

CHANGING CHINA:  
Private Entrepreneurs and Adaptive Informal Institutions\*

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Merchants and traders...are cunning and crooked, but not rebellious.

-- Wang Shituo, 1853-1856 Diary<sup>1</sup>

Perhaps the new entrepreneurs... are the ones with the real power to change things...  
Perhaps among them a new force is gathering, an energy that can be directed toward  
social change. We must not underestimate them.

-- River Elegy, 1988 TV Series<sup>2</sup>

The stunning expansion of China's private sector since the late 1970s has inspired political scientists to speculate that rapid economic development and the ensuing rise of China's capitalists constitute the basis for a transition to liberal democracy. By 2005, there were 29.3 million private businesses, employing over 200 million people and accounting for one-third of the GDP (*China Daily*, December 14, 2006). Chinese entrepreneurs have become statistically consequential, yet they are denied the opportunity to vote for political leaders who will defend their material interests. Based on the evolution of democracy in a handful of western countries, many observers thus expect that China's growing population of capitalists will demand democracy in the spirit of "no taxation without representation." They will strategically leverage their economic resources to acquire political ones. "An emerging powerful entrepreneurial class," Guo Xiaoqin speculates in *State and Society in China's Democratic Transition* (2003), could become "a constituency independent from state power that demands a strong voice in the political process" (220). With greater specificity, Zheng Yongnian posits, "Chinese business classes are likely to play a role that their European counterparts did in the past. Capitalism is generating a Chinese bourgeoisie. It is a class with teeth" (Zheng 2004, 311). And in *China's Democratic Future* (2004), Bruce Gilley asserts, "China's new breed of entrepreneurs have little interest in saving a dying regime." To reinforce this point, Gilley cites a warning from a

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<sup>1</sup>Cited in Yang 1970, 199. Yang goes on to discuss cases of "market strikes" in Shanxi, Anhui, Zhejiang, and Fujian between the years of 1660-1698, however.

<sup>2</sup>Cited by Goodman 1996, 227-28.

Communist Party journal that these disloyal “capitalists will rise up and destroy the Party lock stock, and barrel” (66).<sup>3</sup>

Despite the boldness of such claims, this paper contests the widely held assumption that private entrepreneurs as a group are poised to demand democracy in China.<sup>4</sup> Rather than assuming that Chinese entrepreneurs represent a pro-democratic class, this paper suggests that it is more instructive to assess whether the current generation of capitalists shares a common identity and definition of interests—which would be necessary for constituting a politically assertive class or even part of a class (Thompson 1966). My research demonstrates that China’s business owners are diverse. Most do not fall into the income and life style strata that we regard as constituting the “middle class.” Because of their diversity, entrepreneurs deal with the government in different ways and have different political views, if any. And to the extent that China’s capitalist elites are politically assertive, they are not inclusive in their demands. They are pragmatic and creative, but they are not budding democrats.

Although China’s private entrepreneurs are not clamoring for democracy, this paper shows that they have had a structural impact on Chinese politics—but not in the manner that structural theories of democratization would expect.<sup>5</sup> In the course of their day-to-day interactions, entrepreneurs are changing the country’s formal political institutions in ways that reflect their needs and interests. Although liberal democracies permit many direct forms of

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<sup>3</sup>Besides the authors cited above, many other scholars have predicted more generally that economic development will lead to democracy in China. For example, see Adelman 2001; Diamond 1999; Glassman 1991; Lollar 1994; Rowen 1996; and Vanhanen 2004.

<sup>4</sup>Note, however, that China scholars who have focused on particular sub-sets of private entrepreneurs have reached similar conclusions about the absence of class-based yearnings for democracy. See Dickson 2003; Hong 2004; and Pearson 2002.

Those who expect democratization in China usually mean a liberal democracy, including competitive and fair elections, and protection of civil and political liberties by rule of law. See Zhao 2000 and the special issue, “Will China Democratize?” *Journal of Democracy* 9, 1 (January 1998).

<sup>5</sup>The full version of the argument is presented in Kellee S. Tsai, *Capitalism without Democracy: The Politics of Private Sector Development in China* (Ithaca: Cornell University Press, forthcoming in 2007).

political expression, what China's entrepreneurs are doing is more subtle and possibly more politically effective than voting, lobbying, and protesting. Major reforms in China's formal institutions have enhanced the private sector's political legitimacy and economic security—and yet these institutional reforms have occurred in the absence of political mobilization by business owners. Regardless of whether or not China ultimately experiences a democratic transition, examining the actual political influence of China's private sector presents political scientists with a revealing case of endogenous institutional change. Specifically, business owners have fundamentally altered the formal political landscape through what I call, “adaptive informal institutions.” The broader implication of this contention is that even in an authoritarian regime, informal interactions among state and non-state actors have the causal potential to change formal, state-level institutions.

The paper proceeds as follows. The first section outlines the theoretical context for the issues under consideration. As we shall see, whether structural or voluntarist in orientation, few scholars actually propound a simple linear model of political development based on an overgeneralization of Barrington Moore's famous quotation, “no bourgeois, no democracy” (Moore 1966, 418).<sup>6</sup> Historically, the processes that lead to democratization are highly contingent and involve a multiplicity of actors and institutions.<sup>7</sup> Hence, the more interesting analytical question is examining how major transformations in China's formal institutions could have occurred endogenously and in the absence of regime change. Building on recent theories of institutional development, I propose that adaptive informal institutions can play an important mediating role in explaining the influence of informal practices on formal institutions. The

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<sup>6</sup>Moore's oft-cited “no bourgeois, no democracy” was not intended to travel beyond the countries that he analyzed.

<sup>7</sup>Political scientists writing about the “third wave” of democratization in the late 1970s and early 1980s identified multiple paths for authoritarian breakdown and democratic consolidation. See Collier 1999; Huntington 1991; O'Donnell, Schmitter, and Whitehead 1986; Rueschemeyer, E. H. Stephens, and J. D. Stephens 1992.

second section presents evidence from fieldwork conducted over the course of 2001-2005, which includes a national survey of China's private entrepreneurs. The findings demonstrate the limits of class formation and political mobilization among the current generation of business owners. While private entrepreneurs are not likely to be agents of regime change, their entrepreneurial agency at the grassroots level has had a structural impact on China's most important political institutions: the Chinese Communist Party now admits capitalists and the People's Republic of China (PRC) Constitution now protects private property rights. Ultimately, the private sector's political influence has unfolded in an indirect and incremental manner.

### **Questions for the Literature on Regime Transition and Institutional Change**

The case of private sector development in China raises two complementary questions for two branches of literature in comparative politics that are not typically considered together. First, why do observers expect capitalists to demand democracy in China? Second, how can we explain the regime's ability to endure substantial structural and institutional changes in the country's political economy? The answer to the first question is relatively straightforward: Those who have democratic expectations of China's capitalists are guided by classic theories of democratic development (Schumpeter 1942; Lindblom 1977), which are historically-contingent and inappropriate for explaining democratic transitions in late industrializing countries. Capitalists have at most played a complementary rather than leading role in the twentieth century transitions to democracy. At the same time, although contemporary China lacks both the structural and elite-level conditions necessary for democratic development, major political and economic transformations have in fact occurred. That these changes have taken place in the absence of regime transition raises the issue of how China's formal institutions have managed to adapt, and in some cases, change in light of new economic and social conditions.

Building on insights from historical institutionalist accounts of institutional development, this paper proposes that informal institutions serve an important intermediate role in explaining the process of endogenous institutional change. More specifically, the causal mechanism underlying the flexibility of formal institutions stems from the often informal interactions between various state and non-state actors at the local level. The etiology of formal institutional change lies in the informal coping strategies devised by local actors to evade the restrictions of formal institutions. Formal institutions comprise a myriad of constraints and opportunities, which may motivate everyday actors to devise novel operating arrangements that are not officially sanctioned. With repetition and diffusion, these informal coping strategies may take on an institutional reality of their own. I call the resulting arrangements “adaptive informal institutions” because they represent creative responses to formal institutions that local actors find too constraining. Over time, adaptive informal institutions may then motivate political elites to change the original formal institutions.

#### *The (Misplaced) Sources of Democratic Expectations*

The comparative literature on democratization presents at least two causal sequences that connect private sector development with democratic transition.<sup>8</sup> First, from a structural perspective, capitalists may become a pro-democratic class. Second, from a voluntarist perspective, reform-oriented political elites may collaborate with capitalists to undermine authoritarian rule. Both scenarios require a certain degree of discontent and collective organization on the part of business owners, but neither approach predicts democratization in China in a determinate manner.

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<sup>8</sup>Many accounts of democratization draw on both structural and individual-level variables, e.g., Bratton and van de Walle 1997; Collier 1999; Haggard and Kaufman 1995; Huntington 1991. Helpful reviews include Hagopian 1993; Kitschelt 1993; Munck 1994; Remmer 1991. The applicability of these “third wave” explanations to post-communist societies is questionable; see McFaul 2002.

First, given that China has experienced rapid growth rates under increasingly market-oriented conditions since the late 1970s, the structural, social class-based explanation is the typical framework invoked by observers who anticipate democratic development in China.<sup>9</sup> Yet even a cursory consideration of twentieth century transitions to democracy reveals that capitalists have demonstrated neither consistent opposition to authoritarian regimes nor consistent support for democratic ones. As Eva Bellin (2000, 2002) has argued, the political preferences of capitalists in late industrializing countries hinge upon their degree of state dependence for the protection of their material interests, and the extent to which capitalists fear that mass political empowerment would have destabilizing consequences. That is, capitalists are not likely to support democracy if they are highly dependent on the state and fearful about the disruptive potential of democratization, and vice versa. The cases of Brazil and South Korea are particularly illustrative in this regard: in both countries industrialists supported bureaucratic-authoritarian regimes during periods of economic growth and only gradually came to play a more supportive role for regime transition after other segments of society had already mobilized for democracy (Eckert 1993; Koo 2001; cf. Payne 1994).

Second, if capitalist elites were to partake in a voluntarist version of democratic transition, their participation would be motivated, at a minimum, by exclusion from the current political regime and a loss of confidence in the ability of the current regime to protect its material interests.<sup>10</sup> A related scenario would be if entrepreneurs viewed democratic political institutions as being more likely to protect their material interests. Yet studies of the third wave democracies reveal that business elites have not been especially active in either initiating or consolidating

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<sup>9</sup>The logic of structural approaches resonates with modernization theory, which has experienced a revival in light of post-Cold War notions of convergence towards global norms of capitalism and democracy. See Fukuyama 1992; Lipset 1959; Przeworski and Limongi 1997; Pye 1990.

<sup>10</sup>Colomer, 2000; O'Donnell, Schmitter, & Whitehead, 1986; Przeworski, 1991; Rustow, 1970.

democratic transitions. It seems that the strongest statement that one can make about the role of the Latin American bourgeoisie is that they have not blocked transitions to democracy (O'Donnell 1992).<sup>11</sup> Business elites were similarly quiescent in the South European transitions. The cases of Argentina and Spain show that even when industrialists are dissatisfied with an authoritarian regime, it does not mean that they will necessarily collaborate with other elites in facilitating a transition to democracy (Payne 1994; Smith 1989).

Ultimately, the contemporary association of capitalist development with democracy involves complex processes that extend beyond the mere emergence of private entrepreneurs—as a class and/or as an elitist vanguard.<sup>12</sup> In late industrializing countries, the elite layer of capitalists tends to be incorporated by the existing regime and therefore lacks the incentive to demand political liberalization. The lowest tier of business owners may constitute the bulk of the private sector, but tends to lack the confidence and resources to mobilize politically. Only the middle tier of business owners tends to accumulate both the resources and the desire to pose a serious political challenge; but even then, it is often in collaboration with other sectors in society.

My research shows that China's private entrepreneurs are not prone to engage in collective action, much less demand democracy. The private sector has thrived and once unthinkable changes have occurred in the country's most fundamental political institutions. How can this be explained in the absence of popular mobilization, regime change, or external shocks?<sup>13</sup>

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<sup>11</sup>In Argentina, for example, capitalist leaders supported the military coup of 1976, but then disapproved of the ensuing succession of military governments because the generals pursued economic and foreign policies that undermined rather than enhanced the country's social stability and international legitimacy (Smith 1989).

<sup>12</sup>The development of democracy may stem from a variety of factors, including the rise of civil society, social movements, shifts in elite politics, international pressures, direct foreign intervention, and structural changes in society and the economy. Anderson 1999; Diamond and Plattner 1996; Huntington 1991; O'Donnell et al. 1986; Przeworski 1991.

<sup>13</sup>Most theories of institutional change rely on either the presence of external shocks or highly motivated political leaders to explain institutional transformations. For example, Krasner 1984; Levi 1990; Tsebelis 1990.

### *Explaining Endogenous Institutional Change*

The literature on historical institutionalism and American political development offers two general approaches to explaining endogenous institutional change: the “sequencing” approach, which is more structure oriented, and the “layering” and “conversion” perspectives, which are more action oriented. Both draw upon the internal logic of formal institutions to explain the origins of change. I propose that focusing on informal interactions and informal institutions has the potential to clarify the causal mechanisms in these endogenous accounts of institutional development.

#### Path Dependence and Sequencing

The sequencing approach to institutional development typically focuses on the self-reinforcing dynamics of path dependency and institutional continuity. As Douglass North (1990) explains, “Path dependence comes from the increasing returns mechanisms that reinforce the direction once on a given path” (112).<sup>14</sup> But path dependence does not preclude change over time. In particular, Paul Pierson (2004) distinguishes between “self-reinforcing event sequences” and “non-reinforcing event sequences” in path dependent arguments. A common expression of a self-reinforcing event sequence is when certain political actors consolidate power early on and end up promoting institutions and rules that enable them to maintain their authority (Pierson 2004, 73). On the other hand, in “non-reinforcing event sequences,” or what James Mahoney (2000) calls “reactive sequences,” certain events occur in reaction to earlier events and end up propelling subsequent ones on an alternative trajectory. As in self-reinforcing event sequences, events that occur earlier in a particular sequence can also have greater impact on later events—but as Pierson (2004) points out, “not necessarily by inducing continuous movement in the same direction. Indeed, the route might matter precisely because it sets the stage for a

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<sup>14</sup>Cf. David 1994 and Arthur 1994.

particular kind of reaction in some other direction” (68).

Given that the present explanatory objective concerns institutional transformation amidst regime continuity, the concept of reactive sequences is fruitful for appreciating the potentially non-linear trajectory of institutional development. That is, short of regime transition, it is plausible that significant changes could occur within the apparent limits of the existing political system. Some institutions may elicit responses that undermine the dynamics of institutional reproduction and reinforcement.<sup>15</sup> This raises the question of when reinforcing processes are likely to shift to reactive ones, which is addressed by notions of institutional layering and conversion, discussed next.

### Institutional Layering and Conversion

The second category of explanations for endogenous institutional change emphasizes institutional layering and complexity as a product of multiple sources of human action. The concept of layering refers to the fact that most institutional environments comprise a variety of institutions, some of which may not be consistent with one another. Thus, the reality of multi-layered institutional contexts limits the degree of coherence that particular formal institutions (e.g., the United States Congress) may have at any given point in time (Orren and Skowronek 1994; Schickler 2001). As for the potential timing of endogenous institutional change, Robert Lieberman (2002) hypothesizes that “significant extraordinary political change” is more likely when there is “friction among multiple political orders” (703). In other words, the impetus for institutional change may emerge out of conflicts among otherwise stable patterns of politics. And the “causal mechanism linking structural friction and political change is the reformulation of the incentives and opportunities for individual political action that friction produces” (Lieberman 2002, 704). As a result of this friction among various institutional layers, actors may

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<sup>15</sup>Cf. examples of the difference between self-reinforcing and self-destructing institutions in Greif and Laitin 2003.

establish adaptive patterns that are simultaneously new, yet familiar.

A related phenomenon within the layering approach to institutional development is what Kathleen Thelen calls (2004) “institutional conversion,” meaning the use of existing institutions for new or alternative purposes. In contrast to the self-reinforcing view of institutions, this perspective recognizes that even when the formal attributes of institutions remain in place, their substantive roles may change quite dramatically. Furthermore, unlike explanations of institutional change that privilege the explanatory role of critical junctures during periods of crisis and “unsettled times,” Thelen’s analysis demonstrates that “more subtle and smaller scale changes in ‘settled’ rather than ‘unsettled’ times are also worthy of our attention, as, over time, they can cumulate into significant institutional transformation” (Thelen 2004, 292). The case of private sector development in China provides many examples of how institutional conversion can result from endogenous processes of economic and social change during normal times.<sup>16</sup>

In sum, earlier accounts of path dependence limit the extent to which actors may fundamentally re-orient the direction of formal institutions and view most instances of institutional transformation as being partial and incremental. The more recent sequencing, layering, and conversion approaches also portray institutional development in an evolutionary manner, but emphasize its politically contested processes and potentially discontinuous consequences. These latter theoretical observations go a long way towards explaining the co-existence of regime continuity amidst various institutional changes in China. The next section builds upon the sequencing, layering, and conversion approaches by showing how the analysis of informal institutions may elucidate the potential for flexibility in formal institutions.

### *The Formal Origins of Adaptive Informal Institutions*

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<sup>16</sup>In the Chinese context, X.L. Ding (1994) refers to a similar phenomenon as “institutional amphibiousness.” This notion of organizational appropriation may be traced back to Selznick’s (1949) classic study of the Tennessee Valley Authority.

Formal institutions implicitly represent the baseline from which we evaluate the desirability of various outcomes. To be sure, constructivists and cultural anthropologists engage in interpretive analyses that take informal processes seriously, but they do not theorize directly about the causal impact of informal institutions.<sup>17</sup> One of the few works in political science that endeavors to address this lacuna is Gretchen Helmke and Steven Levitsky (2003). In particular, the authors propose a typology for classifying the relationship between formal and informal institutions, such that they may be complementary, accommodating, competing, or substitutive.<sup>18</sup> The typology is helpful in clarifying the nature and function of informal institutions relative to formal ones, but it does not develop a theory about the processes of informal institutional emergence and change, or the formalization of informal institutions. And indeed, a large part of the challenge in inserting informal institutions into causal explanations is where to place them temporally, given that almost no society is completely devoid of some semblance of formal institutions.

For the purposes of capturing the causal effects of informal institutions at a more manageable intermediate stage, this paper thus brackets what North (1990, 91) calls the “deep-seated cultural inheritance” underlying informal institutions and starts with the blank slate of formal institutions, which I define as rules, regulations, policies, and procedures that are promulgated and meant to be enforced by entities and agents generally recognized as being official.<sup>19</sup> As in my earlier work (Tsai 2002), this study regards formal institutions as being both constraining and enabling. On the one hand, formal institutions limit the range of officially

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<sup>17</sup>Possible exceptions include Geertz (1973) and Wendt (1999), but they do not focus on informal institutions as explanatory variables.

<sup>18</sup>Lauth (2000) identifies five types of informal institutions: clientelism, corruption, putsch threat, civil disobedience, and custom law.

<sup>19</sup>This definition draws from Helmke and Levitsky (2004, 727), but also includes public policies because they typically have institutional consequences. Pierson (2004) suggests that “it makes good sense to think of public policies as important institutions. For the individuals and social organizations that make up civil society, public policies are clearly very central rules governing their interactions” (165).

permissible behavior. On the other hand, multi-layered institutional environments provide opportunities for actors to adjust, ignore, or evade discrete portions of formal institutions. Initially, many of these adaptive responses may appear to be idiosyncratic or isolated. However, when the adaptive strategies become regularized patterns of interaction that violate or transcend the scope of formal institutions, they constitute what I call “adaptive informal institutions.” The analytic rationale for calling these routinized coping strategies “adaptive informal institutions”—not just informal practices or culturally familiar ways of getting things done—lies in its conceptual specificity. Unlike informal institutions writ large, *adaptive* informal institutions refer to regularized patterns of interaction that emerge in reaction to constraints and opportunities in the formal institutional environment. Adaptive responses should not be lumped with customs, norms, values, traditions, and rules of the game that constitute common definitions of informal institutions or “cultural constraints” (e.g., North 1990). Differentiating between long-standing informal practices and those that appear in the context of new opportunities enables us to focus on a subset of informal coping strategies that derive from shorter-term considerations of convenience, efficiency, and possibility.

Hence, by taking a particular formal institution as a given and then process tracing how various actors interact in dealing with its constraints and possibilities, the analysis yields insights into how formal institutions generate the potential seeds of their own reform: adaptive informal institutions. This is the first part of the proposed causal sequence in explaining endogenous institutional development.

The second part concerns what happens after adaptive informal institutions emerge. At the most basic level, the proliferation of adaptive informal institutions may undermine the legitimacy of formal institutions. The relevance of institutions, whether formal or informal,

depends on their capacity to guide human perceptions and practices. But do the enforcers of formal institutions ignore, incorporate, or discipline the actors sustaining adaptive informal institutions? The answer to this question is historically and nationally contingent. We may expect that when adaptive informal institutions constitute flagrant forms of criminal activity, they will elicit the attention of law enforcement entities. But if the latter are party to the offending activities, then efforts to curb the activities are unlikely to be effective. In contrast, adaptive informal institutions that merely stretch the limits of formal institutions or create new patterns of interaction not explicitly governed by formal institutions may endure and even thrive unencumbered for some length of time. And in some cases, adaptive informal institutions may become so widespread that the actors with authority to reform formal institutions choose to incorporate the practices popularized by adaptive informal institutions. Political elites and decisionmakers may decide to exercise their authority—within the context of their official positions—to reform formal institutions. In other words, formalization of adaptive informal institutions could occur without jeopardizing the survival of pre-existing formal institutions. Adaptive informal institutions may have a powerful demonstration effect and shape the direction of formal institutional development in a process of diffusion.

To illustrate this logic more concretely, the next section of the paper presents data from my research on China's private sector. As will be seen, evidence is lacking for claiming that private entrepreneurs constitute the basis for either the structural or voluntarist paths to democratization. In the course of navigating various political and regulatory restrictions, however, private entrepreneurs have had a structural impact on Chinese politics and political institutions.

## China's Private Entrepreneurs: Fragmented, but Influential

From 2002 to 2003 I conducted a national survey of private entrepreneurs as part of a broader project to assess the political implications of private sector development in China.<sup>20</sup> The survey included questions about private entrepreneurs' demographic characteristics, employment background, concerns over business and policy issues, types of problems experienced, means of dispute resolution, participation in political organizations and business associations, attitudes towards different types of political economy, and attitudes towards various policy issues in contemporary China. In the interest of space, this section only highlights a few findings to assess the plausibility of popular hypotheses about the democratic potential of private entrepreneurs.

### *Lack of Capitalist Class Formation*

Support for the structural hypothesis would require, at a minimum, evidence of class formation among private entrepreneurs.<sup>21</sup> Class formation would then provide the basis for collective action in defense of class interests. It is apparent, however, that the current generation of China's business owners has widely divergent identities, interests, and coping strategies. Differences in entrepreneurs' employment backgrounds, political networks, and size of business all contribute to class fragmentation rather than class formation.<sup>22</sup>

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<sup>20</sup>The survey was conducted in collaboration with the Private Economy Research Center of the Chinese Academy of Social Sciences. The sampling frame was a stratified multistage area probability sample. In the first stage the PSUs were ten provinces stratified by region according to the relative development of the private sector. Within each province, two cities/counties were randomly selected and within each county, two townships were randomly selected. At the township level, registration lists from the Industrial and Commercial Management bureau were used to select private businesses (both *getihu* and *siying qiye*) according to PPS measures. A total of 1,600 surveys were administered and the response rate was 84.7 percent, yielding a total of 1,525 completed questionnaires. In addition to the national survey, I conducted 317 interviews with private entrepreneurs (including unregistered business owners), rank-and-file bureaucrats, government officials, bankers, and researchers in eight provinces/municipalities during a two-year period over the course of 2001 to 2005.

<sup>21</sup>Class formation may be defined as the process through which individuals engage in collective action to defend interests generated by class structure. On the distinction among class structure, class consciousness, class formation, and class practices, see Wright 2000, 185-215.

<sup>22</sup>Local variation in the policy environment for private businesses also contributes to class fragmentation, but it is beyond the scope of this paper to address the issue in detail. Cf. Jennings 2003; Manion 1996; Oi and Walder, eds. 1999; Tsai 2002; and Whiting 2001.

Because most contemporary entrepreneurs have different employment backgrounds, the vast majority of business owners do not identify themselves as capitalists. In the course of field interviews, many business owners preferred to describe themselves as teachers, farmers, workers, or even cadres rather than as “entrepreneurs” (*qiyejia*). This limited sense of identity may be attributed to the relative youth of China’s private sector. As shown in Table 1, there are substantial inter- and intra-generational differences in occupational history within the private sector; note that the diversity of private entrepreneurs’ previous work experience is mirrored by the diversity in employment backgrounds of their parents and spouses.

[INSERT TABLE 1 ABOUT HERE]

Although diversity in previous occupation does not necessarily preclude class formation, the survey also found that private entrepreneurs have varying “interests,” as indicated by the types of problems that they encounter in the course of doing business and the extent to which they believe certain policy issues require improvement.

[INSERT TABLE 2 ABOUT HERE]

In particular, entrepreneurs previously employed by the state are more likely than those without state employment backgrounds to complain about accessing bank loans, securing an adequate production site, taxes, fees, the local allocation of collective funds, and stability in employees (Table 2). In addition, former state employees are more likely to express a need for improvement in a wide range of policy areas, including protection of private property rights, intellectual property rights, public opinion of the private sector, tax policy, credit policy, macroeconomic management, more equitable treatment of private businesses, fighting corruption, and improving the provision of public utilities, education, and the social security system. This higher level of “assertiveness” reflects the fact that former state employees are

accustomed to receiving more services from the government than farmers and other rural citizens.

Since the majority of private entrepreneurs do share certain concerns—such as limited access to bank loans and excessive taxes/fees—it is worth reinforcing out that they are not equally concerned about these potentially unifying issues. In the area of credit, for example, Table 2 indicates that former state employees are less likely to report difficulties in securing bank loans. Moreover, the business owners who would be in the best position to make demands on the political system, i.e., the larger scale and politically well-connected capitalists, do not face extreme credit constraints. Table 3 presents t-tests showing that private businesses with a larger number of employees and a higher volume of profit are more likely to have access to bank credit, while those with fewer employees and lower profits are more likely to rely on informal finance.<sup>23</sup> The t-tests also show that entrepreneurs with strong political ties are more likely to have borrowed from official banks; and the correlations in Table 4 demonstrate that politically active entrepreneurs are more likely to have access to bank credit regardless of the size and scale of their operations. In short, these findings call into question the extent to which business owners from all walks of life currently constitute a coherent class with the capacity to engage in collective action in defense of “class” interests.<sup>24</sup>

[INSERT TABLES 3 & 4 ABOUT HERE]

### *Absence of Pro-democratic Elites*

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<sup>23</sup>Yet this does not mean large businesses rely exclusively on bank credit. Even well established private firms may continue to draw on informal finance. The survey found that older businesses are more likely to have private loans outstanding ( $r = -.073$ ,  $p < 0.01$ ). And depending on the nature of their political and social networks, proprietors of smaller-scale businesses may succeed in accessing credit from formal financial institutions. A more extensive discussion of private sector finance is Tsai (2002).

<sup>24</sup>Indeed, in the sociologist Lu Xueyi's (2001) delineation of the ten social strata in contemporary China, different types of business owners are classified into four different socioeconomic ranks: the upper social strata (owners of large private enterprises), upper middle strata (owners of private enterprises), middle middle strata (owners of small enterprises), and lower middle strata (self-employed *getihu*).

Given the limits of class formation among private entrepreneurs in general, do wealthy entrepreneurs who are Communist Party members or “red capitalists” exhibit signs of partaking in a voluntarist path towards democratization in China? Bruce Dickson’s (2003) survey of entrepreneurial elites and local officials offers little evidence for this scenario.<sup>25</sup> In his account, large-scale business owners sound far more politically cautious, if not conservative, than local officials: “Entrepreneurs are much more concerned about the impact of economic competition on stability than are officials, and ironically red capitalists are the most willing to enforce stability at the expense of continued economic growth” (Dickson 2003, 135).

Although my survey did not include local officials, it sampled entrepreneurs from different political and socioeconomic backgrounds and found that business owners who are more politically active—i.e., those who are leaders and members of formal political organizations—face better operating conditions and have fewer grievances than ordinary entrepreneurs.<sup>26</sup> Table 5 shows that both political members and political elites are more likely to be older, to have entered the private sector earlier, and to run businesses that are more profitable and have more employees. With respect to capitalization issues, political members and elites are also more likely than other business owners to have access to formal bank loans and private loans, as well as investment by groups of shareholders, the township government, government agencies, and even investors from abroad. On the whole, political members and elites also less likely to encounter disputes with consumers.<sup>27</sup> Given their membership in formal political institutions, it is not surprising that they are also more likely to express their opinions directly to political

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<sup>25</sup>Margaret Pearson’s (1997, 2002) research on managerial elites in the foreign-invested sector similarly questions the democratic potential of this privileged strata of private entrepreneurs.

<sup>26</sup>To analyze how members and leaders in formal political institutions differ from non-members, I created two variables from the data set, “political member” and “political elite,” respectively, to distinguish among respondents who were members of the NPC, CPPCC, CCP, and/or village committee, respondents who held leadership positions in those organizations, and respondents who were not members in any formal political institution.

<sup>27</sup>But they are more likely than regular entrepreneurs to report that they encounter disputes with local government agencies and residents.

leaders, use the court system, and use other formal political institutions to reflect their views to higher level officials.<sup>28</sup> Yet compared to most entrepreneurs, political members and elites have fewer grievances and are less likely to be concerned about various policy issues; the main areas that they indicate a need for improvement are protection of intellectual property rights, public opinion of private entrepreneurs, and equitable treatment of different types of enterprises.

[INSERT TABLE 5 ABOUT HERE]

Overall, the majority of red capitalists exhibit “loyally acceptant” coping strategies, meaning that they generally express their concerns in a manner that seeks to reform (or merely implement) certain rules and regulations rather than to overthrow the government.<sup>29</sup> Even though capitalist elites possess the material resources, and increasingly, the political access to promote regime transition, they show no signs of doing so at this point.<sup>30</sup>

### *The Informal Influence of Private Entrepreneurs*

Although there is minimal indication of class formation among private entrepreneurs and capitalist elites remain politically quiescent, remarkable changes have occurred in China’s political institutions and official ideology. These changes have elevated the status of private entrepreneurs in official discourse from embodying evil “tails of capitalism” during the Cultural Revolution to representing the country’s “most advanced productive forces” during the early 2000s. In addition to the complete shift in ideology, the political influence of the private sector

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<sup>28</sup>Due to space limitations, this paper does not address the issue of business associations. Suffice it to say that members of business associations are also more likely to be Party members ( $r=.38, p<.01$ ). Cf. Dickson 2003 and Kennedy 2005.

<sup>29</sup>The other categories of political coping strategies in my typology are grudgingly acceptant, avoidant, and assertive (Tsai 2005). For a dynamic parallel to loyally acceptant strategies in the rural context, see Kevin O’Brien’s (1996) discussion of “rightful resistance.”

<sup>30</sup>In a process that Kevin O’Brien (1994) refers to as a strategy of “entwinement,” some business owners “seek proximity to existing centers of power (i.e., entwinement) rather than distance...[because] they realize that independence at this point means irrelevance and that future development demands sensitivity to existing power relations (101). However, my research found that wealthy entrepreneurs who have encountered serious disputes with governmental entities are more likely to invest in exit strategies for their families by sending them abroad rather than devoting resources to affect political changes domestically.

is reflected by its growing representation in formal political organizations: as of 2004, over one-third of private entrepreneurs were Party members and in the Third Session of the 10<sup>th</sup> National People's Congress in 2005, 55 of the delegates were private entrepreneurs (SAIC 2005 and Interview No. 281). How can these political and institutional transformations be explained?

Because the PRC is an authoritarian regime with a unitary political system, many China scholars focus on the dynamics of elite politics and policymaking by formal entities based in Beijing.<sup>31</sup> After all, Deng Xiaoping's consolidation of power at the 3<sup>rd</sup> Plenum of the CCP's 11<sup>th</sup> Central Committee meeting in December 1978 paved the way for key reforms in the non-state sector, including the introduction of regulations allowing the urban nonagricultural individual economy in 1981, rural individual businesses in 1984, and private enterprises with more than eight employees (*siying qiye*) in 1988 (Young 1995). To be sure, the PRC's national policies have facilitated private sector development. It would be overly simplistic, however, to attribute all the political and institutional changes that have occurred solely to elite politics.

A growing number of studies document instances of institutional innovations originating at the local level and then later being sanctioned or adopted by the center. For example, in a manner evocative of James Scott's (1995) notion of "weapons of the weak," Daniel Kelliher (1993), Andrew Watson (1983), Dali Yang (1996), and Kate Xiao Zhou (1996) have shown how farmers spontaneously reverted to household farming well before the state permitted decollectivization.<sup>32</sup> Lynn White (1999) offers numerous examples from Shanghai of local economic and political practices that preceded their formal approval by higher levels of government. And of direct relevance to private sector development, Barry Naughton (1994), Jean Oi (1999), Kristin Parris (1993), Jonathan Unger (2002) and others have studied how

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<sup>31</sup>For example, Baum 1996; Fewsmith 2001; Huang 2005; Li 2001; Shirk 1994; Unger, ed. 2002.

<sup>32</sup>Key critics of this interpretation of peasant power from below include Bianco 2001; Unger 2002; and Zweig 1997.

collective enterprises that were supposed to be run by township and village governments effectively served as an organizational disguise for private businesses before the central government permitted the operation of larger private enterprises. My research (2002) identifies similar dynamics in the area of private sector finance.

Building on these observations, I propose that adaptive informal institutions at the local level have contributed substantially to shaping the substance of major institutional changes concerning the private sector. While central state-level policies have provided an increasingly permissive environment for private commerce, local economic and political actors have interpreted these policies in a highly selective manner, and in the process, created a wide range of adaptive operating strategies that depart from the original scope and spirit of formal regulations. With widespread repetition, these coping strategies evolve into adaptive informal institutions, which in turn, may inspire reactive change on the part of political elites with vested interests in bolstering the legitimacy and efficacy of formal institutions. For illustrative purposes, consider the temporal gaps between the actual practices and formal policies that sanctioned larger private businesses, Communist Party membership of private entrepreneurs, and constitutional protection of private property rights.

### The Path to Private Enterprise

Throughout the 1980s and most of the 1990s, private entrepreneurs experienced not only a social stigma for being profit-oriented, but also political persecution.<sup>33</sup> There was considerable political uncertainty about the trajectory of economic reform and private entrepreneurs were publicly criticized during the national campaigns against “spiritual pollution” in 1983-84 and against “bourgeois liberalization” in 1987. At the local level, entrepreneurs were subjected to

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<sup>33</sup>Accounts of private businesses during the early reform era include Chan and Unger 1982; Gold 1989; Hershkovitz 1985; Kraus 1991; Solinger 1984; and Young 1989.

arbitrary treatment by tax collectors and harassment by other bureaucrats. In contrast, state and collective enterprises received favorable treatment relative to private ones in terms of tax breaks, bank loans, and use of land. Those were the operating realities that business owners faced beneath the impressive growth statistics.

Why, then, were entrepreneurs willing to enter and stay in business? As suggested above, one way for entrepreneurs to avoid social and political ostracism was to wear a red hat. This adaptive strategy was so widespread that “wearing a red hat” became (and remains) a common term in everyday discourse. The practice became institutionalized as a standard, albeit informal, operating practice for private entrepreneurs. Yet the actual process through which this occurred was not simply the case of entrepreneurs deceiving local bureaucrats; instead, the actions of agents were collaborative and reflexively strategic. Most local cadres knew exactly what they were doing when they accepted, or perhaps extracted, a registration fee from a local entrepreneur to run a collective enterprise. Hundreds of thousands of both state and non-state actors were complicit agents in popularizing the red hat phenomenon. And arguably, when central-level elites realized that so many collectives were really private enterprises, it was futile to insist that the scale of the private sector be limited to household producing units with less than eight employees.

The practice of wearing a red hat is an example of how an adaptive informal institution contributed to institutional conversion of a formal regulation, the collective registration status. Camouflaging the true ownership structure of a business rendered the formal distinction in nomenclature between collective and private enterprises virtually meaningless. By the same token, as an adaptive informal institution, the red hat practice also became an increasingly prominent institutional layer in China’s once-limited field of corporate organizational types.

Instead of displacing the collective sector, red hat enterprises represented an additional form of collective enterprise; this innovative practice not only expanded the institutional space for private businesses to operate in, but also generated political pressure to create a more fitting registration status for larger private enterprises. In this case, the impetus for institutional change stemmed from friction between pre-existing institutions that privileged the collective sector and policies that sanctioned limited development of the private sector. Both state and economic actors coped with this dissonance by popularizing the adaptive informal institution of wearing a red hat.

#### The Chinese Communist Party's Incorporation of Capitalists

The first generation of profit-oriented business operators in post-Mao China generally came from two different backgrounds. The “individual entrepreneurs” (*getihu*) comprised of street peddlers, itinerant vendors, and small retail business owners who were marginalized during the socialist period and did not have the benefits of state employment. The popular perception of *getihu* was that they were criminals and social outcasts who lacked alternative employment options; hence, they experienced considerable political and social discrimination. In reality, however, most were simply underemployed farmers who no longer had to work in collectives.

At the other extreme, the other strata of society active in commerce were cadre entrepreneurs and red capitalists who used their privileged political status to run businesses indirectly or help others run red hat operations. Even though CCP members were not allowed to operate private businesses, throughout the 1980s and 1990s many were already active participants in the non-state sector. Indeed, official surveys reveal an increasing proportion of self-identified CCP members among private entrepreneurs over time, such that only seven percent of business owners admitted to being Party members in 1991, but by 2003 over one-third admitted to being private entrepreneurs (see Table 6). It is reasonable to assume that the earlier

official figures underestimate the true proportion of Party members in the private sector due to the politico-ideological sensitivity concerning the appropriate relationship between the CCP and “market socialism with Chinese characteristics.” For many years, the uneasy co-existence between China’s official socialist ideology and reality of private sector development accounts for the simultaneous growth of business owners among Party members—and the underreporting of Party members in official surveys of private entrepreneurs.<sup>34</sup>

[INSERT TABLE 6 ABOUT HERE]

On the occasion of the CCP’s eightieth anniversary on July 1, 2001, General Secretary Jiang Zemin gave a landmark speech widely interpreted as inviting private entrepreneurs to join the Party. The rationale was weaved into Jiang Zemin’s “Theory of the Three Represents,” which was supposed to represent the theoretical extension of Marxism-Leninism, Mao Zedong Thought, and Deng Xiaoping Theory, but made the controversial recommendation that the Party should represent “the most advanced forces of production, the most advanced cultural forces, and the interests of the overwhelming majority of people.” The CCP had launched a mass media campaign publicizing the Three Represents leading up to the anniversary; then the July 1 speech, followed by the 16<sup>th</sup> Party Congress in late 2002, clarified the implication of the “theory,” i.e., that the CCP should not discriminate against private entrepreneurs and should in fact embrace them because they are contributing (the most) to China’s economic development. A number of the Party’s old guard disapproved of the sharp ideological turn that Jiang and his supporters were advocating. Even on-line chat rooms and message boards filled with colorful, passionately

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<sup>34</sup>In my survey, 23.5 percent of the respondents indicated that they were Party members; and of this group, 85.7 were already Party members when they registered their private enterprises. In other words, only 14.3 percent of the entrepreneurs who are Party members joined after they registered their businesses.

argued objections to the selling out of the CCP.<sup>35</sup>

As such, it is remarkable that the CCP agreed to change—and indeed, reverse—its former ideological depiction of capitalists as exploitative “class enemies.” As Dickson (2003) and Fewsmith (2002) have suggested, however, allowing private entrepreneurs into the Party was a strategic decision to incorporate a growing, and increasingly wealthy portion of Chinese society. It was an effort to pre-empt autonomous political organization on the part of private business owners. While this strategic interpretation of the Party’s decision makes sense for explaining regime durability, I would add that the underlying causal mechanisms leading to this decision were rooted in the growing power of the informal rules of the game that had evolved over the first two decades of economic reform. Party members were already active in the private sector well before private entrepreneurs were formally permitted to join the Party. To avoid political trouble, some Party members wore red hats. Others registered businesses in the name of relatives. And in localities such as Wenzhou where the local government has long been supportive of private sector development, red capitalists simply ran their businesses like everyone else.

Ultimately, all of the informal coping strategies that both state and non-state actors had reproduced in their daily interactions took on an institutional reality of their own, thereby challenging national leaders to adapt pre-existing formal institutions to assimilate these hitherto informal practices. This dynamic can also be seen in revisions to the PRC constitution that have become increasingly favorable towards the private sector.

#### Private Sector-Friendly Revisions to the PRC Constitution

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<sup>35</sup>For example, “Deng Liqun, Others, Criticize Jiang Zemin for Agreeing to Admit Capitalists into the CPC,” originally posted on <http://www.renminbao.com> on July 20, 2001, translated text from FBIS-China, July 28, 2001.

Revisions to the PRC Constitution have generally lagged behind developments in actual practices, but also paved the way for major shifts in state policies. During the various rounds of revisions that have been made to the PRC Constitution since 1982, the following sections have had—or may eventually have—far reaching consequences for the private sector.

First, in 1988 the First Session of the Seventh NPC added a paragraph to Article 11 that “permits the private sector of the economy to exist and develop within the limits prescribed by law.” The paragraph also recognizes, “The private sector of the economy is a complement to the socialist economy.” This provided the legal basis for allowing “private enterprises” (*siying qiye*) with more than eight employees to operate, while indicating that the private sector would still be subject to state control, as indicated in the final clause of the paragraph: “The state protects the lawful rights and interests of the private sector of the economy, and exercises guidance, supervision, and control over the private sector of the economy.” As discussed earlier, this formal recognition of the private sector trailed ground-level practices, but ultimately, it also rendered the adaptive informal institution of red hat disguises less necessary.

Second, in 1999 the Second Session of the Ninth NPC amended the aforementioned paragraph in Article 11 to say, “Individual, private and other non-public economies that exist within the limits prescribed by law are major components of the socialist market economy.”<sup>36</sup> The 1999 revisions also included a statement indicating, “The People’s Republic of China governs the country according to law and makes it a socialist country ruled by law.” The combination of elevating the non-state sector to a “major component” of the economy and the

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<sup>36</sup>Note that in 1993 the First Session of the Eighth NPC reoriented the economic mission of the country in the Preamble to acknowledge that China is “in the primary stage of socialism” and would therefore concentrate on “socialist modernization” to “build China into a strong and prosperous, culturally advanced, democratic socialist nation.” (The previous version of that statement did not mention “strong” or “prosperous.”) Also, in Article 15, the “state practices a planned economy on the basis of socialist public ownership” was replaced with “the state practices a socialist market economy.” The fact that the constitution mentioned the market economy reinforced the message conveyed in the series of speeches that Deng Xiaoping had delivered during his tour of the southern coastal provinces in 1992; that is, economic reform would continue despite the political crisis of 1989.

introduction of the notion that the country is governed by the rule of law signaled a more legitimate and secure status for the private sector. By this time, “privatization” or restructuring (*gaizhi*) of TVEs had already been occurring for five years and the selling off of small and medium SOEs, announced at the 15<sup>th</sup> Party Congress in 1997, was gaining momentum.

Third, in 2004 the Second Session of the Tenth NPC made the even deeper (or to some, more radical) revision of encouraging private sector development and protecting private property rights under the constitution. Article 11 was changed again to stipulate,

The state protects the lawful rights and interests of the private sector of the economy, including individual and private businesses. The state encourages, supports and guides the development of the private sector, and exercises supervision and administration over the sector according to law.

And Article 13 introduced, “The lawful private property of citizens shall not be encroached upon” while Article 33 added, “The state respects and protects human rights.” Meanwhile, the Theory of the Three Represents was incorporated into state ideology alongside “Marxism, Leninism, Mao Zedong Thought and the Theories of Deng Xiaoping.” Since the 16<sup>th</sup> Party Congress in 2002 had already incorporated upholding the Three Represents into the CCP’s mission statement, it was not surprising that the state constitution would be similarly amended.<sup>37</sup>

Unlike the first two amendments discussed above, however, the constitutional stipulation that private property rights would be protected should be viewed as an objective rather than post-hoc recognition of ground-level realities. Although certain adaptive informal institutions enable economic actors to engage in contractual exchanges as if they were guaranteed by a formal legal system of private property rights (Clarke 2003; Oi and Walder 1999; Tsai 2002), the rise of serious disputes concerning asset ownership demonstrate that such arrangements are not immune from government intervention/expropriation. This is, of course, a risk that all adaptive informal

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<sup>37</sup>Each constitutional revision has first been proposed by the Central Committee of the CCP, and then taken on by the NPC Standing Committee.

institutions face, but the point here is that because the most recent constitutional revisions have more complex systemic implications for China's political economy, lags in actual implementation should be expected. Formal protection of private property rights ultimately requires strengthening the institutions that support the rule of law (Clarke, Murrell, and Whiting 2005). In the interim, various adaptive informal institutions will continue to serve as self-enforcing substitutes for property rights.

Although the series of constitutional revisions relating to the private sector appears to be a linear progression of increasing official recognition and legal protection of its interests, it is important to remember that there was nothing automatic or pre-determined about the development of various formal institutions to support the private sector. The process of institutional development has been highly contested and incremental—and as this paper suggests, an outgrowth of adaptive informal practices at the local level.

## **Conclusion**

Theoretically, this paper builds upon existing theories of institutional development by proposing that adaptive informal institutions may play an important role in endogenous accounts of institutional change. Specifically, adaptive informal institutions may emerge out of the collaborative coping strategies of state and non-state actors when they find formal institutions too constraining. Over time, adaptive informal institutions may then inspire significant changes in formal institutions. This reactive sequence of institutional change may occur even in authoritarian contexts where political institutions are not necessarily expected to be responsive to grassroots interactions.

Although private entrepreneurs do not vote for leaders in Beijing—or show any indication of supporting regime transition to a liberal democracy—the PRC has nonetheless

proven to be quite receptive to formalizing many of the informal practices that entrepreneurs have relied upon to run their businesses. And the key point is that this apparent political “responsiveness” has occurred through indirect means. Private entrepreneurs as a group have not lobbied directly for protection of their property rights or for membership in the Chinese Communist Party. Instead, people from different social backgrounds have entered the private sector as a self-help strategy to enhance their material welfare, and in the process, appeared to party-state elites as an increasingly important constituency. In the course of their daily interactions with one another and with local staff of the party-state, business owners have had a structural impact on the direction of formal institutional reforms. Therefore, even though the regime has pursued policies that imply a strategy of corporatist inclusion of private capital, this paper suggests that the causal mechanism underlying these pre-emptive corporatist efforts lie in the cumulative effect of informal interactions at the local level.

The methodological implication of this argument is that day-to-day modes of interaction at the grassroots level warrant our attention. To be sure, many adaptive informal institutions have not resulted in changes in official policies and institutions. For example, the on-going popularity of underground finance shows that the state banking system does not serve the credit needs of private entrepreneurs. However, if we were only to examine the intricacies of elite-level debates and political maneuvering, then we would miss the fact that certain curb market innovations have already contributed to liberalizing the formal financial system (e.g., in the form of floating exchange rates and the establishment of Urban Commercial Banks meant to serve the private sector.) We would also miss the fact that many entrepreneurs have managed to establish financial intermediaries through creative interpretation of existing rules and regulations. Although the approach outlined in this paper does not make deterministic predictions about when

and if formal institutions will incorporate various informal practices, it is apparent that adaptive informal institutions nonetheless mediate, and sometimes subvert, the substance and spirit of formal institutions. Hence, rather than speculating about the prospects for democracy in China, it would be more fruitful to examine the extent to which informal interactions and adaptive informal institutions are undermining or contributing to the country's political resilience.

Ultimately, the ability of the nominally socialist regime to accommodate private sector development is only one expression of the broader transformation that has occurred in China's institutional context.

**Table 1. Employment Background of Entrepreneurs, Spouses, and Parents 2002**

<b>Occupation</b>	<b>Self</b>	<b>Spouse</b>	<b>Parents</b>
Professional, skilled personnel	11.3%	6.4%	4.9%
Government/administrative officer/cadre	4.0	4.9	7.9
Enterprise manager	15.7	5.7	7.2
Administrative staff	7.2	8.0	4.2
Ordinary worker	17.8	20.7	18.7
Commercial/sales personnel	8.7	9.5	4.4
Farmer	20.3	21.5	42.7
Soldier	1.9	0.2	0.8
Other	7.7	7.8	4.1
No occupation	5.3	15.3	5.1
	100%	100%	100%
Valid responses	1,465	1,148	1,133
<b>Type of Work Unit</b>			
Party/government organization	5.4	4.5	6.6
State-owned enterprise	22.4	15.5	23.0
Collective enterprise	19.4	9.5	12.4
Foreign enterprise	0.8	1.1	0.1
Private enterprise	10.3	19.8	2.6
Individual business	10.8	11.1	3.4
Rural household or collective	21.9	20.8	45.2
Other	3.3	5.8	3.2
No unit	5.7	11.8	3.6
	100%	100%	100%
Valid responses	1,453	1,132	1,114
<b>Position</b>			
General cadre	12.4	7.9	11.7
Branch level cadre	5.1	2.6	5.8
County level cadre	1.5	0.7	2.6
Township/village (people's commune) director	0.7	0.4	1.0
Village (production brigade) leading cadre	3.4	0.3	3.2
SOE/collective enterprise contractor	6.6	1.3	1.5
Enterprise marketing & sales personnel	8.2	4.1	2.2
Military officer	0.2	0.1	0.3
Other	15.7	15.8	10.8
No position	46.2	66.8	60.7
	100%	100%	100%
Valid Responses	1,445	1,116	1,113

**Table 2. Experiences and Attitudes of Entrepreneurs with State Employment Backgrounds: Independent Samples t-Test**

<b>Encountered Problems with:</b>	Mean(a)		t	df	Mean diff.	Std. Error	95% CI	
	No state employment	Former state employee					lower	upper
Access to bank loans	2.26	2.09	4.53**	738	.17	.038	.098	.247
Securing production site	2.68	2.56	3.56**	686	.12	.033	.053	.183
Utilities	2.81	2.77	1.12	662	.03	.030	-.025	.091
Attracting skilled staff	2.62	2.56	1.90	1383	.07	.036	-.002	.138
Taxes	2.61	2.55	1.99*	1406	.07	.035	.001	.138
Fees	2.53	2.37	4.37**	1398	.16	.036	.087	.228
Allocation of collective funds	2.57	2.45	3.30**	692	.12	.036	.048	.189
Government services	2.60	2.54	1.63	700	.06	.036	-.012	.129
Employee stability	2.74	2.66	2.54**	684	.08	.031	.018	.141
Safety of self/family	2.89	2.88	.47	1400	.01	.021	-.032	.051
<b>Need improvement in:</b>								
Protection of property rights	.69	.78	-3.66**	1451	-.10	.026	-.148	-.048
Protection of intellectual property rights	.62	.76	-5.25**	821	-.14	.028	-.191	-.083
Public opinion of entrepreneurs	.65	.78	-4.57**	1451	-.12	.027	-.176	-.070
Tax policy	.82	.90	-4.14**	921	-.08	.019	-.118	-.042
Credit policy	.81	.88	-3.20**	864	-.07	.020	-.104	-.025
Macroeconomic controls	.57	.67	-3.66**	768	-.10	.028	-.157	-.047
Management of private business	.76	.82	-2.54**	1451	-.06	.024	-.109	-.014
Household registration system	.57	.60	-1.21	739	-.04	.029	-.091	.022
Equal treatment of different business types	.76	.85	-4.19**	873	-.09	.022	-.136	-.046
Eliminating corruption	.91	.95	-3.12**	974	-.04	.014	-.072	-.063
Political system reform	.67	.72	-1.65	758	-.04	.027	-.097	.008
Public utilities	.75	.80	-2.10*	786	-.05	.024	-.098	-.003
Education system	.80	.85	-2.61**	824	-.06	.022	-.099	-.014
Social security system	.85	.92	-4.30**	972	-.08	.018	-.120	-.041

\*\*Significant at the  $p < .01$  level; \*significant at the  $p < .05$  level.

- (a) For the first set of issues, the responses were measured on a scale of 1 to 3 such that 1 indicated “large problem” and 3 indicated “not a problem.” For the second set of issues, dummy variables were used such that 0 indicated “no need for improvement” and 1 indicated “need for improvement.”

**Table 3. Business Size, Political Background, and Credit Access:  
Independent Samples t-Test**

	Mean		t	df	Mean diff.	Std. Error	95% CI	
	No bank loans	Has bank loans					lower	upper
	No private loans	Has private loans						
Number of employees	45	110	-5.22**	1196	-64.15	12.28	-88.244	-40.054
	81	69	.89	1493	11.92	13.35	-14.264	38.110
Gross sales at end of first year of business ( <i>wan</i> =10,000 RMB)	178	450	-3.44**	980	-271.52	78.92	-426.379	-116.653
	356	250	1.43	1188	106.00	74.09	-39.356	-251.359
Net profit at end of first year of business ( <i>wan</i> )	13	36	-3.73**	746	-23.24	6.24	-35.489	-10.998
	28	20	1.45	1156	7.87	5.43	-2.789	18.536
Gross sales at end of 2001 ( <i>wan</i> )	44777	1202	.99	674	443575	444444	-429086	1316236
	959	682197	-.99	439	81238	681817	-2021270	658794
Net profit at end of 2001 ( <i>wan</i> )	37	79	-2.64**	1256	-41.77	15.83	-72.814	-10.719
	69	35	2.71**	1234	34.54	12.77	9.495	59.590
Members of formal political organizations (a)(c)	.1164	.2527	-6.95**	1381	-.14	.02	-.174	-.0978
	.1490	.2611	-4.87**	757	-.11	.02	-.157	-.0670
Leaders of formal political organizations (b)(c)	.0673	.1689	-6.21**	1306	-.10	.02	-.138	-.069
	.0958	.1656	-3.60**	744	-.07	.19	-.108	-.032

- (a) Includes membership in at least one of the following: National People's Congress, Chinese People's Political Consultative Committee, Chinese Communist Party, People's Government, or village committee.  
 (b) Holds a leadership position in at least one of the organizations listed in (a).  
 (c) This is a dummy variable where 0 indicates not a member/leader of a formal political organization and 1 indicates that the respondent is a member/leader of a formal political organization.

**Table 4. Partial Correlations: Political Activity and Bank Loans  
--Controlling for Business Size and Scale**

	Members of formal political organizations	Leaders of formal political organizations	Implication
Controlling for No. of Employees: Bank Loans	.1502**	.1374**	Both leaders and members of formal political organizations are more likely to have access to bank loans than non-members, regardless of the size of their businesses.
Controlling for Gross Sales in 2001: Bank Loans	.1718**	.1531**	Both leaders and members of formal political organizations are more likely to have access to bank loans than non-members, regardless of the sales volume of their businesses.

Controlling for Net Sales in 2001: Bank Loans	.1676**	.1453**	Both leaders and members of formal political organizations are more likely to have access to bank loans than non-members, regardless of the profitability of their businesses.
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\*\*Indicates statistical significance at the 0.01 level.

**Table 5. Attributes of Members and Elites of Formal Political Institutions:  
t-Test Comparison of Means**

General Attributes	Non-Political Members	Political Members	Political Elites
Birth year	1963	1956**	1956**
Year business started	1995	1992**	1992**
Gross Sales in 2001 (10,000 <i>yuan</i> )	334	1,147,651*	252,045
Net Sales in 2001 (10,000 <i>yuan</i> )	29	183**	195**
Number of employees	44	222**	222**
<b>Credit and Investment Conditions</b>			
Use of bank loans	.4763	.6107**	.6145**
Ease of access to bank loans	2.24	2.34**	2.40**
Private loans outstanding	.2795	.4393**	.4358**
Investment by group of shareholders	.0257	.0679**	.1006**
Investment by township gov't/neighborhood committee	.0024	.0179**	.0168**
Investment by government agency/military/law enforcement, etc.	.0032	.0107**	.0112**
Investment from abroad	.0040	.0143**	.0223**
<b>Nature of Disputes Encountered</b>			
With suppliers	.5149	.4893	.4637
With buyers	.6201	.5893	.6089
With employees	.1245	.1179	.1173
With consumers	.4193	.2893**	.3017**
With local government agencies and/or officials	.2169	.2714**	.2682**
With local residents or other local organizations	.1494	.2000**	.2067**
With news media	.0145	.0214	.0223
<b>Policy Concerns</b>			
Need for improvement in property rights	.7068	.7214	.7095
Need for improvement in intellectual property rights	.6410	.7000*	.6983**
Need for improvement in public opinion & propaganda	.6739	.7464**	.7486**
Need for improvement in tax policy	.8386	.8429	.8380
Need for improvement in credit policy	.8345	.8286	.8324
Need for improvement in macroeconomic regulation & policy	.5904	.6357	.6313*
Need for improvement in regulation of business	.7871	.7500	.7430*
Need for improvement in household registration system	.5735	.5714	.5531
Need for improvement in equality of treatment in	.7695	.8500**	.8436**

enterprises			
Need for improvement in eliminating corruption	.9285	.8857**	.8827**
Need for improvement in reform in the political system	.6803	.7000	.6816
Need for improvement in public utilities	.7582	.7607	.7318
Need for improvement in education system	.8177	.7821**	.7654**
Need for improvement in social security system	.8643	.8750	.8715
<b>Forms of Dispute Resolution Used</b>			
Negotiate and compromise as much as possible, and then let the issue resolve itself	.8273	.8321	.8380
Appeal to local government or higher authorities	.2490	.2786*	.2682
Appeal to court	.2378	.2929**	.2682
Mediation through relatives and/or friends	.2161	.2161**	.1955
Resolve through society and social relations	.4410	.4357	.4860
Resolve through news media	.0153	.0143	.0168
Feel powerless	.1382	.1536	.1397
Express opinion directly to political leaders	.5165	.7500**	.7318**
Ask for help from those with influence over political leaders	.5454	.5607	.5419
Reflect opinion through mass rally groups	.3470	.4071**	.3911
Reflect opinion through NPC delegates	.1863	.3214**	.2793**
Reflect opinion through CPPCC members	.1904	.3679**	.3184**
Reflect opinion to higher authorities via business associations	.4161	.5357*	.5084
Write letters to the relevant government department	.2129	.2607**	.2514
Write letters to the media	.1703	.1429*	.1173**
Report to organizations accepting inquiries	.1663	.1750	.1508
Look for organizations to arbitrate the dispute	.2120	.2286	.1955
Meet with higher authorities for help	.2546	.3643**	.3017
Refuse to be bribed	.1622	.1500	.1453

\*\*Indicates .01 level of significance; \*indicates .05 level of significance.

**Table 6 Political Background of Private Entrepreneurs**

Political Membership	1991	1993	1995	1997/8	2000	2002	2003
Chinese Communist Party	7.0%	13.1%	17.1%	18.1%	19.8%	30.2%	33.9%
Youth League	16.7	7.4	4.5	n.a.	n.a.	n.a.	n.a.
Non-Party members	76.3	79.5	78.4	81.9	80.2	69.8%	66.1%
TOTAL	100%	100%	100%	100%	100%	100%	100%

Sources: China Economic System Reform Committee and National Bureau of Industrial and Commercial Management, *Survey of the Individual and Private Economy 1991*; *Investigation of Private Enterprises 1993*—data sets from Universities Service Center, Chinese University of Hong Kong; *Zhongguo siying jingji nianjian*, various years; and *Zhongguo siying qiye fazhan baogao*, 2003.

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