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The Hidden Political Roles of Firms in China

> The economy is secondary to politics in this country. We'd give up economic growth without hesitation for political needs.
>
> Teaching from a Communist Party study session in Beijing, 2015

How does an authoritarian state see firms? Engines of growth and employment? Sources of rents and clientelism? If firms fulfill these widely recognized roles, do they consequently experience a stable business environment and maintain a stable relationship with an authoritarian state?

Not necessarily. Even in China, where the legitimacy of the authoritarian state largely stems from economic growth resulting from its liberal market reforms, the fate of private firms is often subject to the whims of the state, even when these firms deliver economic outcomes and play by the political rules.

If one casually browses through Chinese economic news since 1978, the year China began its economic reform, it is easy to get lost in the abundance of news about China's commitment to a market economy and the increasingly vital roles played by private firms, both domestic and foreign. The Chinese state and private firms, it would seem, have found a mutually beneficial way to coexist. But if one reads carefully, every once in a while, there are noticeable discordant stories of the Chinese government encroaching on yet another private sector. By encroachment, I am not referring to regulations, but rather to drastic measures including nationalization, forced merger with and acquisition by state-owned enterprises (SOEs), forced state buyout of shareholders, forced issuance of new shares to SOEs, forced establishment of party cells in a company, direct state interference with business operations, and even the shutdown of an entire private sector.

A recent wave of state encroachment that unfolded at the national level in several prominent sectors can shed light on this phenomenon. In 2021, China's Ministry of Education suddenly shut down the multibillion-dollar industry of private tutoring for schoolchildren, ordering over half a million private firms to turn into nonprofit organizations. That same year, the Publicity Department of the Central Committee of the Communist Party of China (CCP) denounced video gaming as "opium for the mind" and ordered online gaming companies, including internet giants such as Tencent, to enforce gaming curfews and increase monitoring of users with facial recognition technology. Also in that same year, companies affiliated with the Chinese government took equity stakes and board seats in Weibo and the Chinese entity of ByteDance. Weibo is China's largest microblogging platform, and ByteDance is the parent company of TikTok, the most popular short-form video hosting service in the world.

These events were a continuation of actions taken a year prior, in 2020, when the government cracked down on the fourteen largest tech companies in China, including Alibaba, Baidu, and ByteDance. The government ordered these conglomerates to change their data privacy policies and halt their overseas initial public offering (IPO) plans. All these firms are successful in business and are considered major contributors to China's economic growth. They have also adhered to the state–business norms in China, or, one might say, the norms of crony capitalism. Alibaba, for example, has deep ties with the CCP elites, with some of its major investors being families of officials at the highest level of Chinese politics.[1] Likewise, the founder of Tencent is called an "ambassador of the Chinese state" and actively participated in CCP's key policies, and Tencent has invested generously in government relations.[2] Additionally, all of these tech companies have made substantial donations to social

[1] On Alibaba's ties with top Chinese leaders, see, for example, "Alibaba's I.P.O. Could Be a Bonanza for the Scions of Chinese Leaders," *New York Times*, 2014-07-20, https://archive.nytimes.com/dealbook.nytimes.com/2014/07/20/alibabas-i-p-o-could-be-a-bonanza-for-the-scions-of-chinese-leaders/.

[2] "Tencent rugu zhongjin gongsi, weishenme shuo Ma Huateng shen'an zhengshang guanxi," *Sohu News*, 2017-09-23, www.sohu.com/a/193958328_999672 67; "Tencent executive earned more than HK$274 million in annual salary, filings reveal," *Southern China Morning Post*, www.scmp.com/tech/article/1939584/tencent-executive-earned-more-hk274-million-annual-salary-filings-reveal.

programs launched by the CCP to maintain good relations with the Chinese government.[3]

Therefore, this wave of high-profile state encroachment into some of China's most successful private sectors took many by surprise, and is often seen as a mark of the times, with increasingly powerful private firms suffering under the personalistic rule of President Xi Jinping, a strongman whom many suspect wants to bring back Marxism or at least a stronger form of state capitalism.[4] This assertion holds some truth considering Xi is tightening societal control on multiple fronts, but it does not fully explain similar crackdowns on the private sector before Xi's ascension to power and at the local level.

State encroachment into the private sector has been happening in various industries since China's 1978 economic reform, and the particular forms of encroachment that we observe today in the national events already mentioned can be traced back to 1993, the year the CCP formally incorporated a "socialist market economy" into China's constitution and recognized the private sector as an integral part of the Chinese economy. It is less that the CCP is turning against the market than that we are seeing the same pattern of state–business relations previously observed at the local level being played out in some high-profile sectors. Through the years, similar stories gained prominence as they do today, sparking anxious debates on whether China is scaling back its commitment to building a market economy. Eventually, they then gradually fade into a larger narrative of the growing pains of economic reform, forgotten amid another round of reassurance from the Chinese government regarding its unwavering support for the private sector, until the next wave of state encroachment arrives somewhere else.

Based on an open-source search for state encroachment in its narrowest forms, including nationalization, merger with and acquisition by SOEs, sale of control to SOEs and local governments, and administrative shutdown of an entire sector,[5] state encroachment into the private sector

[3] "BAT Zhengshang guanxi ju niubi," *IT Time*, 2014-10-27, www.ittime.com.cn/news/news_2518.shtml.

[4] This is a popular claim by some China watchers – see, for example, "The Return of Red China: Xi Jinping Brings Back Marxism," *Foreign Affairs*, 2022-11-09, www.foreignaffairs.com/china/return-red-china, and "Xi Jinping Is Reinventing State Capitalism. Don't Underestimate It," *The Economist*, 2020-08-13, www.economist.com/leaders/2020/08/13/xi-jinping-is-reinventing-state-capitalism-dont-underestimate-it.

[5] Other "softer" forms of state encroachment can include the government purchasing minority stakes in a company, as the central government did in the technology sector mentioned at the beginning of the chapter, or the CCP setting up party cells in a

has happened at least in the following sectors and years in different locations:[6] gas stations (1998–2012), urban transportation (1999–2018), airlines (2002, 2009–2010), the publication industry (2003–2004), trust funds (2004–2005), steel (2004–2010), rare earth minerals (2002–2011), coal mining (2006–2009), online streaming platforms (2009), online payment systems (2018, 2021), food manufacturing (2005, 2009), real estate (2009, 2021–2022), paper manufacturing (2006–2010), city gas supply (2010), hog farms (2011–2012, 2018–2023), the seed industry (2010–2018, 2023), and others. (See Appendix for Chapter 1.)

These incidents exhibit a sector-specific pattern, happened at the local government level, and did not always have identifiable central government guidance, often appearing to be uncoordinated actions by local governments. These patterns of state encroachment are different from those prior to 1993, when the entire private economy was considered a potential threat to socialism and was operating in a legal grey zone in China's socialist economy. State encroachment into the private economy before 1993 happened in the form of two waves of national crackdowns indiscriminately across all private entrepreneurs in all sectors, investigating and charging them for economic offenses that were later decriminalized, and confiscating or nationalizing private property.[7]

A few examples can help us better understand the nature of state encroachment into private sectors after 1993. An example of forced merger with and acquisition by SOEs is the case of Rizhao, a steel manufacturer. Rizhao was relatively profitable and one of the largest private steel companies in China, but in 2008 it was forced by the provincial government of Shandong to merge with the Shandong Iron and Steel Group, a loss-making provincial SOE. Rizhao initially refused this deal, and to compel the

company. Because it is difficult to discern whether these state interventions make the state the dominant actor in the private sector, I do not include them in this list.

6 Appendix 1 offers a comprehensive chronological account of these incidents compiled from academic and news sources from 1993 to 2024. All the articles collected can be accessed through this online depository: https://drive.google.com/drive/folders/11YHwSh7a_mLVR-QUnKU7tm9OI_AIrxTw?usp=drive_link. The keyword for my search is "Guo jin min tui" ("国进民退"), a term commonly used in Chinese to describe state encroachment. Of all the results I find in this search, I only include those events in the narrow forms of state encroachment as explained in the text. This means there are many more incidents of state encroachment than the list I compiled.

7 The central government of China launched two waves of indiscriminate crackdown on the private economy between 1982 and 1984, and then again between 1989 and 1992. These crackdowns took the form of investigations and charging of private entrepreneurs for economic offenses, which were later decriminalized. These episodes are detailed later in this chapter.

merger, the Shandong government suspended Rizhao's ongoing investments and procurement deals until the company agreed to it.[8] In a similar vein, within the airline sector, the Wuhan city government suspended the operations of Dongxing, a private airline, to pressure it into acquisition by Air China, an SOE, at a value much lower than its market price.[9]

Occasionally, local Chinese governments would use the extreme form of state encroachment – shutting down an entire private sector, as the central government did to the tutoring industry in 2021. Between 2006 and 2010, provincial governments of Shanxi, Henan, Hebei, and Inner Mongolia, China's main coal-producing provinces, forced private coal mines to shut down, some of which were later reopened by SOEs. Similarly, multiple local governments shut down the paper manufacturing industry throughout the 2010s. And as this book will detail, local city governments across China forced private firms in the urban bus sector to exit, starting in the early 2000s.

These examples of state encroachment, then, are inherently distinct from typical government regulation, and they consistently result in private firms ceding ground to SOEs in a certain sector. This outcome and its cause – the underlying rationale behind state encroachment – are what this book sets out to explain. I show how firms in China have been systematically politicized by the state and government officials to provide political services, and these political services often put private firms at a disadvantage to SOEs. I reveal two particular forms of political services provided by firms that have thus far remained under the radar: contributions to authoritarian officials' careers and assistance with societal control. When private firms refuse or fail to provide these services, state encroachment may follow. But before I elaborate on this mechanism, let me first introduce the research questions and the motivation for this book.

THE PUZZLE AND RESEARCH QUESTIONS

When and *where* does the state encroach into the private sector? And *why*? The encroachment behavior of various levels of Chinese

8 "Chongzu rigang buneng qiangmai qiangmai," *Zhonghua gongshang shibao*, 2009-08-07, https://finance.sina.cn/sa/2009-08-07/detail-ikkntiam4397474.d.html?from=wap.

9 "Dongxing hangkong zuo bei tingfei gaoguan cheng zao yeman shougou," *Guangzhou Daily*, 2009-03-16, https://finance.sina.com.cn/chanjing/b/20090316/07595979647.shtml; "Wuhanshi chuli dongxing tingfei shiyi, zhonghang fouren qiangzhi shougou," *Securities Daily*, 2009-03-17, https://business.sohu.com/20090317/n262841630.shtml; and "Dongxing hangkong pochan," *Sina News*, https://finance.sina.com.cn/focus/eaststar_tf/index.shtml.

government across different sectors and localities presents two puzzles. First, it goes against the central state's stated policy goals since 1993 that have been consistently pro-market. *Why* the inconsistency? Second, the existing literature cannot fully explain the pattern as to *when* and *where* state encroachment happens. What can China tell us about the rationale of state encroachment on the private sector?

The first puzzle is an empirical one, embedded in the contradiction between the Chinese state's behavior and its own mantra of promoting the private economy. Xi Jinping has openly stressed the CCP's continuing strong support for market liberalization and private entrepreneurs every year since 2013, promising to further expand the private sector.[10] Even among the most recent waves of high-profile state encroachment, the Chinese state has continued to stress its support for private firms. In his 2022 Party Congress speech, which was intended to set the tone for China's trajectory, Xi Jinping said, "China will unwaveringly encourage, support, and guide the private economy, and let the market play a decisive role in resource allocation."[11] In 2020, the central government vowed to level the uneven playing field between private firms and SOEs and improve competition law.[12] In 2013, the CCP published a decision to deepen economic reform, detailing sixty specific reforms to further promote the market economy and the private sector, and to reduce the role of government in the economy.[13] Numerous laws and policies have since been passed to reduce administrative burdens for companies, reduce taxes and fees, protect intellectual property, increase private companies' access to credit, and simplify procedures for companies to get listed on stock markets.[14] These policies are very much in line with the CCP's

[10] For example, "Xi Jinping de gaige zuji – xinshidai zaichufa!," *China Media Group*, 2018-12-15, https://news.cctv.com/2018/12/15/ARTIUltBoC69BzK2N8x7qUye181215.shtml.

[11] "Xi Jinping: Opening Speech at the 20th Party Congress in China," *Xinhua News*, www.news.cn/politics/cpc20/zb/xhwkmh1016/wzsl.htm.

[12] "Zaici jujiao minying jingji, zhongyang pinfan fasheng youhe shenyi," the State Council, 2020-09-18, www.gov.cn/zhengce/2020-09/18/content_5544516.htm; and "Niandi qian shixian gongping jingzheng shencha zhidu zai guojia, sheng, shi, xian sijizhengfu quan fugai," *People's Daily*, 2019-04-03, www.gov.cn/zhengce/2019-04/03/content_5379226.htm.

[13] "Zhonggong zhongyang guanyu quanmian shenhua gaige ruogan zhongda wenti de jueding," *Xinhua News*, 2013-11-15, www.gov.cn/jrzg/2013-11/15/content_2528179.htm.

[14] For example, "Zhonggong zhongyang guowuyuan guanyu yingzao genghao fazhan huanjing zhichi minying qiye gaige fazhan de yijian," the State Council, 2019-12-22, www.gov.cn/zhengce/2019-12/22/content_5463137.htm; "Foreign Investment Law of the People's Republic of China," adopted at the second session of the Thirteenth

official stance toward private entrepreneurs since 1993. The CCP even granted private entrepreneurs political legitimacy in 2002 by accepting them into the Party; they then became one of the fastest growing groups among CCP members.[15]

All in all, the Chinese state has not formally moved away from its commitment in the constitution to "build a socialist market economy," a goal in place since 1978. There is a scholarly consensus that the Chinese state has partially but substantially tied its own hands and made credible commitments to the private sector, and Chinese officials are believed to respect quid-pro-quo relationships, which reduces the risk of government expropriation and creates a market environment conducive to investment.[16] These policies allowed private firms to be the main pillar of China's economy and an important source of performance legitimacy for the CCP. In 2022, private firms accounted for over 90 percent of all firms in China, over 90 percent of urban employment, over 80 percent of total employment, over 80 percent of exports, over 60 percent of gross domestic product, and over 50 percent of tax revenues.[17]

For an authoritarian state that had been touting market reform as one of its greatest achievements, the CCP presumably does not want to risk stifling its private sector. But then what explains the sporadic state advances that break from the state's own commitment to the private sector and a market economy?

The second puzzle is one regarding the incompatibility between the pattern of state encroachment in China and existing academic explanations for state encroachment. When it comes to reasons for state intrusion on the private sector, the political science and economics literature

National People's Congress, 2019-03-15, www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm; "Xuejian 1/3 shenpi shixiang mubiao yiwancheng," 2014-12-13, www.gov.cn/zhengce/2014-12/13/content_2790388.htm; and "Guowuyuan guanyu yinfa 2016 nian tuijin jianzheng fangquan fangguan jiehe youhua fuwu gaige gongzuo de tongzhi," the State Council, 2016-05-24, www.gov.cn/zhengce/content/2016-05/24/content_5076241.htm.

[15] The number of private entrepreneurs who are CCP members increased from 590,000 in 2012 to 1.65 million in 2020, representing an increase of 250 percent: www.xinhuanet.com/politics/2020-11/10/c_1126691339.htm.

[16] See, for example, Nee 1992; Yang 2004; Wang 2015; Ang 2020.

[17] "Xi Jinping: zai minying qiye zuotanhui shang de jianghua," Organization Department of the Chinese Communist Party, 2018-11-01, www.12371.cn/2018/11/01/ARTI1541079015074692.shtml; "Woguo gelei shichang zhuti huoli jingxiang bengfa," *China Economic Network*, 2022-02-02, https://k.sina.cn/article_7517400647_1c0126e4705902n9ja.html?from=news; and "Woguo minying qiye shuliang shi nian fan liangfan," *People's Daily*, 2022-03-23, www.gov.cn/xinwen/2022-03/23/content_5680738.htm.

offers four groups of explanations: national security, economic predation, political gain, and the difficulty of writing complete contracts.

National security is often cited as a reason for nationalization of strategic sectors that are at risk of foreign dependency, such as railways, oil, banking, and telecommunications (Shafer 1983; Kobrin 1984). Keeping the control of these sectors in a national government's hands reduces dependency on, and the risk of expropriation by, foreign governments. Economic predation is a second reason for state intrusion. A sector that harbors valuable assets or can generate large cash flow could fall prey to a predatory state and experience state takeover, especially when product prices rise in these sectors. This is often seen in oil, mining, and other resource extraction sectors (Shleifer and Vishny 2002; Guriev, Kolotilin, and Sonin 2011). Third, the decision to nationalize could be triggered by politicians' desire for political gains. Since public ownership tends to employ more workers, a politician could nationalize a sector and increase its employment size to gain support from the labor union or to attract voters (Hart, Shleifer, and Vishny 1997). Similarly, when a dictator feels insecure about their rule, they could nationalize resource extractive sectors to distribute the windfall for political support (Mahdavi 2020). Lastly, the state might have incentives to intrude and take over a sector where the state lacks the ability to create a complete contract with private companies, particularly in monopolistic public service sectors. In these sectors, the private providers could exploit the incomplete contract through the bargaining power they amass from their monopoly status, creating various problems such as de facto soft budget constraint problems, lack of innovation, high product prices, and insufficient supply of services or goods (Hart and Moore 1990; Holmstrom and Milgrom 1991; Vickers and Yarrow 1991; Hart 1995, 2003; Ohemeng and Grant 2008). The state might then resort to nationalization to solve these problems.

Within the Chinese context, a few more China-specific explanations of the outsized role of the state in the economy are relevant to understand state encroachment. One centers around interest groups. Some scholars suggest that the legacy institutions of socialism that support China's SOEs, such as the State-Owned Assets Supervision and Administration Commission of the State Council, led to the growing power of central SOEs and their expansion in the market (Nolan 2001; Naughton 2008). The other explanation centers around the model of state capitalism, which is akin to the concept of the developmental state (Wade 1990; Evans 1995). State capitalism sees the state's role to be directing industrial development and increasing global competitiveness, and the state might expand into sectors that can help the state reach these goals. Lastly, and more recently, scholars have started to discuss the role of economic nationalism and domestic security in the Chinese state's expansion into the market. The Chinese state might be expanding into certain sensitive sectors to both reduce the power of a rapidly rising private sector, such as in the airline industry, and to protect sensitive sectors from foreign competition, such as in the telecommunications sector (Eaton 2015). And the CCP is increasingly emboldened in controlling private sectors crucial to domestic security, including social media and technology companies (Pearson, Rithmire, and Tsai 2021).

Together, this existing scholarship offers credible explanations for the Chinese state's encroachment into certain sectors. Economic predation could be an incentive for the Chinese state to encroach into real estate, gas stations, and finance sectors – sectors that generate high profit margins. The Chinese state might also want to control private firms in sectors of strategic importance to China's national security, which could explain the merger and acquisition of private companies in the rare earth sector, a product key to many strategic manufacturing sectors, including defense, green energy, and technology; or the seed industry, which matters for food security in China. The Chinese state is also increasingly worried about domestic security and stability, and therefore has become more intrusive in the business operations of social media and technology companies. Finally, in a new industry where a few dominant companies could form a cartel, such as in the ride share app sector, the Chinese government might find it difficult to write complete contracts with those companies that act like a monopolist, and that could be why the state forced shareholder sales of these companies to SOEs to increase state control. In general, for sectors that hold significant political and economic importance for the state, and sectors that could present serious challenges for the state to manage and to regulate, existing scholarship offers compelling explanations for state encroachment into these sectors.

But existing explanations do not fully explain state encroachment into many other sectors that do not possess strategic importance, and they do not fully explain local variations in state encroachment within each sector. For example, why do China's local governments want to encroach into paper manufacturing, city gas supply, urban buses, and other businesses that lack geopolitical or domestic security significance, are not pivotal to China's global strategy, are not monopolistic, do not appear to suffer from more regulatory failures than other sectors, and yield only slim profit margins? Moreover, how do we explain the local variations of state encroachment into the same sector? For example, why do some local governments shut down private paper manufacturing factories or take over hog farms and urban buses, while others do not?

Leveraging variations in state encroachment across sectors and localities, this book explains state encroachment with the hidden political roles of firms in China. Drawing on some of the most mundane sectors, such as urban buses and solid waste treatment, as well as variations in state encroachment in these two sectors across localities, I show how firms in China have been systematically politicized by the state and government officials to provide political services, not just to the Party-state as a whole but also to individual politicians. This book reveals two particular political services provided by firms: contributions to officials' careers through *visibility projects*; and acting as a supplement to the state in direct *societal control* beyond surveillance and monitoring of the public.

The outcome of politicizing firms is a deepened preference for SOEs by the Chinese government. A hidden arena for firm competition, these political services imposed on firms further separate private firms and SOEs by political competitiveness. In any sector with both private firms and SOEs present, private firms fall behind SOEs on provision of most types of political services, particularly in the long term. When politicians need political services, this lack of political competitiveness, while not necessarily lacking economic or technological competitiveness, is an important reason for private firms to lose favor with the state.

This book further explains the political origin of the politicization of firms. The first service, visibility projects, stems from the incentive structure that the Party-state uses to keep its government officials in line. The second service, societal control, stems from the need to keep societal grievances under control. Fundamentally, politicization of firms is the result of two key imperatives for the authoritarian Party-state: the constant tradeoff it must make between encouraging private investment and preventing organized opposition of private entrepreneurs; and the constant struggle of an authoritarian state to select government officials who are both loyal and competent. The first imperative creates the conditions for politicization of firms, and the second imperative creates incentives for government officials to use firms for risky and unpopular projects and policies. These institutional roots of firms' political roles exemplify the difficulties of the Chinese state in juggling between the goals of maintaining authoritarian rule, attracting and retaining private investments for a market economy, and pursuing sustainable development.

THE POLITICAL SERVICES DEMANDED OF FIRMS BY AUTHORITARIAN OFFICIALS

Firms engage not only in production and transactions but also in other economic and political activities to stay in business and to generate profits. Through these activities, all firms, intentionally and unintentionally, voluntarily and involuntarily, create potential economic and political benefits for both the state as a whole and state officials as individuals (Table 1.1).

We are most familiar with the economic functions of firms. Firms directly benefit the state by creating growth, tax revenues, and employment. Firms can also directly benefit individual state agents, providing them and their family with rents and job opportunities. These economic functions of firms are universal across firm types and regime types, and they can create indirect political impacts. For example, a strong economic growth record is an important source of a government's performance legitimacy, and corruption almost always hurts legitimacy.[18]

What can firms provide to the state and politicians beyond the benefits listed here? When it comes to firms' direct political services to the state and its agents,[19] our best developed knowledge is on firms' policy impacts and, in electoral contexts, their political impact through campaign donations. Policy impacts can come from lobbying, consultation, and associational activities where firms use their information advantages to promote favorable industrial and regulatory policies. Campaign donations by firms are an important source for politicians' careers in electoral

TABLE 1.1 *Economic and political services of firms*

		Direct beneficiary	
		State officials	**State**
Firms as providers of:	Economic services	Rents and job opportunities	Growth, tax, and employment
	Political services	*Contributions to political career*	Information, policy input, policy feedback, and *societal control*

[18] See, for example, Rose-Ackerman and Palifka (2016) and Manion (2004).

[19] Another dimension of firms' roles in society is their social roles, such as impact on the environment, labor, welfare, and equity.

contexts, and they also have indirect effects on policymaking.[20] In nonelectoral contexts, lobbying and associational activities also exist but to a lesser extent, depending on the regime's receptiveness to business and tolerance for organizational activities (Frye 2002; Kennedy 2009). But beyond these better-known phenomena, in authoritarian states, firms provide two more political services that are understudied so far: contributions to state agents' political career through *visibility projects*, which are an element of *selectoral campaigns*; and supplements to state functions of *societal control* by being the state's allies or scapegoats.

Selectoral Campaigns and Visibility Projects

Firms directly contribute to the political career of authoritarian officials. Authoritarian officials routinely launch what I call *selectoral campaigns* to promote themselves to their superiors. Selectoral campaigns, a group of strategies to promote oneself in a nonelectoral context, serve as an informal supplement to the formal government personnel system that selects politicians and bureaucrats. One better known form of selectoral campaigns is office buying, often with firm contributions. In publicized corruption cases in China, firms, particularly private firms, were found to supply the money that government officials used to bribe for promotion.[21] Another form of selectoral campaign is media campaigns, where officials sing the praises of their superiors or talk about their own achievements on TV and other media outlets (Shih 2008; Zhu and Wang 2013). In this book, I introduce another way for firms to contribute to selectoral campaigns: *visibility projects*, a safer, legal, inconspicuous, and therefore more common albeit more costly approach for authoritarian officials to promote themselves.

Visibility projects are projects launched to showcase competence and improve the career prospects of government officials. They include highly visible infrastructure, public projects, and government activities that can be readily noticed by higher-up government leaders. Examples include building industrial parks, malls, bridges, and other "signature" infrastructure projects; hosting sports events and government galas; and winning national titles such as "the cleanest city in China." For visibility

[20] For example, Powell (2012).

[21] "Maiguan Maiguan Qianguize," *Xinhua News*, 2014-11-17, http://finance.china.com.cn/roll/20141117/2792897.shtml; and "Zhaidiao minqi zanzhu de guanmao haiyao zhuihui liyi," *Hunan Rednet*, 2014-11-18, http://news.sina.com.cn/o/2014-11-18/000831159272.shtml.

projects, form dictates function. The purpose of visibility projects is to showcase one's governing capability to the higher political echelons to improve one's chance of promotion, and therefore these projects must be noticeable and are often large in scale. These concepts are defined and developed in more detail in Chapter 2.

Societal Control: Allies and Scapegoats of the State

The second political service that firms directly provide is to supplement state functions of societal control. Firms either become an ally of or a scapegoat for the state in performing this function. As an ally, firms can supplement government functions where the state lacks capacity, such as providing surveillance for the state, and help the state appease or suppress the public during state–society conflicts. As a scapegoat, firms can take on the full responsibility for a failed policy, project, or event to help the state and state agents deflect blame. This political service directly benefits the state but also indirectly benefits government officials, agents of the state.

This political service by firms is particularly difficult to observe, and we only occasionally get a glimpse of it at the national level. During the Suharto era, two of Indonesia's richest businessmen and allies of Suharto, Liong and Hasan, donated to Suharto's private foundations that launched police and military operations to suppress his political opponents and the public (King 2000). More recently, after the Russian occupation of Crimea, one of Putin's closest business allies, Arkady Rotenberg, built the Kerch Strait Bridge in 2015 that connected Russia to Crimea. The three billion dollar bridge symbolized Putin's rule and helped to solidify Russian control of the region. Out of concerns of fragile security and the dim prospect of profitability from this bridge (which was bombed during the Russian invasion of Ukraine in 2022), few other businesses were willing to invest, leaving Rotenberg alone to build it.[22]

In China, providing this political service has been a common but rarely documented role of firms. It is now widely known that social media and technology firms provide monitoring and surveillance of the society for the Chinese state (King, Pan, and Roberts 2013; Huang and Tsai 2022). But that is not the only way for firms to participate in societal control. Firms can be allies of the state by providing "hush money" and

[22] "Putin's Shadow Cabinet and the Bridge to Crimea," *The New Yorker*, 2022-05-09, www.newyorker.com/magazine/2017/05/29/putins-shadow-cabinet-and-the-bridge-to-crimea.

employment opportunities to protesters, or even directly participating in suppression, either by providing manpower or by bringing in political support to legitimize local government suppression. And firms sometimes serve as scapegoats, shouldering blame for failed policies or projects in the place of the state. These functions are further elucidated in Chapter 3.

These two direct political roles of firms, providing contributions to visibility projects and supplements to the state for societal control, are often dormant. They become activated when a sector or a firm is designated by government officials to provide political services. Firms can take up these political roles voluntarily or involuntarily, and intentionally or unintentionally. But once these political roles of firms are activated, state–business relations start to change. Such change can be good news for firms, but it frequently is not.

WHY DO OFFICIALS NEED THESE POLITICAL SERVICES, AND WHY ASK FIRMS?

As in all countries, there is no shortage of ambitious politicians and bureaucrats in China. In an authoritarian Party-state, power is not only an end but also a means to share the resources controlled by the state. To climb up the political ladder, Chinese officials must outcompete each other on loyalty and competence. But they also need to be careful to not fall off the political ladder, meaning they must avoid grave political mistakes. That is, they must engage in both credit-claiming and blame-avoidance.[23] Unlike in systems of open electoral competition, Chinese officials are subject to evaluation not by the public, but by their political superiors and the "scorecards" in China's personnel evaluation system. Operationally, this would mean any ambitious Chinese official needs to excel in a set of formal evaluations designed by the CCP, and they must avoid stepping over the Party's red lines, including losing control of the mass public and appearing defiant by making policies or conducting local governance differently from the CCP's guidance.

These conditions for career advancement are tricky to grasp for a Chinese official. While the formal evaluations seem clear and transparent, Chinese officials are disillusioned with the effectiveness of the system. They find that excelling at formal evaluations is at best a prerequisite

[23] "Blame avoidance" is a key incentive for politicians in making policy decisions. This concept is developed by Kent Weaver (1986), who observes that politicians are primarily driven by blame avoidance for unpopular actions rather than claiming credit for popular ones. See also Hood (2010).

for promotion. The quantitative evaluations that assess the competence of a government official in delivering policy outcomes, designed to select the most competent, suffer from rigidity, gaming behavior, and under-the-table negotiations that allow too many officials to get good evaluations (Gao 2015; Leng and Zuo 2021). Doing well in this system will grant a pass, but not an A on one's report card.

Realizing that simply doing well in the formal evaluation does not guarantee promotion, ambitious Chinese officials seek to stand out in other ways. It is with this incentive that they have developed selectoral campaigns – visibility projects, media exposure, and office buying. Like high schoolers eyeing Ivy League universities, doing well on the SAT and having a good grade point average – quantitative evaluations – are considered just a minimum threshold; they also endeavor to show "extracurricular" achievements akin to selectoral campaigns, including sports and community services, in their application to improve their prospects for admission. Within the Chinese state, officials similarly create selectoral campaigns to supplement their formal evaluations for a better chance to stand out in the cut-throat competition for promotion in the Party-state.

The high costs of selectoral campaigns give rise to the demand for firm contributions. Visibility projects, a major type of selectoral campaign, can be very expensive. Many involve excessive investment in large infrastructure, projects, or events, which often incurs financial losses and is not sustainable. Because the whole point of visibility projects is to go beyond the top-down requirements and to get extra credit, it is hard to justify paying for these projects within government budgets. Always trying to avoid blame for imprudent spending, government officials find it safer to have firms cover the costs. This combination of officials' incentives to balance credit claiming and blame avoidance creates the first political role of firms – contributions to authoritarian officials' selectoral campaigns and visibility projects that will aid their political career. This mechanism is discussed in detail in Chapter 2.

The demand for the second political service, supplementing state capacity for societal control, has a more direct political logic: blame deflection. When controversies and public opposition arise in relation to government policies and projects, it is in the government officials' interests to distance themselves from the policies and projects to avoid blame from both the public and their superiors. It is also in the officials' interests to avoid dealing with the public directly to reduce political ramifications. These blame avoidance incentives lead to the incentive of blame deflection, with firms that carry out the controversial or failed projects being blamed rather than the state itself. Firms become the natural choice to take on blame and to exercise part of the societal control function, either appeasement or coercion, so that the legitimacy of the state is preserved and local officials are not blamed for social disturbances by the Party.

HOW DO FIRMS PERCEIVE POLITICAL SERVICES? REGULATION VERSUS BRIBE

Firms, both SOEs and private firms, often comply with political service provision to maintain a good relationship with state officials, as they have strong incentives to stay in the good graces of the Party-state. But compliance is often reluctant. Providing political services to an authoritarian state is a risky and inefficient way for firms to benefit themselves. Unlike other corporate political activities such as lobbying, network building, or bribery, providing direct political services – contributions to officials' career and supplements to societal control – has a distinctive feature: Firms do not have full control over the *costs* of these political services.

Firms do not have full control over the costs because firms do not have full control over almost all aspects of political services – the timing, the scope, and even the type of political services are dictated by government officials. Sometimes, firms do not even have a choice over whom the political services are benefiting. Compare political services with lobbying, for example. Firms have control over when to lobby – crucial moments in legislation; and whom to lobby – key politicians in the legislative process. Compare political services with bribery, and firms still have more control over when to bribe – at the time of tendering or licensing; the target of bribery – specific government officials that matter for sealing the deal; and how much to pay – based on the "going rate" and negotiations. But when it comes to political services, firms might not have options over any of these aspects. In the end, political services cater not to business interests, but to politicians' incentives, which are shaped by China's political institutions. This is a key difference between political services and other corporate political activities.

Consider this tricky scenario I observed in one Chinese city. A top city leader asked a local wastewater treatment company to build a "museum of water." This museum was not going to be profitable for the company, but it would showcase the city leader's dedication to water quality and public education, both considered important by the CCP. Should the company build the museum? How can the company recoup the costs? Can the company be sure that it will be rewarded with other government contracts or subsidies, as was implied by the city leader? What if this leader is reposted before the firm can get any returns? But then if the company refuses to build this museum, will there be coercion or retribution from the city leader? Knowing their business success depends on the state, can the company say no? There is no clear answer to any of these questions, rendering the situation more like a high-risk gamble than a low-risk investment for the firm.

In certain situations, firms do get payoffs for their political services. This can be seen in several publicized corruption cases of Chinese politicians, including the former vice Party secretary of Sichuan province, Chuncheng Li; and the former Party secretary of Lüliang city, Chunyu Nie. In Nie's case, he asked an entrepreneur to cover the costs of bribes to upper-level officials for office buying. Owing to the secrecy of the matter, Nie only asked one entrepreneur, his longtime business ally. In return, Nie provided various government support to this entrepreneur's business. Even though the entrepreneur could not set the price for office buying, which is dictated by the market for government positions, the entrepreneur happily obliged because he (correctly) expected returns for his contributions, including purchasing a small state-owned coal mine priced below market value and getting preferential loans from state-owned banks.[24]

In former Sichuan Vice Party Secretary Li's case, one real estate developer benefited from contributing to Li's loss-incurring visibility project, the New Century Global Center in the provincial capital of Chengdu. Opened in 2013, the Global Center is the largest single-building by floor space in the world; it incorporates shopping, entertainment, hotels, and conference centers. According to my interviews with officials in Chengdu who participated in the project,[25] the Global Center was meant to showcase Li's ability to introduce consumption-driven economic growth, a model advocated by Beijing. The Global Center was estimated to be loss-incurring owing to its location and enormous size, and the Chengdu city government could not afford building it with an estimated government debt level at over 100 percent of the budget.[26] Li turned to one of his

[24] An example of a private entrepreneur paying for a city mayor's office buying can be seen here: "Nie Chunyu zhuzheng xia de Lvliang: meilaoban chuqian maiguan guanyuan bangmang pingshi," *Beijing News*, 2014-11-09, http://politics.people.com.cn/n/2014/0901/c1001-25575863.html.

[25] Interview 20151022a, b, c.

[26] "Zhaiwulv chao 100% de jiuge shenghui chengshi hui shi shei?," *Reuters*, 2013-07-29, www.reuters.com/article/idUSL4S0G00SG/.

closest business allies. The businessman agreed to build the Center but proposed a smaller scale to limit loss. Li vetoed the idea, but to coax this reluctant businessman into a loss-incurring project, he promised a separate land development deal elsewhere, and the businessman agreed.[27]

In these two cases, political contributions from firms are similar to a *bribe* in nature, where the firms could differentiate themselves from other firms in providing a unique political service and thereafter claim credit for this service. Therefore, the firm agreed to the demanded contributions. But when the political services in question are closer to *regulations* in nature, meaning that firms cannot differentiate themselves from other firms in providing these political services, because every firm has been providing them, they are less likely to welcome these political services and would only agree to provide these services out of concern for political retribution and coercion.

Take one visibility project I observed as an example. A city leader decided to "build a verdant city," a response to the central government's call for environmental protection. The city leader insisted on turning the city "green" within three months, with part of the plan being to install green walls (also called vertical gardens) on the outer walls of major buildings in a busy tourism area. Seeing as this was a very expensive project, the city government "invited" all the relevant buildings' owners and business occupants to "voluntarily" pay for the green walls. Business owners were reluctant because it was unclear how they could recoup the costs. Having a green wall would not necessarily attract more customers, and more importantly, because all businesses in the area were asked to participate, no business could stand out as the hero in realizing the leader's vision and get preferential treatment. Quite the opposite: Any business objecting to this plan would stand out as obstructing the leader's vision and might invite retribution such as tax audits and unannounced health and safety inspections. All businesses eventually contributed, and green walls were installed. This project was quickly abandoned a few months later when the top leader was promoted and

[27] This information comes from both my interviews and is corroborated with news articles. See "Li Chuncheng liyi shusong duoshe tudi xiangmu," *Beijing News*, 2014-05-08, http://epaper.bjnews.com.cn/html/2014-05/08/content_510592.htm?div=0; "Corruption and the World's Biggest Building," *The Telegraph*, 2013-09-13, www.telegraph.co.uk/news/worldnews/asia/china/10308029/Corruption-and-the-worlds-biggest-building.html; and "Amid Probe, Chinese Moguls Vanish," *Wall Street Journal*, 2013-09-26, www.wsj.com/articles/SB10001424052702303983904579092990279667928.

moved to another city. Not making any extra income from these green walls, the businesses had no incentive to keep up with the expensive maintenance and the walls died.

Another example is the societal control services demanded of internet firms in China. In 2010, an official Google announcement revealed that Google China had been censoring search results for the Chinese government since it entered the Chinese market.[28] This is essentially a societal control service Google provided as the Chinese state's ally. The censorship service was requested by the Chinese state of all internet companies, and it did not bring Google extra benefits. Instead, it increased the costs for Google to operate in China. Providing this service led to reputational losses and potential legal consequences outside China for Google. It was accused of "sickening collaboration" with the Chinese state in a US congressional hearing and was criticized by numerous American news media and nongovernmental organizations (NGOs).[29] Google was probably also vulnerable to the EU Data Protection Directive, predecessor of the General Data Protection Regulation. This law would later become the strictest privacy and security law in the world, imposing fines on companies operating in Europe for any breaches of privacy and security, regardless of where they occur in the world. When providing this political service for China, Google had little ability to negotiate the terms of censorship, as it constitutes one of the foundational pillars of the CCP's rule. Google also could not secure additional benefits over other internet companies, as this political service is mandated for all tech companies.

Therefore, this political service is in nature closer to *regulation* of the firm rather than a *bribe* from the firm. Google cannot differentiate itself from other internet companies by providing this political service because every internet company must provide it, and this makes it difficult for Google to negotiate with the state for compensation for providing this service. Years after entering China, Google still had only around 30 percent of the search engine market share in 2010, far behind the largest domestic company, Baidu, which controlled almost 70 percent of the

[28] "A New Approach to China," Google Official Blog, 2010-01-12, https://googleblog.blogspot.com/2010/01/new-approach-to-china.html.

[29] In terms of reputational costs, Google was criticized by NGOs and media all over the world. See, for example, "Google to End Censorship in China over Cyber Attacks," *The Guardian*, 2010-01-12, www.theguardian.com/technology/2010/jan/12/google-china-ends-censorship.

market.[30] This political service of being the state's ally did not yield additional business returns, and so when the associated costs became too high and led to reputational loss and increased risks of losing other markets, Google exited China.

Providing political services, therefore, is not the most efficient means for firms to gain favor from China's politicians. If the political services demanded are in nature closer to a bribe, meaning firms can differentiate themselves in claiming credit from these political services, then firms are more likely to comply to gain favor of the state or individual leaders. If the political services are in nature closer to regulations, meaning the firms cannot easily differentiate themselves from others by providing these services, then a firm's response would depend on the foreseeable costs of these political services. If the costs are bearable, then firms might agree to prevent government retribution. But when the costs become too high, many firms would not be able to afford the political services demanded of them. The nature of the political service demanded of a firm, and the ability of a firm to bear the costs of political services, are what eventually set firms apart in the eyes of the state. Some firms are better providers for certain political services, and this often correlates with the firm's ownership type.

POLITICAL SERVICES, THE HIDDEN UNEVEN PLAYING FIELD FOR PRIVATE AND STATE-OWNED FIRMS

Political service provision is a hidden battleground for firms in China, an authoritarian country. Firms not only compete over efficiency, market shares, and networks with political elites, but they also must compete on their capability to provide political services for the state and its agents. Facing the high uncertainty of returns over political service provision, firm competition comes down to two dimensions: budget constraints and political capital.

Budget constraints are particularly important for a firm's capacity to contribute to visibility projects. When it comes to budget constraints, on average, private firms lack the financial capacity to sustain expensive political services for an extended time. Unlike SOEs, private firms have hard budget constraints and they are profit driven. SOEs, on the other

30 "Google Loses Chinese Market Share," *Wall Street Journal*, 2010-04-27, www.wsj.com/articles/SB10001424052748703465204575207833281993688.

hand, have relatively soft budget constraints.[31] Even though they are supposed to have a fixed budget in theory, loss-making SOEs often get bailed out by the government with subsidies, write-offs of bad loans owed to state-owned banks, and other financial instruments often not available to private firms. This means that SOEs depend much less on profits to stay in business compared with private firms. When political services require large investments that do not promise acceptable returns, private firms are more likely to refuse to provide these services than SOEs, or they are more likely to fail at providing the demanded services if they cannot recoup the costs. This difference in budget constraints creates the first uneven playing field between SOEs and private firms in political service provision. Private firms' refusal or failure to shoulder the high costs of political services is an important reason for a sector to experience the exit of private firms, sometimes voluntarily, and at other times owing to state coercion.

Political capital is another important dimension for firm competition, and this is particularly important when exercising societal control for the state. Like the concept of social capital, which refers to capital gained from social networks (Coleman 1988; Putnam 2000), political capital is often understood as capital gained from relational ties with politicians. In the literature, a firm's political capital is often operationalized with the firm owner's political positions, the number of board members, shareholders, and top officers with a political background, or a firm's expenditure on government relations. This literature has focused on how political capital matters to companies and has produced a rich body of works. In general, companies that have more political connections tend to have higher company values on the stock market or revenue across different political contexts (e.g. Fisman 2001; Faccio 2006; Goldman, Rocholl, and So 2009; Kostovetsky 2015; Szakonyi 2018) and are more likely to obtain bank loans and have higher leverage (Li et al. 2008; Firth et al. 2009). However, they also suffer from a weakness that comes from dependency on political connections: Once the politicians that lend political capital to these firms lose power, these firms are more likely to experience a sharper drop in their value and profitability compared with firms with fewer political connections (Fisman 2001; Faccio 2010). After all, a

[31] Kornai (1979) developed the concept of soft budget constraints by observing SOEs in Hungary. Kornai, Maskin, and Gerard (2003) provide a comprehensive review on the development of this concept, its historical contexts, and enabling conditions.

state–business relationship built on individual ties is precarious and is more likely to collapse (Rithmire 2023).

The stability and reliability of political connections, therefore, is key to any company's political capital, and this is exactly where an SOE's political capital fundamentally differs from that of private firms, even if an SOE has an equal number of connections with politicians as a private company has, based on these commonly used measures of political capital. In most sectors, private firms' political capital comes from a selected set of individual politicians that the firm owner is able to cultivate. These ties are vulnerable to change in politics. Once the connected politicians lose power, private firms' political capital plummets. But SOEs, extensions of the state's economic function, have ties with not only a selected groups of individual state agents, but also with the state as a whole. In other words, SOEs are *always* connected to a set of politicians in power, and their political capital does not depend as much on specific politicians as is the case with private firms. SOEs' political capital, therefore, does not fluctuate nearly as much as that of private firms. This direct and more stable tie with the state is what differentiates SOEs from private firms in political capital.

This fundamental difference in the nature and stability of political capital between SOEs and private firms is what sets them apart in providing the political service of societal control in the eyes of the state. In general, government officials find it easier to "conscript" private firms for societal control functions unwelcome by the firms. Private firms, understanding their ability to do business depends on individual government officials, are more likely to comply with government officials' demands. In a local leader's own words, "private firms are the most motivated to work with us [local government officials]. It's not that SOEs won't work with us, but we find them difficult to deal with. They [SOE managers] are like government officials."[32] Another local official made a similar comparison, noting that "private firms are easy to work with. SOEs are so bossy, so bureaucratic … we need to negotiate with them on every decision, and every decision takes such a long time in their super bureaucratic structure. They are even more bureaucratic than us [the government]!"[33]

But this does not mean private firms can outcompete SOEs in providing societal control functions. Rather, they each have their comparative advantages. It is easier for government officials to use private firms as scapegoats. Dependent on relations with government officials, private

[32] Interview 2015102.

[33] Interview 20151018.

firms are more likely to agree to shoulder blame for unpopular or failed projects and be publicly punished. But SOEs, particularly large SOEs, are better political allies when controversial projects invite large scale public opposition. If public opposition is high and requires suppression, SOEs can not only participate in suppression but also bring in extra political support to justify and support the decision of suppression. Depending on what government officials need from a firm, they would prefer firms of different ownership types.

All in all, when one observes a change in the landscape of firms in a sector, it is important to examine the political services demanded by the state in that sector. On average, private firms lag behind SOEs on financial capacity, and while they are better scapegoats, private firms are not better allies to the state. Depending on the costs and types of political services needed by the state and its agents, firms of different ownership types will be favored. State encroachment into a sector can happen when private firms fail at providing political services.

REVISITING CHINA'S MARKET REFORM: CONTAINING ECONOMIC PREDATION, BUT NOT POLITICAL PREDATION

Throughout China's market reform, economic actors never gained full autonomy from politics. Despite the progress in limited institutionalization, the Chinese state always reserves its ability to politicize economic actors, bestowing on them political roles and making them part of authoritarian politics.

Politicization of business, to borrow from Boycko, Shleifer and Vishny (1996), is to have businesses "pressured or bribed to bring their objectives in line with those of the politicians" (1996: 318). By showing how government officials demand political services from firms, and how these political services create an extra dimension of firm competition that often benefits SOEs rather than private firms, this book shows in detail how the politicization of firms distorts China's state–business relations and changes the landscape of firms in different sectors. In the process of market reform, the Chinese Party-state neither reduced the incentives of its officials to politicize firms, nor completely tied the officials' hands to prevent them from politicizing firms.

This is not to say that China did not curb state predation – it did curb economic predation to a certain degree. In the quest to answer why authoritarianism did not deter China's economic growth and investment attraction, scholars generally agree that a key factor is the Chinese state tying its own hands to limit economic predation, perhaps partly incentivized by an early form of public–private partnership, collectively owned enterprises, that gave Chinese officials a mindset of "corporatism" (Oi 1999). On the legal side, the Chinese state has launched several legal reforms since the 1980s. These include laws allowing private parties to sue government agencies (Pei 1997; Yang 2004). The state also institutionalized legal dispute resolution processes to restrict government officials from overtly distorting market outcomes or biasing them toward SOEs (Clarke, Murrell, and Whiting 2008). While China still does not have robust property rights institutions and faces challenges in enforcing contract law, competition law, labor law, and other laws governing the economic realm (Peerenboom 2002; Williams 2005; Du, Lu, and Tao 2015), it has nonetheless strengthened the legal aspects of transactions (Nee 1992; Zhang 2008), improved judicial fairness in the commercial realm (Wang 2015), regularized enforcement of laws and regulations in selected areas (Dimitrov 2016), and established a legal framework for labor without granting extensive labor rights (Gallagher 2011). Many argue that even though China does not have rule *of* law, it nonetheless has rule *by* law (Lubman 1999; Peerenboom 2002; Clarke 2003).

The Chinese state has also tied its hands on the administrative side to some degree. For instance, China reined in the discretionary tax authority of local governments (Naughton 2008). A centralized regulatory bureaucracy has been created to prevent local protectionism and to standardize policy enforcement with partial success (Mertha 2005). The capacity of Chinese regulatory agencies has increased as well, though they remain weak and not independent (Pearson 2005; Yasuda 2017). While China has never fully curbed corruption, and some argue that corruption is part of the system (Pei 2016), the state did launch anticorruption campaigns that kept corruption from spiraling out of control (Wedeman 2012; Manion 2016). This has been particularly notable in mitigating low-level corruption, though not high-level corruption (Wedeman 2005). Some argue that the dominant type of corruption in China today is high-level corruption, which, although not ideal, may have a stimulating effect on investment (Ang 2020). These administrative reforms, along with the legal reforms, enabled China to attract robust investment without undertaking political reforms.

But these same measures are less effective at containing the politicization of economic actors. For one thing, these measures to tie the government's hands are only partial efforts rather than complete institutionalization, which requires political reform that some convincingly argue is extremely difficult to achieve (Fewsmith 2013). As previously outlined, much of this scholarship, while acknowledging the Chinese state's efforts to improve property rights protection, also notes the limits of these reforms. This partial nature of China's economic reform is particularly salient when taking on a sectoral perspective. Examining deregulation patterns in China, for example, Hsueh (2011) points out that China was never fully committed to pursuing a sweeping liberal market reform. In sectors that concern national interests such as telecommunications, the Chinese state would reintroduce sectoral regulations after pursuing macro-level deregulation in compliance with the World Trade Organization. Similarly, by studying the information technology sector, Fuller (2016) observes that, unlike Japan or Korea, China can only be best described as having improved, but never fully developed, the market institutions necessary for technological innovation. Examining China's financial sector, Shih (2007) reaches similar conclusions – that the market reform in this sector is only partial, with the state retaining control over it.

Therefore, China has surely increased predictability and security for firms by building up "intermediate institutions" (Rodrik 2000), just as China for a period of time increased predictability and security in politics with partial political reforms (Nathan 2003). However, these substitutions for market-supporting institutions are not fully credible commitments, much like China's limited political reforms (Fewsmith and Nathan 2019). They leave room for government intervention in the economy, which allows politicization of business to happen.

And politicization of business does happen, because the incentives of the Chinese government officials to politicize firms are rooted in two authoritarian logics essential for the survival of the Party-state that outweigh economic growth: the Party-state's needs for loyalty from its government officials, and its needs for controlling the society without undermining its legitimacy.

The first authoritarian logic, to make sure government officials are loyal, is translated into a top-down personnel system that controls all government officials in China and attempts to strike a balance between loyalty and competence in selecting officials. This system, with its pros and cons, motivates government officials to use firms when they adopt unconventional political strategies to advance their careers. This mechanism is explained in detail in Chapter 2. The second authoritarian logic, to mitigate significant grievances from its citizens without sabotaging legitimacy, motivates the Party-state to use third parties such as firms for societal control. This mechanism is explained in Chapter 3. The incentives to politicize firms are thus present as long as these authoritarian logics are in place, and these authoritarian logics carry a higher degree of importance to the CCP's survival than that of economic growth. Therefore, the incentives to politicize firms are not bounded by, and cannot be weakened by the aforementioned state efforts to curb economic predation by state officials.

The Party-state even provides direct justification to politicize firms for its government officials. The CCP's official documents on building a market economy contain statements such as "the private sector will continue to be the pillar of China's economy" and private entrepreneurs are "our [the Party's] own people."[34] But they also contain statements that the private sector needs to "be consistent with the Party" and be "politically sensible."[35] Both are sincere messages from the Party, stemming from the Party's fear that capitalists could become an organized opposition. And this fear has a history as long as China's economic reform since 1978.

In 1982, a mere four years after China's economic reform began, the CCP had its first crackdown on the private economy in the reform era. This was directed by Deng Xiaoping himself, the very person who initiated China's economic reform. Speaking at a meeting of the CCP Politburo on April 10 that year,[36] Deng cautioned that there was a risk of regime change resulting from rapidly growing capitalism in China. He demanded every provincial government to prosecute several large cases of economic offenses within two months. Deng's order started a wave of investigations into the economic crime of "speculation and profiteering."[37] Loosely defined in the 1979 Criminal Law, this offense encompasses any behavior that involves selling products for substantial profits that could potentially disrupt the market, with no specific criteria for what constitutes "substantial."

By the end of 1982, courts across China had investigated more than 164,000 cases of "speculation and profiteering," sentenced nearly 30,000 people, and confiscated over 320 million yuan.[38] This led to a heavy blow

[34] "Guanyu jiaqiang xinshidai minying jingji tongzhan gongzuo de yijian," General Office of the Chinese Communist Party, 2020-09-15, www.gov.cn/zhengce/2020-09/15/content_5543685.htm.

[35] Ibid.

[36] "Deng Xiaoping: jianjue daji jingji fanzui huodong," Deng Xiaoping wenxuan dierjuan, 1982-04-10, www.reformdata.org/1982/0410/5291.shtml.

[37] In Chinese, this offense is called "tou ji dao ba (投机倒把)."

[38] "Zhongguo gongchandang dashiji (1982)," *Xinhua News*, 2006-06-26, https://news.sina.cn/sa/2006-06-26/detail-ikftssap2649518.d.html.

on China's economic growth. Take Wenzhou city in Zhejiang province, for example. Wenzhou is known as a cradle for entrepreneurship and, unrelatedly, Christian house churches. It made national headlines in this wave of crackdowns when the Wenzhou city government sentenced eight of its most successful private entrepreneurs to jail for "speculation and profiteering," spanning sectors from manufacturing screws to coils. The result was the retraction of the city's private firms and the city's industrial output dropping by 53 percent at the end of 1982.[39] Seeing this devastating effect on the economy, the CCP reversed course in 1984 and restarted encouraging private entrepreneurship, and the crime of "speculation and profiteering" was removed from China's 1988 Criminal Law.

After a few quiet years, in 1989, after Tiananmen, another wave of crackdowns on private sectors began. This wave of crackdowns began with the CCP's associating private entrepreneurs with the student protesters at Tiananmen. At a Party study session in December 1989 that was later published in *People's Daily*,[40] the then head of the CCP's Propaganda Department summarized the lessons of Tiananmen. Specifically, he stated that the financial backing for the student protesters originated from China's private entrepreneurs. Moreover, he asserted that these entrepreneurs, empowered by their newfound wealth, were actively seeking political agents in the government to participate in politics. This statement prompted local governments across China to engage in the politically motivated targeting of private entrepreneurs and scrutinizing of the tax records of private enterprises.

Consequently, between 1989 and 1992, a trend of nationalization of private firms emerged across the country. Some private firms voluntarily sought to change their ownership type by merging with SOEs, while others were subject to forced mergers and acquisitions, and some went so far as to "donate" their private companies to the state (Zhang 1993), which were then transformed into "Township and Village Enterprises," an early form of local public enterprise.[41] Some of China's most successful entrepreneurs explained the rationale of voluntary nationalization later in interviews. For instance, the founder of Geely Auto, one of China's largest car manufacturers in the 2020s, relinquished ownership of his

[39] "Wenzhou 1982 nian zaoyu badawang shijian," *Changchengwang*, 2011-06-24, www.reformdata.org/2011/0624/15658.shtml.

[40] "Wang Renzhi: guanyu fandui zichanjieji ziyouhua," *People's Daily*, 1990-02-22, www.reformdata.org/1990/0222/6145.shtml.

[41] See Oi (1999) for a detailed account on these enterprises and how they contributed to China's economic growth.

then refrigerator company to a local government in 1989 owing to fears that he would be thrown into jail for being a successful capitalist.[42] The founder of New Hope Group, China's largest agricultural products company, also offered to surrender his enterprise to a local government in 1990 to avoid political troubles.[43] Likewise, the founder of China's largest cable company, Far East, was forced to relinquish the company to a local government in 1992.[44] In the second half of 1989 alone, the number of self-employed individuals and microenterprises decreased by 15 percent, and the number of private enterprises decreased by 50 percent nationwide.[45] Again, fearing these crackdowns were hurting the economy too much, Deng Xiaoping went on his famous 1992 southern tour to reverse course and reaffirm the CCP's commitment to economic reform and capitalism.[46]

This earlier history of the CCP's distrust in entrepreneurs set the tone for a partial reform that tries to strike a balance between attracting private investments and not empowering private entrepreneurs politically. And the CCP was probably right to think that private entrepreneurs could potentially challenge the regime. After all, the bourgeoisie or the middle class, many of whom were business owners, were considered a driving force behind democratization in many parts of the world (Lipset 1960; Moore 1966),[47] and so the CCP has always sought to keep China's rising entrepreneurs in line. Regarding this goal, the CCP has largely succeeded. Survey research throughout the years shows that private entrepreneurs in China do not generally demand democracy (Pearson 2000; Dickson 2003; Tsai 2007; Chen and Dickson 2010). This is probably

[42] "Qiche jie de nian yu: Li Shufu," *Workers' Daily*, 2008-12-16, www.chinanews.com.cn/auto/kong/news/2008/12-16/1489069.shtml.

[43] "Liu Yonghao: chuangye shengya zhong wuge jingxindongpo de gushi," *Zhongguo qiyejia wang*, 2013-12-17, https://finance.sina.com.cn/leadership/crz/20131217/075617655931.shtml.

[44] "Dianlan dawang Jiang Xipei: cong xiubiao jiang dao jituan zhuxi," *Zhongguo Cishanjia Zazhi*, 2018-03-05, https://finance.sina.cn/chanjing/gsxw/2018-03-05/detail-ifxipenm9276265.d.html?from=wap.

[45] Private enterprises are those employing more than eight people in 1989. Source of data: Dong (1999: 429–30).

[46] This back-and-forth reflects the uncertainty among Chinese elites regarding the direction of China's economic reforms. For those interested in seeing the debates among China's top political elites on economic reforms in the 1980s, see Fewsmith (2016).

[47] Modernization theory claims economic development will lead to democratization, largely as a result of a rising middle class that will demand political rights. This theory has been widely debated ever since: See, for example, Przeworski and Limongi (1997), which shows its limits, and Marsh (2014), which argues for its validity.

because many entrepreneurs perceive themselves as winners in China's partial reforms, and we know from the Soviet Union experience that winners of partial reforms often resist further, full liberal reforms to maintain their advantages in the existing system (Hellman 1998).

Therefore, the CCP will continue to, as stated in its documents, make sure entrepreneurs remain "politically sensible." This very incentive is what leaves open the possibility to politicize firms. In today's China, the CCP probably views private entrepreneurs as less of a threat to the regime than in the 1980s, but they continue to view private entrepreneurs as political servants to the Party-state. And thanks to a partial reform process that did not empower private entrepreneurs, the CCP is able to call for firms to provide political services when they see fit, because the firms are required to be "politically sensible." This creates conflicts between the state and firms, leading to oscillations in state–business relations that persist to this day.

But what is being "politically sensible"? What does it mean to the private sector? Is it regarding a firm's production? Investment? Competition? This vagueness around the Party's "bottom line" for private firms, intentional or not, deprives firms of full autonomy as economic actors. Such a statement leaves open the possibility for any government official to rein in firms in the name of political needs. Adding onto this justification handed over by the Party, the stealthy nature of political services makes it a relatively safe act for government officials. Compared with economic predation such as demanding bribes, it is more difficult to detect or convict politicization. Asking firms to provide political services does not often produce direct evidence against a government official individually, because political services, such as visibility projects or societal control, are easily framed as genuine efforts to carry out Party agendas and benefit society, and do not produce piles of cash or arms full of expensive wristwatches. When these favorable conditions for politicization of firms meet the incentives to demand political services from firms, we see firms turned into political actors by the state.

As a result, China's economic reform has focused on containing economic predation but not political predation. Politicization of firms is both of lesser concern to the CCP and a more challenging issue to tackle. The CCP certainly enjoys performance legitimacy from economic growth brought by firms, but it is also wary of potential organized opposition from the private sector. If the Party tells its officials to leave the private sector alone, how can it make sure the private sector stays only in the economic lane? But then how does the Party define the proper scope of monitoring and guidance of the firms to be in line with the Party, without overstepping into regular business operations? When asking an official in Beijing in 2015 whether the government might be concerned that using firms for political services, such as asking companies to contribute to the aforementioned green walls or to share customer data with the state, might go too far and deter future investments, he gave me the quote at the beginning of this chapter, from Party learning sessions: "The [Party's] teaching is clear. The economy is secondary to politics in this country. We'd give up economic growth without hesitation for political needs."[48]

The impossibility of defining the Party line in business operations therefore provides government officials political leeway when they use firms for political services, since most of these political services can be framed in the name of executing Party agendas. Consequently, despite all the institutional building efforts to tie the state's hands, the CCP has left open the possibility of politicization of firms. This facilitating condition, combined with the built-in incentives of Chinese officials to use firms for political goals, has created a market reform process in which the state has reduced its economic predation of the private sector but retained its power to politicize them.

The politicization of firms, as depicted in this book, thus extends our understanding of state–business relations in China in two ways. First, it shows the limits of firms' efforts to reduce political risks in an authoritarian environment. It is well documented that firms in China are adept at protecting and advancing their interests through engaging in corruption, building ties with important government figures, joining government bodies and representative institutions, and forming business alliances and coalitions (e.g. Dickson 2003; Tsai 2002; Kennedy 2009; Cai, Fang, and Xu 2011; Hou 2019; Dimitrov 2020). These measures, while indeed improving their business environment by compensating for weak market institutions, nonetheless fall short in protecting them from political predation in an authoritarian state. Political predation by the authoritarian state stems from the state's need to prevent regime change, a political logic of a higher order than to enhance regime legitimacy through economic growth. Therefore, all the political ties with the state accumulated by firms, regardless of their depth or extent, are not sufficient to shield them from political demands of the state.

[48] Interview 20150428.

The companies depicted in this book, whether private (including foreign) or state-owned, are sophisticated economic actors that understand how to operate in an environment lacking full protection of property rights. These firms have undertaken the necessary actions, some of which they are proud of and others less so, to establish a mutually beneficial relation with the Chinese state. They are not oblivious to the complicated environment they operate in, and they are skilled and seasoned economic actors that are often quite ready to work with an authoritarian state and its officials when such cooperation aligns with their business interests.

However, the demand by the state to provide political services is different from the average state–business exchange of interests. It is often when conscripted to provide political services that businesses realize the limits on their end to protect their business interests. Even the winners of China's partial reform who are adept at building ties with the state discovered the often unbearable costs associated with political demands by the state. And the high costs associated with providing political services is what often puts private companies at a disadvantage compared to SOEs in a sector with both types of ownerships, and which may lead to their exit from a sector, sometimes voluntarily, other times not.

Second, this book reminds us that *all* sectors, including the most mundane, can be politicized by the state. If we only focus on the central government of China, then it would seem as if the Chinese state tends to exert statist control over highly profitable sectors for economic predation, or strategic sectors for developmental purposes or out of national and domestic security concerns. But sectors of less strategic importance could still have political value to the state. This book, through studying some of the most mundane sectors, such as urban buses and waste treatment, shows how the political values of a sector are separate from its strategic values. Firms are beyond economic actors in the eyes of the authoritarian state. They are considered an integral part of the Chinese political system, and authoritarian politics can pull all firms, strategic or not, into politics.

So, returning to the driving question of this book: When and where does the Chinese state encroach into a private sector? Not only when the state needs to directly control an industry for economic gains, national development trajectory, or geopolitical and security reasons, but also when the authoritarian machine requires private firms to cooperate with the state for deeply political reasons.

RESEARCH DESIGN

This book uncovers the phenomenon of politicization of firms in China, traces its institutional origins, and examines its outcome in state–business relations and ownership change in a business sector. I adopt a mixed method design involving quantitative analysis of original datasets I compiled on two sectors, over 200 semi-structured interviews with government officials, businesspeople, and various stakeholders in fifteen cities, and in-depth case studies and process tracing in four cities across China. The outcome of interest is an extreme form of state encroachment, deprivatization, an outcome not easily confused with standard government regulation of a sector. I leverage both sectoral variation and local variation within each sector on the outcome of deprivatization to tease out the effect of politicization of firms on state–business relations.

I select two sectors – urban buses and municipal waste treatment – to fulfil this analytical purpose. Both sectors were open to private investors in the early 1990s and experienced notable success in initially attracting private companies, and the Chinese central government continues to call for more private provision of both services to this date (2025). Both sectors experienced intense politicization nationwide. Firms in the urban bus sector were asked to contribute to visibility projects, and firms in the waste treatment sector were asked to provide societal control over protests against waste incineration projects, and in some locations also to provide visibility projects. Nonetheless, the outcomes faced by private companies vary between these two sectors and across different cities within each sector. In the urban bus sector, private firms in the majority of Chinese municipalities were forced to exit the sector by local governments. Conversely, in the waste treatment sector, local governments did not systematically coerce private firms to exit as they did in the bus sector. Private firms in some localities continued to thrive and in other localities started to lose ground to SOEs, opting to voluntarily exit or form joint ventures with SOEs at a later stage.

This variation in outcomes by sector and locality of the private firms allows me to tease out several alternative hypotheses generated in the literature for nationalization or deprivatization of a sector. Unlike oil and telecommunications, both urban buses and waste treatment sectors are mundane foot soldiers of urban life that are not crucial to national security or geopolitics. Furthermore, both urban buses and waste treatment are semi-public service sectors with price regulations, and between these two sectors, the waste treatment sector has a higher profit margin than that of urban buses. Some scholars optimistically estimated that the return on investment of waste-to-energy plants in China is about 18 percent in 2015 (Zhao et al. 2016), and my interviews revealed a range of profitability percentage between 10 percent and 12 percent between 2009 and 2018. While systematic data on profit margins do not exist for the urban bus sector, my collection of data shows the range of profitability percentage of bus firms between 2009 and 2016 to be between 1.48 percent and 13.22 percent.[49] These differences exclude the possibility that local governments might force private companies out of the urban bus sector for economic predation incentives. In particular, if state encroachment was driven by economic predation, we should observe coerced exit of private firms in the waste treatment sector rather than the urban bus sector.

Similarly, the difficulty for the government to write complete contracts with these sectors does not well explain the outcome of privatization in these two sectors. Around the world, services in these two sectors are successfully provided by the private sector in many countries. A large literature describes how public transportation is an ideal sector for privatization and contracting out, and private provision of public transit is often more efficient and effective than government-provided public transit across the world. Privatization introduces competition into the urban transit sector, and this sector has easily measurable services, therefore making it easy for local governments to come up with specified contracts with private providers. As a result, privatization in the bus sector often leads to efficient private provision of high-quality services (Perry and Babitsky 1986; Gomez-Ibanez and Meyer 1993; Finn and Mulley 2011). In the solid waste management sector, privatization and contracting out would often initially save costs compared with service under public ownership. In the long run, however, the experience of privatization of waste management in North America and Europe did not show significant change in cost savings for the government, mostly because the waste treatment sector is naturally more concentrated and has little competition within a city (Bartone et al. 1991; Dijkgraaf and Gradus 2007; Bel and Warner 2008; Bae 2010; Bel, Fageda, and Warner 2010).

[49] The figure of 13.22 percent is the revenue percentage of one of the busiest bus routes in China's capital city (Liu et al. 2018). The profitability percentage for the bus company that owns this route is certainly lower than 13.22 percent.

In China, both sectors have been privatized for more than twenty years, and there has been more competition in the urban bus sector than in the waste treatment sector. On average, each Chinese city had 8.0 bus companies and 3.9 waste treatment firms following privatization.[50] If the difficulty associated with writing complete contracts and regulation in sectors with limited competition were the rationale behind deprivatization, then we should expect the local Chinese governments to deprivatize the solid waste sector before the urban bus sector, but the reality is the opposite.

I also leverage local variations within each sector to control for the different nature of political services demanded in these sectors, as well as sectoral factors related to strategic importance, profitability, ease of contract writing, and regulations, all of which are difficult to compare quantitatively between sectors. For each sector, I first conduct statistical analysis of trends across Chinese cities with original data I compiled, revealing a correlation between politicization of firms and sectoral ownership change. I then delve deeper into the causal mechanisms at work with a most-similar case comparison using process tracing of ownership change in two cities in each sector. These cities would be similar in respect to key variables other than politicization of firms, but experienced different outcomes in ownership change in a sector, allowing me to identify the impact of politicization on state–business relation outcomes.

An original quantitative dataset was compiled for the statistical analysis component. State–business outcome data are collected and coded from news reports and government documents. Data on protests are collected and coded from news reports; People's Congress documents; the Wickedonna blog; the Social Unrest Database of the Chinese Academy of Social Sciences; the Global Database of Events, Language, and Tone (GDELT); and the China Labour Bulletin. The qualitative evidence comes from two waves of over 200 in-depth interviews conducted between 2015 and 2019 in fifteen cities across China, as well as in-depth case studies and process tracing based on government documents, news reports, and academic journal articles. The first wave of interviews included thirty-four loosely structured interviews to generate hypotheses and develop a question bank, while the follow-up wave consisted of semi-structured interviews across all fifteen cities to test the hypotheses. Of all the interviewees, 41 percent are city government officials in charge of a public service sector, 46 percent are business executives and

[50] Author's data collection.

managers providing these public services, and 13 percent are academics, NGO managers, and journalists. The selection of interview cities follows the principle of stratified sampling, with the cities varying along the dimensions of population size, economic development level, and industry composition. In each city, I use the snowball sampling method to select interviewees.

Through this cross-sector and cross-locality comparative study utilizing mixed methods, I explain the different state–business outcomes in the two sectors with the different nature of politicization these sectors experienced. In the urban bus sector, political services of visibility projects resemble regulations that increased costs for all private firms beyond their capacity. This led to the private firms, but not SOEs, to eventually refuse to provide more political services and led to deprivatization of the noncooperative private companies. In the waste treatment sector, political services of societal control resemble bribes. Only those private companies unable to afford the "bribe," especially those lacking political competitiveness relative to SOEs in providing societal control, exited the sector one way or another, and other private companies remained.

BOOK STRUCTURE

The rest of the book is organized as follows. Chapter 2 explains the first political service provided by firms' contributions to visibility projects. This chapter provides a definition of visibility projects and distinguishes it from other public projects, including development projects, white elephant projects, Potemkin projects, and performative governance. The chapter then proceeds to outline the motivations driving Chinese officials to launch visibility projects, elucidates how firms are enlisted to provide this political service, and underscores the disadvantage faced by private firms compared with SOEs in providing this political service. This mechanism is empirically tested in Chapters 4 and 5, which respectively use quantitative and qualitative analyses in the urban bus sector to show this process across Chinese cities.

Chapter 3 describes the second political service provided by firms: supplementing the state in societal control. It details how Chinese officials respond to public opposition when launching controversial projects, and how the officials use private firms and SOEs differently to appease or suppress protesters. This mechanism is tested in Chapters 6 and 7. I use the municipal solid waste treatment sector to show how waste incineration plants act as allies or scapegoats in the face of public protests, and how private firms and SOEs have different advantages in providing this service. Eventually, based on the nature of societal control that a city needs, private firms either remain in the sector or lose their competitiveness and become replaced by SOEs.

Chapter 8 concludes by discussing how China's prospect of attracting and retaining private investments can be diminished by the state's politicization of firms. It also raises concerns about the quality of China's sustainable development, which is an important goal in both the urban bus sector and the solid waste sector. The chapter ends with a reflection on how China's authoritarian institutional arrangements might compromise the country's effort to attract and retain investment and to build a market economy, and to break from a model of economic growth at all costs to one of sustainable development.