

Connection for Protection?

Theory and empirical evidence from rural China

Christian Henning and Jiangping Han^a

^a*University of Kiel, Germany*

Abstract

This paper provides a theoretical framework modeling political connections as formal and informal firm-government relations functioning simultaneously as a commitment device on the part of firms and on the part of local government. Based on this theoretical framework we show that as a commitment device of firms political connections are only productive at the micro, but not at the macro level, while as a commitment device of the government political connections are productive at both the micro and macro level. Further, using an own survey of agribusiness firms in rural China we estimate a stochastic frontier production function incorporating political connections as formal and informal network relations to local government determining firms' technical efficiency and firm specific terms of trade, respectively. Based on this approach we are able to test empirically whether firm's political connections function as a commitment device on the part of firms or the government. Major results imply that at least for agribusiness firm sample political connections are basically used by firms to capture local government implying favorable access to scarce resources as well as lucrative output markets, while no empirical support has been found for their function as a commitment device on the part of the local government.

Key words: Firm-Government relation, Networks, Stochastic frontier analysis, China, transition economies
