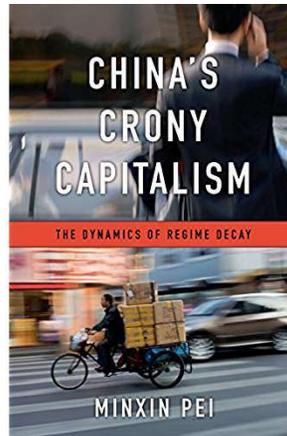


**Pei, Minxin. 2016, China's Crony Capitalism (pp. 256-268). Harvard University Press**



## **Conclusion**

*If we fail to govern our party effectively or strictly ... sooner or later it will lose its standing for ruling the country and will be cast aside by history. —Xi Jinping, June 28, 2013*

The worries expressed by Xi that corruption could be the undoing of the CCP are understandable. Yet senior party leaders like him might need a better understanding of the roots of corruption in post-Tiananmen China to appreciate the difficulties they face in fighting this scourge and defending the party's rule. Our analysis of the cases of collusion among elites in this study shows that the roots of crony capitalism in general, and collusive corruption in particular, run much deeper. Mitigation of the pathologies of crony capitalism is unthinkable without severing its close link with public property that can be stolen with relative ease by the ruling elites. Beneath the unsightly surface of corruption hides a story of the looting of nominally state-owned property by elites who either have direct control over the disposal of such property or can seize such property through bribery or violence. Phrased differently, had public property not been made available for looting, the type of rapacious crony capitalism that has replaced Maoism would have been inconceivable. This statement does not imply that China's economic reform is to blame for the emergence of crony capitalism. Such reform, in and of itself, does not necessarily lead to crony capitalism, as the cases of Poland, the Czech Republic, the Baltic states, and, to a lesser extent, Hungary, show. The critical determinant is the nature of the regime in control of the disposal of state-owned assets. Of course, the privatization of such

assets in Eastern Europe was deeply flawed, largely due to the lack of basic institutions, such as capital markets and a functioning regulatory framework. The adverse macroeconomic environment, marked by a transitional recession, trade disruptions, and fiscal distress, further hampered the reform process. Yet, despite all the turmoil and setbacks most Eastern European countries experienced during transition, they largely avoided the fate of the former Soviet Union, where a kleptocracy emerged from the ruins of communism.

The most likely explanation lies in the divergent political paths of these postcommunist societies. In the most successful Eastern European and Baltic states, democratic transitions and consolidations were accomplished quickly, thus constraining the ruling elites and preventing large-scale looting.<sup>3</sup> The experience of Eastern Europe provides a counterexample as well as an important clue about the linkage between the nature of the regime and the origins of crony capitalism in postcommunist states. Unlike Eastern Europe, post-Mao China has been ruled by a Leninist regime that, except for a brief period in the 1980s, has shown no inclination to liberalize its political system, let alone give up its monopoly of power. And unlike post-Soviet Russia, where the rapid collapse of the old regime allowed a tiny group of entrepreneurs to amass huge private fortunes but deprived most of the elites of the opportunity to loot, Chinese ruling elites have maintained political control and enjoyed boundless opportunities to convert the riches of the state into their personal wealth.

Thus, we need to incorporate insights from the literature on the predatory state to understand the origins of China's crony capitalism. As Douglass North argues, the state defines and enforces property rights, and a predatory state always defines these rights to maximize its income and privileges. In this light, the real rationale behind the CCP's post-Tiananmen approach to the restructuring of the rights of state-owned property—decentralization of control rights without clarification of ownership rights—becomes obvious. Such a change of the rights in the nominally state-owned property provides the ruling elites maximum advantage to extract wealth from society. If we follow the dismal reasoning of institutionalists, crony capitalism is the only logical and inevitable outcome of economic transition under a Leninist regime.

Identifying the critical linkage between property rights and the origins of crony capitalism enriches the institutionalist literature with a contemporary example of elite predation through a redefinition of property rights. By introducing the analytical concept of elite collusion, this study also advances our understanding of the micro-level dynamics of crony capitalism. In our theoretical formulation, collusion among elites is a predictable and rational micro-level response to substantive but

incremental changes in the rights to public property. The interaction of institutional changes in property rights and the adaptive response by elites gives rise to crony capitalism. To fully understand China's crony capitalism, we must retrace these institutional changes, connect them to the resultant behavioral responses by the elites, and explore its manifestations in real life.

An important finding of this study of China's crony capitalism is its decentralized characteristics. The decentralization of administrative power, the fragmentation of political authority, a diverse manufacturing-based economy, and the close connection between the value of assets and macroeconomic performance ensure that looting must be decentralized and accomplished through collusion, which in turn allows lower-level elites to share some of the spoils. Our study indicates that China's crony capitalism may have produced a unique multilayered oligarchy, based largely on geographical jurisdictions in which a small group of elites connected with local party chiefs control an inordinate amount of power and have a capacity to loot that is disproportionate to their relatively modest status inside the Chinese party-state. While this observation explains why local elites in China have benefited immeasurably from the emergence of crony capitalism, we should also note the indispensable role played by private entrepreneurs. Another noteworthy feature of China's crony capitalism is that political elites, such as the princelings and family members of the elites, have not managed to loot all the wealth. It is true that they have gained enormous wealth, but the bulk of the benefits from the looting of the state appears to have flowed toward private entrepreneurs from ordinary or even humble backgrounds, people like Lou Zhongfu and Wang Chuncheng, whose stories we briefly tell in Introduction, as well as countless others who forged lucrative alliances with the local officials featured in our study. In addition to showing that China's crony capitalism, at least in its early phase, provides more open access and allows private entrepreneurs to bribe their way into an exclusive circle of power and wealth, our story merely reconfirms the well-established fact that private entrepreneurs possess far greater capabilities than political elites in making state-owned assets more productive and making them appreciate in value. The problem is, of course, that the gains from the conversion of unproductive state-owned assets to more productive private assets accrue to a small number of well-connected businessmen, not to the rightful owners of these assets: ordinary Chinese citizens.

It would be a mistake, however, to assume that these private entrepreneurs, once they have gained both economic wealth and political power, will prefer liberal capitalism to crony capitalism. Although the Chinese private sector has made tremendous progress since the 1990s, it has been hobbled by government restrictions and, as this study shows, incestuous ties with the political elites. 6 Research on the

political values of Chinese private entrepreneurs also shows that they are highly sympathetic to those championed by the CCP. The reason is not hard to fathom. Those already inside this select circle have every incentive to preserve their privileges and the institutions that make them possible. But lucrative private returns from privileges granted under crony capitalism come at the expense of the social benefits of liberal capitalism. In pursuing collusion with government officials, private entrepreneurs not only waste precious resources that could have been invested more productively, but also divert their energy and talents into rent-rich sectors that are unlikely to be the growth engines needed to upgrade the Chinese economy. It is no coincidence that nearly all the biggest private fortunes in China are concentrated in real estate and mining, sectors most plagued by collusion. According to estimates, one-quarter of China's dollar billionaires in 2015 are in the real estate business. China's dynamic information technology sector is one of the very few exceptions. The close ties between rent-seeking private entrepreneurs and political elites bode ill for the development of liberal capitalism. This alliance has exclusivist instincts because maintaining high barriers to entry protects the rich rents that accrue to its members and ensures its hereditary nature. The result is not competitive liberal capitalism, but oligarchical cronyism.

### **Collusion and Regime Decay**

The emergence and entrenchment of crony capitalism in China's political economy, in retrospect, is the logical outcome of Deng Xiaoping's authoritarian model of economic modernization because elites in control of unconstrained power cannot resist using it to loot the wealth generated by economic growth. More than a quarter century after the Tiananmen crackdown, the limitations of this model have become plainly visible. Economically, the deceleration of growth exposes the underlying structural and institutional flaws of the Chinese economy. Politically, endemic corruption raises the specter, as Xi Jinping warns, that the CCP could lose its grip on power. The logic of crony capitalism in general, and that of collusive corruption in particular, suggests that the top leaders of the party has good reason to worry. Ostensibly, they fear that corruption will destroy the legitimacy of the party by undermining economic growth and alienating the masses. While such conventional wisdom is not necessarily wrong, our study demonstrates that collusion among elites produces a self-destructive dynamic inside the Leninist regime that will almost certainly accelerate its demise through various mechanisms.

Although collusion among elites initially emerged in sectors where decentralized control of poorly defined property rights and lucrative infrastructure contracts attracted officials and businessmen, this behavior has spread throughout the Chinese

state and public sector. Predictably, collusion has also invaded the agencies the CCP depends on to police its own members and to defend its security. For instance, more than a dozen senior officials on the CCP's commissions for discipline inspection, the agencies charged with monitoring and policing party officials, have been implicated in cases of collusive corruption. The Ministry of State Security (MSS), China's equivalent of the Soviet KGB, is also apparently riddled with corruption. Ma Jian, a vice minister in the MSS responsible for counterintelligence, was arrested in early 2015 in a mega corruption scandal. According to Caixin's investigation, Ma not only used the power and spying capabilities of the MSS to help a real estate tycoon, but also amassed a personal fortune, maintained six mistresses (two of them MSS officers), and fathered two illegitimate children. Le Dake, who served as the director of the MSS in Tibet between 2004 and 2013, was arrested for corruption in June 2015.<sup>13</sup> Among the cases collected for this study, three senior MSS officers, all directors of the agency in large municipalities (Shenyang, Fuzhou, and Fuyang), were involved in collusive corruption. (Two other senior MSS bureau directors, of Beijing and Qingdao, respectively, have also been arrested for corruption.)

**Collusive corruption inside the People's Liberation Army** (PLA), the ultimate guarantor of the CCP's survival, has reached similarly epidemic proportions. During Xi's anticorruption campaign, more than three dozen generals have been arrested. According to the PLA, 90 percent of the corruption cases occurred in military construction projects, logistics, real estate development, health care, finance, and personnel management. **Collusive corruption— *wo'an* and *chuan'an*— is a prominent feature. The rot has even spread to the highest level of the Chinese military command.** The two most senior PLA commanders, former Politburo members and vice chairmen of the Central Military Affairs Commission, Guo Boxiong and Xu Caihou, were both arrested in 2014–2015 for accepting huge bribes in return for promoting subordinates.

The inexorable spread of collusion may be shocking, but it is not hard to explain theoretically. The prevalence of collusion in the Chinese regime can be attributed to the intrinsic attractiveness of collusion— higher potential returns from corruption and reduced risks of detection. Additionally, our study demonstrates that collusion begets collusion due to the dynamic of bad money driving out good money. Since collusive elites acquire competitive advantages vis-à-vis noncollusive elites, those who engage in *maiguan maiguan* are destined to rise faster and higher than their less unscrupulous comrades. Finally, collusion results in the progressive degeneration of the organizational norms of the party-state due to the behavioral requirements of collusion and its externalities. As we see in our case studies, colluders perform rituals such as joint participation in criminal activities or other degenerate acts to

establish mutual trust. In organizations where collusion is rife, knowledge of corrupt acts perpetrated by colleagues often inspires similar acts. Corrupt leaders in these organizations predictably condone corruption by subordinates.

Taken together, **these dynamics of regime decay** destroy the institutional integrity of the Chinese party-state through three possible mechanisms. First, as collusive networks form and colonize all corners of the party-state, they subvert its political authority. These networks transform the authority of the regime into their private instruments of power. Instead of advancing the regime's interests, they primarily seek private benefits. While proclaiming loyalty to the party-state, they are beholden only to their local patrons, either the party chiefs or the wealthy businessmen. Second, corruption networks inevitably compete with each other for power and rents, thus weakening the CCP's internal unity and increasing the risk of purges that endanger the personal security of its top elites. As demonstrated by Xi Jinping's high-profile anticorruption campaign that felled hundreds of senior officials, many of them belonging to rival factions, power struggles, an inevitable product of the rise of collusive networks, have severely damaged the unity of leadership essential to the party's survival. Third, when collusive corruption pervades the security apparatus of the party-state, it is almost certain to undermine the effectiveness and loyalty of the pillar institutions upon which the party-state's survival rests.

Endemic collusion also challenges the theory of "authoritarian resilience." Instead of evidence of institutional resilience, which ultimately rests on the political loyalty, integrity, and capabilities of the regime's core elites, this study finds pervasive institutional decay—degeneration of norms, disloyalty to the regime, and subordination of the regime's corporate interests to the private interests of members of corruption networks. The CCP has seen its power of personnel appointment, a key instrument in maintaining its institutional cohesion and integrity, appropriated by local party chiefs through the pervasive practice of *maiguan maiguan*. The patronage networks thus created have dubious loyalty to the party as an institution. Institutional decay has also spread to another key component of the CCP—SOEs, the economic pillar of the party-state. Our study of collusive corruption in SOEs offers evidence that the party's control over this vital sector is also slipping as the agents it has appointed to run these firms are engaged in systemic looting and self-enrichment. The rot of collusive corruption has also seeped into the key institutions of the Chinese party-state, such as the CDIs, police, the judiciary, and other regulatory agencies.

The practical effect of the decay of the critical institutions of the Chinese party-state leads not only to deteriorating governance, but also to elite disunity and power

struggles. The disunity of elites is created by struggles for power and economic spoils. Collusion does not equal unity. In fact, collusive alliances compete with each other. The outcomes of this competition are unavoidably perceived as unfair by the losing side because the winners of such competitions simply have more power. The resentment of the losers thus constitutes a key source of elite disunity. Another political consequence, perhaps lethal to the CCP, is the opportunity created by a decaying regime for an opportunistic strongman who can vanquish his political opponents through tactics disguised as anticorruption efforts. Because of the widespread nature of corruption and its collusive characteristics, a strongman enjoys huge tactical advantages to destroy his political rivals. It is relatively easy to connect them with corrupt acts and, because their supporters and cronies are all tied together through collusion, the downfall of one patron typically claims all of his clients. Given the popular resentment against corruption, a strongman employing this strategy is sure to gain, at least initially, an immense boost in his political capital. Indeed, Bo Xilai, the former party chief of Chongqing who ironically was himself purged on charges of corruption, used this strategy with remarkable initial success in his quest for political visibility. His archrival, Xi Jinping, launched a ferocious anticorruption drive immediately after his rise to power and, in short order, dismantled the patronage networks of his political rivals. While conventional wisdom is inclined to see such an anticorruption drive as a positive for the CCP, the actual effects are likely to be the opposite. If anything, politically motivated anticorruption efforts will more likely increase insecurity and rivalry among elites, thus degrading the political cohesiveness of the autocratic regime and making it even more brittle.

### **Economic and Political Implications**

In the literature on extractive institutions and economic development popularized by Daron Acemoglu and James Robinson, social, economic, and political arrangements that determine the allocation of property rights and access to wealth-creating opportunities are seen as key to the prosperity of nations. Societies where a small elite monopolizes such rights and opportunities are unlikely to produce lasting prosperity.<sup>16</sup> While this influential theory may be a prescient warning that China's autocratic development model is likely to end in failure, it does not pinpoint the mechanisms and processes through which the elite perpetrates extraction. Institutions themselves cannot extract wealth; only individuals in control of them can. The empirical evidence gathered for this study provides a useful contribution to the theory of extractive institutions by uncovering the underlying political alliances—collusive networks connecting political, business, and criminal elites—that create, manipulate, and operate these institutions. These alliances, both

exclusive and oligarchical, are the inevitable outcomes of economic modernization under autocratic rule. Of course, similar alliances may also exist in democratic societies, and the existence of such alliances both undermines democracy and hampers economic development. In other words, democracy may not be a sufficient condition for ensuring inclusive institutions and political alliances. However, under autocratic rule, there can be no necessary, let alone sufficient, conditions for the formation of inclusive alliances and institutions. The autocratic ruling elites in control of the coercive capacity of the state are inherently hostile to inclusive political alliances because they threaten the survival of the autocracy itself. Theoretically, inclusive institutions under autocratic systems are similarly impossible because the essence of autocracy is the exclusion of the majority by a small minority of elites who rule through fear and violence.

If crony capitalism results in long-term economic stagnation, which in turn imperils the survival of the CCP, the question is whether the party itself can undertake the necessary reforms to address the pathologies of crony capitalism. As shown by Xi Jinping's sense of crisis and his anticorruption campaign, apparently he and his supporters believe they must—and can. Yet we must distinguish such campaign-style corrective actions from the self-corrective capacity of a Leninist regime. Corrective actions are effective only in a narrow, technical, and temporary sense. Individuals targeted in a crackdown are removed and punished. Looting is temporarily curbed. But a self-corrective capacity entails more: A regime possessing such a capacity is capable of both destroying the individual collusive networks and changing the underlying environments in which such networks breed, survive, and prosper. The evidence in this study shows that it is inconceivable that the CCP can reform the political and economic institutions of crony capitalism because these are the very foundations of the regime's monopoly of power.

Since the inevitable outcome of elite collusion is the enrichment of a small minority and high levels of inequality, socioeconomic conditions in a predatory autocratic regime are certain to be unfavorable to the consolidation of democracy or the establishment of liberal democratic institutions, even in the event of a collapse of the corrupt autocratic regime. If members of these collusive alliances survive the fall of autocracy physically, they will be well positioned to gain disproportionate influence in the postauthoritarian political order and to eviscerate the newly established democratic institutions. The unsuccessful experience of democratic consolidation in Russia and Ukraine during the last two decades could be repeated in China as well.

One sobering conclusion is that the path to democracy in China is unlikely to be a linear or smooth one. If the rise of liberal capitalism facilitates the emergence of

democracy, the entrenchment of crony capitalism in the Chinese case will make the transition both more difficult and more disorderly. A scenario of regime change initiated by elites becomes highly unlikely under crony capitalism. The capitalist class itself will be divided between well-connected cronies and excluded and frustrated entrepreneurs. The ruling elites will be less inclined to introduce political reform because such a step would threaten their economic interests. The fragility of the institutions of the party-state also raises fears that even modest reform efforts could unleash a revolution. The prospect of genuine market-oriented economic reform is equally unpromising because such a change would eliminate the source of rents for the ruling autocratic elites. If a regime transition should come, the initiating event is more likely to be a breakdown of the decaying autocracy, possibly induced by a split among the elites inside the party-state, a devastating economic shock, an Arab Spring– style mass revolt that the authorities fail to crush quickly, a disastrous external adventure, or a combination of such events. Unfortunately, even a revolutionary overthrow of the old order may not usher in the dawn of a liberal democracy. The legacies of crony capitalism— great inequality of wealth, local mafia states, and the entrenchment of privileged tycoons— will enable those who have acquired enormous illicit wealth under the old regime to wield outsized political influence in a struggling new democracy that will have poor odds of survival.