Introduction

Scholars of economic development have been trying to explain East Asia’s economic miracle, more specifically China’s rapid economic development, for decades. Distinguished political scientist Stephan Haggard considers China “the biggest anomaly of all”: how did China manage such rapid economic development in the absence of any legal infrastructure for property rights and corporate governance? China is an outlier on all fronts. The neoclassical “Washington Consensus” on economic development dictates that development requires stable fiscal and monetary policy, low inflation, exploitation of comparative advantage, flexible labor markets, and laissez-faire governments.¹ Strong property rights is usually seen in development literature as a necessary condition for development. It is a widely accepted notion that strong property rights provide incentives to invest, overcome problems that arise in private contracting, and constitute a check on any exploitative behavior of the state.² Cross-national empirical work by

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¹ Stephan Haggard, “Institutions and Growth in East Asia,” *Studies in Comparative International Development* 38, no. 4 (December 1, 2004): 54.
² Ibid, 57.
multiple scholars has found that strong property rights are positively related to growth.\(^3\) Not surprisingly, it follows that political uncertainty is associated with lower growth in a cross-section of countries.\(^4\) To explore China’s economic growth despite not meeting any of the development prerequisites, in this paper we will take a closer look at where it all began: China’s transitional period right after the start of Reform and Opening Up, from 1979 through the 1980s.

To understand the significance of the lack of property rights legislation during a country’s development, we must first understand the concept of legal property rights. Yoram Barzel synthesizes the definition of multiple other scholars and defines economic property rights an individual has over a commodity or asset to be “the individual’s ability, in expected terms, to consume the good directly or to consume it indirectly through exchange.”\(^5\) Barzel argues that the economic rights people have over assets are not constant but instead a function of their own direct efforts at protection, of other people’s capture attempts, or of both non-governmental and governmental protection. Legal rights are the rights recognized and enforced, in part, by the government. Most notably, Barzel believes that legal rights enhance economic rights, but are neither necessary nor sufficient for the existence of property rights.\(^6\) The fact that Barzel

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\(^3\) Ibid, 57.
\(^4\) Ibid, 58.
\(^6\) Ibid., 4.
believes property rights can exist independent of the law is significant, especially in the context of studying transition economies like China.

However, *de facto* ownership is still subordinate to *de jure* property rights. The concept of property rights is closely related to that of transaction costs, and a major consequence of the lack of established legal framework is high transaction costs. A property-rights based legal framework enforced by the state is generally considered a prerequisite for markets to function smoothly, as they bring the costs of transacting through markets under control.\(^7\) Coupled with the fact that neoclassical economic theory is based on the assumption that individuals will always seek to maximize the value of their property, it follows that property rights law would be a driver of investment and economic growth.

Seeing as there are empirical anomalies to how China’s case has failed to conform to the conventional neoclassical models of development, we must take a closer look at explaining this anomaly. While China’s transition to a market economy began in 1978, legal status was not conferred to private firms until “The Temporary Regulations of Private Enterprise” of July 1988, and regulations concerning the creation, transfer, and ownership of property were not put in place until China’s Property Rights Law of 2007.\(^8\)

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In China, formal institutions have typically followed rather than preceded economic development, directly challenging the economic literature proposing that without appropriate institutions no market economy is possible.\textsuperscript{9} If property rights were seemingly secure, such security did not rest on formal legal and institutional constraints on state power. Informal institutions or some other mechanism must have been at work—China’s communist regime with weak legal and judicial institutions has nonetheless enjoyed unprecedented capital inflows, investment, and growth for two decades. Using a case study comparison of the establishment and growth of two of the earliest firms in post-reform China, I will argue that Chinese businesspeople used business connections as a substitute for property rights, with relationship-based lending and business-government relations playing large role in a firm’s establishment and growth.

First, I will provide an overview of existing literature on institutional growth in transitioning economies. Then, I will apply the theory to my case studies, the Aijian Corporation (上海工商界爱国建设公司, or “Shanghai Patriotic Construction Corporation”) and the China International Trust and Investment Corporation (中国国际信托投资公司, or CITIC). Both corporations were officially incorporated within a month of each other in 1979 and contributed to China’s development as a whole, Aijian on the local level and CITIC on the national level. The Aijian Corporation was the first

\textsuperscript{9} Ibid, 17.
corporation in post-reform China not under state ownership, and has never been formally studied outside of Chinese social science literature. CITIC was one of the first state-owned corporations to be newly established post-reform, and the first corporation to have overseas dealings. Both companies, though Aijian more than CITIC, relied on network-based models of investment and growth. This makes Aijian and CITIC ideal case studies in how firms navigated a volatile transitioning economy to promote development in post-reform China.

**Literature Overview**

A growing collection of literature offers explanations of mechanisms as substitutes for formal property rights in China’s transitional stages. A transition economy is characterized by weak market structures, unspecified property rights, weak formal enforcement of contracts, and institutional uncertainty. This lack of business laws makes market exchanges uncertain and very costly, so fledgling companies have to navigate growth in a hostile environment.
Existing models of institutional growth also emphasize the link between property rights and development. Stephen Haggard compiled various models of capital accumulation showing the conditions necessary for growth. Assuming that the existence of property rights reduces transaction costs and that the assurance of property rights is directly related to political regime stability, we can see that all the models in the figure above posit property rights or a substitute for property rights as a precursor to investment and growth. What model did China follow? China’s case does not neatly fit in

**FIGURE 1**

**Institutional Models of Capital Accumulation**

<table>
<thead>
<tr>
<th>Model</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Rights I</td>
<td>Strong property rights → investment → growth</td>
</tr>
<tr>
<td>Property Rights II</td>
<td>Political stability → certainty over property rights → investment → growth</td>
</tr>
<tr>
<td>Regime Type I</td>
<td>Authoritarian regime → direct mobilization of resources and pro-investment policies → investment → growth</td>
</tr>
<tr>
<td>Regime Type IIa</td>
<td>Authoritarian regime → stable macroeconomic policy → investment → growth</td>
</tr>
<tr>
<td>Regime Type IIb</td>
<td>Authoritarian regime → policy reforms that improve allocative efficiency → investment and increased productivity → growth</td>
</tr>
<tr>
<td>Credible commitments I</td>
<td>Business-government networks and/or counsels limit predation and solve credible commitment problems → investment → growth</td>
</tr>
<tr>
<td>Representative</td>
<td>Delegation and “Weberian” bureaucracies limit predation, solve credible commitment problems, and improve the quality of policy → investment → growth</td>
</tr>
<tr>
<td>institutions</td>
<td>Delegative institutions</td>
</tr>
</tbody>
</table>

**FIGURE ONE.** From Stephan Haggard, "Institutions and Growth in East Asia."
any of the institutional models above, and is instead a combination of multiple models. China’s substitution for property rights during its transitional period seems to be a mixture of the authoritarian regime’s policy reforms that mobilized resources and improved allocative efficiency as well as business-government networks that solved commitment problems.

Stephan Haggard offers a top-down hypothesis for growth without property rights: “One possible explanation for East Asia’s success is that authoritarian regimes inherited, evolved, or consciously devised institutions that allowed them to signal their commitment to property rights and a stable policy environment conducive to long-run growth.”  

Other scholars, most notably Victor Nee and Sonja Opper, go beyond a state-centered explanation to argue that throughout China’s decades of economic reform bottom-up institutional innovations played a crucial role in enabling and motivating capitalist economic development. Nee and Opper also emphasize the importance of the rise of a privately owned manufacturing economy, arguing that it played a key role in wealth creation and has dramatically changed China’s industrial landscape. We will mainly focus on two forms of guanxi: business network relationships and business-government relations.

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10 Stephan Haggard, “Institutions and Growth in East Asia,” 60.
12 Ibid, 3.
Informal norms develop to facilitate economic activity when economic actors cannot rely on the legal system to litigate the resolution of disputes over property rights and contracts. From a sociology perspective, informal norms arise from the problem-solving activities of human beings in their attempts to improve their chances for success through cooperation.\textsuperscript{13} According to Nee and Opper, it was the development and use of innovative informal arrangements within networks of like-minded economic actors that provided the necessary funding and reliable business norms in early post-reform China.\textsuperscript{14} In such cases of a volatile and hostile transitioning economy, entrepreneurs in China’s transition economy rely on informal norms within their close-knit communities of economic actors to secure trust, acquire information, and make cooperation possible in a competitive economy. In spite of bureaucratic red tape and missing property rights protection, entrepreneurs have founded firms and built businesses on the basis of social norms without state-mandated contractual law guiding business behavior.\textsuperscript{15}

The lack of property rights translates to uncertainty and risk in business dealings. In a piece from 1992, Victor Nee notes that socialist hybrids must rely more on personal ties than on legal contracts to provide assurances that the terms of a transaction will be met by both parties. The need for intense investment in personal connections (\textit{guanxi}) stems from having to cope with widespread uncertainties in the institutional

\textsuperscript{13} Ibid, 21.
\textsuperscript{14} Victor Nee and Sonja Opper, \textit{Capitalism from Below}, 9.
\textsuperscript{15} Ibid, 15.
environment.\textsuperscript{16} Katherine Xin and Jone Pearce establish trust as a commodity and propose that executives seek out connections and cultivate close personal relationships to obtain resources or protection not otherwise available. In their study of various economies in transition, they conclude that such personal connections seem particularly important to executives in countries without a stable legal and regulatory environment that allows for impersonal business dealings.\textsuperscript{17} Specifically, Xin and Pearce argue that managers in China’s transition economy cultivated personal connections to substitute for reliable government and an established rule of law, as those networks are useful in the regulation of transactions in the absence of state institutions for that purpose.\textsuperscript{18} They suggest that Chinese private company executives operating without the structural protection of governmental support will not passively await their fate. Instead, they will cultivate close personal relations with people useful to business and use those \textit{guanxi} as a substitute for the formal institutional protection.\textsuperscript{19} Mike Peng and Peggy Heath agree that during economic transitions, preexisting networks of affiliation are used to reduce uncertainties in economic exchanges during an extremely volatile period.\textsuperscript{20}

\textsuperscript{17} Katherine R. Xin and Jone L. Pearce, "Guanxi: Connections as Substitutes for Formal Institutional Support," \textit{The Academy of Management Journal} 39, no. 6 (1996): 1641.
\textsuperscript{18} Xin and Pearce, "Guanxi: Connections as Substitutes," 1642.
\textsuperscript{19} Ibid, 1643.
Stemming from a well-established business community and *guanxi*, relationship-based lending is a mechanism many businesspeople turned to in a time when the banking system would not loan to private firms. According to Nee and Opper, during the founding stage, when investment risks are highest, entrepreneurs seeking capital usually turn almost exclusively to close relatives and long-term acquaintances. But without any legal contracts or property rights, how did relationship-based lending succeed? Nee and Opper believe that within these close-knit groups, lenders tend to feel a strong social and moral pressure to meet loan requests.\(^\text{21}\) Even so, the question of how they trusted their fellow businessmen to follow through remains. In this case, Nee and Opper argue that the stakes are high for those asking for an investment or loan in capital. Any defaults would be costly and would affect the continuation of business relations with other members of the business community.\(^\text{22}\)

Next, we turn to a discussion of business-government relations as a substitute for certainty in a transition economy. Stephan Haggard believes that throughout East Asia’s development, political elites forged alliances with the private sector but simultaneously retained independent sources of political power over it.\(^\text{23}\) That political connections grease the wheels in all economic orders is a “nearly universal supposition.”\(^\text{24}\) But is it a substitute for institutions and infrastructure? Nee and Opper posit that political capital

\(^{21}\) Victor Nee and Sonja Opper, *Capitalism from Below*, 102.

\(^{22}\) Ibid, 105.

\(^{23}\) Stephan Haggard, “Institutions and Growth in East Asia,” 56.

\(^{24}\) Victor Nee and Sonja Opper, *Capitalism from Below*, 233.
shares with other forms of capital the capacity to make possible, under certain conditions, the realization of interests that otherwise would not be achieved.\textsuperscript{25} Without its political capital, our case study corporation Aijian would have likely not been approved.

For the economic actor, political capital accrues through personal connections with politicians and with the party in power.\textsuperscript{26} In China, the most "readily available source of political capital" is membership in the Communist Party.\textsuperscript{27} According to Nee and Opper, political connections serve as conduits of information between economic and political actors, with information flow favoring those with an inside track to the politician.\textsuperscript{28} These relationships are sustainable because both economic and political actors can secure gains in maintaining them. Good relations with the government can act as "insurance" to reduce the risk of unfavorable treatment by politicians and regulatory agents. Insider information flow can limit the uncertainties of a volatile political environment. For private firms that are often marginalized, ties with the local government and the Party can provide valuable networks and serve as social as well as political capital.\textsuperscript{29} Overall, good relations with local government fostered by participation in industry-wide associations sponsored by local government or by

\begin{footnotesize}
\begin{enumerate}
\item Ibid, 234.
\item Ibid, 234.
\item Ibid, 237.
\item Ibid, 235.
\item Victor Nee, "Organizational Dynamics of Market Transition," 10.
\end{enumerate}
\end{footnotesize}
membership in the Communist Party confer legitimacy to the firm.\textsuperscript{30} Especially for entrepreneurs experimenting with new forms of production or risky business ventures, the signal of political approval conferred by party membership can be critical for survival.\textsuperscript{31}

Finally, we will examine theories on a network-based model of growth. Existing economic literature assumes that the firm in question operates in a market-based economy, is motivated to grow, and has a number of strategic choices that it can adopt to achieve growth. However, the socialist legacy as well as the recent transformations in these countries present an institutional environment that is immensely different from what a typical Western firm would encounter.\textsuperscript{32} In order to contrast the network-based model of growth with the Western model of firm growth, we must first understand the conventional Western model.

The Western model of firm growth is based on the assumption that growth driven by a strategic choice by top managers. Additionally, the existence of excess resources is a pre-condition for growth. The principal motivation for growth is the desire to fully employ underutilized resources. According to the Western model, the firm has three basic strategic choices for growth: 1) undertake generic expansion, 2) conduct mergers and acquisitions, and/or 3) develop inter-organizational relationships. The

\textsuperscript{30} Victor Nee and Sonja Opper. \textit{Capitalism from Below}, 236.
\textsuperscript{31} Ibid, 237.
growth of the firm is limited by its ability to overcome transaction cost and bureaucratic cost incurred in the course of growth. However, in a volatile and uncertain environment, firms often do not have the luxury of excess resources, nor are there institutions in place to conduct mergers and acquisitions. Instead, networks stabilize economic activities by having members engage in reciprocal, preferential, and mutually supportive action. Information passed through networks from reliable sources becomes far more trustworthy. By pooling and coordinating resources, economies of scale and scope can be achieved.

Case Studies

Both the Aijian Corporation (上海工商界爱国建设公司, or “Shanghai Patriotic Construction Corporation”) and the China International Trust and Investment Corporation (中国国际信托投资公司, or CITIC) were products of China’s reform and opening up period. In early 1979, 邓小平 (Deng Xiaoping) invited the top five patriotic industrialists including 荣毅仁 (Rong Yiren) to his home and remarked: “We need to implement policy for the former industrialists and return their assets so they can establish factories or invest in the travel industry for foreign exchange. It is not good to let this money go unused, we need to give them options. In sum, we need to start using

34 Ibid, 514.
the money, we need to start using the people.”\textsuperscript{35} What arose from this shift towards using capitalism for development was two corporations established with largely the same goals. Aijian was established in Shanghai with completely private capital, while CITIC was established in Beijing by Rong Yiren under the State Council with state capital. Both corporations were officially incorporated within a month of each other in 1979, dealt in similar industries, and were used to promote the Four Modernizations. The Four Modernizations were goals for national development enacted by Deng Xiaoping during reform in 1978 to strengthen the fields of agriculture, industry, national defense, and science and technology in China. This makes Aijian and CITIC ideal case studies in how business intertwined with politics to further development in post-reform China.

\textbf{The Shanghai Aijian Corporation}

The Aijian Corporation was created as a special breed of private capitalism for patriotic purpose. Using a combination of private monetary capital and human capital, it was chartered in Shanghai on September 22\textsuperscript{nd}, 1979 under the auspices of the municipal government. A hybrid of state and private capitalism, it was the first corporation in post-reform China not under state ownership. The Aijian Corporation was not state-owned as all capital came from individual investors, but the goals of the company aligned with those of the state and the government was still closely involved in its establishment.

After ten years of unrest from the Cultural Revolution, the government began to make reparations during the reform period to former industrialists by returning their assets, making interest payments on their assets and removing their “Rightist caps”. According to the official history published by the Aijian Corporation, this return of assets led to “fervent passion among the former industrialists to repay the motherland.” Some of these industrialists proposed using their “excess” funds and overseas connections to start an investment corporation in order to “serve the motherland and the Four Modernizations.” With all these former industrialists allegedly seeking a place to re-invest their returned assets, leading Shanghai businessman 刘靖基 (Liu Jingji) had an idea to create a “patriotic investment” fund. Since it would be too risky and nearly impossible to gain government approval for small private firms in the transitioning socialist economy, the former businessmen in Shanghai decided to pool their resources.

On May 19th, 1979, the director of the Shanghai Federation of Industry and Commerce (SFIC) Liu Jingji suggested the creation of the Shanghai Industry and Commerce Patriotic Development Foundation (上海工商界爱国建设基金会). Two days later, the SFIC and the Shanghai Committee of the China National Democratic Construction Association created the foundation’s Leading Small Group, chaired by Liu

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In mid-June, SFIC’s nine representatives to the National Chinese People’s Political Consultative Conference (CPPCC) presented a proposal of the 爱国建设公司 (Shanghai Aiguo Jianshe Corporation). The creation of the Aiguo Jianshe Corporation (“Aijian” for short) was well received by the central government, with the CPPCC and related departments pledging their support and attention. After securing the necessary political support for the creation of the company, it was time to raise the initial capital. At that point, they had already accumulated about 17 million RMB in investments, and set the fundraising goal for chartering the corporation at 50 million RMB.

According to a 2013 interview with vice-chair Yang Yanxiu, they were the first company in the post-reform era to solicit investments from private individual investors. Since the company was privately funded and did not receive bank loans or government investment, the corporation would technically be considered under private ownership as the very first privately-run (minying) corporation in post-reform China. In what Yang considers


39 Ibid.


“unanticipated success,” over 1100 former business owners and their relatives chipped in to raise the company’s starting capital to 57 million RMB in only three months.\(^{42}\)

On September 22nd, 1979, the SFIC and the Shanghai Committee of National Democratic Construction Association held a grand plenary at the Shanghai Exhibition Center announcing the establishment of the Shanghai Aijian Corporation. The Shanghai municipal government, the Shanghai Committee of the People’s Political Consultative Conference, related municipal departments, representatives from various Democratic parties as well as over 800 of the 1100 stakeholders were in attendance.\(^{43}\) The company was officially chartered and signed at this meeting, establishing Liu Jingji as chairman of the board of directors and Yang Yanxiu and Wu Zhichao as vice chairmen.\(^{44}\) It was also announced at this meeting that the board of directors selected Liu Jingji as Chief Executive Officer. The charter created a regulatory board to preside over the decisions of the board of directors and management, in order to ensure that “the governing bodies of this corporation followed the policies of the Party and the government.”\(^{45}\)

Representatives from the Shanghai municipal government were invited to sit on the regulatory board. While Aijian was to be privately run with voluntary private investments, establishing any corporation during this period in China’s history required a certain level of integration and accommodation by the government.

\(^{42}\) Ibid.
\(^{43}\) Shanghai Gazeteers Office, “The Creation of Aijian Corporation”.
\(^{44}\) Ibid.
\(^{45}\) Ai Jian Zhi 1979-1999, 35.
Aijian’s original 1979 charter reveals much about its establishment and intent. The approved charter was deliberately worded to be politically correct. The first line explicitly states that the company was “formed under the leadership of the Shanghai municipal government”, and that it was a “socialist corporation.” This, of course, was said to appease government officials, as Aijian’s leadership team had fundraised all the capital themselves. The charter then claims that the company’s only purpose was “patriotic development,” that “private profit is not the goal.” The second line states that the company was fully funded on a “voluntary basis” from the “excess” assets of former industrialists, so that they could “contribute to the modernization of socialist industry.” The charter establishes three main operations of the corporation: property construction, construction and service for the Four Modernizations, as well as funding compensation trade. Compensation trade is a form of countertrade in which an incoming investment is repaid from the revenues generated by that investment, for example repaid as a percentage of output from a new factory. Most striking is that the corporation would not take any profits, completely at odds with any modern conception of a corporation. The corporation’s revenues were “not for private gain” and besides paying taxes, were to all go directly to the accumulation fund of a public economic collective for “patriotic reinvestment.”

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46 Ibid.
47 Ibid.
48 Ibid.
The charter also provides more details on the terms of the individual investments that formed Aijian’s initial starting capital. Only former industrialists, their relatives, and overseas industrialists were allowed to invest, and the minimum investment was 10,000 RMB. The investment would be for five years at a fixed interest rate, and at the end of the five years the interest would be paid and the investor given the option to withdraw part of or all of their investment.\(^ {50}\) Under these terms, investing in this company was more similar to buying a fixed-yield bond with a five year maturity rate. As mentioned above, the 1979 version of Aijian would not take any profits, so there would not be any returns on an investment. Shareholders knew going in that they would not profit, which makes it interesting to examine the incentives behind so many people investing so much in a company that would not increase the value of their investment. Theories on how Aijian was successfully established with private capital will be discussed in the analysis section below.

*The China International Trust and Investment Corporation (CITIC)*

CITIC, on the other hand, was slated to be state-owned from the start. The China International Trust and Investment Corporation was established on October 4, 1979 as an “experimental financial organization” to pursue “opening-up to the outside world” and “separating politics and business.”\(^ {51}\) According to the CITIC’s Articles of

\(^{50}\) Ibid.

Incorporation, the corporation is “a state-owned socialist enterprise” operating under the direct leadership of the State Council, with an initial capital of 200 million RMB.\textsuperscript{52} The State Council was primarily involved in approving CITIC’s charter, setting out CITIC’s mission, appointing the company’s executives, and examining its mid-to-long-term development plans. Former Vice Chairman of CITIC Qin Xiao claims that all other decision-making power was delegated to the company, even from the beginning.\textsuperscript{53}

While pitching his conception of CITIC, Deng Xiaoping told CEO and Chairman Rong Yiren: “You have the full authority to select the people you want. You take charge and assume all responsibilities. Don’t let bureaucracy grow in your own company.”\textsuperscript{54}

Therefore, while CITIC is and was state-owned, it has never been state-run.

Both corporations were established to move the Four Modernizations forward, with CITIC slated to bring in foreign technologies to modernize China. The corporation was originally conceived by Deng Xiaoping, as Deng believed that that China could use its money and nationalist capitalists to expedite China’s economic development. Deng had a meeting with Rong Yiren and four other top industrialists in January 1979 and specifically asked Rong to take advantage of his unique background and influence and do something significant to promote China’s opening and system reforms.\textsuperscript{55}

\textsuperscript{52} Ibid.
\textsuperscript{54} Ibid, 95.
\textsuperscript{55} Ibid, 93.
Rong to use his “business mindset” to create a corporation and “sign contracts that will earn profit or foreign exchange.” He told Rong to “completely let go of worry about administrative matters,” that he was giving Rong “full control over company matters, as long as socialist matters are taken care of.”56 Deng even designated State Council Vice Premier Gu Mu (谷牧) to be in contact with Rong regarding the new corporation.57 Deng Xiaoping made it very clear in this meeting with China’s top industrialists that the state needed the technical and management skills of former industrialists. Deng asked for recommendations of businesspeople who could be of use, even those who had gone overseas so long as they were “patriotic and capable.”58

Rong immediately set to work on what in six months would become CITIC. By that time, central leadership had come to terms with the idea that they could harness the talent and resources of the capitalist class for national development. The People’s Daily reported that members of the China Democratic National Construction Association, National Federation of Industry and Commerce, over two hundred nationalist capitalists, and select members of the Chinese People’s Political Consultative Conference (CPPCC) gathered to celebrate the 1979 new year and dedicate themselves to contributing to “modernizing the motherland.”59 Rong Yiren was quoted on the eve

56 Feng Xiaowei, “The Story of Deng Xiaoping Interacting with those outside the Party.”
57 Ibid.
58 Ibid.
59 “决心为实现祖国四化贡献力量 [Determined to contribute the Motherland’s Four Modernizations],” People’s Daily, January 16th 1979.
of the corporation’s chartering that “we industrialists are one and the same with workers and farmers—we want to move the Four Modernizations forward.”\(^{60}\)

The China Investment Trust and Investment Corporation was approved by the State Council on July 9\(^{th}\), 1979, and officially established on October 4\(^{th}\) of that year with its first Board of Directors meeting in the Taiwan Hall of the Great Hall of the People. CITIC was chartered with an initial capital of 100 million RMB from the state. Between the initial capital, overseas investment funds, fixed assets, and tax rebates, the state injected a total of 1.825 billion RMB into CITIC.\(^{61}\) The Board of Directors was comprised of 44 people, with Rong Yiren appointed as CEO and Lei Renmin, Wu Zhichao, Chen Shuzi as vice-CEOs.\(^{62}\) The corporation’s primary function, outlined in its charter, is to introduce, absorb and apply foreign investment and advanced technology. The corporation is to import advanced equipment and to bring in advanced technology for the purposes of China’s national construction and promotion of socialist modernization.\(^{63}\) At the meeting, Rong Yiren stated that in the past three months, over 300 overseas companies have contacted him regarding investment and partnership, and that a Hong Kong subsidiary was already in the works.\(^{64}\) The company’s original Board

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60 “同此一心献身四化” [Dedicating our lives to the Four Modernizations together], *People’s Daily*, October 4\(^{th}\) 1979.
62 “中国国际信托投资公司董事会正式成立” [China International Trust and Investment Corporation’s Board of Directors officially established], *People’s Daily*, October 5\(^{th}\) 1979.
64 “中国国际信托投资公司董事会正式成立” [China International Trust and Investment Corporation’s Board of Directors officially established], *People’s Daily*, October 5\(^{th}\) 1979.
of Directors included figures from related state bureaus, the China Democratic National Construction Association, and National Federation of Industry and Commerce, among others. Most notably, Liu Jingji, the founder of Aijian Corporation, was appointed to CITIC’s Board of Directors.

Analysis

During economic transitions, scholars have concluded that pre-existing networks of affiliation are activated, and network ties become much more important as informal checks on business practices. These network-based personalized exchanges can be found in planned economies both before and during the transition. Reducing uncertainties in economic exchanges during an extremely volatile period, they are an important part of the informal constraints as well as the dominant logic that shapes the institutional frameworks. Given that both Aijian and CITIC were established during a volatile and uncertain time at the beginning of China’s transition to a market economy, how did they obtain solid footing despite the lack of property rights and other institutions? How did Aijian raise so much private capital? I argue that these anomalies can be explained by the founders of Aijian and CITIC maneuvering business network connections as well as business-government relations to gain monetary, social, and

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65 Ibid.
political capital for the establishment of their corporations. Tying back to the literature and theories on this subject, we will first examine the roles of these two types of guanxi, then look at the role that the political uncertainty of the time played in business decisions.

In a time without formal institutions like property rights to protect assets and lower transaction costs, institutionalized networks play an important role in facilitating and formalizing business network connections. These institutionalized networks form the basis of informal norms and take the place of contractual law to guide business behavior. The World Bank first developed the argument that “deliberation councils” linking business and government played an important role in resolving credibility problems associated with authoritarian rule and building trust between the public and private sectors. Other scholars characterize East Asian states as having a level of “embedded autonomy,” or strong political and bureaucratic institutions that simultaneously maintained dense ties with the private sector. These councils and networks operate at different levels in the political system, can include representatives of formal business associations as well as individual firms, and may consider functional, industry-specific, or firm-specific issues. The existence and operation of such councils is thoroughly documented for Japan and Korea, but not for China.

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67 Stephan Haggard, “Institutions and Growth in East Asia,” 61.
68 Stephan Haggard, “Institutions and Growth in East Asia,” 61.
I have found two such institutionalized networks for businesspeople beginning in the Mao era: the China National Democratic Construction Association (CNDCA) and the All-China Federation of Industry and Commerce (ACFIC). Both had regional branches throughout China, and both became a forum for businessmen to network with politically prominent businessmen. In fact, the leadership boards of these organizations often had crossover with political leadership. The CNDCA, established in Chongqing by “patriotic industrialists, businessmen and intellectuals” in 1945, is one of China’s eight legally recognized non-communist political parties. To this day, it maintains ties with the Communist Party of China Central Committee and National People’s Congress, with a member of Standing Committee of the Politburo attending and speaking at its 11th National Congress.69 It is also closely involved with the All-China Federation of Industry and Commerce, a formal business association established in 1953, as its members consist of mostly businesspeople. According to its website, the CFIC is a mass organization “led by the Communist Party of China” and aims to promote the sound development of the non-public sector of the economy.70 During the political turmoil of the 1960s and 70s, these two institutions became the pillars of the business community, with much overlap in membership between the two organizations and with political figures in leadership roles.

For example, Hu Ziang (胡子昂) was one of the original founders of the China National Democratic Construction Association and later became the fourth and fifth chairman of the All-China Federation of Industry and Commerce. Hu Ziang was also a vice committee chair for the second, third, fourth, and fifth National People's Congress and a vice chairman of the fifth, sixth, and seventh National Chinese People's Political Consultative Conference (CPPCC). In addition, Hu Ziang was known as the “King of Iron and Steel” and one of the top five patriotic industrialists during the pre-reform period, received alongside Rong Yiren and three others at Deng Xiaoping’s home when Deng Xiaoping announced new policy towards former industrialists. This is just one example of how prominent business leaders who were tapped to be political figures remained involved in these institutionalized business networks.

The founders of Aijian and CITIC, Rong Yiren and Liu Jingji, were also heavily involved in both organizations at the national and Shanghai level. Rong Yiren and Liu Jingji were vice chairs of the Shanghai National Democratic Construction Association (SNDCA) together from its first congress in 1956 until 1980. At the party’s fifth convention in 1980, Liu Jingji was appointed the chairman, a position he held until 1988. Additionally, Liu Jingji held the position as chairman of the Shanghai Federation

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71 Feng Xiaowei, “The Story of Deng Xiaoping Interacting with those outside the Party.”
of Industry and Commerce (SFIC) from 1961 until his death in 1997.\textsuperscript{73} On the national level, Liu Jingji and Rong Yiren served as vice chairs of the All-China Federation of Industry and Commerce between 1979 and 1983, when Hu Ziang happened to be the national chairman. Liu Jingji remained a vice chairman between 1983 and 1988 during ACFIC’s fifth congress, and Rong Yiren was appointed the sixth national chairman in 1988.\textsuperscript{74} The leaders and boards of both corporations were pulled from these organizations. The founding of Aijian was essentially sponsored by the SFIC and SNDCA, and the members of its first board were concurrently leaders in both organizations, with the exception of Communist cadre Yang Yanxiu. Similarly, CITIC’s first board of directors contains many familiar names from both organizations. Being a prominent businessman in the form of being on the leadership boards of these two organizations led to being a valued member of the institutionalized business network, translating into gains in political and social capital.

The social capital gained from being a leading businessman in these institutionalized networks made it possible for Liu Jingji to solicit monetary capital from the community. The importance of reputation within the business community allowed Liu Jingji to convert his social and political capital into monetary capital in a time when


trust was a substitute for contract and property law. During times of transition, businessmen seeking initial capital like Liu Jingji turn to their networks of like-minded economic actors for funding because within institutionalized networks, informal norms make cooperation possible. The SFIC and SNDCA became a community of former capitalist business elites willing to take part in relationship-based lending. Reiterating Nee and Opper, during the founding stage when investment risks are highest, entrepreneurs turn almost exclusively to these networks. Within these communities, lenders tend to feel a strong social and moral pressure to meet requests.75 On the other end of the transaction, investors see a trusted businessman like Liu Jingji putting his reputation on the line, as any defaults on his end would be costly and affect future relations with members of the close-knit business community.

Identity as well as interests explains the willingness to cooperate in a competitive and uncertain environment. In the business community, identities are linked to the group’s success.76 The former Chinese business community, whether domestic or overseas, was an identity as well as a community. They constituted a group of people ostracized under the Communist regime, and thus had shared struggles and shared roots. This would explain the number of overseas Chinese businesspeople investing in Aijian in 1979. According to company records, 80 out of the 1100 initial investors were

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75 Victor Nee and Sonja Opper, *Capitalism from Below*, 105.
76 Ibid, 22.
from Hong Kong and abroad, and they alone backed 23.5% of the initial capital.\textsuperscript{77} The top three investors in the company resided in Hong Kong, Australia, and the United States, respectively. The top individual investor in the company was 王宽诚 (Wang Kuancheng) of Hong Kong’s Verder and Company, pledging over two million RMB.\textsuperscript{78} One step down at one million RMB, Rong Hongren resided in Australia and 郭志娴 (Guo Zhixian) was the wife of Chinese-American businessman 沈坚白 (Shen Jianbai).\textsuperscript{79} One of Rong Yiren’s brothers, 荣鸿仁 (Rong Hongren), was also listed as one of the top backers of the company with an initial investment of over one million RMB.\textsuperscript{80} Rong Hongren’s involvement with the Aijian Corporation extended beyond a one-time investment, as he was later appointed to the board of directors in 1988 and served as acting CEO for a period of time in the 1990s.\textsuperscript{81} A prominent Shanghai industrialist who moved to Australia after the Communist takeover, Rong Hongren played a large role in using his connections to promote the Aijian Corporation among overseas Chinese.\textsuperscript{82} Altogether, the theory of institutionalized networks and the role of reputation and identity in such a community help explain how Aijian raised so much capital in a volatile time.

Shifting to the other form of guanxi, business-government relations, we see more evidence of these networks acting as a facilitator for corporations during the transition.

\textsuperscript{77}Ai Jian Zhi 1979-1999, 16.
\textsuperscript{78}Ibid, 7.
\textsuperscript{79}Ibid, 20.
\textsuperscript{80}Ibid, 20.
\textsuperscript{81}Ibid, 16.
\textsuperscript{82}Nian Shiping and Ni Leyuan, “Interview with Yang Yanxiu”.
Of course, it is intuitive that political connections are important in a regime like China’s especially during a transitional period. However, political capital was imperative for private firms like Aijian seeking legitimacy and survival. Because of the fear of “liability of newness,” newly founded private and collective firms have to resort to networking in order to achieve survival and growth. For young firms without the protection of a property-rights based legal framework such as Aijian, the “harassment from the state” remains a constant danger unless the firm played its political cards correctly. Such an uncertainty necessitates a defensive strategy to compensate for their lack of institutional protection in an uncertain environment. Institutional protection is a non-tradeable political resource, one that all private firms strive for. The resource-dependent model states that external linkages may increase the legitimacy of the new firm, thus improving its chances for survival. Aijian’s linkages with para-governmental institutions like SFIC and SNDCA certainly aided its chances at success as the very first privately owned corporation.

The leaders of Aijian played their political cards with tact from the beginning. They made sure to include a top Communist cadre as a vice chairman, and the other chairmen were leaders in either SFIC or SNDCA and thus politically well connected. Not only did they accredit the government and the Party for establishing the corporation, using patriotic language in its charter and being development-focused simultaneously

earned the support of the Shanghai municipal government and boosted investor confidence. Overall, good relations with local government fostered by participation in industry-wide associations sponsored by local government or by membership in the Communist Party confer legitimacy to the firm.\textsuperscript{84} In addition, Aijian’s association with the SNDCA allowed its leadership access to top figures in the Shanghai government like Hu Juwen (胡厥文). Hu Juwen was another one of the top five nationalist capitalists invited to Deng Xiaoping’s home, known for his dealings in machinery. He also successively served as Shanghai’s vice mayor, vice chairman of Shanghai city council, then a member of the Shanghai municipal economic council.\textsuperscript{85} Liu Jingji (and Rong Yiren) served alongside Hu Juwen as vice chairmen of SNDCA from 1956 to 1961, at which point Hu Juwen became the chairman of the organization.\textsuperscript{86} The annals of Aijian include photographs of Hu Juwen visiting with Liu Jingji and touring Aijian’s headquarters. Having someone like Hu Juwen advocate for a budding corporation like Aijian at the municipal level certainly improved its legitimacy, while also being a source of vital information.

In terms of CITIC, as a state-owned entity, its ties to the government are obvious. Rong Yiren and Deng Xiaoping had known each other since the 1950s, and Deng

\textsuperscript{84} Victor Nee and Sonja Opper. \textit{Capitalism from Below}, 236.
\textsuperscript{86} Shanghai Committee of China National Democratic Construction Association, “Historical Roster of Shanghai CNDCA Membership.”
Xiaoping appointed Rong Yiren to special positions on multiple occasions. Of course, most importantly, Deng Xiaoping personally entrusted Rong Yiren with state resources to create a corporation that would become known as CITIC. However, there are benefits of being closely tied to the government beyond access to capital and top Party leadership. Being an influential state-owned enterprise also meant access to the policymaking process. Starting from 1979 and throughout the 1980s, China promulgated more than 500 pieces of economic legislature, including Contract Law, Joint Venture Law, and Foreign Investment Law. Although still not adequate, the emerging legal infrastructure greatly stabilized the transaction environment, fostered the infusion of foreign capital and technology into China, and encouraged a great deal of entrepreneurial activities. Most significantly, the China Joint Venture Laws were enacted on July 1st, 1979, three months before the chartering of CITIC and days before CITIC’s formal approval by the State Council. This law presented foreign firms with opportunities to set up factories and manufacturing facilities within China. The Joint Venture Law was the precursor to establishing foreign joint ventures through CITIC, and necessary for the growth of CITIC. Of course, the passing of the Joint Venture Law coinciding with the establishment of CITIC does not prove causation, but it is important

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87 Feng Xiaowei, “The Story of Deng Xiaoping Interacting with those outside the Party.”
to note that CITIC had much more favorable policy environment to navigate as a state-owned corporation as opposed to Aijian, which had to rely on informal norms.

Last but not least, we will look beyond the two forms of guanxi to investigate the climate of political uncertainty at the time. In a study of a transitioning economy, it is important to not overlook the important role that uncertainty and risk plays in business decisions. The anomaly of individual investors choosing to put their assets in Aijian in 1979 without any return cannot be explained by any relational network theory. However, economic theory also fails to explain the incentive behind their investment. Neoclassical economic theory is based on the assumption of individual maximization, which implies whenever individuals of any society perceives that certain actions will enhance the value of their rights, they will undertake such actions. So why would over a thousand former industrialists decide to put their recently returned assets into a concept of a corporation when neither the corporation’s survival nor their investments themselves could be guaranteed? I would like to argue that these investments were not fully voluntary, and instead influenced by the level of political uncertainty at the time.

First, Deng Xiaoping had already taken the lead and said that “it is not good for money to go unused.” The government encouraged and perhaps even pressured former industrialists to not hold on to their returned money and to invest it— Yang mentioned in his interview that the Shanghai municipal government showed “enthusiastic support”

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towards the former industrialists’ interest in re-investing their assets in national
development.\footnote{Nian Shiping and Ni Leyuan, “Interview with Yang Yanxiu”.
} Meanwhile, with their assets returned, this former bourgeoisie class had
so much more money than the average household and were perhaps afraid of being
labeled as such again. While these former business owners were able to give over
10,000 RMB (and often over 100,000 RMB) to this corporation, in 1979 the average
yearly wage was a mere 668 RMB.\footnote{Tradingeconomics.com, China Average Yearly Wages 1952-2017, http://www.tradingeconomics.com/china/wages (Accessed May 16th, 2017).} It is important to keep in mind that these were
capitalists who did not have their “Rightist caps” formally removed until Deng Xiaoping’s
announcement at a CPPCC meeting on June 15\textsuperscript{th}, 1979.\footnote{“祖籍梅州的红色资本家 [Meizhou’s Red Capitalists],” Meizhou Daily, June 11 2016, http://www.meizhou.cn/2016/0611/445053.shtml.} There was widespread
uncertainty over whether the government would regress on its promises and pardons.
With an undeveloped capital market and few choices to invest elsewhere, investing in
Aijian was a move that could maintain a “patriotic” political image for a group of people
who were heavily ostracized during the Cultural Revolution.

Coupled with the lack of a property rights-based legal framework, the lack of
political certainty played a role in these former capitalists prioritizing some form of
assurance over their assets over economic profit. In China, the political process has
experienced a number of ups and downs characterized by years of unrest and reaction,
particularly during the Cultural Revolution. Peng and Heath agree that such fluctuation
in the political arena generated a great deal of uncertainty for the business community. I would like to argue that business people and asset holders during this time instead channeled this uncertainty into placing more trust in relational networks. Aijian investors put their money in a private corporation owned by someone well-respected in the Chinese business community instead of in a state-owned bank, where their assets could potentially be once again confiscated by the state. In this case, barely a year into an uncertain political reform process and without any laws formally granting them rights over their assets, the former capitalists used informal norms within the business community as a substitute and entrusted their money with a colleague.

**Conclusion and further research**

With sufficient funding and government support, the Aijian Corporation experienced rapid growth during its first decade. When Aijian was chartered in September 1979, it had three departments, two offices, 26 employees, and a total capital base of 57 million RMB. By the 1990s, the company’s operations had expanded beyond housing development to focus on four main areas: financial fund investment, industrial investment, property development, and foreign trade. In July 1992, when it was re-chartered to become a limited-liability corporation, it had four departments, two

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95 Shanghai Gazeteers Office, “The Creation of Aijian Corporation”.
main offices, and 198 employees with over 150 million RMB in capital.\textsuperscript{96} The re-chartered corporation, now formally known as AJ Corp Ltd., was publicly listed on the Shanghai Stock Exchange on April 26th, 1993.\textsuperscript{97} AJ Corp’s capital base grew exponentially after offering its shares to the public, doubling its total capital to 302 million RMB by 1997. At that point, AJ Corp had 5 departments, 169 employees, and over 100 subsidiaries and joint operations.\textsuperscript{98}

CITIC also experienced rapid growth and expansion. CITIC began its equity investment activities in 1981. CITIC’s total assets grew from 255 million RMB in 1981 to a whopping 4.6 billion RMB by 1985, with this growth mainly attributable to equity investments and joint ventures. CITIC’s net profit was 2.5 million RMB in 1981, but had grown to 107.3 million RMB by 1985.\textsuperscript{99} By 1993, CITIC reported total assets of 82.5 billion RMB, which include the accounts of CITIC’s overseas wholly owned subsidiaries and companies in which CITIC has substantial shareholdings.\textsuperscript{100} By 1994, financial services was confirmed as the company’s core business, covering commercial banking, trust, leasing, futures, and securities.\textsuperscript{101} Exactly how either corporation expanded without the presence of any financial markets or legal structures like merger and acquisition laws requires further study. While a network-based theory can explain the initial stages of

\textsuperscript{96} Shanghai Gazeteers Office, “The Creation of Aijian Corporation”.
\textsuperscript{97} Ibid.
\textsuperscript{98} Ibid.
\textsuperscript{100} Ibid, 113.
\textsuperscript{101} Ibid, 117.
growth, how these Chinese corporations experienced exponential growth remains an anomaly. Even after the initial transition period of approximately 1979-1983, there was a lack of business structure, and China did not have a formal property rights law until 2007.

This paper takes a closer look at China’s transitional period right after the start of Reform and Opening Up to explore China’s economic growth despite not meeting any of the development prerequisites. Using a case study comparison of the establishment and growth of two of the earliest firms in post-reform China, I show how Chinese businesspeople used business connections as a substitute for property rights, with relationship-based lending and business-government relations playing large role in a firm’s establishment and growth. Business in China cannot exist in a vacuum, so this paper explores the interconnections between disciplines and shows how sociology, political science, and economics need to intertwine to explain China’s anomalies.

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