challenges to the “developmental state” model, which emphasizes strong state intervention. The marriage between power and wealth presents a peril to sustainable economic growth as “cronyism” rather than efficiency becomes the principle of investment decisions.<sup>114</sup> As Ong argued, the Chinese state has decayed from a developmental state to a clientelist state with weakened state autonomy and capacity.<sup>115</sup> And as this study shows, the “embeddedness” is fragile, facing political uncertainties that are common in autocracies.

**Notes:**

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<sup>1</sup> The word “princeling” refers to the descendants of prominent and influential senior communist officials in the People’s Republic of China.

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- <sup>2</sup> A firm is considered to be connected with the national government if at least one of its board members is or was an employee of a national government organization.
- <sup>3</sup> A firm is considered to be connected with the local government if at least one of its board members is or was an employee of a local (province and below) government organization.
- <sup>4</sup> Raymond Fisman, “Estimating the Value of Political Connections,” *American Economic Review* 91(4) (2001): 1095–1102; Mara Faccio, “Politically Connected Firms,” *American Economic Review* 96(1) (2006): 369–386.
- <sup>5</sup> David Wank, *Commodifying Communism: Business, Trust, and Politics in a Chinese City* (New York: NY: Cambridge University Press, 1999).
- <sup>6</sup> Thomas Ferguson and Hans-Joachim Voth, “Betting on Hitler—The Value of Political Connections in Nazi Germany,” *The Quarterly Journal of Economics* 123(1) (2008): 101–137.
- <sup>7</sup> Brian E. Roberts, “A Dead Senator Tells No Lies: Seniority and the Distribution of Federal Benefits,” *American Journal of Political Science* 34(1) (1990): 31–58; Seema Jayachandran, “The Jeffords Effect,” *Journal of Law & Economics* 49(2) (2006): 397–425; Andrew C. Eggers and Jens Hainmueller, “MPs for Sale? Returns to Office in Postwar British Politics,” *American Political Science Review* 103(4) (2009): 513–533; Rory Truex, “The Returns to Office in a “Rubber Stamp” Parliament,” *American Political Science Review* 108(02) (2014): 235–251.
- <sup>8</sup> Some recent research argues otherwise, please see Truex.
- <sup>9</sup> Jennifer Gandhi, *Political Institutions Under Dictatorship* (New York, NY: Cambridge University Press, 2008).
- <sup>10</sup> George J. Stigler, “The Theory of Economic Regulation,” *The Bell Journal of Economics and Management Science* 2(1) (1971): 3–21.
- <sup>11</sup> Susan C. Stokes, “Perverse Accountability: A Formal Model of Machine Politics With Evidence From Argentina,” *American Political Science Review* 99 (03) (2005): 315–325; Allen Hicken, “Clientelism,” *Annual Review of Political Science* 14 (2011): 289–310.
- <sup>12</sup> Fisman; Faccio; Ferguson and Voth; Eggers and Hainmueller; Truex.
- <sup>13</sup> Ferguson and Voth.
- <sup>14</sup> Fisman.
- <sup>15</sup> Simon Johnson and Todd Mitton, “Cronyism and Capital Controls: Evidence from Malaysia,” *Journal of Financial Economics* 67(2) (2003): 351–382.
- <sup>16</sup> Eggers and Hainmueller.
- <sup>17</sup> Roberts; Daron Acemoglu, Simon Johnson, Amir Kermani and Todd Kwak, James Mitton, “The Value of Connections In Turbulent Times: Evidence from the United States,” *Working Paper* (2014).
- <sup>18</sup> Faccio.
- <sup>19</sup> Fisman; Johnson and Mitton.
- <sup>20</sup> Ferguson and Voth.
- <sup>21</sup> Faccio, p. 5380.
- <sup>22</sup> William H. Riker, *The Theory of Political Coalitions* (New Haven, CT: Yale University Press, 1962).
- <sup>23</sup> Ibid.

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- <sup>24</sup> Gene M. Grossman and Elhanan Helpman, “Protection for Sale.” *The American Economic Review* 84(4) (1994): 833–850.
- <sup>25</sup> Tim Groseclose and James M. Snyder, “Buying Supermajorities.” *American Political Science Review* 90(2) (1996): 303–315.
- <sup>26</sup> Riker; Groseclose and Snyder.
- <sup>27</sup> Fisman.
- <sup>28</sup> Faccio, p. 372.
- <sup>29</sup> Jayachandran.
- <sup>30</sup> Acemoglu et al.
- <sup>31</sup> Exceptions include Eggers and Hainmueller, who show that political connections are formed when firms hire retired British Members of Parliament, and Truex who shows that “reputation boost” is a major mechanism linking political connections and firm values.
- <sup>32</sup> Joseph PH Fan, Tak Jun Wong and Tianyu Zhang, “Politically Connected CEOs, Corporate Governance, and Post-IPO Performance of China’s Newly Partially Privatized Firms,” *Journal of Financial Economics* 84(2) (2007): 330–357.
- <sup>33</sup> Asim Ijaz Khwaja and Atif Mian, “Tracing the Impact of Bank Liquidity Shocks: Evidence from an Emerging Market.” *American Economic Review* 98(4) (2008): 1413–1442, p. 588.
- <sup>34</sup> For a more detailed discussion of this strategy, please see Asim Ijaz Khwaja and Atif Mian, “Rent Seeking and Corruption in Financial Markets,” *Annual Review of Economics* 3(1) (2011): 579–600 and for an application of such a strategy, please see Fisman.
- <sup>35</sup> <http://www.wind.com.cn/En/> (Accessed August 2, 2013).
- <sup>36</sup> It is important to note that this information is publicly available on the Internet as well, so stock market investors have the same information.
- <sup>37</sup> Every board member was double-coded by a group of research assistants and me. Section 1.1 in the web appendix shows examples of board members’ biographies.
- <sup>38</sup> Agrawal and Knoeber 2001; Narjess Boubakri, Jean-Claude Cosset and Walid Saffar, “Political Connections of Newly Privatized Firms.” *Journal of Corporate Finance* 14(5) (2008): 654–673.
- <sup>39</sup> Daniel Treisman, *The Architecture of Government: Rethinking Political Decentralization* (New York, NY: Cambridge University Press, 2007).
- <sup>40</sup> Andrei Shleifer and Robert W Vishny, “Corruption,” *The Quarterly Journal of Economics* 108(3) (1993): 599–617.
- <sup>41</sup> Susan L. Shirk, *The Political Logic of Economic Reform in China* (Berkeley, CA: University of California Press, 1993); Barry Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge, MA: The MIT Press, 2007).
- <sup>42</sup> Naughton, p. 101.
- <sup>43</sup> Christine PW Wong, “Central-Local Relations Revisited: The 1994 Tax- Sharing Reform and Public Expenditure Management in China,” *China Perspectives* (2000): 52–63.
- <sup>44</sup> Kenneth G. Lieberthal, “Introduction: The ‘Fragmented Authoritarianism’ Model and Its Limitations,” In *Bureaucracy, Politics and Decision Making in Post-Mao China*, ed. Kenneth G. Lieberthal and David M. Lampton (Berkeley, CA: University of California

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Press, 1992), 1–22; Andrew Mertha, ““Fragmented Authoritarianism 2.0”: Political Pluralization in the Chinese Policy Process.” *The China Quarterly* 200 (2009): 995–1012.

<sup>45</sup> Gabriella Montinola, Yingyi Qian and Barry Weingast, “Federalism, Chinese Style: The Political Basis for Economic Success.” *World Politics* 48(1) (1995): 50– 81.

<sup>46</sup> Dali L. Yang, “Economic Transformation and Its Political Discontents in China: Authoritarianism, Unequal Growth, and the Dilemmas of Political Development,” *Annual Review of Political Science* 9 (2006): 143–164, p. 143.

<sup>47</sup> Faccio.

<sup>48</sup> Melanie Manion, *Retirement of Revolutionaries in China: Public Policies, Social Norms, Private Interests* (Princeton, NJ: Princeton University Press, 1993).

<sup>49</sup> The Civil Servant Law of China stipulates, “Where a civil servant resigns his post or retires, he shall not take any post in an enterprise or any other profit-making organization, which is directly related to his original post, or shall not engage in any profit-making activity directly related to his original work within three years after he leaves his post, if he is a leader before resignation. For any other civil servant, the time limit is two years.” However, this law is rarely enforced. For the law, please see <http://alturl.com/swa2e> (Accessed September 17, 2013). And for a discussion of its enforcement, please see <http://alturl.com/th8qv> (Accessed September 17, 2013).

<sup>50</sup> Pierre Landry, *Decentralized Authoritarianism in China* (New York, NY: Cambridge University Press, 2008); Victor Shih, Christopher Adolph and Mingxing Liu, “Getting Ahead in the Communist Party: Explaining the Advancement of Central Committee Members in China,” *American Political Science Review* 106(01) (2012): 166–187. It is estimated that the probability of a civil servant in China finally being elevated to the ministerial level is 0.04%. Please see <http://alturl.com/cwnhs> (Accessed August 1, 2013).

<sup>51</sup> According to official reports, the yearly salary of Yu Zhengsheng—then the Party secretary of Shanghai and a Politburo member—was 132,000 yuan (\$20,000) compared to Wang Shi’s—Chairman of China Vanke, a real estate company—which was 15.6 million yuan (\$2.5 million). For Yu’s salary, please see <http://alturl.com/wwu68> (Accessed August 1, 2013). For Wang’s salary, please see <http://alturl.com/tgw2q> (Accessed August 1, 2013). Certainly, these comparisons should be taken with a grain of salt due to the other sources of income for government employees such as graft, health care, pension, housing, and other government-subsidized services.

<sup>52</sup> Bruce Dickson, *Red Capitalists in China* (New York, NY: Cambridge University Press, 2003); Truex.

<sup>53</sup> Jennifer Gandhi and Adam Przeworski, “Dictatorial Institutions and the Survival of Autocrats,” *Comparative Political Studies* 40 (2007): 1279–1301.

<sup>54</sup> Dickson; Kellee Tsai, “Adaptive Informal Institutions and Endogenous Institutional Change in China,” *World Politics* 59 (2006): 116–141.

<sup>55</sup> For my code book, please see Section 1.2 in the web appendix.

<sup>56</sup> For lists of firms and their connectedness, please see Tables 1 and 2 in the web appendix.

<sup>57</sup> The difference is similar to how Shleifer and Vishny distinguished between a “centralized monopolist” and “independent monopolists.”

<sup>58</sup> Faccio.

<sup>59</sup> Shih, Adolph and Liu.

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- <sup>60</sup> <http://alturl.com/yh58c> (Accessed August 7, 2013)
- <sup>61</sup> Yuen Yuen Ang, “Explaining Patronage Distribution in One-Party Regimes: Evidence from China’s Public Employment,” Presented at the American Political Science Association Annual Meeting, Washington D.C, 2010.
- <sup>62</sup> Truex.
- <sup>63</sup> Please see <http://alturl.com/wusdk> (Accessed August 6, 2013).
- <sup>64</sup> A Craig MacKinlay, “Event Studies in Economics and Finance,” *Journal of Economic Literature* 35(1) (1997): 13–39..
- <sup>65</sup> Roberts 1990; Fisman 2001; William Bernhard and David Leblang, *Democratic Processes and Financial Markets: Pricing Politics* (New York, NY: Cambridge University Press, 2006); Acemoglu et al.
- <sup>66</sup> <http://alturl.com/o25sr> (Accessed August 8, 2013).
- <sup>67</sup> Please see <http://alturl.com/w7h8u> (Accessed August 7, 2013) for more information about the scandal.
- <sup>68</sup> Pei Sun, Haoping Xu and Jian Zhou, “The Value of Local Political Capital in Transition China.” *Economics Letters* 110(3) (2011): 189–192.
- <sup>69</sup> <http://alturl.com/nrz3w> (Accessed August 7, 2013).
- <sup>70</sup> <http://alturl.com/codwe> (Accessed August 8, 2013).
- <sup>71</sup> For the whole timeline, please see <http://alturl.com/p3g48> (Accessed August 8, 2013).
- <sup>72</sup> Fisman; Joseph PH Fan, Oliver Meng Rui and Mengxin Zhao, “Public Governance and Corporate Finance: Evidence from Corruption Cases,” *Journal of Comparative Economics* 36(3) (2008): 343–364.
- <sup>73</sup> The rationale to include the two days prior to the event is to consider the possibility of information leak, and this is a standard practice in event studies, please see a discussion in MacKinlay.
- <sup>74</sup> The daily return data are from the China Securities Market and Accounting Research (CSMAR).
- <sup>75</sup> Selection bias is a lesser concern because my sample companies constitute the vast majority of all Shanghai listed firms (133) and all Chongqing listed firms (35).
- <sup>76</sup> The procedure and simple t-tests are presented in Section 3 in the web appendix.
- <sup>77</sup> Roselyn Hsueh, *China’s Regulatory State: A New Strategy for Globalization* (Ithaca, NY: Cornell University Press, 2011).
- <sup>78</sup> I also estimated a “fully loaded” model that include all the connection variables, but because of low degree of freedom (N=27, # of variables=11), none of the connection variables is significant.
- <sup>79</sup> I did not show the results of firms connected with the Party Congress, because there are so few cases. Results are available upon request.
- <sup>80</sup> The null results of these other connections might be due to two reasons. First, according to my theoretical expectations, parliament and military connections are robust in the face of leadership changes. Second, the null results might be caused by the low degree of freedom, because there were few firms connected with parliament or the PLA. I argue that the null results are more likely to be the consequence of substantive rather than statistical reasons, because with only seven firms connected with the national government in Chongqing, the variable NATIONAL GOVERNMENT is still significant; the low

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degree of freedom of these other connection variables should not prevent them from being significant if they are substantively important.

<sup>81</sup> Ferguson and Voth.

<sup>82</sup> The share data are from CSMAR.

<sup>83</sup> Fan, Wong and Zhang.

<sup>84</sup> Tables 21 and 22 in the web appendix present the results.

<sup>85</sup> <http://alturl.com/tedj4> (Accessed August 8, 2013).

<sup>86</sup> For more details about these two variables, please see Tables 5 and 6 in the web appendix.

<sup>87</sup> Fan, Wong and Zhang.

<sup>88</sup> For more information about these panel datasets, please see Tables 7 and 8 in the web appendix.

<sup>89</sup> And the higher percentage of nationally connected firms in Shanghai is not because Shanghai had more SOEs: in 2012, only 3% of Shanghai firms were SOEs, while 18.5% Chongqing firms were SOEs.

<sup>90</sup> The leaders of Chongqing before Bo had no major central government experience.

<sup>91</sup> This rules out the possibility that Chongqing's outcome was caused by the national "go west" policy to promote development in the western provinces.

<sup>92</sup> For the panel data of Sichuan firms, please see Table 9 in the web appendix.

<sup>93</sup> For more information about the case, please see <http://alturl.com/z2p4h> (Accessed September 12, 2012), and for the Jiang-Bo connection, please see <http://alturl.com/ooz9c> (Accessed September 12, 2012).

<sup>94</sup> Table 10 in the web appendix presents the positions of former bureaucrats in affected Chongqing firms.

<sup>95</sup> Many observers believed so. Please see <http://alturl.com/re8pi> (Accessed September 12, 2012).

<sup>96</sup> I appreciate that these categories are rather crude and might miss some of the nuances of services an official can do to a firm, but a more disaggregate categorization would decrease the degree of freedom for each variable and undermine its statistical power.

<sup>97</sup> In a recent study, Ang and Jia showed that politically connected firms are more likely to go to court when having a dispute, please see Yuen Yuen Ang and Nan Jia, "Perverse Complementarity: Political Connections and the Use of Courts among Private Firms in China." *The Journal of Politics* 76(02) (2014): 318–332.

<sup>98</sup> For positions of former bureaucrats in each firm, please see Tables 11 and 12 in the web appendix.

<sup>99</sup> Stigler.

<sup>100</sup> Mary Elizabeth Gallagher, *Contagious Capitalism* (Princeton, NJ: Princeton University Press, 2005).

<sup>101</sup> Again, there is a trade-off between statistical significance and power because of the small number of cases in some of the categories. However, the fact that firms were not interested in hiring LICENSER and LABOR OFFICIAL itself reveals a less important role these positions can play.

<sup>102</sup> Groseclose and Snyder.

<sup>103</sup> Lieberthal; Mertha.

<sup>104</sup> The results are presented in Tables 17 and 18 in the web appendix.

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<sup>105</sup> Table 19 in the web appendix presents the results.

<sup>106</sup> I searched national media websites, including xinhuanet.com, china.com.cn, and sina.com.cn, and I searched shanghaidaily.com for Shanghai local news and cqnews.net for Chongqing local news.

<sup>107</sup> <http://alturl.com/tzxab> (Accessed August 7, 2013).

<sup>108</sup> Table 20 in the web appendix presents the results.

<sup>109</sup> Many believed that Wang, a liberal who encouraged the development of the private sector and foreign investment, represented a different ideology among the Chinese elites from the conservative Bo. Wang was also the predecessor of Bo as Party boss of Chongqing. Both were promising candidates for the Politburo Standing Committee at the Party's 18th Congress before Bo's purge. Please see [http:// alturl.com/5miyw](http://alturl.com/5miyw) (Accessed July 8, 2014).

<sup>110</sup> Table 23 in the web appendix presents the results.

<sup>111</sup> Roberts.

<sup>112</sup> Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Sanford, CA: Stanford University Press, 1982); Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton, NJ: Princeton University Press, 1995).

<sup>113</sup> Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge, MA: Belknap Press of Harvard University Press, 1962).

<sup>114</sup> David Kang, *Crony Capitalism: Corruption and Development in South Korea and the Philippines* (New York, NY: Cambridge University Press, 2002).

<sup>115</sup> Lynette H. Ong, "Between Developmental and Clientelist States: Local State-Business Relationships in China." *Comparative Politics* 44(2) (2012): 191-209.