

## **ABSTRACT**

QING, CHANG. Cooptation Strategy in China: Empirical Evidence from Integration of Private Sector Entrepreneurs. (Under the direction of co-chairs Edward Kick and Tomislav Vukina).

Political parties are useful institutions for coopting elite organization and reducing potential opposition within authoritarian countries. Political scientists and economists have explicitly demonstrated how cooptation theoretically works within several authoritarian countries, but, few studies focused on one specific country. The present study used data from a nation-wide survey of privately owned enterprises in China conducted by the Chinese Industry and Commerce Federation to describe entrepreneurs who possess characteristics that are more likely to be integrated into the Communist Party. The goal of the study was to examine the cooptation from the perspective of the elite selection mechanism. Results indicated that economic factors such as local economic growth and a firm's tax contribution to the government impact how the Chinese Communist Party (CCP) coopts entrepreneurs. No evidence was found that the CCP will intentionally coopt an entrepreneur who has the potential of rebellion to reduce potential oppositions and to protect the regime's stability.

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Cooptation Strategy in China: Empirical Evidence from Integration  
of Private Sector Entrepreneurs

by  
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## 1. Introduction

The private sector has become the main source of Chinese economic growth (reference needed). The number of private enterprises has increased annually by 35 percent; indeed, their numbers were estimated at 12.53 million in 2013. Private sector enterprises have created almost 0.2 billion jobs. As of 2013, the value of the products and services they provided was 60 percent of the national GDP (xinhuanet.com, 2014). The increasing prominence of the private sector has captured the attention of influential scholars and given them reason to believe that this new emerging political power could be the agent of China's political change. Scholars with an optimistic view of China's change have even estimated that China will become a fully democratic country (Svolik, 2012). However, after nearly 15 years of economic development and the increasing strength of the private sector, there is no sign of real democracy in China. On the contrary, the CCP has adopted several strategies to keep private entrepreneurs under control. They support the development of the private sector, while at the same time they embrace these new elites into the political system so that they cannot become challengers from outside the political system.

Political scientists and economists suggest theories and research as to why rulers want to coopt elites and how they achieve this goal. Svolik illustrated why authoritarian rulers need political parties and he studies parties as a tool to realize the rent distribution within the party members as well as to facilitate rulers' ability to coopt the elites (2012). Empirical studies based on international comparisons also suggested evidence for the cooptation theory. For example, Gandhi and Przeworski (2006) use the number of parties in parliaments to measure the degree of autocrats' cooptation and suggested that cooptation

extended rulers tenures. However, few of the studies focused on one specific authoritarian country to analyze how cooptation strategy works in that country. Just like democratic institutions in democratic countries, authoritarian institutions should be different from each other. Focusing on one specific country may help scholars more deeply understanding the micro-logic of cooptation. Thus, in this paper, I will use data from a national survey of privately-owned enterprises in China, conducted by the Chinese Industry and Commerce Federation, to describe entrepreneurs who possess characteristics that are more likely to be integrated into the Communist Party, and illustrate how cooptation works in China. My goal was to test cooptation based on the selection mechanism of elites and help scholars more deeply understand the potential political change in China.

In this paper, I find that economic factors such as local economic growth and the firm's tax contributions to the government impact how the Chinese Communist Party co-opts the entrepreneur, but find no evidence that in order to reduce potential oppositions and protect regime's stability, the CCP will intentionally co-opt the entrepreneur who has the potential of rebellion. More specifically, entrepreneur's age, sex, education and firm scale have a positive impact on party recruitment. When I exclude the population of entrepreneurs who are party members before they start their businesses from the sample, however, education becomes a negative factor impacting party recruitment. This implies that the CCP does not use co-optation strategies to deliberately embrace private entrepreneurs. A further study using proxy variables, which measure the potential risk of one entrepreneur, also verify this finding.

## **2. Literature Review**

### **2.1 Theoretical Study of Cooptation**

King (2007) defines cooptation as “a process whereby organizations incorporate dissenting elements into their leadership or policy-making structures in order to reduce environmental uncertainty or to mitigate threats to the survival or success of the organization. The internalizing of adversaries or adversarial elements can be either symbolic, having no significant effect on outcomes or processes, or can result in goal displacement, which occurs when group resources are deployed for purposes other than those for which they were originally intended.”

From the state’s perspective, cooptation is a selection and adaption process, which can ensure the rulers’ ability to govern. In authoritarian countries, dictators normally use parties and legislatures to integrate the dissidents. Jennifer Gandhi and Adam Przeworski develop a model in which the dictator faces a threat of rebellion and study the relationship between the authoritarian institutions, such as parties and legislatures, and their regimes’ duration. They find that regimes with multiparty legislatures are more durable than those who do not have (Gandhi & Przeworski, 2006). Furthermore, they argue that parties and parliaments in authoritarian countries are not only seen as “window dressing” institutions, but also have a true function. Contrary to monetary rewards that can be distributed directly from a dictator to their followers, political concession must need a certain forum to implement, and parliaments are ideally suited for this purpose. A dictator can select groups to access the legislature, legitimize the policy decision making process, gathering information from the opposition as well as broaden the mass support for the dictator.

Joseph Wright (2008) takes this argument further by pointing out that legislatures in “poor natural resources countries” provide forums of cooperation to achieve economic growth. He differentiates between two types of legislatures, binding legislatures and unbinding ones. Wright concludes that single party regimes and military regimes tend to establish binding legislatures, while personalist and monarchies prefer the unbinding ones. The reason for this difference depends on the dictators’ reliance on domestic productivity. He argues that under single party and military regimes, dictators rely heavily on domestic enterprises to produce commodities and pay taxes for their ruling, so in order to guarantee investors that their properties will not be arbitrarily expropriated by the government, dictators tend to establish binding legislatures to solve the commitment problem. In the personalist regimes and monarchies; however, because dictators rely more on the “unearned” income such as natural resources and foreign aid, they do not have the incentives to build binding legislatures. Normally, legislatures in these countries are not established to regulate dictators, but for dictators to punish and reward their followers.

On the contrary, Jenson, Malesky, and Weymouth (2014) argue that the positive correlation between legislatures and investment is not driven by property right protection through establishing binding legislature, rather, it is the legislature that provides forums for different interest groups to bargain with each other that serve the function of protecting the investors’ interests. They also point out that although existing literatures find robust empirical evidence supporting relationship between legislatures and economic growth, scholars lack micro-data to further unravel this correlation, and thus the micro-mechanism between legislations and economic growth remains under studied.

Svolik (2012) developed a new formal model of authoritarian regime parties which indicates why parties are important institutions for dictators in coopting the elites. He identifies three organizational features: hierarchical assignment of services and benefits, political control over appointment, and selective recruitment and repression. Generally, the political control of appointment, alone with the selective recruitment and repressions build the basis for the primary feature of the party. Svolik argues “these features effectively exploit the opportunism and career incentives among the population in order to create a stake in the perpetuation of the regime among the most productive and ideologically agreeable segments of the population” (p. 163). For instance, when junior members serve senior party members within the party, they have the hope that one day they can be promoted to senior member status and ultimately enjoy the same benefit. This is the sunk investment mechanism, which requires short-run effort and promises bright long-run benefit in attracting fresh members. Also, this sunk investment increases the opportunity cost in party members’ defection preparation and therefore decreases the volatility and fragility of the party.

## 2.2 Empirical study of cooptation

Gandhi and Przeworski (2006) use 3518 country-year observations in 139 countries, empirically proving that those dictators who over or optimally institutionalize parliaments and parties survive longer than under-institutionalizing dictators. Furthermore, using data from 121 authoritarian countries from 1950 to 2002, Joseph Wright finds that the binding legislatures exert a positive impact on economic growth and investment, while nonbinding legislatures have a negative impact on economic growth. Their belief is different from Joseph Wright (2008), who only uses the existence of the legislature as a dummy variable to

examine his hypothesis, Jensen, Malesky, and Weymouth (2014) use the number of parties in legislatures as a proxy variable to suggest that authoritarian legislatures are better at generating the corporate government to protect the insiders' interests. Also, relying on the data from Vietnam's National Assembly query session, Malesky and Schuler (2010) prove that cooptation indeed works in Vietnam, but that scholars need to take seriously in the different aspects of parliamentary institutions seriously in various countries. Specifically, the delegate nomination procedure, electoral competitiveness, professionalism and the role of individual delegates in policy making, play important roles in the usefulness of cooptation strategy.

Dimitar Gueorguiev and Weiyi Shi (2014) use the dataset of the Chinese People's Political Consultative Conference (CPPCC) members to conclude that the CPPCC is a cooptation institution rather than a policy influential one. Since political elites and central state owned enterprise (SOE) managers are actually the least likely to participate in proposals submission, this implies that the CPPCC members are not pursuing their political influence through this institution. As well, this counters Jennifer Gandhi and Adam Przeworski's (2006) proposal that parliaments are venues for dictators and political elites to make agreement. Meanwhile, they find evidence that members with a connection to the central SOE are also less likely to make proposals during the CPPCC's sessions, which indirectly implies that members with sufficient political power are less likely to realize their influence through formal institutions than by informal institutions.

In Li Hongbin's (2012) studies on urban Chinese twins' economic returns to Communist Party membership, the economic profits of the twins (one of whom is a party

member whereas the other is not) are the same after they control the family effect. The premium of the party membership is zero and the seemingly higher economic return of the Communist Party member is due to the CCP's intentionally recruitments of high ability peoples. This finding does not support the Svobik model's prediction, because in Svobik's paper he points out that the Party delivers economic benefits to their fellows and their total earnings should thus be higher than the nonparty members in order to attract new people to join in.

Li Han uses the data collected from a major Shanghai university on students' College Entrance Examination score, combined with the national household survey. Her difference in difference estimation generates a positive robustness result showing that the CCP has changed its cooptation strategy. Due to the increasing numbers of foreigner and domestic private enterprises in China, the CCP confronts a heated competition in attracting high ability people to these companies, and in order to keep the recruitment rate high, the CCP lowers the entry barriers for them (Li, 2007).

Dickson (2003) uses survey results collected directly from entrepreneurs from four provinces including eight counties in China, to study the dynamics of CCP's cooptation strategy towards private sector entrepreneurs and shows that private entrepreneurs are unlikely to be the challengers of the regime; on the contrary, they seemed more satisfied with the status quo. In his subsequent book, written with Chen Jie in 2010, they expand their sample size to five provinces, including 40 counties and use this large sample size, they re-affirmed that private entrepreneurs largely share the same political values and policy preferences with the government. That is to say, they are more likely to be the "Allies of the

state” rather than the enemies of the state (Chen & Dixon, 2010). Tsai (2006) focuses on the private sector as a group, studying whether entrepreneurs share a common identity and definition of interest or not. Since entrepreneurs who have the same goal will join and form a class, they have an incentive to act collectively. However, according to his study, Chinese entrepreneurs are more diverse than conforming; entrepreneurs have the different opinions on politics and use different ways to bargain with the government. In conclusion, “they are pragmatic and creative but they are not budding democratic” (Tsai, 2006).

There are some drawbacks to their empirical studies, however. First, in Jennifer Gandhi and Adam Przeworski’s paper, the numbers of parties in parliaments cannot measure the strength of the opposition. Multiple parties can exist in a legislature, but they may not have the strength to bind the dictators. For example, in China’s National People’s Congress, there are eight democratic parties, but none of these nominally oppositional parties has the power to bargain with the CCP, not even to bind the CCP’s action. Thus, the variable “LPARTY”, which is used in their paper to measure the degree of cooptation, is not suitable, but rather misleading. Secondly, even scholars proving that existence of the multi-party system in legislatures indeed increases the longevity of the regimes, scholars still need to verify whether this is the result of parliament’s contribution to the regime’s durability. Since informal institutions are critical in authoritarian countries, different interest groups could use informal institutions in mediating and making agreements with each other, and go through the formal institutions to legitimize their decisions. Then if this is the case, formal institutions are only used as “window dressing” institutions. Moreover, there is a micro-mechanism gap between the theoretical study of cooptation and China’s reality. Although researchers such as

Bruce Dickson and Kellee S. Tsai find the evidence that the Chinese Communist Party embraces entrepreneurs into the political system to realize the sharing of power, they do not show that the CCP embraces these entrepreneurs in order to eliminate opposition and win broad support from Ahe dissidents.

There are two reasons responsible for this gap: first, collecting data from an authoritarian country is very difficult, no matter whether the collection is from their own government or is collected by scientists from outside their country. Secondly, scholars lack a good measurement for some critical indicators, such as potential risk of the people and their true political preferences. These indicators are critical for researchers to verify the cooptation practic but often hard to obtain. In this paper, I will fill this gap by using proxy variables, such as the entrepreneur's parents' education and his or her spouse's education, to measure the potential risk of entrepreneurs and to discern the relationship between the entrepreneur's potential threat to the CCP and his or her likelihood of being coopted.

### **3. Integrating the Capitalist into the Political System**

#### **3.1 Political Background on China's Private Sector Development**

##### **3.1.1 Mao's Area**

Private sector's development in China has been uncertain and unstable as political change has occurred. During Mao's reign, because class struggle and socialist transformation were the top goals, private enterprise and private entrepreneurs almost disappeared. With the succeeding political campaign initiated by Mao at the end of the 1956, the private sector was eliminated, and all of the enterprises and industries were transformed to socialist enterprises. Even small-scale private businesses in rural areas were eliminated. Since the private

businesses were treated as “the tails of the capitalism” that had to be cut, anyone who traded with someone else would be treated as a “capitalist”.

### **3.1.2 Post-Mao Reform**

After Mao’s death, Deng Xiaoping became the prime leader of China, and consolidation of power at the 3<sup>rd</sup> plenum session of the 11<sup>th</sup> central committee of the CCP. His returned to office paved the way for China’s economic reform, particularly the non-state sector reform.

*1978-1989.* Although within the Communist Party there was still much debate between reformers and conservatives on whether allowing a private economy was a betrayal to socialism, small businesses began to spring up after 1978. In the beginning, the private economy was largely composed of individually owned enterprises (*getihu*), including street vendors, family stores, bicycle repair stores etc, most of which were run by people who had criminal records, who were underemployed farmers, or who were social outcasts who lacking alternative employment skills. For these small-size enterprises, in order to avoid ideological criticism, they often limited their employees or workers to fewer than eight people (Jinglian, 2005). In other places, most often in rural areas, entrepreneurs broadly used township and village enterprises as a way to circumvent the central government prohibitions.<sup>1</sup> Township and village level enterprises (TVEs) were registered as collective enterprises, assets which were owned by the community as a whole and managed by local government, but, in reality, the enterprises and local government were all aware that these enterprises were all privately

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<sup>1</sup> In this paper, I categorize enterprises as 1)state owned enterprises, 2)private enterprises and 3)township and village enterprises.

owned and operated.

During the first decade of the reform, debates were held between top leaders, including Deng Xiaoping and Hu Yaobang, who wanted to loosen the central control on the economy and give more incentives to the people themselves to raise production, and more conservative leaders, like Chen Yun and Li Xiannian, who believed that the private economy could only be a complement of the socialist economy. The debates slowed reform efforts and added uncertainty to the future of private enterprises. During 1983, 1984 and 1987, entrepreneurs were publically criticized during a national campaign against “spiritual pollution” and “bourgeois liberalization”. With this uncertainty and criticism, many entrepreneurs chose to wear a “red hat” to avoid social and political ostracism. Table 3.1 indicates a great increase of TVEs during the period of 1985 to 1990. These TVEs were actually privately owned enterprises; although collectively owned enterprises, on the surface. This practice was institutionalized practice, since enterprises could benefit from political protection and circumvent central government sanctions, and local government could benefit from collecting new tax revenues, and create more jobs. As a result, local governments and entrepreneurs were all happy to choose these “adaptive informal institutions” (Tsai, 2006).

Table 3.1: The Growth of TVEs from 1978 to 2002 (ten-thousand)

Year	Enterprises	Increase Rate%	Total Employee (TE)	Median of TE
1978	152.4	**	**	**
1980	142.5	**	**	**
1985	1222.5	**	6979.0	5.7
1986	1515.3	24	7937.0	5.2
1987	1750.2	16	8805.0	5.0
1988	1888.2	7.9	9545.4	5.1
1989	1868.6	-1	9366.7	5.0
1990	1850.4	-1	9264.8	5.0
1991	1908.9	3.2	9609.1	5.0
1992	2079.2	8.9	10624.6	5.1
1993	2452.9	18	12345.3	5.0
1994	2494.5	1.6	12018.2	4.8
1995	2202.7	-11.7	12862.1	5.8
1996	2336.3	6	13508.3	5.8
1997	2014.9	-13.7	13050.4	6.5
1998	2003.9	-0.5	12536.5	6.3
1999	2070.9	3.3	12704.0	6.1
2000	2084.7	0.7	12820.0	6.1
2001	2115.5	1.4	13086.0	6.2
2002	2132.7	0.8	13288.0	6.2

Note: Figures for 1978-1983 include only township and village level enterprises, since 1984 figures cover all the township and village enterprises.

Sources: China Statistical Yearbook from 1996-2003.

Although Deng Xiaoping had returned to a leadership position in the CCP and tried to increase production by opening the limits on the private sector, there was still strong opposition in the Party. In 1983, the private sector had increased in size and many of the entrepreneurs defied the prohibition of private enterprises size as more than seven employees. The Central Committee of the CCP still continued to publicize their dissent and

discourage this practice and adopted a “wait and see” attitude. Until 1988, the China National People’s Congress issued a new paragraph, which said, “The central government admitted that the private economy is a complement to the socialist public economy and the state will protect the rights and interests of the private sector”. Additionally, the “dual price policy” issued by the central government in January 1985, began to motivate people who had a relationship with government officials to go into the business world. To be a businessman became a very popular trend in China.

*1989-2002.* The opposing voice from the conservative side never ceased during the first decade of reform. On one hand, opponents believed that allowing enterprises to hire more than seven employees would lead to the exploitation of workers, and contradict what Marx had said. On the other hand, they worried that increasing the people’s wealth would also increase illegal activity, including corruption, drug use and prostitution, which would eventually destroy the sustainability of Chinese society. The 1989 Tiananmen movement produced an avenue for these orthodox thinkers to halt economic reform, which they believed to be the cause of the protest. During this movement, many entrepreneurs not only supported the students by giving them money and food, but also some of them stood directly at the front line of the movement. Private sector entrepreneurs automatically became the target of orthodox thinkers. Thus, the private sector’s development almost stagnated during that period and received a lot of criticisms from the media and orthodox leaders in the party. Some entrepreneurs were imprisoned with the excuse that they advocated the movement. Some private assets were illegally confiscated without compensation. Private entrepreneurs faced unfair treatment from the government during that period, and because entrepreneurs lost

confidence in private economy, some of them closed or cancelled their enterprises registration. It seemed that the “socialism” had returned, and the government would eventually abandon the ten-years-old reform.

In 1992, however, the fate of China’s private sector faced a new turning point because Deng Xiaoping was not satisfied with the slowly pace of the reform process after the Tiananmen Square Movement. He gave several speeches to local officials and army leaders during his tour of southern China to push people to continue to emancipate their minds and accelerate the reform process.

Deng’s tour attracted a lot of attention from the media, and began to relieve the strained atmosphere in China. His speeches restarted the growth of the private sector. From Table 3.2, we can see that the number of private enterprises only increased by 49,000 from 1989 to 1992; but it increased by 515,000 from 1992 to 1995, an increase of 368%.

Table 3.2: The Growth of Private Sector in China (ten-thousand)

Year	The Numbers of Enterprises (1)	Increase Rate % (1)	Total Registered Capital (Hundred million)(2)	The Number of Workers (3)
1988	22.5	**	**	360.0
1989	9.1	-59.6	84.0	164.0
1990	9.8	8.4	95.0	170.0
1991	10.8	9.9	123.0	184.0
1992	14.0	29.5	221.2	231.9
1993	23.8	90.4	680.5	372.6
1994	43.2	81.7	1,447.8	648.4
1995	65.5	51.4	2,621.7	956.0
1996	81.9	25.2	3,752.4	1171.1
1997	96.1	17.3	5,140.1	1349.3
1998	120.1	25.0	7,198.1	1709.1
1999	150.9	25.6	10,287.3	2021.6
2000	176.1	16.8	13,307.7	2406.5
2001	202.9	15.1	18,212.2	2713.9
2002	263.8	20.0	25,000.0	3247.5
2003	328.7	24.8	35,000.0	4299.1
2004	402.4	22.4	48,000.0	5017.3
2005	471.9	17.3	61,000.0	5824.0

NOTE: In the table \*\* means data are missing. Source: China Private Economy Year Book, 1992-2005

During the administration of Deng Xiaoping's successor, Jiang Zemin, the CCP showed more support for the private sector. In 1997, at the 15<sup>th</sup> party congress, the CCP changed its evaluation of the private sector from a "complement of the socialist economy" to an "important component of the socialist market economy." Facing private sector expansion both in size and scope, in 2000 at the 5<sup>th</sup> plenum of the 15<sup>th</sup> Central Committee, the CCP

announced, “self-employed and private-owned business will be supported, encouraged and guided.” This announcement gave the private sector the same status as the public sector. Moreover, the political status of private enterprises was greatly improved after Jiang Zemin’s slogan, “Three Represents”, which means “the CCP must always represent the requirements for developing China's advanced productive forces, the orientation of China's advanced culture and the fundamental interests of the overwhelming majority of the Chinese people”<sup>2</sup>(Zemin, 2002). Traditionally, the CCP only represents peasants, workers and soldiers; but, in Jiang Zemin’s “Three Represents”, the CCP also represented the “advanced productive force” in China, which implied that the CCP began to legitimize its embracing of the private sector. Since the private sector became the major contributor of tax revenue and jobs, the CCP believed that these private entrepreneurs had the right to participate in the political decision-making process. During the 16<sup>th</sup> party congress in 2002, the CCP revised the party’s constitution to include the “Three Represents” as one of the theoretical extensions of Marxism-Leninism, Mao Zedong Thought, and Deng Xiaoping Theory. After that, private entrepreneurial status improved to heights they had never envisioned to be possible.

*2002-Present.* Under the leadership of the CCP’s fourth generation, the private sector’s economic and political status improved and was confirmed by the constitution. In 2003, the 3<sup>th</sup> plenum of the 16<sup>th</sup> Central Committee, the CCP issued a decree that the private

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<sup>2</sup> Detail from Jiang Zemin's work report at the 16th CPC Congress, November 8, 2002. In proper English, the “three represents” would be “three representation”.

sector would be treated equally as the public sector regarding investment, financing and taxation, land use, and foreign trade. In 2004, during the second session of the 10<sup>th</sup> National People's Congress, Article 11 of the constitution was revised to protect the rights, interests and legality of individual and private enterprises. This revision was recognized as the CCP's most important step in protecting the property rights of private enterprise.

The reformation of the Township and Village Enterprises (TVEs) and State Owned Enterprises (SOEs) also contributed to the growth of the private sector. At the beginning of the reform, Deng already knew that a large portion of SOEs had become a burden of the central government. With the growth of the private sector, SOEs gradually lost their advantage in the market orientation system, and most of them were on the verge of bankruptcy. The reform of SOEs began by giving an incentive to managers to be profitable. This reform ended at the 15<sup>th</sup> party congress in 1997, where the CCP decided to adopt a new strategy called "grasp the big, release the small", which meant SOEs would only possess the important industrial and privatization enterprises that related to people's normal lives and small enterprises. From Table 3.3, we can see that SOEs decreased from 99,000 in 1997 to 41,000 in 2002. Until 2007, the number of SOEs was only 10,000. According to a national survey during 2002, 25.3 percent of private enterprises founded between 2000 and 2002 were originally state owned enterprises. Also, the privatization of TVEs comes with the SOE' reform. 4.1

As the private sector was later politically supported by the government, TVEs began to be privatized. Using the same report from the national survey, 41.9 percent of private enterprises founded from 2000 to 2002 were originally TVEs.

Table 3.3: Numbers of SOEs in China (ten-thousand)

Year	Number of State-Owned Enterprises	Increase rate%	Year	Number of State-Owned Enterprises	Increase rate%
1990	10.4	**	1999	6.1	-5.3
1991	10.5	0.3	2000	5.4	-12.7
1992	10.3	-1.3	2001	4.7	-12.5
1993	10.5	1.4	2002	4.1	-12.2
1994	10.2	-2.4	2003	3.4	-16.5
1995	11.8	15.5	2004	3.6	3.8
1996	11.4	-3.6	2005	2.8	-22.8
1997	9.9	-13.4	2006	2.5	-9.1
1998	6.5	-34.4	2007	1.0	-60.0

Sources: China Statistical Yearbook from 1996-2010.

Currently, according to the report from “People.cn”, the private sector has contributed 60 percent of the total GDP in China and created almost 0.2 billion jobs at 2013. The private economy has become a strong economic force, which cannot be ignored in China’s political arena. According to Samuel Huntington’s (2006) analysis, one organization must adopt a dynamic environment in order to survive. Thus, we should analyze how the CCP keep private entrepreneurs from using their economic strength to ask for more political rights and how the CCP prevent entrepreneurs from becoming challengers to the CCP’s ruling.

### 3.2 Changing criteria for becoming a party member

After 1980, local governments began to recruit private entrepreneurs into the party, since local economic performance had become an important criterion for promoting local cadres and they had great incentives to recruit entrepreneurs. After the Tiananmen Square Movement, the central government banned the recruitment of private entrepreneurs in 1989 and during the following years, the central government reinforced this ban again and again.

In September of 1995, the Central Organization Department declared that the Party would not recruit entrepreneurs as member. In 1999, the director of the Central Organization Department, Yu Yunyao, reiterated that local government should comply with the rule banning private entrepreneurs from joining the Party.

Table 3.4: Political Membership of Private Entrepreneurs (%)

Period	Chinese Communist Party	Chinese Communist Youth League	Others
1993	13.1	7.3	6.5
1995	17.1	4.5	5
1997	16.6	**	4.7
2000	19.8	**	5.1
2002	29.9	2	5.7
2004	33.9	6.8	6.7
2006	32.2	**	5
2008	33.4	**	6.9
2012	34	**	5.6

NOTE: \*\* means data are missing.

Sources: China Private Economy Year Book, 1992-2012.

Although the central government explicitly banned the recruitment of private entrepreneurs, local governments still found ways to recruit entrepreneurs. One way to circumvent the central government sanction was to change private enterprises to collective ones, so that entrepreneurs could qualify for recruitment. According to the results of a national survey shown in Table 3.4, we see that although central government stopped coopting, the number of private entrepreneurs who joined the party was still growing by to 4

percent in 1995. Even during the years from 1995 to 1997, data indicate a slight decreased trend, from 17.1 percent to 16.1 percent, after which it increases to 19.8 in 2000. These figures clearly show that local government violates the ban enacted by the central government. However, the data are consistent with the broad environment in which local governments are more concerned with economic development than ideological conflict.

During this period, a debate about whether the CCP should recruit private entrepreneurs into the Party continues between Party leaders. The most widely known opponent was Deng Liqun, former secretary of Liu Shaoqi and one of the party's conservative leaders. In one of Deng Liqun's reports, he showed his concern for the rapid rise of the private sector and the decline of the public sector. He argued that the increasing numbers of wealthy people in China not only corrupted the social environment, making people more fascinated with money and hedonistic pleasure but it also caused the abandonment of the socialist orthodoxy. The Party also was threatened because private entrepreneurs may not have been as loyal to the Leninist party, and as such might betray the party's interests. He was so distrustful of the loyalty of private entrepreneurs that he believed once the conditions were right they would completely destroy the Party and turn to a bourgeois dictatorship. Understandably, recruitment of entrepreneurs into the Party aggravated the ideological conflict between the CCP's original mission with its political practice. Since the CCP was supposed to represent the interests of workers and peasants, it would have been inconsistent to recruit too many private entrepreneurs into the Party. The Party could lose its identity and the support of these two classes if the problem continued to be ignored.

With the increase in China's entrepreneurs, the government relationship with them has become an ideological and practical issue. If the government could not reach an agreement on how to respond to this new development, then the CCP could lose their control of the private sector; and it would be highly probable that these new elites would develop their own influence outside the communist party. Wang Changjian, who was a professor in the Central Party School, once argued that if the Party did not embrace the vast majority of Chinese people, they would seek to organize themselves outside the political system". Party members' opposition from within would jeopardize the Party because even if the Party followed the conservative side's strategy to consolidate the Party's basis on peasants and workers, the risk would still exist. In January 2001, the CCP's General Secretary Jiang Zemin said that the Party was considering eliminating the restriction on recruiting private entrepreneurs; otherwise they would become a potential risk to the Party. Thus, it seems that the top priority for the Party was to find a way to embrace the wealthy without losing the basis for the Party's ideology. On July 1 2001, Jiang Zemin again proposed his "Three Represents" on the 80<sup>th</sup> anniversary of the founding of the CCP. One of these proclamations "the CCP represents the advanced productive forces in China" became widely accepted as the CCP reopened the door to private entrepreneurs. And Table 3.4 shows the numbers of private entrepreneurs who joined the CCP increased 10 percent from 2000 to 2002. In 2000, this ratio was 19.8 percent; but in 2002, the ratio increased to 29.9 percent, increasing by 10 percent in two years. Since reopening the door to entrepreneurs, the central government did not provide a clear criterion for which entrepreneurs could be recruited into the Party; hence this increase was understandable. After 2002, however, when the government began to

develop a methodology for recruiting entrepreneurs, the increase became more stable.

### 3.3 Becoming a member of the CCP

Entrepreneurs want to join the CCP because they can obtain many benefits as a party member. A good connection to government is a very valuable resource for a businessman in China, since China is an authoritarian country, and the Party controls almost every economic resource, such as land, finances and licenses. Therefore, a businessman with a government connection can obtain the above resources more easily, and party membership is definitely a good way to build this connection. Also, party membership can give entrepreneurs intangible benefits, such as: preventing enterprises from arbitrary government interference; gaining better protection from competitors; and easily solving conflicts. Thus, entrepreneurs have an incentive to join the party.

To join in the party, entrepreneurs must do the following: First, entrepreneurs must submit a 20-page application letter that convinces the party leader of the applicant's sincere desire to join the Communist Party. Normally, in this letter, applicants would express the knowledge of the Chinese Communist Party and their absolute agreement with the party's ideology, proving the applicants desire to be one of them. Applicants also need to illustrate their initial motivation to join the party and how many accomplishments the applicant has performed to meet the party's requirement. Second, after the local party branch leaders have considered applicants to be eligible as a candidate, applicants will be subjected to observation and training for a minimum period of one year. Party leaders will appoint two party members as applicants training supervisors. During this period, applicants will need to schedule conversations on a regular basis with applicants training supervisors and submit a report of

applicants' recent thinking to them. At the same time candidates need to participate in the Party's regular activities and community services. Third, when applicants finish the above training and observation, the department of party organization will evaluate the applicants' efforts and decide whether they are eligible to become a probationary party member. Usually this evaluation will combine the opinions of applicants' colleagues, party supervisors, and party branch leaders. After a thorough evaluation, if the applicant is passed, they will still have a one-year probationary period before becoming a formal member. Needless to say, this process is time consuming, and it may take two for them to three years to become a formal party member.

### 3.4 Testable Hypotheses Generated by Chinese Institutions

Having a co-optation strategy is the best way for the CCP to integrate the elite in China. Using this strategy, the CCP would let entrepreneurs join the party, be elected and serve as representatives in congress, and allow some of them to be the head at the township or village-level government.

There are several reasons why the CCP would integrate the wealthy into the party. However, the main reason for doing this is the rapid change of China's social environment is forcing the CCP to change their methods of recruiting members. After Deng Xiaoping announced "opening and reform" and re-visited the idea "four modernizations", the CCP needed a large number of people with an appropriate amount of knowledge in economics, education and technology to help them manage the country. Also, according to the studies of other scholars such as Maria Edin (2002) and Susan Whiting (2004), the cadres' evaluation system in China encourages them to have strong economic performance. Thus, to better

control and promote economic growth, local cadres rely on these entrepreneurs to help them provide jobs and tax revenues. Welcoming them into the political system will help cadres build good relationships with entrepreneurs. Secondly, according to the definition of cooptation, the CCP incorporate dissenting elements in order to reduce environmental uncertainty and to mitigate threats to the survival or success of the organization. As the market-oriented reform goes deeper, private enterprise becomes the main source of economic growth; and this change keeps pressure on the CCP from the outside, because if they have no institutional links with these new emerging elites, the CCP will lose what Andrew Walder (1994) calls “the institution pillars” in a communist system; the new wealthy elites will become the alternative source that will provide the economic benefit and security to the common people.

Thus, combined with the definition of cooptation and specific Chinese political institution background, the CCP will integrate private sector entrepreneurs in order to achieve their two goals: 1) to better control the economy, especially in a high economic growth area, and 2) to co-opt entrepreneurs who have potential of rebellion, in order to keep regime stability. Based on these two logics, I put forth two hypotheses as follows:

*Hypothesis1:* In order to better control the economy, the CCP is more likely to coopt the entrepreneurs who can contribute more taxes.

*Hypothesis2:* In order to ensure that the regime remains stable and reduce potential political change, the CCP is more likely to coopt entrepreneurs who have opposition potential.

## **4. Empirical Methodology and Estimation Procedure**

### 4.1 Econometric model

Because this paper attempts to identify which entrepreneur is more likely to be recruited as the CCP member, the dependent variable is a dummy variable, equal to 1 when the entrepreneur is the CCP member and 0 when he is not. Thus, the probit model is the feasible estimation strategy for this empirical analysis.

### 4.2 Data sources and measurement construction

The data set for this paper are obtained from a survey conducted by the China Industry and Commerce Federation and the Central United Front Work Department. It is a nationwide sampling of privately owned enterprises and their owners. The first survey was done in 1991 and has been repeated subsequently every two years. The data sets used in this paper were collected at the end of 2001, and include 3,258 observations, which, after dropping all the missing value observations, resulted in a total of 2,455 observations. The reason I used the 2001 survey is because that was the year when the CCP began to legitimize its political practice of embracing private sector entrepreneurs and reflects the CCP's true purpose of embracing the entrepreneurs. With the dynamic of a social environment, the CCP may change their purpose of embracing the entrepreneurs, so using the results from other data set would lead to misinterpreting results.

Table 4.1 Descriptions of Variables in the Model

Variables	Abbreviation	Description	Expected sign
<b>Dependent Variables</b>			
Party member	Partymember	Dummy variable=1 if entrepreneurs are party members and otherwise=0	
Party member1	Partymember1	Dummy variable=1 if entrepreneurs become a party member after they start their business, otherwise=0	
PC	PC	Dummy variable=1 if entrepreneurs is People's Congress members and otherwise=0	
PPCC	PPCC	Dummy variable=1 if entrepreneurs is People's Political Consultative Conference members and otherwise=0	
<b>Independent Variables</b>			
Sex	sex	Dummy variable =1 if entrepreneurs are male and otherwise =0	+
Age	age	Age of entrepreneurs	+
Education	edu	Years of education entrepreneurs have	+
Parents' education	Pedu	Entrepreneur's parents' education	-
Spouse's education	sedu	Entrepreneur's spouse's education	-
Per GDP capita	pGDPc	City level per GDP capita	+
GDP growth rate (%)	GDPg	City level GDP growth rate	+
Tax (yuan)	tax	Tax enterprises contribute to government	+
Part branch	partyb	Dummy variable =1 if enterprises have party branch and otherwise =0	+
Xiahai	xiahai	Dummy variable =1 if entrepreneurs have already been the party member before start the business and otherwise =0	

Table 4.2: Summary Statistics of Variables in the Model

Variable	Obs	Mean	Std.Dev.	Min	Max
Party member	2455	0.309	0.462	0	1
Sex	2455	0.896	0.306	0	1
Age	2455	43.68	7.964	7	75
Education	2455	13.05	2.991	6	19
Parents' education	2455	13.534	8.039	0	32
Spouse' education	2455	11.33	3.371	0	16
Per GDP capita	2455	17086	11289	2235	56321
GDP growth	2455	10.66	3.703	1.5	20
Tax	2455	742912	1.84E+06	0	2.97E+07
Party branch	2455	0.342	0.474	0	1
Xiahai	2455	0.38	0.485	0	1
PC	2455	0.1775967	0.3822508	0	1
PPCC	2455	0.3425662	0.4746645	0	1

Table 4.1 describes the variables used in the model. Table 4.2 is a summary of variable statistics in the model. From the above analysis, the CCP aims to achieve two goals through co-opting private sector entrepreneurs; one goal is to promote economic growth to consolidate the legitimacy of their ruling; the second goal is to win broader support from the elites as well as incorporate potential opposition forces. Thus to achieve the first goal, the scale of the target firms should be the main factors impacting the CCP's recruitment decision. The larger the firm, the more jobs will be provided and the more taxes will be collected. Thus, logically, entrepreneurs from big firms should more likely be selected. In this paper, I use taxes the firm contributes to the local government as the measurement of a firm's scales. Some indicators that can be used to describe a firm's scale include their revenues, total employees, and net profit. Tax, however, might be the best indicator of all, because the amount of tax one firm

contributes to government is easily obtained from a government agency, revenues, total employees, and profits are more difficult to trace and are considered to be inner information for the outsiders. Second, after China's fiscal decentralization, local governments are always pressured to balance their budgets; more tax contributions means local governments can manage their budgets more efficiently, which is greatly advantageous to them. The more tax the firm contributes, the more likely their entrepreneur will be selected. In the Table 4.2, an entrepreneur's average tax contribution to the government is 742,912 yuan (119980 USD) and the standard deviation is 1,840,140 yuan (297182 USD). This substantial difference reflects the difference of firm's scales and allows us to study the impact of an individual firm's scale on obtaining party membership.

In the econometric model, per GDP capita used to measure the level of local economic development and GDP growth rate to measure local economic growth. These two variables can help to explain the variation strategies used by the local Communist Party given their economic situation. Table 4.2 indicate that the average per GDP capita across the country is 17,086 yuan (2759 USD) but the standard deviation is 11,289 yuan (1823 USD), a large number which implies unbalanced economic development in China. The average GDP growth rate across the country is 10.66 and the standard deviation is 3.7. These different economic indicators will help illustrate how different economic situations impact party member recruitment.

To measure an entrepreneur's potential opposition risk, I will use an entrepreneur's parent's education, which is equal to his father's education plus his mother's education, and the spouse's education as proxy variables. The underlying logic here is that the more educated the

family members are, the less likely they will agree with the Communist Party's ideology, and there is a high possibility that this disagreement will affect an entrepreneur's ideology. Historically, the Cultural Revolution from 1966 to 1976 belittled people who had higher education. Entrepreneurs, whose mothers and fathers are highly educated people, tend to be largely impacted by the political movement, so they are relatively more likely to disagree with the Communist Party. When an entrepreneur's ideology deviates far from the CCP's ideology, that person's potential opposition risk is very high.

Also, in order to verify that using proxy variable method is a feasible solution to analyze this problem, I also use the same method and variables to study member selection of the People's Congress (PC) and People's Political Consultative Conference (PPCC) in China. The PC is widely known as the supreme organ of the state, and it is responsible for overseeing government operation and has the power to elect major officers of the state. But in reality, PC is reckoned to be a rubber-stamp for decisions already made by the executive organs and the CCP. The PPCC is a political advisory body in China led by the CCP and cooperates with multi-party members. As such, it is an important forum for promoting socialist democracy. In fact, the PPCC only functions as part of the CCP's united-front strategy to win support from different social classes. The PPCC and its local branches are controlled by the CCP's leader and have no chance to contradict the party.

Based on the above analysis, the education variable sign should be negative for PC member selection; that is, the PC member selection should be more rigorous than party member selection, because the CCP would not want high-risk people in their nominally highest organ of the city. Following the same logic, we should expect the positive sign for PPCC member

selection, because the PPCC has no physical political power in the Chinese political arena, and the CCP needs these highly educated people to advise them.

Besides the above variables, this model also includes demographic indicators of the entrepreneur, such as: age, education and sex. Table 4.2 shows that the mean age of the entrepreneur is 43.68. The average years of education of the entrepreneurs accept is 13.05, which denotes a high school diploma. This information indicates that the average education an entrepreneur has earned is not very high in China; but this is understandable considering that the Cultural Revolution might have interrupted their studies when they were young. The table also shows that average years of education attained by an entrepreneur's parents and spouse are 13.53 and 11.3, respectively, which is even lower than that of the entrepreneurs.

Also, in order to measure other factors that may affect the selection decision, I code the firm with a party branch as a dummy variable in order to analyze the likelihood of selection if the firm had a party branch. According to the CCP's constitution, when one organization has three or more party members, it is eligible to build a party branch, and those firms with less than three members can form a party branch with another organization or association. In China, some firms that have a party branch; but whose owner or CEO does not have a party membership do exist. One famous example is Alibaba Group's founder, Ma Yun, who is not a party member; yet, his company has a party branch and there are around 1,386 party members in the company. Using this variable, the goal is to show how the establishment of a party branch in private enterprise can impact the owner's chance of obtaining party membership. In this sample, we have 839 firms that have party branches in their firms, and this number represents 34 percent of the entire sample.

Last, I used the xiahai variable to describe entrepreneurs who were already party members before they started their businesses. This paper focuses on how the CCP coopts the entrepreneurs who are not party members before they start their businesses and analyzes the characteristics they have which facilitate them in joining the party. Including entrepreneurs who were already party members prior to starting the businesses might cause us to misinterpret the results from the econometric model. Thus, we need to exclude these people. Unfortunately, we lack this specific information in the survey, and the only valuable information is the positions entrepreneurs had before they started the businesses. In this survey, the options they had when they answering the question “What is your position before you start the businesses” are categorized as government cadres, businessmen, and workers or under-employed. To capture the population of xiahai entrepreneurs, I will use government cadres as a proxy dummy variable to measure it. This is because in an authoritarian country like China, the party controls all the key positions in the government, so, if someone wants to be a cadre in China, the first step is to be a party member. In this sample, 932 entrepreneurs are government cadres before they start their businesses, which mean that the number of xiahai entrepreneurs is 932. Then I code xiahai entrepreneurs as 1, otherwise 0. Last, the party member variable minus the xiahai variable, and whose result will be named the party member1, indicates the entrepreneurs who are integrated into the party after they start their businesses. Note, It’s very likely that -1, where the entrepreneur is not a party member but is a cadre, will exit in the sample when we are doing this calculation, but I simply changed -1 to 0 when this happened. The total population of -1 is 594.

Table 4.3 is the correlation matrix for the independent variables; we can see that there is no apparent problem of multicollinearity.

Table 4.3 Correlation Matrix for Dependent and Independent Variables

	age	sex	edu	tax	pGDPc	GDPg	partyb	pedu	sedu
age	1								
sex	0.0711*	1							
edu	-0.2246*	-0.0583*	1						
tax	0.0115	0.0592*	0.1343*	1					
pGDPc	-0.0162	-0.0228	0.1054*	0.0605*	1				
GDPg	-0.0118	0.0328	-0.1589*	-0.0274	-0.3128*	1			
partyb	-0.000900	0.0520*	0.1727*	0.1242*	0.0408*	-0.0556*	1		
pedu	-0.2786*	-0.1398*	0.3631*	0.0437*	0.1435*	-0.1105*	0.0901*	1	
sedu	-0.3392*	-0.2019*	0.5137*	0.0690*	0.1157*	-0.1126*	0.1091*	0.4653*	1

### 4.3 Estimation Results

Table 4.4 shows the estimation results using the probit model. An estimation result in model 1 is developed using all the data from the sample, including the xiahai entrepreneurs. According to these results, age and entrepreneur's education has a positive impact on recruitment of party members, and both of them are significant. The dummy variable sex is measured as male equal to 1 and female is 0. The estimation result from the table indicates that male entrepreneur have a better chance of being a party member than female, and significantly at a level of 5%.

Table 4.4 Marginal effects of Entrepreneur's potential risk and the party member selection

	(1) Party member	(2) Party member1	(3) PC	(4) PPCC
Age	0.0091*** (0.0013)	0.0010 (0.0010)	0.0038*** (0.0010)	0.0075*** (0.0013)
Sex	0.0680** (0.0341)	0.0717** (0.0297)	0.0091 (0.0274)	0.0068 (0.0328)
Edu	0.0236*** (0.0038)	-0.0044 (0.0029)	-0.0015 (0.0030)	0.0125*** (0.0039)
Tax	1.94e-08*** (4.88e-09)	1.08e-08*** (3.65e-09)	2.70e-08*** (3.79e-09)	1.05e-08** (5.22e-09)
pGDPc	-1.18e-06 (8.93e-07)	9.32e-07 (6.81e-07)	-7.83e-07 (7.04e-07)	-9.93e-06*** (9.44e-07)
GDPg	0.0095*** (0.0028)	0.0089*** (0.0022)	0.0098*** (0.0023)	-0.0054* (0.0028)
Partyb	0.0749*** (0.0202)	0.0046 (0.0159)	0.0385** (0.0161)	-0.0252 (0.0210)
Pedu	-0.0053*** (0.0014)	-0.0028** (0.0011)	-0.0027** (0.0011)	0.0025* (0.0014)
Sedu	-0.0116*** (0.0036)	-0.0149*** (0.0028)	-0.0078*** (0.0028)	-0.0033 (0.0037)
<i>N</i>	2455	2455	2455	2455

Standard errors in parentheses \*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

The dependent variable in model 2 is the party member variable minus the xiahai variable, which measures the true population of party members selected by the CCP after entrepreneurs started their businesses. Model 2 confirms my previous finding that entrepreneurs who are male and contribute more taxes are more likely to be selected as party member. Meanwhile, entrepreneurs' parents and spouse education is negative and highly significant, which also re-affirm my previous finding that the CCP is not deliberately integrating entrepreneurs who have potential of opposition.

However, a comparison of model 1 and model 2, reveals that age, education and party

branch variable becomes insignificant at all levels, which shows the CCP, in fact, does not consider age as an important factor when they recruit the party member. Also, although the entrepreneur's education variable is not significant, the negative sign in model 2 shows the CCP is concerned about the people who have not been screened and have high education, but is less concerned with the people who are pre-screened. The insignificant of party branch variable shows that most entrepreneurs who are already party members before opening their firms choose to build a party branch in their firms. Entrepreneurs who build a party branch in their firms would not necessarily increase their chances of being party members.

Models 3 to 6 in Table 4.4 confirm my expectation. Entrepreneur's parents' and spouse's education sign of the PC member is negative with significant level of 5% and 1% respectively. And Entrepreneur's parents' sign is positive of PPCC with a 10% significant level. Founded on this analysis, the method of using proxy variables is a feasible solution to measure entrepreneurs' potential risk, and following results are convincing.

## **5. Conclusions and Discussion**

The main purpose of this research is to study the cooptation in the context of the Chinese political system. But drawbacks of current study and the result we point out in this paper can be generalized. Political scientists and economists have explicitly demonstrated how cooptation works theoretically in authoritarian countries; but few of them focus empirically on one specific country. In this paper I proposed two hypotheses to examine this theory: 1) in order to better control the economy, the CCP is more likely to coopt the entrepreneurs who can contribute more taxes; 2) in order to keep the regime stable and reduce potential political change, the CCP is more likely to coopt the entrepreneurs who have the opposite potential.

Using data about Chinese private sector entrepreneurs, results indicate that the CCP is, indeed, more likely to integrate entrepreneurs who can contribute more taxes to government, which means that economic factors do have an impact on the CCP's member selection. However, further study does not confirm that the CCP would coopt entrepreneurs, who have high probability of opposing the CCP, into communist party. This finding does not provide evidence to confirm the cooptation strategy developed by social scientists and calls attention to the micro-logic of cooptation when we study one specific country.

Importantly, this paper reveals the necessity of further study. First, the measurement of entrepreneur's potential risk is not a direct indicator of his or her underling threat. Secondly, this paper does not specify the CCP's select recruitment and oppression strategy, which means that when entrepreneur's ideology is close to the CCP's ideology, the CCP will recruit them, but when entrepreneur's ideology is far from the CCP's, they will be oppressed. In my finding, the negative sign of entrepreneur's parents and spouse's education only illustrates that the CCP will not embrace the far deviation entrepreneur, but does not provide evidence that the CCP will recruit entrepreneur whose ideology is close to theirs.

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