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Risky Neighbors and Co-Ethnic Groups:
The Political Logic of Fiscal Grants in China

A dissertation submitted in partial satisfaction of
the requirements for the degree Doctor of Philosophy

in

Political Science

by

Jihyeon Jeong

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      Professor Barry Naughton

2012

The Dissertation of Jihyeon Jeong is approved, and it is acceptable

in quality and form for publication on microfilm and electronically:

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University of California, San Diego

2012

To my family

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ABSTRACT OF THE DISSERTATION

Risky Neighbors and Co-Ethnic Groups:
The Political Logic of Fiscal Grants in China

by

Jihyeon Jeong

Doctor of Philosophy in Political Science

University of California, San Diego, 2012

Professor Susan Shirk, Co-Chair
Professor David Lake, Co-Chair

How do China's ethnic politics and border concerns drive distributional outcomes? While many of China's 14 neighbors are widely considered unstable regimes, systematic studies of political risk diffusion have been surprisingly sparse. China's ethnic minorities, many of whom straddle borders with neighboring countries, have also been largely ignored in studies of fiscal distribution. I bridge this gap by focusing on China's transborder ethnic minorities (TEMs) – co-ethnic groups with external kin across the border. Using rare comprehensive center-to-local budget data from 1995 to 2003, I argue TEMs can easily create "porous borders" when neighbors experience political risk, spurring the Chinese leadership to give grants to prevent ethnic unrest. I also draw on 14 months of fieldwork to present in-depth case studies of the North Korea-China border area.

CHAPTER ONE

INTRODUCTION

1.1 Introduction

The mid- to late-1990s bore witness to a growing refugee crisis of unprecedented proportions on the North Korea-China border. Driven by harsh economic and political conditions, thousands of North Korean refugees began crossing the Yalu and Tumen Rivers into northeast China.

These refugees fled a high-risk regime with low state capacity to provide for its citizens, whose planned economy and public provision system had collapsed after the fall of the communist bloc, and whose totalitarian regime sought to retain control through severe political repression. They crossed the border into an area with a substantial concentration of Korean minorities, often through existing and recognized family and social ties, and were absorbed by this group. Some remained in this area. Others made their way into rural areas or large cities in inland northeast China, to Beijing and the coastal cities down south. Some even managed to gain political asylum in South Korea. Regardless of the outcome, an estimated total of at least 30,000[1] North Korean refugees found their way into China during this period of time, with the surge reaching its height in the late 1990s.

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[1]Figures of N. Korean refugees in China are controversial. Here I present a conservative estimate based on a 2005 report by the U.S. Congressional Executive Commission on China. (http://www.cecc.gov/pages/annualRpt/annualRpt05/2005_7_refugees.php). As he report notes, estimates by NGOs of North Koreans living in China in 2005 alone can range up to 300,000.

The Chinese government reacted to this influx on its border with sharp alarm. Internationally, efforts were made to pressure North Korean authorities to increase surveillance on the border. Efforts to this regard were met with cooperation by the North Korean leadership whose incentives to prevent information of the outside world from trickling in and a mass exodus of people exiting out were aligned with those of the Chinese government. North Korea responded with a severe crackdown on illegal crossings. In addition, conditional grants of food, oil and other forms of foreign aid contributed to the process. In 1999, China reportedly struck an agreement with the Pyongyang government to provide aid in exchange for stronger patrol enforcement on the North Korean side of the border.

Domestically, the Chinese government increased surveillance on the border and also began issuing its own crackdown on illegal refugees. In 2006, rewards for reporting illegal aliens were tripled to approximately 300 RMB yuan in the province of Jilin in Northeast China. In January 1997, Chinese patrol along the Sino-North Korean line was heavily increased, and foreign media outlets were rife with reports of a sharp uptick in border patrol movements, increased risks for refugees and harsh penalties such as on-the-spot executions.

In the midst of this crisis, an additional distributional outcome emerged: a reported increase in government transfers to Korean minority areas in neighboring provinces in Northeast China. From 1996 to 2003, transfers to Jilin province – with the largest concentration of Korean minorities – increased dramatically. Korean minority areas were

reported to receive a larger share than other areas. Why the greater transfers to these areas immediately after crisis in a foreign country?

Evidence shows this is not an isolated or idiosyncratic case of Chinese government assistance to a minority area. In 2009 and 2010, inter-ethnic riots rocked Xinjiang province in western China. Amidst the public broadcasts of immediate wide-scale crackdowns and public demotion of local leaders who proved unable to meet the task of controlling the outbreaks of violence, one crucial component was left unreported in the foreign media: the immense amounts of central government funding that began pouring into the area. In 2011 the Chinese government conducted a media campaign to bring these funds to foreign media attention. While the central government's motives in broadcasting the fact to the outside world was more self-serving than any other, the bottom line was clear: regardless of the reasoning, restive minority areas on the border received incredible amounts of central government funding, especially in comparison to nearby Han majority areas. Why distribute so much to areas that cannot credibly threaten to secede? And why do so in spite of the risk of public unpopularity and resentment among the Han majority?

Conventional academic wisdom gives surprisingly little explanation for this phenomenon. The literature has argued that authoritarian regimes are expected to have little incentive to give to poor, small minority groups, without political representation. Under such circumstances these groups fall outside the minimum winning coalition(MWC) which is assumed in the literature to attract private goods (Bueno de Mesquita, et al, 2003). In particular, the literature on federalism has argued for a relatively simplistic explanation which

explains subsidies to minorities as a mechanism used by the central government models

repression as a less costly alternative to payoffs such as subsidies (Alesina & Spolaore, 1997).

Such approaches have already been challenged by widespread examples showing

authoritarian and democratic governments alike mix repression and payoffs in dealing with

minority populations. The counter-cases incorporate such challenges, but also present

evidence of challenges from a different angle. Why do these minority areas on the border

appear to receive handouts? How does an authoritarian regime react to these particular

groups and what are the factors driving grant distribution?

The next section addresses these questions in detail. I approach this question from

two directions: the flow of foreign risk from outside the border to inside China's TEM

regions, and the reaction inside China from the central and province-level government to the

border TEM locality. I examine more closely the cross-border effects of foreign political risk

upon ethnic groups, and the authoritarian logic of allocation of goods. I argue China's the

interactive effect of foreign political risk in neighbors, proximity and the existence of ethnic

minorities straddling borders with China creates a source of instability, or "porous border."

Thus domestic grants follow a particular pattern: transfers are distributed to minorities on

border areas who correspond to ethnic groups across the border, when these co-ethnics

across the border experience high levels of political risk. The net effect is a change in

resource allocation within China – to the point where previously disadvantaged minorities

are given greater handouts.

1.2 Puzzle and Research Questions

This dissertation stems from a single, important question: what factors determine fiscal grants in China? I focus on two potential factors previously ignored in the field: minorities and foreign political risk. The literature on fiscal distribution in China has identified many different determinants, from income to natural resources to local official payroll (Shih, Zhang & Liu, 2008 ms). While a few scholars have detected significant minority area effects in leadership efforts to deal with social stability in China (Wallace, 2009), much of the literature on fiscal distribution has either ignored minority presence or argued it has been less than significant (Zhan, 2011). By the same token, the literature has examined how wide-scale exogenous shocks such as global economic crises and the fall of the communist bloc have affected regime turnover and democratization (Geddes, 1999). But systematic studies on how political risk in a neighboring state – geographically limited, prior to breakdown or regime change – affects domestic politics in China are scarce, and no study to date has examined fiscal distribution as an outcome variable of external risk. This project addresses both gaps, bringing together two disparate literatures to explain domestic distribution in China. I argue foreign political risk and a certain *type* of ethnic minority – transborder ethnic minorities (TEMs) near the border – drive grant distribution.

These factors introduce new puzzles. First, given that TEMs in China cannot pose a credible secession threat, what incentive does the central government have to give handouts to minorities? Minorities in China are on average poor, politically and economically marginalized, and without access to tools of violence or military power. Given the imbalance in capabilities and the central government's strong state apparatus, attempts to break away

from central power are likely to be met with severe repression and failure. Further, minority areas are likely to suffer economic losses if they break away and form their own states, or join with neighboring states which are often in even more problematic economic circumstances. Although unevenly distributed, the benefits of economic development in China have not been lost on local minority populations. In such cases handouts appear an unnecessary expense of resources which may be easily allocated elsewhere.

Second, given that China's borders are considered particularly secure, by what means does foreign political risk affect domestic policy outcomes? China's territorial borders, though by no means uncontested in recent years, have been considered stable. Spillover of foreign conflict is considered less of a threat given China's sheer military size and power vis-à-vis surrounding neighbors, in particular the smaller states. Given this context, it is reasonable to assume foreign political risk exerts little if any effect upon domestic politics in China. Yet we find an unexpected temporal relationship between risk increase and grant transfers. What explains this phenomenon?

Third, given the fiscal autonomy enjoyed by subnational governments (Guo, 2009), what incentive do they have to comply with central distribution to TEMs? China's post-1994 fiscal system has been marked by a dichotomy of centralized collection and decentralized distribution and spending (Naughton, 2007; Yang, 2004), which allows abundant discretion by province-level governments in within-province fiscal affairs. Even with central directives, local governments have little incentive to comply and sub-province level spending patterns

vary widely over provinces (Shah & Shen, 2008). Even with central incentives to give to TEMs, do we see local governments follow? And what motivates compliance?

By providing answers to these questions, I make several contributions to the field of Chinese politics. I provide a systematic study of ethnic politics in China, an area that has attracted considerable media and political attention but until very recently been lacking in rigorous social science research. This work also introduces political risk in bordering countries as an explanatory factor in domestic outcomes, again adding to the small but growing body of work on cross-border factors of domestic politics in China. More importantly, I contribute to the burgeoning field of research which seeks to recognize and examine government incentives to maintain political power through "social stability." A primary roadblock to such work has been the difficulty in identifying and collecting reliable time-series data on groups which are potential challenges to government. I offer a unique study which introduces a clearly identifiable, geographically clustered group of ethnic minorities located in administrative units which allows for application of rigorous methods, ruling out the majority of factors which bias results.

My project also contributes to wide fields of research in international relations and comparative politics in three distinct focus areas: authoritarian institutions, political risk and ethnic conflict. Through the case of China, I shed light on regime type differences in incentives to distribute to groups outside the minimum winning coalition (Bueno de Mesquita, et al, 2003), providing an example of an authoritarian regime which distributes to marginalized minority groups. The conceptualization of political risk introduces investment

and credit risk ratings as proxies for political regime stability and state fragility. Additionally, while effects of co-ethnicity on conflict outcomes have been examined in the past under terms such as "diaspora networks," the triangular relationship between external kin, TEM and host state have only recently been afforded systematic attention (Cederman, Girardin & Gleditsch, 2009). I provide a valuable case of political risk diffusion through co-ethnic groups, informing debates on the role of ethnic affiliation in mobilization and conflict.

Finally, I use a unique dataset consisting of center-to-local grant transfers[2], reaching beyond previous province-level indicators down to the county level. This allows for much greater accuracy in determining the effect of cross-border instability. Because official local-level budget data in China are not usually available to foreign researchers, the use of such data represents a new opportunity to link domestic outcomes and foreign factors in examining China's response to instability. Discussion of the data and controls continues in Chapter 4.

The following section gives a brief summary of my argument regarding fiscal distribution in China. I answer the questions posed above, and provide a theoretical background for quantitative analysis of fiscal grants data to follow.

1.3 Theory

How do we explain grant handouts to ethnic minorities on the border? I argue foreign political risk and a particular *type* of minority – transborder ethnic minorities (TEMs)

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[2] I am deeply indebted to Profs. Victor Shih (Northwestern/UCSD) and Mingxing Liu (Peking University) for sharing this data.

– on the border drive grant distribution in China. The theory warrants the following three stages of explanation: a definition of key concepts, a description of foreign political risk diffusion to TEM and TEM incentives to mobilize following risk effects, and a discussion of leadership incentives to distribute to TEMs at all levels.

Political risk refers to the composite level challenge to the political system of government in any given state or political unit. A high level of political risk simply refers to a level of challenge to the system which approximates forced leadership change or takeover of government. By defining political risk as a challenge against the political system rather than the incumbent government itself, I keep this concept open and applicable to all democracies and non-democracies. Thus opposition parties in democracies, for example, do not pose a challenge to the political system per se as long as they are committed to continue supporting the current political system. *Foreign political risk* can diffuse across borders to produce a variety of outcomes in regional neighbors, as we will see in the following pages.

Transborder ethnic minorities (TEMs) refer to minority ethnic groups in a given state, in close proximity, existing on either side of a border. While the concept has been used to refer to "diaspora groups" who may co-exist in widely separated geographic locations across the globe, here I limit the sample of states to China and its immediate land neighbors. In the current context of China, these are clear minority groups whose political roles are substantively different from the majority ethnic Han group. I use the term "minorities" in order to differentiate from cross-border Han networks. TEMs are by definition subgroups

of transborder ethnic groups (TEGs), which may be a more appropriate moniker in contexts where the ethnic makeup is comprised of large groups of similar size.

Foreign political risk in a neighboring state affects the Chinese border through three distinct but overlapping mechanisms: migration, information flows and economic linkages. TEM areas attract flows through co-ethnic ties, creating a "porous border." First migration– both legal and illegal – across the border resulting from political risk causes demographic, social and economic shifts from the status quo, which creates conditions conductive to mass mobilization in an ethnic group. Migration further increased chances of mobilization through the introduction of political entrepreneurs and activists into Chinese society. The Chinese leadership recognizes and seeks to prevent this type of phenomena, as shown recently in its reaction to the 2009 intra-ethnic conflict in Myanmar (Burma) which led to an influx of 37,000 people crossing the border from the Kokang regime to Yunnan province in Southeast China (Thompson, 2009). Central and local governments immediately moved to secure the border, isolating incoming migrants from the local population and swiftly deporting the group back to Myanmar.

Second, information on political risk, mobilization, conflict, and other incentives and action involving co-ethnics travels across the border through word of mouth and media outlets. These flows again represent shifts from the status quo which can create incentives for ethnic groups to mobilize. Migration enhances information flows, although it is not a necessary condition given the word of mouth and access to technology possible in modern-

day China. Even with efforts to censor news and close borders, information flows present an obstacle to government efforts to control mobilization.

Third, economic linkages created through closely integrated co-ethnic border economies break down in periods of political risk, creating economic costs and fallout in the TEM area. Domestic and cross-border economic activity almost invariably suffers in the wake of political risk increase, a fact exemplified in the worldwide popularity (and proliferation) of credit risk evaluation services for foreign direct investment. Following reform in the 1980s, China's leadership has encouraged cross-border economic activity and minority communities have capitalized on co-ethnic ties to build strong border economies, benefiting groups on either side of the border (Dreyer, 2012). This increased integration creates unexpected costs in periods of economic risk, which are also borne by co-ethnics in China and create, again, incentives for mass action.

From the TEM point of view, the three effects described above interact with pre-existing horizontal inequalities among ethnic groups in China to increase incentives for mass action such as protests, riots, even violence and general "societal unrest." When cross-border foreign political risk creates changes from the status quo, these changes interact with pre-existing inequalities and grievances to promote mobilization and mass action.

From the leadership point of view, I argue central leadership has incentive to give grants to TEMs when the prospect of mobilization increases with foreign political risk. The cost of losing political power is far greater for authoritarian leaders versus leaders in

democracies, and as a result the leader is faced with a "Dictator's Dilemma" (Wintrobe, 1998) in which she seeks to identify and repress challenges to power only to increase incentives among the local population to hide such information. Thus in order to pre-empt a challenge to social stability such as mass action by a minority group, the leadership gives grants aimed at preventing mobilization. In contrast, province-level leaders, who retain considerable autonomy in fiscal distribution (Guo, 2009), follow central directives to distribute to TEMs because of the career costs of outbreaks of protests or violence. This process demonstrates how central leaders prioritize regime needs and continue to enforce throughout the ranks by setting strict mechanisms for compliance.

1.4 Research Design

The empirical strategy of this dissertation is twofold: first, I test the overall countrywide association between foreign political risk and TEMs on the border, and outcomes of grant distribution. Chapters 2 and 3 of my dissertation provide theory background, and in Chapter 4 I present the results of statistical analysis of rare comprehensive center-to-local budget data from 1995 to 2003 (Shih, Zhang & Liu 2008, ms). I use fixed effects at both province and county levels to obtain results relevant to center-province and province-county distribution. The method controls for all unit-specific characteristics that do not vary over time, ruling out numerous unobservable factors and strengthening the analysis. Results support the argument laid out above: both center and local governments distribute to TEMs near the border when foreign political risk is on the rise.

Second, I use in-depth case studies of the China-North Korea border areas to substantiate earlier claims of the roots of ethnic mobilization and government intervention to prevent mobilization using grants. In Chapter 5, I replicate the results of Chapter 4 at a local scale, and add difference-in-differences analysis to show how exogenous shocks from North Korea impact grant transfers to Korean minorities on the Chinese side of the border. In Chapter 6, I expand the analysis to local spending and provision of goods in order to measure the actual impact upon the local population. I provide trends in local expenditures from budget data as evidence grants are targeted at specifically preventing mobilization, and test the impact of transfers upon public goods provision in the Yanbian Korean Autonomous Area (*Yanbian Chaoxianzu Zizhiqu*) and trade between China and North Korea.

The theory and data on my dependent variable are drawn solely from one country, the People's Republic of China (PRC). I limit my study to China for several important reasons: the PRC is a long-standing single-party authoritarian regime, which has been able to maintain a stable government for over 60 years. It is also a "strong" authoritarian regime, with high state capacity for collecting rents and providing goods, collecting information, and carrying out repression when necessary. The ability of the central leadership to control the apparatus of the state increases the likelihood that government actions of fiscal distribution can proxy for political motives. High state capacity, the organized, formalized nature of its government, and central incentives to maintain control increase the likelihood that reliable data will be collected and maintained.

Next, China's land border is 22,117 km long and neighbors 14 countries[3], making it one of the most diverse in the world. These countries represent a particularly broad range of cultures, histories and ethnicities. The sample also represents a wide spectrum of political institutions and risk: some of the world's most risky regimes such as North Korea, Myanmar (Burma), and Kyrgyzstan as well as stable states such as India exist on this border, and the scale varies from totalitarian states to democracies which rank high on the Polity scale. These ranges are in turn represented in China's TEMs, who have co-ethnic compatriots in 13 of these 14 countries. This large sample and range in variation renders China a unique and particularly useful example of a state which enables us to draw inferences from a wide range of foreign neighbors while holding constant factors in the outcome areas' political and economic institutional environment.

Finally, China itself is a geographically large, diverse state with local governments operating at the level of 31 province-level districts and again at 36,000 county-level units, and the world's largest population which includes 56 official ethnic groups. At the same time its strong authoritarian state enables an umbrella of unified and centralized political, economic and fiscal systems. This stratification from the national level to province and again to the county, and the organized nature of the administrative system, allows us to control for and examine freely the dynamics of in-country multi-level variation while simultaneously drawing causal inferences about unified top-to-bottom policy outcomes based on case studies.

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[3]Neighboring countries are: Afghanistan, Bhutan, Burma, India, Kazakhstan, North Korea, Kyrgyzstan, Laos, Mongolia, Nepal, Pakistan, Russia, Tajikistan, Vietnam. (Source: CIA World Factbook, https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html, accessed 1/22/2012)

CHAPTER TWO

CO-ETHNIC GROUPS AND THE CROSS-BORDER

SPREAD OF POLITICAL RISK

2.1   Introduction

Several major questions emerge in a discussion of government-led grants in China. First, why would an authoritarian government choose to give to TEMs? TEMs are minorities clearly outnumbered by the Han majority, with few economic or political resources to place them in the regime's minimum winning coalition (MWC). Given the small size of the MWC in authoritarian regimes (Bueno de Mesquita, et al , 2003), and previous models which argue ruling ethnicities tend to redistribute in favor of their own groups (Caselli & Coleman, 2006), we would expect TEMs to receive less than their Han neighbors. Additionally, while secession may drive government support (Alesina & Spolaore, 1997) the asymmetries involved indicate that any threat of secession on their part is unrealistic. Within this context, what drives government to give grants?

Second, what is the causal mechanism linking foreign political risk to increase in transfers to TEMs? Conventional explanations of domestic policy in China have been predominantly focused upon factors within China's borders. Fiscal distribution is no exception. The size of China's economy, its traditional presence as a regional power, and the imbalance in land mass, population and military power between China and its neighbors contribute to inward-looking scholarship on domestic policy, particularly on issues such as fiscal budget decisions which appear to have few links to foreign policy. Given this context,

it is reasonable to assume foreign political risk exerts little if any effect upon fiscal grants in China. Yet we find an unexpected temporal relationship between risk increase and grant transfers. What explains this phenomenon? The following chapter provides a detailed answer to this question, tracing the process of foreign political risk transmission through TEMs near the border and its effect upon the local population.

Answers to these questions rest on three main factors: TEMs, proximity to the border, and foreign political risk. In the following pages, I discuss a theory which incorporates these factors in detail. I begin with TEMs in China, presenting a brief overview of minority politics in China and TEM populations in this context. Next I discuss how porous borders, created by TEM presence on China's frontiers, drive transfers by creating and facilitating domestic threats to government. Foreign political risk is introduced in this context as an external factor that can be transmitted into China via TEM presence. I point to the ground-level causes of domestic risk or threats, the interaction between domestic and foreign risk, and the unique cross-border flows characterizing TEM areas which pose a challenge for the central government and ultimately, drive transfers distribution.

2.2   Transborder Ethnic Minorities in China

2.2.1   Ethnic Politics in China: Minority Policy and Co-Ethnic Groups

China is home to 56 ethnic groups, 55 of which are official minority ethnic groups (*shaoshu minzu*)[1] recognized by the state. Together these groups make up about 9% of the

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[1]Translation of the term "*shaoshu minzu*" has been more contentious and politically fraught than appearances might warrant. While earlier translations by the PRC government referred to "minority nationalities," more recent versions term these "minority ethnic groups" or "minorities," suggesting a shift toward de-emphasizing differences in ethnic identity and removing terminology which might

entire population, or approximately 110 million people (Han, 2011; Dreyer, 2012). Ethnic

minority groups show a wide range of variation in all aspects, such as size of population,

geographic location, income and other socioeconomic indicators. Minorities range from a

small group of 2,900 Lhoba, located in the far western end of Tibet, to the Zhuang, a

population of 16 million scattered across southern Guangxi, Yunnan and Guangdong

provinces (Mackerras, 2003). Many reside in border areas but sizeable groups also exist in far

inland provinces such as Ningxia.

On average, a few generalizations of socioeconomic characteristics of minorities

appear to hold. Educationally, minorities on average do less well. Table 2.1 shows this trend

in the late 1980s to early 1990s; higher education achievement is markedly low among

minorities, which corresponds to expectations in the literature and lay knowledge. Table 2.2

shows trends in health care, which reflect the troubling national-level trend towards a

decrease in adequate health care, particularly in rural areas, and rising health burdens for the

public. Table 2.2 also shows differences between minorities and non-minorities are

particularly severe, especially in rural areas[2]. These trends are apparent in spite of central

government-mandated preferential policies toward minorities in education, including

funding for enrolment and affirmative action policies.

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suggest independent nationhood. For further discussion of the political construction of ethnic
identity, see Harrell, 2002.
[2] Bhalla & Qiu (2006) note an exception to this trend in Xinjiang and Tibet provinces, where a
concentration of government funding appears to make up the difference.

Table 2.1 Educational Characteristics of Minorities and Non-minorities (1988, 1995 CASS Household Survey Data) (%)

	Minorities		Non-minorities	
	1988	**1995**	**1988**	**1995**
Urban Households				
College graduate or above	5.9	4.54	6.1	7.82
Community college, professional school, or middle-level professional, technical or vocational graduate	18.1	26.2	15.9	28
High school graduate	18	18.7	21.6	21.2
Middle school graduate	40.3	32.9	37.8	30.2
Rural Households				
College graduate or above	0.2	0.5	0.6	0.1
Community college, professional school, or middle-level professional, technical or vocational graduate	0.8	1.2	0.83	1.7
High school graduate	5.9	5.4	8.9	9.2
Middle school graduate	24.6	28.7	31.7	36.7

Source: Bhalla & Qiu, 2006; p.54

Table 2.2 Health Characteristics of Minorities and Non-minorities (1988, 1995 CASS Household Survey Data) (%)

Health Variable	Minorities		Non-Minorities	
	1988	**1995**	**1988**	**1995**
Urban Households				
Access to running water	72.8	92.3	78.1	94
Sanitary facilities:				
lack of sanitary facilities	45	49.2	34.7	25.2
shared sanitary facilities	18.1	5.5	20.5	8.7
have toilet, lack bath	34.6	25.1	40.2	36.4
have bath and toilet	2.3	20.2	4.8	29.8
Medical expense per capita (yuan)	57.3	64.7	46.9	70.4
Child care expenses per capita (yuan)	35	53	29.8	76.7
Rural Households				
Access to running water		16.6		28.1
Villages with health clinics		50.3		85.7
Medical expenses per capita (yuan)	2.1	11.4	4.4	16.2
Child care expenses per capita (yuan)	52.9		30.6	

Source: Bhalla & Qiu, 2006; p.108

However, surprising variation exists at both the intra- and inter-group levels. Contrary to the stereotypical assumption of minorities living in widespread poverty, while over 33% of officially recognized poverty counties (National Poverty Counties, NPC) are minority autonomous areas, the average income of some minority areas are on par with or at times higher than Han majority areas in the same area. Education levels also vary widely, with percentages of students entering higher/secondary education at low levels on average toward the West but higher in the Northeast. Levels of employment in non-agricultural sectors, the percentage of CCP cadres in the ethnic group – which serves as a measure of political inclusion – and other indicators also vary dramatically and appear unsystematic at first glance.

In the literature, so far a wide body of work has attempted to disseminate the state of minority group existence and point to some commonalities in state policy vis-à-vis minorities. Beginning from early ethnographic research, these works have asked: how can we characterize state policy toward minorities? Is the state systematically repressive or the reverse? And given the answers, what factors underlie state behavior? Discussion has centered on political repression of mass action by ethnic minorities versus preferential social policies; the distribution of economic goods or lack thereof; the politics of state rhetoric regarding nationalism and unity among ethnic groups versus political repression; and other issue areas.

The picture emerging from such discussion, however, does not present a consensus or even a clear-cut debate on the systematic nature of government policy toward minorities. Combined with opaque information on ground-level conditions and events, due to government incentives to hide or obfuscate data, this presents a puzzling picture of the state of minority policy in China which conflicts with media and lay perceptions of unified state policy toward minorities, either oppressive or otherwise. Is the study of minorities irrelevant to political outcomes – a few isolated incidents sensationalized by the foreign press, but in no way representative of an actual causal relationship? Does this apparent lack of meaningful, unified minority policy on the part of the central government and lack of clear effects point to the irrelevance of minorities in the political context? Should we view minorities as any other societal group in China and look to other factors, such as income, political representation, natural resource endowment, etc to explain variation in outcomes?

In part, the literature has been limited by approaches which concentrate on single or limited comparative case-study analyses. Much work on ethnic politics has been concentrated on single or within-group case studies, in Xinjiang (Bovingdon, 2004), Tibet (Sautman & Dreyer, 2006; Gladney, 2004; Dreyer, 2012) and numerous other groups groups in the Southwest and inland (Davis, 2005; Kaup, 2001; Harrell, 1995). This approach has contributed to the lack of meaningful cross-group debate in the literature. Due to selection bias, arguments regarding the political and economic status of minorities vis-à-vis the state have been difficult to systematically analyze or apply to a wider population. Other studies with countrywide or larger samples have pointed to minorities as a factor of interest (Wallace, 2009; Fravel, 2008), but much of the work has focused on using the administrative designation of minority autonomous area as a proxy for high ethnic minority levels[3]. To my knowledge, few works look to variation in levels of minority population, and none have focused on transborder ethic groups.

This study attempts to contribute to the literature by using a country-wide sample to analyze state policy toward ethnic minorities. In chapters 4, 5, and 6, I find outcomes are driven by not just minority/non-minority status, but rather a subset of ethnic minorities – transborder ethnic minorities (TEMs). In this process I look to vary previous work in several substantive areas: I introduce and break down the ethnic minorities variable to TEMs/non-TEMs, and I introduce foreign political risk as a factor driving outcomes in conjunction with

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[3]Guo (2009) and others use the minority autonomous area (administrative status) as a proxy, and thus assert county or geographic fixed effects analysis controls for the "minority factor" in their analysis. However, such administrative status does not necessarily correlate with ethnic minority size or TEM status.

TEMs. The following pages introduce the concept of TEMs and unpack the threat TEMs represent to the central government, which drives subsequent distribution of transfers.

2.2.2 TEMs

The term *transborder ethnic minorities (TEMs)* refers to co-ethnic groups living on either side of a border, in two or more different states. While the concept has been used to refer to "diaspora groups" "diaspora networks" or *transborder ethnic groups* (TEGs) in general who may co-exist in widely separated geographic locations across the globe, here I limit the sample of states to China and its immediate land neighbors. Although the Han ethnic majority in China is also a transborder ethnic group given the large numbers of Han in surrounding states, the groups which concern us here are minority ethnic groups in China, albeit possibly majority ethnic groups in neighboring countries. Hence I use the term transborder ethnic minorities (TEMs) to refer to TEGs in this context.

Among 55 minority groups in China, 34 are TEMs with a substantial co-ethnic kin population living across the border[4]. Out of 14 countries which share contiguous land borders with China, 13 have TEMs to some extent. Like minority groups in general TEMs show considerable variation in socioeconomic indicators. While statistics for TEMs alone are not available, accounts show income, education levels, and employment trends mirror minorities in general, with overall averages lower than the majority Han but again considerable variation among and within groups. TEMs are also geographically scattered across China, albeit with greater concentration on border areas than general minorities.

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[4]Groups with 1,000 or more members.

A number of factors affect the analysis of TEM effects: group size and concentration, proximity to the border, and the extent of cross-border integration. The population concentration, or the minority population percentage, in a local geographical unit is relevant in considering the strength of cross-border co-ethnic flows. Many TEM groups are heavily concentrated in border areas, and in a small number of geographical units. Given that China's government has encouraged the mass migration of ethnic Hans to minority-populated areas in the past, the contrast is even more remarkable. In urban areas the maximum level of minority population percentage rarely exceeds 60%; but rural areas tell a different story. Many local counties have high minority populations, for instance up to 96% in Xinjiang (Bhalla & Qiu, 2006). Overall, higher levels of TEM concentration in geographical units suggest stronger networks and linkages between individual members of the group in comparison to TEMs scattered across large provinces.

Second, the *proximity* of the TEM in China to the border of the corresponding country must be considered. The closer the TEM is to the border, the more likely it is to be affected by – and transmit – cross-border flows of political risk. The map shows how TEMs are distributed in areas close to the border.

Third, TEM level of integration with co-ethnic kin across the border is of interest. While measures of social and economic integration which capture interaction between co-ethnic groups are not available, much of the literature points to increased economic integration during and after the reform period in China. As Dreyer (2012) mentions, central

and local government encouraged cross-border trade and economic activity as a means of development, and given pre-existing social networks between co-ethnic groups, TEMs naturally began developing strong economic ties with their kin. Such cross-border economies have been mutually beneficial and contributed to flows of people (migration), goods (trade) and capital (investment) both into and out of China. While examples of local and central government-level action to prevent such integration from becoming wide-scale social and political integration exist (Dreyer 2012) nevertheless economic integration is common and continues today. Cases of deep integration can be seen in most TEM areas: for instance Xinjiang, where local TEMs often move freely across the border between regions in the Yili Valley, and the North Korea-China border, where the hermit state of North Korea has been increasingly viewed as heavily reliant on cross-border trade with nearby Korean minority areas.

2.3   *TEMs and Porous Borders: Foreign Political Risk*

A catchphrase in much of the scholarly work regarding authoritarian regimes is "regime instability." Across the literature, the field has evidenced a strong interest in "political instability" or "regime instability" and its consequences, which are often stark. Work examining the diffusion of instability across borders charts the severe consequences of civil war breakout and conflict diffusion to neighbors (Sambanis, 2001; Gleditsch, 2002). The ethnic conflict literature has addressed this topic in detail (Lake & Rothschild, 1998) and a variety of approaches have been used to link factors such as natural resources (Collier & Hoeffler, 1998) and to conflict outcomes.

In contrast to the widespread interest in "regime instability" we see little consensus as to the empirical regularity of what this term captures. On one hand, media analyses regularly use terms such as "unstable regimes" "high-risk regimes" and "weak governments" to describe assessments of relative political stability at the state level in non-democracies and semi- democracies alike. On the other, instability is difficult to measure. The word has been used as a catch-all term for everything ranging from low popularity ratings for the leadership, public discontent, labor protests to riots, electoral violence to regime breakdown and forced ousters of leadership. In authoritarian regimes it has been even more vaguely applied to refer to any phenomena that could construe an increase in challenge to the leadership; the result is that it has become a term referring to any ex-post departure from the status quo power balance.

Empirically, recent and past studies have increasingly focused on regime durability. An extensive body of work on democratization and regime transition (Geddes, 1999; Linz & Stepan, 1996; Gandhi & Przeworski, 2007) has covered the dynamics of often abrupt change in leadership in non-democracies. More recent works explicitly test a variety of causal mechanisms on regime survival measures such as the Polity IV durability index (Morrison 2009; Smith 2004).

But what about political risk – the level of risk associated with breakdown? It is necessary to distinguish between ex-post observed regime change and ex-ante risk. A long-enduring regime may have a high level of durability but endure high levels of risk and therefore considerable instability in the form of intra- or inter-state conflict, acts of terrorism

and violence by groups or the state directed at certain groups, before experiencing actual breakdown[5]. Democracies and non-democracies alike experience protests, riots and societal upheaval which are widely associated with political instability prior to leadership breakdown (Weiss, 2012). Authoritarian regimes often continue in this grey area of heightened political risk in which the political system experiences little to no breakdown or unexpected transition but high risk of future challenge to the leadership, kept in check by a strong state repressive mechanism. Regimes such as these can hardly be termed "stable," and it is misleading to use a political durability index based on ex-post measures of breakdown or transition when the driving factor in outcomes is the level of political risk.

Here I argue the risk level of a government – its probability of collapse, relative to the size of the challenge against it, which limits state capacity – is a concept underlying much of the past and present debates about regime instability, state capacity, regime change, and inter- and intra-state conflict. I broadly define political risk as the presence of a viable challenge[6], foreign or domestic, to the political system. I view the spectrum of political risk as the following diagram, ranging from "no risk (no challenge)" to "high risk (highest challenge)." As challenges to incumbent leaders increase, leaders steadily lose control over the state, thus increasing political risk. After a challenger successfully wrests power from the incumbent we should expect a decrease in risk[7].

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[5]Li 2006 uses political violence to capture both inter- and intra-state conflict but also includes terrorist acts in this measurement

[6] Challengers may come in many shapes and forms. This study does not propose to examine in any systematic way the wide variety of challengers in the entire universe of cases. Instead, I focus on specific types of challengers and the threats they present to incumbents in the case of post-Cold War People's Republic of China.

[7]The exception to this rule is a situation in which the challenger wrests power from the incumbent, but the incumbent continues on as a significant challenger to the new leadership. In such situations

Highest Risk
C

Low Risk
B

Less Risk
D

Highest Challenge

Low Challenge

Challenger in
Power
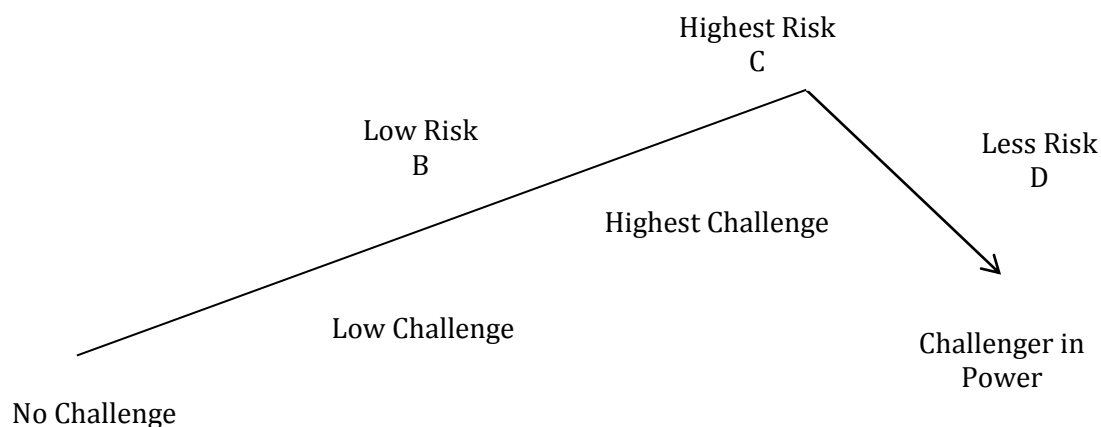
No Challenge

Figure 2.1 Conceptualization of Political Risk over Time

Note the conceptualization here refers to a challenge to the system rather than the incumbent leadership. By this definition, the concept is applicable to democracies and non-democracies alike. In the case of a democracy, the incumbent leadership can co-exist with a political opponent without threat or risk of challenge to the political system. Because leadership transition is an institutionalized process via elections, a change in power does not equal high risk. A challenge to the system in the form of a set of political actors who seek to change leadership through means outside the current political process, on the other hand, creates significant political risk. This does not preclude the possibility that these challengers may exist inside the current political institutions, and indeed may in some cases make up a portion of the current leadership. While the political actors who seek to challenge the current system may exist inside the current political institutions (as well as outside), the means by which they seek to achieve change in power must be outside current political processes. This is even more the case in non-democracies where power transition to a political opponent is often not institutionalized via elections or other open political processes.

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we would see a reversion to point C (Highest Risk).

2.3.1   *Foreign Political Risk*

I conceptualize political risk as simply the extent of challenge against the standing government. In authoritarian regimes the need to identify and control potential challenges is greater because of the costs of regime change to the autocrat. Foreign political risk – or risk in neighboring countries – is important both in terms of foreign security, with effects exacerbated by geographical proximity; also in terms of domestic stability, or diffusion of conflict and risk.

Economic country-level political risk measures can be highly useful analytical tools which accurately proxy for political stability. While most measures have been developed by the international business community, the academic field of political science has come to recognize their utility in recent studies[8]. In addition, many have begun acknowledge the utility of political risk measures in studies of authoritarian institutions (Henisz 2002; Jensen 2003, 2006, 2008; Li & Resnick 2003). Many of these are composite measures which aggregate risk of conflict, economic breakdown (dips in economic indicators) and government expropriation into one or several political risk indicators.

Using the measures in this literature, I observe that China is surrounded by countries with wide variation in political risk. China has 14 land neighbors, many of whom are frequently cited as "high-risk" regimes; for instance the unstable regimes of North Korea, Myanmar (Burma) and Afghanistan all share borders with China. Risk levels not only vary

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[8]See Jensen (2008) for a succinct summary

between countries but also within countries over time; risky regimes are also highly volatile

regimes, as can be seen from the case of North Korea, whose risk levels vary from low (0.4)

to very high (1) on a 0 to 1 scale[9]. The figure below gives an idea of the variation in risk

levels of countries surrounding China:
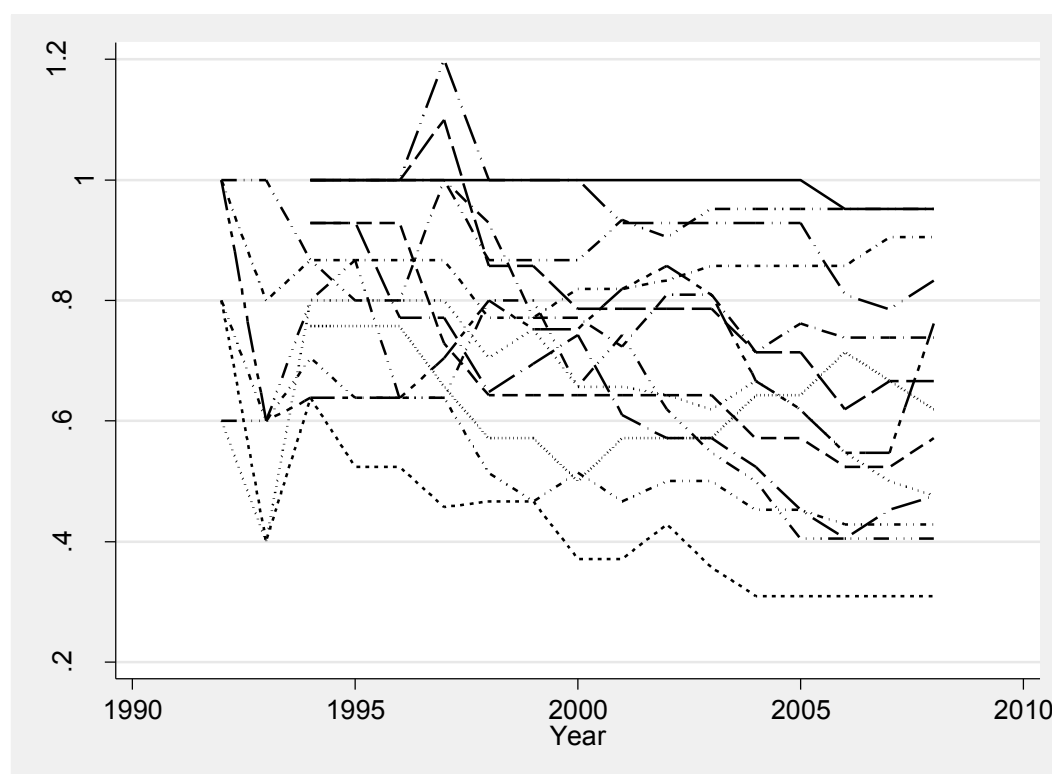
*Source: ONDD Credit Risk Data

Figure 2.2 Country-level Risk in 14 Countries Surrounding China (1993-2008)

In many cases risk overflows and threatens to spill over the border into China. In the

past, over a quarter-million refugees fled Vietnam for China in 1979; more recently in 2009

intra-ethnic conflict in Myanmar (Burma) led to an influx of 37,000 people crossing the

border from the Kokang regime to Yunnan province in Southeast China (Thompson, 2009).

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[9]ONDD political risk measures, aggregated and scaled (0 to 1)

North Korea's famine in the 1990s propelled an unprecedented number of illegal refugees into Jilin province, a trend which continues today. China has also experienced territorial disputes which have threatened to burgeon into refugee crises in the past. The following section details the role of transborder ethnic minorities(TEMs) in spillover of foreign political risk and its implications for policy outcomes in China.

2.3.2   *The Spread of Foreign Political Risk: TEMs and Proximity*

How does an increase in foreign political risk lead to greater transfers in certain minority areas? While in the past external shocks such as global economic crises and trends have been known to affect regime durability (Geddes 1999), political risk in neighboring states – which is often more limited in scope and extent – has been rarely discussed as a factor in cross-border political outcomes.

I argue transborder ethnic minorities (TEMs) transmit political risk from a foreign state into China. The presence of a TEM straddling borders leads to cross-border economic and social integration. When foreign political risk increases, the destabilizing effects are transferred to TEM compatriots in China, leading to further incentives of mobilization and mass action vis-à-vis the authoritarian leadership. The leadership responds by implementing measures to prevent the spread of risk and subsequent mobilization, including fiscal transfers to TEMs. Thus a foreign factor such as political risk leads to change in domestic fiscal policy outcomes.

The following provides a more detailed discussion of the theory. In the first section, I discuss previous work on foreign determinants of domestic policy and in particular application to authoritarian regimes, and the concept of political risk and in particular foreign political risk. Next, I introduce TEMs in China, tracing the process of diffusion of foreign political risk through TEMs. The subsequent section lays out my theory of mobilization of TEMs, tracing incentives of both the individual TEM member and the authoritarian leader. I conclude by touching on the methods the authoritarian leader uses to prevent such outcomes, setting the stage for discussion of authoritarian allocation of goods in Chapter 3.

2.3.3   *Foreign Determinants of Domestic Policy*

The literature examining foreign effects upon domestic politics has been well developed in political science over the last few decades. Beginning with Gourevitch's seminal work on the "second image reversed" (1978), the fields of international relations and comparative politics have gradually incorporated the blurring boundaries between the international environment and political institutions and policy outcomes within state borders. Scholars have extensively examined the macro-level effects of globalization of the international economy upon domestic institutions (Keohane & Milner, 1996). More recently, at the macro-level a literature has developed which examines the effects of globalization and the changing international environment upon state sovereignty and authority structures (Lake, 2009; Cooley & Spruyt, 2009; Owen, 2002). At the micro-level, the field has continued to look at effects of a variety of international factors upon policy-making in new democracies, developing countries (Mosley 2002) such as domestic fiscal policies (Wibbels,

2006; Brender & Drazen, 2005).[10] Scholars have fully accepted that the causal arrow of interaction is not only from the domestic to foreign policy, but also the reverse – foreign factors lead to changes in domestic politics.

Increasingly, attention is being paid to regime type differences in states and their interaction with foreign factors to produce variation in outcomes. Recent work on authoritarian regimes has linked the politics of international globalization, FDI, foreign electoral monitoring, reputation and institutions to fiscal policy (Hyde & O'Mahoney, 2010), natural resources and regime stability (Morrison, 2009; Smith, 2004) and investment risk in non-democracies (Li & Resnick, 2003; Li, 2006). In particular, the democratization literature has linked breakdown in authoritarian regimes with large-scale exogenous shocks such as global economic crises or the end of the Cold War (Geddes, 1999; Bratton & Van de Walle, 1997).

While China is often cited as a primary example of a one-party authoritarian regime, the China field, however, has seen less advancement in these directions discussed above. The field has been well populated with work linking domestic politics and foreign policy in the post-Cold War era. In particular the composition of domestic elite leadership and bureaucratic institutions which lead to variation in the foreign policy decision-making process (Christensen, 1997; Lampton, 2001). Economic reform has brought about discussion of the increasing role of economic and social groups in constraining leadership (Lampton, 2001), domestic intergovernmental relations between central and local

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[10]The strands of literature referenced here are broad and extensive, and the authors cited here represent only a small sample of the work involved.

governments (Shirk, 1994). In addition, research has drawn attention to links between foreign policy outcomes and anti-foreign protests under China's one-party leadership (Weiss, 2012). However work on how external security changes lead to domestic regime stability, and policy shifts in its authoritarian regime, have seen less development in recent years. With the notable exception of literature on economic globalization (Kim, 2006; Pearson, 2006), the impacts of foreign causal factors upon domestic politics has been limited.

This work aims to contribute to this literature by introducing an external factor: foreign political risk. In the previous section we have examined the concept of political risk, presenting a simplified model of risk and its implications in an authoritarian regime. I carry the discussion a step further by asking the question: how do states deal with political risk in neighboring countries? If a country across the border becomes less stable, do we see a reaction? What are the implications of risk diffusion, and how does it affect domestic policy? I shed light on these questions by examining foreign political risk and its consequences.

2.3.4   TEMs and Foreign Political Risk Diffusion

In this section I argue transborder ethnic minorities (TEMs) in China facilitate the spread of political risk across borders and lead to changes in domestic political outcomes. I examine the diffusion of risk from the point of view of the TEM member and the authoritarian leader, and show how the influx of foreign political risk leads to TEMs becoming salient as mobilized challenge groups to the authoritarian regime.

Why do TEMs channel foreign political risk more than other groups? The idea that ethnic affiliation or kinship ties create stronger social links between members of the group has been advanced frequently in many branches of the literature. Ethnic networks have been shown to create greater economic opportunities and facilitate trade as well as migration flows. Explanations of co-ethnic affiliation based on informational advantages (Fearon, 1996) have gained credence in the field, and scholars have come to accept the idea that co-ethnics groups may be able to confer reputational and material benefits that are larger than non-co-ethnic members may provide.

Three crucial flows mark interaction between groups on either side of the border: flows of people, information, and economic goods. Flows of people include both legal and illegal migration. Economic flows encompass investment(capital), trade, and other economic activities, while information flows range from simple communication of daily activities to political agendas spread by activists and can be transmitted over a variety of communication methods from word of mouth (through flows of people) to media, cell phones, internet access and modern technology. While in some cases state intervention such as banning trade, immigration policies and censorship may partially prevent certain flows, at a basic level the strength of TEM affiliation attracts both legal and illegal (state-subverting) flows, leading to economic and social integration between groups on either side of the border.

An increase in political risk in a country with co-ethnic TEMs creates effects that are transmitted through these flows, leading to high risk of mobilization in the corresponding

TEM group in China. In the following sections, I look to the logic of the spread of foreign political risk and how individual decision-making creates systematic group effects. When foreign political risk is transmitted through TEMs, the possibility of mobilization creates a threat to government. The government in turn responds with methods to prevent political risk.

2.3.5 The Individual TEM Member's POV

Once foreign political risk is on the rise, TEM members have an incentive toward mobilization in order to offset the effect of these flows. **First, an increase in foreign political risk leads to disruption in economic flows**. As political risk increases across the border, cross-border trade and investment ties break down. Disruption occurs through displacement of citizens, economic downturn, breakdown in regulations governing economic activities, or a combination of all of these mechanisms. As conditions for economic activity deteriorate, political risk leads to further breakdown in economic ties spanning the border.

A rich literature exists on the extent of transborder co-ethnic economic ties across the world. In China, as Dreyer (2012), points out, during and after economic reform TEMs were actively encouraged to open up borders to trade and attract investment from co-ethnic kin in order to boost local economies. TEMs attract both legal and illegal economic flows, and in the process form and increase strong social linkages. We assume therefore the existence of cross-border economic integration in all TEMs. While the level and extent of integration may vary, given the substantial cross-border ethnic economy in most TEM areas

near the border, disruption will likely have a considerable effect on the economies of TEM members. From the individual TEM member's point of view, foreign political risk can affect in adverse ways as increased levels of integration lead to greater indirect or direct costs, either in the form of direct investment losses or indirectly through trickle down effects from the regional economy. Mobilization creates an opportunity or method by which an individual TEM member can demand distribution of goods from the central government.

Second, flows of people, or migration flows occur. In regimes experiencing increasing levels of political risk governments gradually lose control over order, thus becoming unable to assure provision of property rights and security. Citizens defect to entities who can give credible assurances – roving bandits or even foreign governments (emigration). Conflict, violence, and continued unrest further increase disorder, defection and movement of citizens out of the country.

As political risk increases citizens will look for options elsewhere. Because the costs of relocation in any situation are high, citizens only move when the loss of security and property rights are such that they outweigh costs of relocation – that is, when political risk is significantly high. All things equal, refugees will prefer co-ethnic areas because lower information and transaction costs in the same ethnic group increase the probability of successful relocation and employment (Fearon, 1996). While all areas which meet the two conditions of proximity and relative political stability will be candidates to experience some

form of refugee inflows, TEMs attract greater flows, enhancing changes to group preferences and aggravating the threats of ethnic unrest identified above[11].

This type of flow can include political actors and entrepreneurs, combatants, and ordinary civilian refugees. For example, after the Sept 11, 2001 attacks on the World Trade Center and Pentagon, PRC sources claimed that over a thousand Taliban-trained Uyghurs had infiltrated Muslim communities in China to disseminate fundamentalism and terrorist propaganda. While reports were likely greatly exaggerated – foreign experts have placed their numbers at much lower levels, from 4 to 13 individuals (Dreyer, 2012) – the claims reflected the strength of cross-border social networks in conducting flows of people through a tightly controlled border area under a strong government. Such movements are possible at almost any level of risk – for example migration inflows can occur even when risk is low because of high levels of persecution targeted specifically towards the challenger group, or because inflows occur with a specific purpose in mind, such as terrorist training – but as political risk increases we will expect refugees to increase significantly. Barring peaceful transitions of power to challenger government, we expect highest amounts of migration when risk is at the highest level.[12]

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[11]Here I assume political risk affects all citizens in terms of creating uncertainty and/or risk to safety. While it is quite true that certain groups or ethnicities may be aggressors or on the "winning side" of an intrastate conflict situation, members of either the "winning side" or the "losing side" bear costs of an increase in political risk and individuals in either group are both likely to have incentives to migrate out of the country in search of a safe environment.

[12]Here I assume migration occurs regardless of individual TEM member preferences to accept or reject refugees, simply because inflows of illegal migration are difficult to contain for both current residents as well as government. Regarding the argument that the receiving TEM group may reject refugees, however, it is useful to note such actions may be conditioned by reputation costs and the social linkages and institutions within the TEM.As previously discussed, ethnic groups are often characterized by strong social institutions. Frequently these social institutions impose costs – punishment of defectors –on members who refuse to extend help to others in the same group in the

When political risk increases in neighboring country, from the individual TEM member's point of view migration flows brings substantial costs and benefits to the TEM member. Economically, migrants also bring in new, inexpensive labor and eventually increase the size of the TEM local economy, creating in the long term economic growth and economic opportunities.

On the short term, however, migration also can incur costs for the TEM member by creating competition for jobs in the area, bringing down wages, and creating a fiscal burden (Cornelius & Rosenblum, 2005). The advent of political and social uncertainty may also be costly for the individual, in the sense that migration upsets the current status quo ethnic balance between TEMs and non-TEMs in the area. If the ethnic makeup changes, political change is probable and uncertainty creates economic downturn and political problems for TEMs as well as non-TEMs. These conditions lead to incentives for individual TEM members to mobilize in order to demand greater distribution of goods or autonomy.

Third, informational flows between TEM co-ethnic groups on either side of the border and within the group in China create incentives and conditions for mobilization. In times of political risk and crisis, information travels across the border through legally sanctioned and also illegal mean, through flows of people and communication networks. Information about mobilization across the border often leads to

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form of ostracization or retaliation. A similar mechanism may be at work when a minority member mobilizes in order to demand greater autonomy or redistribution of goods of the central government if the idea has gained enough support in the ethnic community so that defection incurs significant costs.

mobilization of a co-ethnic group[13]. The individual TEM member receives information as to group activities of mobilization, which creates incentives to participate and mobilize because of both costs of defection and benefits of gaining redistribution through group demands (see footnote3).

In addition, demographic increases create a higher concentration of ethnic population and increased formal and informal networks of communication. Mobilization is commonly understood to be effective in greater numbers, and individual members have increased incentive to participate if they know that the strength and extent of mobilization will be such that it will attract greater attention and possibly lead to redistribution of goods or that demands will be met.

At minimum inflows and changes create a shift from the status quo in the TEM area which creates a climate of uncertainty for individual members. At the maximum, this change leads to incentives to mobilize and gain through demands and challenges to the central leadership. The next section examines the incentives of the authoritarian leadership in the face of foreign political risk effects and the expected reaction.

2.4   *Conclusion*

In the next section I elaborate further on the next step in this process: authoritarian perception of political risk and the incentives and methods of its leadership in dealing with

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[13]In a reverse example, mobilization among ethnic Uyghurs, Kazakhs and other ethnic groups in western China during 2009 led to mass-scale protests among pan-Turkic co-ethnics in Kazakhstan and Kyrgyzstan.

challenges. In order to deal with increased domestic political risk, the authoritarian leadership uses a variety of methods. I shed further light on the conditions that make a group salient as a challenge, and how the government reacts by distributing goods.

CHAPTER THREE

THE POLITICS OF DISTRIBUTION:

CENTRAL AND LOCAL INCENTIVES TO GIVE TO TEMS

3.1 Introduction

How does the possibility of ethnic unrest in transborder ethnic minority (TEM) areas lead to increased fiscal transfers? This chapter inverts the process, looking at distribution from the viewpoint of both the central and province-level leadership. We face two puzzles: 1) Given the low possibility of secession, why does the center have incentive to distribute to restive TEMs? And 2) given the fiscal autonomy enjoyed by provincial governments, what incentive do they have to distribute to TEMs?

In the following pages I provide answers. Within the context of China's political system, I argue politicians' incentives to retain power condition allocation of scarce resources at both center and province levels. I draw upon a rich literature regarding the development of the fiscal system and cadre evaluation process in China to show the central leadership prioritizes regime needs among a variety of goals. The current fiscal system and center-mandated system of career incentives reflect the emphasis on maintaining political power while regulating outbreaks of mass action, protests and general unrest. Such goals have wide-ranging implications for fiscal expenditures and distribution. I argue that the political costs of restive TEMs motivate transfers from the central government that would otherwise be directed to different purposes. Moreover, the center ensures this distribution is duplicated at the local government level by imposing strong career incentives on province-level officials.

Emerging from this discussion is the image of an authoritarian leadership in China which both constrains and pre-empts challenges to the regime but is also constrained by informational problems and costs arising from domestic public opinion. The high costs of losing power in an authoritarian regime, and the public opinion costs of allowing mass action by ethnic groups, compel authoritarian leaders to pre-empt ethnic mobilization by identifying conditions which lead to distributing handouts as a preventative measure. Groups which become salient due to a combination of factors in such situations become recipients of goods.

3.2 Central Government Incentives to Distribute to TEMs: "Social Stability" and the Paradox of the Autocrat

The field of China studies has long recognized the priority placed upon maintenance of power among the Chinese leadership. Economic development and "social stability" – the Chinese leadership's choice phrase for referring to regime needs or regime stability – have been emphasized as the twin drivers of national policy since economic reform began in 1978 (Shirk, 1993; Oi, 1992; Montinola et al, 1995; Yang, 2004a). More recently, works have explicitly tested whether leaders prioritize regime goals above others, using cadre promotion data (Shih et al, 2012) or local budget expenditures (Guo, 2009) and fiscal transfers (Wallace, 2009). Implicitly, much of the recent literature has pointed to regime stability goals as a driving force behind government-led action and policy (Weiss, 2013 forth.; Shih et al, 2012).

Leaders in authoritarian regimes such as China face a set of incentives which differ markedly from democracies. In contrast to democratic leaders who expect peaceful

transitions in power after losing office, authoritarian leaders face the possibility of violent

ousters and costs of losing office ranging from loss of wealth or possessions to

incarceration, exile or death. The costs are thus extremely high in comparison. Therefore, the

incentives of authoritarian leaders are structured in a way so that they keep a high priority on

retaining power. Authoritarian leaders have a stronger incentive to use any available means

to control challenges to the system, and given the same actual size of challenge, non-

democratic leaders will be more likely to react strongly compared to democratic leadership;

i.e. non-democracies are more "sensitive" to challenges. Combined with the lack of

institutional constraint and capacities available to authoritarian leaders, and the weaker

institutional constraints on positions of power, these incentives can often explain the

development of authoritarian control and repression.

It follows that dictators must place a high priority upon gaining information on

challenges to the current regime in order to properly control and repress threats to

maintaining power. However, perceptions of political challenge are determined by barriers to

obtaining correct information. Informational barriers are low in democracies relative to

authoritarian regimes, so given a functional state apparatus[1] we can expect perceived

challenges to equate more or less with the actual challenges. In contrast, leaders in non-

democracies face endemic information problems because citizens have incentives to hide

information about preferences for government change. Non-democratic leaders must deal

with what Wintrobe (1998) terms the "Dictator's Dilemma," or hidden information and the

lack of ability of the leadership to objectively gather it. This results in a vicious cycle in

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[1]Weak/failing states may differ simply because the state does not have the means to collect
information on challengers.

which weak institutional constraints allow leaders to use repression, which increases

incentives to hide information, which increases leadership difficulties in finding information,

and in turn leads to greater repression.

In the case of China, therefore, the leadership has a strong incentive to identify and

pre-empt sources of social instability. The following section covers challenges to the

government in detail.

3.2.1 Runup to Mass Action & Government Response

Mass action is the easiest public signal of discontent in a state. Once mass action

occurs, the authoritarian leader can observe two types: outbreaks of violence and outbreaks

of protests. The two often occur in tandem and are not mutually exclusive by any means, but

inclusion of violence increases the level of challenge to the regime and thereby the reaction

of the autocrat.

In a domestic context, outbreaks of violence include but are not limited to intrastate

war, organized riots, rebel attacks, and acts of non-state terrorism. This is obviously a clear

sign of a challenge to state authority. In many authoritarian regimes we do not observe these

types of phenomena simply because they are undesirable to the state and the state seeks to

pre-empt violence before it occurs. In these cases, state repressive capacity is such that rebel

organizations cannot become viable. Outbreaks of violence assume the ability of challengers

to obtain weapons and build organizations, both of which are extraordinarily difficult to

achieve in a strong authoritarian regime with well-functioning security and intelligence

agencies. The state has a clear preference to stop outbreaks of violence beforehand because any outbreak of violence immediately constitutes high level of challenge against the government. Usually the state identifies the challenge before this happens, especially in a strong state with strong informational capabilities.

In the absence of organized violence, mass protests and sporadic riots can be easy identifiers of a challenge to any government. Even totalitarian regimes with very strong state repressive capacity such as North Korea experience this type of phenomenon – although information is limited, we hear of sporadic outbursts of demonstrations and protests on occasion. While such outbreaks of mass action are generally considered undesirable in authoritarian regimes, authors have indicated that in some cases they may actually be useful to the incumbent leaders (Lorentzen, 2010 ms; Weiss, 2013 forth.). Lorentzen (2010 ms) among others points to the use of protests as an informational source, an indicator of public opinion and societal unrest; protests can also be a useful source of information to identify and remove corrupt officials.

Empirically, however, protests and violence are not really accurate measures of challenge to government. The frequency or duration, or even size, of mass action alone is not an accurate proxy for political risk. Because a protest serves as a clear indicator of discontent to the public and any foreign or domestic observers, it follows that authoritarian leaders will allow such protests only when they benefit the government – such as protests as a signal in bargaining with a foreign entity (Weiss, 2013 forth.) or when their usefulness as monitoring or information-gathering tool outweighs the cost of public mass action. Some

protests may be driven by the government or even "fakes" created for a specific purpose; some protests are natural and spontaneous but nevertheless encourage and controlled. Under these circumstances, observed increase in protests may simply mean that the government is allowing "constrained" protests to happen, rather than being spontaneous and uncontrolled. When protests are an indicator of a challenge the state will want to pre-empt these as much as possible. Thus it follows that an absence of protest does not equal absence of challenge. By the same token, any type of public or private bottom-up action in an authoritarian state would be subject to the same constraints and would be an unclear or "muddied" signal.

This simply reinforces the "Dictator's Dilemma"—the same mechanisms of control and repression which enable the regime to control challenges and thereby stay in power also result in an informational problem, where the difficulty in obtaining reliable signals and information leads to greater problems in control. It also reinforces the idea that the outbreak of mass action in the first place is often pre-empted when it presents a high-level challenge to the government. It follows that the stronger the state, the more ex-ante rather than ex-post identification methods the government will pursue.

Prior to outbreak of mass action, therefore, authoritarian leaders have been argued to turn to methods of obtaining signals, such as authoritarian elections. Literature on the role of authoritarian elections has been vibrant, and in particular works have singled out elections in one-party regimes as a tool for gathering and providing information for the central government (Malesky & Schuler, 2011; Hyde, 2011). However, many authoritarian states do

not choose to hold elections[2] – possibly because strong authoritarian states may not need the other benefits elections provide, such as conferring legitimacy. Regimes such as China have local rather than national-level elections, which have been argued to serve the function of providing the central leadership with information about the loyalty and competence of local-level party cadres (Blaydes, 2009; Landry et al, 2010; Gandhi & Lust-Okar, 2009). Local-level elections serve to root out corrupt or unpopular officials and reward competent and/or popular ones who subsequently are promoted to higher levels of authority or whose districts gain additional powers (Sheng, 2005; Malesky & Schuler, 2011).

Conversely, strong authoritarian states may find the costs of introducing and holding elections too high. Elections raise expectations of democratization and political rights for ordinary citizens. In addition, national-level elections in a large, geographically dispersed state are simply logistically difficult, especially if the state has no prior experience with the electoral process. But the utility of elections in China as an informational tool is limited; such limited elections may serve as a monitoring mechanism within the current winning coalition but do little to provide information on potential societal challenges outside the coalition itself.[3]

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[2]Approximately 14 authoritarian states in the world today do not hold national-level elections, including China (see Hyde & O' Mahoney, 2010)

[3]This is not to argue that a broader scope of elections may serve this function in China in the future. I argue that at present, all signals seem to indicate that the costs of instituting and holding nation-wide elections outweigh the potential informational benefits to the leadership. Work on authoritarian elections indicates that national or in-party elections may provide the benefits currently cited to national-level authoritarian elections in other one-party regimes in the literature (on authoritarian elections see Hyde, 2011; Gandhi & Lust-Okar, 2009).

Authoritarian leaders instead have often been known to look to the issue area of unrest or pre-existing group affiliation cues in order to identify challenges. High priority issues include those which threaten the integrity of the unified state, such as separatist protests, or protests which challenge the legitimacy of the regime by asking for democratization, human rights or religious freedoms. Nationalist protests, including protests over territorial conflict or foreign presence in China, can become a threat without adequate government control. Other issues of concern are corruption by local and on occasion, higher-level officials; and labor protests.

While the issue area is of utmost importance, in all of these protests the location, size and violence involved are crucial to leadership perception of threat. Unrest in major urban areas is much more sensitive to the government, particularly large cities such as Beijing and Shanghai where the combination of large populations, close proximity and the media attention by domestic and foreign reporters increases the threat level of any type of mass action. Small, non-violent rallies present less threat compared to large-scale riots and outbreaks of violence. In a comparative sense localized labor or corruption protests, particularly in rural areas, garner less attention and present far less of a threat to the central leadership.

Group affiliation defines the issue and often geographic location. Conventionally, we have assumed groups that are part of the "winning coalition", such as the army (PLA) and top elite political actors, are the main powerful potential challenges. The autocrat's distribution of private goods to the winning coalition is assumed to be a payoff in exchange

for support (Bueno de Mesquita et al, 2003). But we can observe certain groups are given distinct political power, even direct power-sharing arrangements, while others are not given political power, but seem to be targeted as challenges. The former are often elites; the latter non-elite societal groups that are sometimes repressed and at other times given rewards or handouts. In this context, all groups have the potential to develop into a challenge through mass action, but certain groups immediately become a high-level challenge from the moment of outbreak of mass action or violence. By nature of the group, mass action itself heightens risk considerably. Thus, the group itself is an identified challenge. The autocrat identifies these groups from the outset and seeks to pre-empt any mass action before it occurs.

Among groups which present a challenge, TEMs presents a unique and high-priority threat to central control. While the disintegration threat is an automatic high-priority issue (Sheng, 2010), threats to secede by TEMs are often less than credible. However the combination of ethnic minority and border unrest creates a high-priority issue. Ethnic minority unrest may not be a credible as a separatist threat, but the publicity it receives from the domestic and foreign press, and the subsequent cascade effect created by widespread knowledge that one ethnic group has challenged central authority, creates a serious problem for the government. When it occurs in a border area the threat is heightened further.

3.2.2   The Authoritarian Leadership's POV and Group Salience

From the authoritarian leader's point of view, mobilization by TEMs creates strong challenges to the leadership, increasing the level of domestic political risk. By acting as a

conduit or "porous border" through which foreign political risk is transmitted into the country, TEMs pose a threat of mobilization and ethnic unrest, leading to potential social and political consequences. The leadership has a strong preference, therefore, to prevent and stop mobilization within the TEM.

The authoritarian leadership is faced with sets of problems from TEM flows which spread foreign political risk:

First, TEM transmittal of risk creates demographic changes. Refugees result in an influx of new ethnic groups which presents a major shift in demographic balance between ethnic groups or minority-majority relations in the region. TEM inflows of migrants add weight to an existing ethnic group, increasing the relative political or economic power of one vis-à-vis other ethnic minority groups. A large influx of compatriot refugees creates costs and benefits to existing minority group members, creating an atmosphere of change and uncertainty. In particular, larger number and concentration enable mobilization to demand greater redistribution of goods or toward greater autonomy and less cooperation.

Second, TEM transmittal of risk creates direct security risks such as spillover of physical conflict. Political and military leaders and combatants may cross the border, creating a security crisis within China. Large-scale spillovers may act to directly challenge the central government on occasion, while small-scale spillover also shifts demands of ethnic and non-ethnic groups alike towards stronger military action, such as intervention or border control. Han residents may incur costs from security threats and demand government

intervene to stop the conflict or step up on border control, while local ethnic groups may take sides over intervention.

This process creates an opportunity for third party intervention through TEMs. A related aspect of spillover of crisis is the external threat to Chinese political stability in the form of third-party intervention and escalation[4]. In the case of TEM transmittal of unrest, TEMs are mechanisms by which bordering states can also intervene in Chinese domestic politics and potentially act as a third party ally to compatriots who mobilize, influencing the conflict in compatriots' favor. The government risks not only a security threat but also the loss of authority to its own population by suffering foreign intervention in a domestic dispute. The possibility of a close ally creates greater incentives for ethnic groups to demand autonomy and/or secession.

Third, risk spillover creates threats to the political legitimacy of the CCP. In direct terms, risk spillover creates a threat to legitimacy by exposing weaknesses in government abilities to protect its citizens in general. Both a decrease in legitimacy to general citizens, and the increased incentives for mobilization and collective action by challengers and ethnic groups who perceive the government as weak and unable to effectively control security, present high-level threats to the authoritarian leadership. Thus government has a strong incentive to prevent the spread of foreign political risk both for the purpose of preventing mobilization and also for the purpose of preventing the spillover of security crises.

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[4]Lake & Rothchild (1998)

Less obvious, but even more important to the CCP, is the challenge to the party's authority to rule, and ideological legitimacy. Without placing undue emphasis on the position of ideology in Chinese politics today, it is sufficient to note that irredentism and ethnic unrest threaten both the image of the CCP as a capable leader of the nation as well as the long-held Marxist ideal that CCP governance benefits all nationalities alike (Dreyer, 2012). The audience costs of ethnic unrest are severe, and historical evidence shows the CCP has been highly aware of such risks to maintaining power. For example, after widely publicized events of Tiananmen Square in 1989, a large-scale effort by the leadership to repress and re-organize society was accompanied by severe repression of ethnic protests in Tibet, Xinjiang and Inner Mongolia (Fravel, 2010; Dreyer, 2012). More recently, international coverage (mostly) in favor of ethnic protests in Tibet have been severely criticized by the CCP. The leadership began launching domestic, government-led efforts to critique foreign reports, such as the anti-CNN movement.

These factors combine to increase the salience of the TEM group as a political challenge, and the authoritarian leadership seeks to pre-empt this process before it occurs.[5] In order to prevent TEM mobilization, the leadership uses a carrot and stick method: **distribution of goods**, and **threat of repression**. The government threatens severe repressive consequences should TEM members facilitate the effect of inflows and shift away from the status quo. Acceptance of refugees is often outlawed and government may threaten frequent, regular crackdowns with strong surveillance and increased harsh penalties for non-

[5]The leadership may also seek to address the source of foreign political risk directly by using leverage including foreign aid or military action to decrease political risk in the neighbor. Similarly it may also close down the border area and impose censorship to prevent flows from reaching the TEM in China. We have seen, however, that the latter measures may be limited because flows invariably include legal and illegal actions which may subvert state prevention.

compliance. For example, in Northeast China (Jilin) fines for harboring illegal refugees tripled after waves of refugees smuggle across the China-North Korea border.

On the other hand, distribution of goods to the TEM serves several functions: 1) as a redress of costs incurred by increased foreign political risk, and 2) as a conditional reward for non-compliance with foreign refugees or mobilizing forces. As an example, strategic resource allocation through the fiscal apparatus of a state – the formal setup of institutions of tax revenue collection, budget expenditures and intergovernmental transfer distribution – has long been recognized in the literature, and similar fiscal manipulation has been identified in authoritarian regimes (Pepinksy, 2007), particularly China (Guo, 2009). In the next section I describe the setup and development of the current fiscal system in China and how fiscal grant allocation is used to promote leadership goals.

3.3 The Current Fiscal System: Centralized Collection and Decentralized Distribution

The current intergovernmental fiscal system in China is widely recognized as a direct result of the process of economic reform. Beginning in 1978, China experienced a center-led transition to a market economy. The political demands of maintaining support for reform spurred overall decentralization, in particular increased devolution of fiscal authority to province-level governments (Shirk, 1993; Tsai K, 2004; Saich, 2004). Successive fiscal reforms in 1980 and 1988 witnessed the development of a fiscal contracting system (*caizheng chengbaozhi*) in which provinces struck bargains with the center to share revenue. The

development was beneficial for the center in two ways: the revenue-sharing bargains provided political support, but also increased local incentives for economic expansion in order to raise greater revenue (Oi, 1992; Montinola, et al, 1995), thereby encouraging the process of economic reform at the local level.

Another fiscal reform in 1994 re-centralized the collection process while maintaining the decentralized nature of distribution and spending (Naughton, 2007; Pei, 2006). A significant decrease in central revenue over the last decade following economic reform, and general fear of political instability in the wake of the events of Tiananmen Square in 1989 contributed to recognition of the political dangers of weakened state fiscal capacity (Yang, 2004b). Central revenue mobilization continued to decrease from over 23% of GNP in 1984 to barely 11% within a decade[6], and the center was running an increasing deficit (Bahl, 1998; Bird & Chen, 1998). In the face of this building threat to the very core of its authority – its ability to collect rents – the center initiated an overhaul of the collection system, reconstructing tax bases and rates. Most of the previous sales tax was consolidated under the VAT (value-added tax)[7]. The center replaced the previous negotiation-based tax system, which had served as a substitute for the market process by setting widely different, almost arbitrary, tax burdens as a mechanism for regulating competition and prices, in favor of a simplified Tax Sharing System (TSS, *fenshuizhi*) based on universal rules of revenue sharing between the center and provinces. Local governments lost the ability to strike tax bargains with local enterprises, while local revenue bases and tax-sharing rates shifted in favor of the center. In particular, local and central tax services at the local level were separated and the

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[6]Bahl, 1998
[7]Bahl, 1998 p.138

State Tax Administration (STA) made independent of local governments, resolving the problem of "divided loyalties" of local tax employees whose ambiguous position between central and local government led to weaker central authority in the past[8].

While the collection process was dramatically re-centralized and improved in efficiency as a result of this reform, scholars have noted the distribution and expenditure process continued the previous trend of de-centralization (Pei, 2006; Naughton, 2007). In exchange for acceptance of central authority in the collection process, provinces were guaranteed set partial returns of revenue and greater autonomy in subnational distribution. In fact, the 1994 reform paradoxically formalized the fiscal decentralization continued throughout the 1980s by enshrining provincial fiscal autonomy in the Budget Law announced the same year. Thus sub-national distribution is now widely recognized as a process in which provincial leaders have considerable leeway to distribute as they see fit (Shih et al, 2007; Liu et al, 2009; Guo, 2009). Within provinces, distribution to counties and lower levels of government vary widely.

Additionally, these twin competing process of centralization in revenue collection and decentralization in distribution are the direct results of central government pursuit of two conflicting goals: regime stability and economic development[9]. This trend continues from the onset of economic reform to today, and extends to not only fiscal administration but all aspects of state governance. The state, due to its priority upon maintaining power and

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[8]Bahl, 1998 p.139

[9] The original concept of "social stability" is replaced here by "regime stability" in order to highlight the political aspect, in which the central leadership maintains its hold on power.

high costs of losing control in an authoritarian regime, seeks to consolidate and continue power by ensuring revenue and extractive capacity. Simultaneously, continuing economic development necessitates devolution of greater autonomy to provinces in order to encourage competition and local incentives toward growth. The push and pull between these conflicting processes characterizes fiscal policy and spills over into other aspects of China's governance and leadership behavior as well.

Therefore for the purposes of this study, we glean two important characteristics: distribution is increasingly decentralized, but the center worries about its priorities and seeks to keep the lower levels of government in line in order to ensure compliance on social stability issues. These characteristics explain the patterns of center-to-local distribution we see in this study. The following section covers local government incentives to distribute to TEMs – to comply with, and possibly deviate from, central directives.

3.4 Province-level Incentives for Distribution

3.4.1   Province-level Leadership Incentives

The above discussion warrants a major question about province-level distribution to TEMs. If provincial governments have sufficient autonomy over sub-national distribution, what incentive do they have to follow central priorities of regime stability? The explanation provided here is that province-level leaders face both mechanisms of compliance set in place by the center –personnel appointment power, and also autonomy in distribution to comply with such mechanisms and further their own career incentives. Because the center punishes officials whose mismanagement leads to, or proves unequal to the challenge of, ethnic

unrest, province-level leaders have strong incentive to prevent ethnic mobilization among TEMs near risky borders. At the same time, because provincial leaders have considerable discretion over distribution and a limited amount of funds, they have incentive to over-distribute toward TEMs in periods of high risk.

Personnel appointment and advancement in China is consistently linked to a number of key factors. As Shih et al (2012) note, economic development is a commonly identified top priority issue. Local leaders whose areas showed significant economic advances during their tenure are widely considered as strong candidates for top political positions. Implementation of central policy directives, such as the one-child policy, is also crucial. Whiting (2004) discusses the highly specific performance evaluations which weight economic development and family planning among other factors.

In this system, "social stability" or "regime need" (Shih et al, 2012) acts as a veto point. Broadly, Whiting's (2004) examples of performance evaluation factors cite maintenance of public order as a factor assessed outside the standard list. The category, although opaque, points to official management of outbreaks of violence, mass protests, and riots. While this category is not assigned a standardized set of points, accounts indicate failure to control public order disturbances, or even failure to prevent the outbreak of disturbances, reflects negatively on an official's performance. This category may be considered particularly weighted in that both central and regional officials have been known to lose their positions as a consequence of mass action. In counties, townships and villages, protests over corruption and local predation often result in a higher-level reaction to punish

local officials. For example, in 2011, mass unrest flared up over local corruption in the southwest Chinese village of Wukan. As a result of widely publicized riots, in which villagers drove out officials and barricaded themselves for 10 days, the provincial government interceded by punishing 20 officials and former leaders, and allowing unusually free village elections in which protest organizers were voted into office.[10]

Ethnic unrest serves as a particularly strong veto point for a variety of reasons, as noted in previous sections. Ethnic unrest represents a threat to central power, to both legitimacy of rule and to its abilities to keep a unified nation. The impact of ethnic unrest, both inside and outside the country, is profound enough to warrant immediate and heavy punishment for local officials. For example, following disastrous interethnic clashes and tensions in Tibet in 2009, successive party leaders and officials in Tibet were sacked or removed from positions of power.

Thus, regional officials have particular reason to prioritize management of unrest in TEM areas. In direct contrast to their known preferences in non-TEM areas, where provision of public goods is not a priority, local officials have incentive to cater to the public in TEM areas by providing social services. Province-level officials, conscious of the career damage ethnic riots can cause, have incentive to distribute earmarked grants to TEM counties and ensure spending, at the expense of non-TEM counties who may not receive the same benefits. This type of distortion mirrors the local-level perversion of incentives in which provinces squeeze county budgets and increase their responsibilities, at the expense of

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[10] Jacobs, Andrew. (2012 Feb 1) "Residents Vote in Chinese Village at Center of Protest". *New York Times*

public services and goods. Invariably during periods of high risk transfers distributed to TEMs take away from other areas, leaving other areas underfunded at the expense of TEM counties.

3.5 Conclusion

The discussion so far lays forth the idea that the incentives of authoritarian leaders, both central and local, are aligned in preventing and managing outbreaks of unrest in TEM communities. In the following chapters I test this theory. Chapter 4 first takes a country-wide sample and examines distribution of earmarked transfers from both center to province, and province to county. Chapters 5 and 6 look to case study evidence to provide both localized application of the theory, and also support of the idea that distribution leads to spending on measures which increase welfare in TEM localities.

CHAPTER FOUR

STATISTICAL ANALYSIS OF THE COUNTRY-WIDE SAMPLE

4.1 Introduction

In this chapter, I establish the association between foreign political risk, TEM populations near the border, and distribution of grants. As discussed previously, this dissertation argues foreign political risk diffusion in China creates the possibility of mobilization, which drives fiscal handouts. **I hypothesize the following: an increase in foreign political risk will lead to more grants to corresponding TEM areas close to the border**.

The chapter begins with a discussion of China's current fiscal system and theoretical debate on factors driving grant transfers distribution. Over the following pages, I support and advance my hypothesis using quantitative analysis of rare county-level data on fiscal transfers in China[1] from 1995 to 2003. Fixed-effects are used to test a three-way interaction between foreign political risk, TEM population share and proximity to the border on earmarked transfer outcomes at both county and province levels, and a battery of domestic and foreign controls are included. By using a variety of techniques to isolate individual interaction variable effects, I shed light on the factors driving transfer allocation and their substantive effects.

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[1]Kindly shared by Profs. Mingxing Liu and Victor Shih

4.2 Grants &Factors of Distribution

An examination of overall fiscal grants, or center-to-local transfers, in China shows a wide range of variation over a diverse, large geographical area. Transfers are distributed from the center to 31 province-level units and from the provinces, down to approximately 36,000 county-level units. Trends since fiscal reform in 1994 show overall, transfers have increased steadily. At the province-level, at first glance, minority or border regions do not seem to appear to receive more transfers. Fiscal transfer figures are disproportionately high in eastern coastal provinces of the country, traditionally far from TEM areas toward the borders and western regions.

However, fiscal transfers can be broken down into separate categories. Post-1994, China's fiscal system has relied on two major components: returned tax revenue and remaining intergovernmental transfers. Returned tax revenue, or "tax rebate subsidies" (*shuishou fanhuan buzhu*) is simply proportional to the amount of taxes collected by local government and remitted to the central government. Thus, wealthy provinces which generate greater tax revenue are likely to receive much more in terms of returned taxes[2].

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[2]It should be noted that the Chinese system of taxation relies heavily on industrial taxes, increasing tax revenue (and subsequent rebates) in favor of industrialized coastal areas to the East. This has the effect of further skewing allocations toward already wealthy coastal areas and away from poor inland provinces.

Table 4.1 Center-to-Local Transfers in China

Type of Transfers		Description
General-Purpose	**Revenue-sharing Transfers**	25% of VAT, 40% of enterprise income taxes and personal income tax,; collected by the center and redistributed as transfers to provinces
	Returned Taxes (Tax Rebates)	Formula-based share of tax revenue from each province, collected by center and returned afterwards. *shuishoufanhuanbuzhu*
	Equalization Transfer	Put in place in 1995 in an effort to ease widening regional disparities (transitory period grant until 2001; since 2002 called general purpose grant)
Specific-Purpose	**Old-system Transfers**	Transfers put in place during 1994 reforms to ensure provinces receive funds similar to pre-reform allocations, based on pre-reform center-province budget allocations
	Earmarked Transfers	Transfers designated ("earmarked") for specific policy purposes, also called ad-hoc transfers; *zhuanxiangzhuanyizhifu*
	Minority Region Transfers	Established in 2000 to support ethnic minority regions, formula-based
	Rural Tax Reform Transfers	Added in 2000 to cover government abolishment of rural fees, which traditionally financed village and township public services

In order to obtain a proxy for government grants it is necessary to exclude returned taxes from overall fiscal transfers. I instead look to earmarked transfers[3]. Among distributed subsidies, earmarked transfers (*zhuanxiang zhuanyi zhifu,* or *zhuanxiang buzhu*) are grants designated (or "earmarked") for various specific social and economic purposes and programs such as investment in resource development projects, education, alleviation of poverty, etc (Smart & Bird, 2009).[4] Earmarked transfers have increased as a share of total transfers, from 13.6% in 1995 to 33% in 2004. In particular, the fiscal stimulus programs of

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[3]Also known as ad-hoc discretionary transfers (Naughton, 2007)
[4]Under government mandate, earmarked transfers serve as a redistributive mechanism and should allocate greater resources to poor areas; however the effectiveness of earmarked grants in this regard has been questioned (Wong, Heady & Woo 1995).

1997-8 contributed to their increase in the form of capital construction channeled through earmarked subsidies. Much of these funds have been specially designated to address issues in agricultural and rural areas, although their effectiveness has been frequently questioned (Wong, 2007). Because the category is subject to considerable yearly variation at the discretion of central decision-makers, earmarked transfers have been used in the literature as a politically motivated form of fiscal transfers (Liu et al, 2009). Often when transfers are referred to in lay or media accounts these are earmarked of non-returned-tax categories.
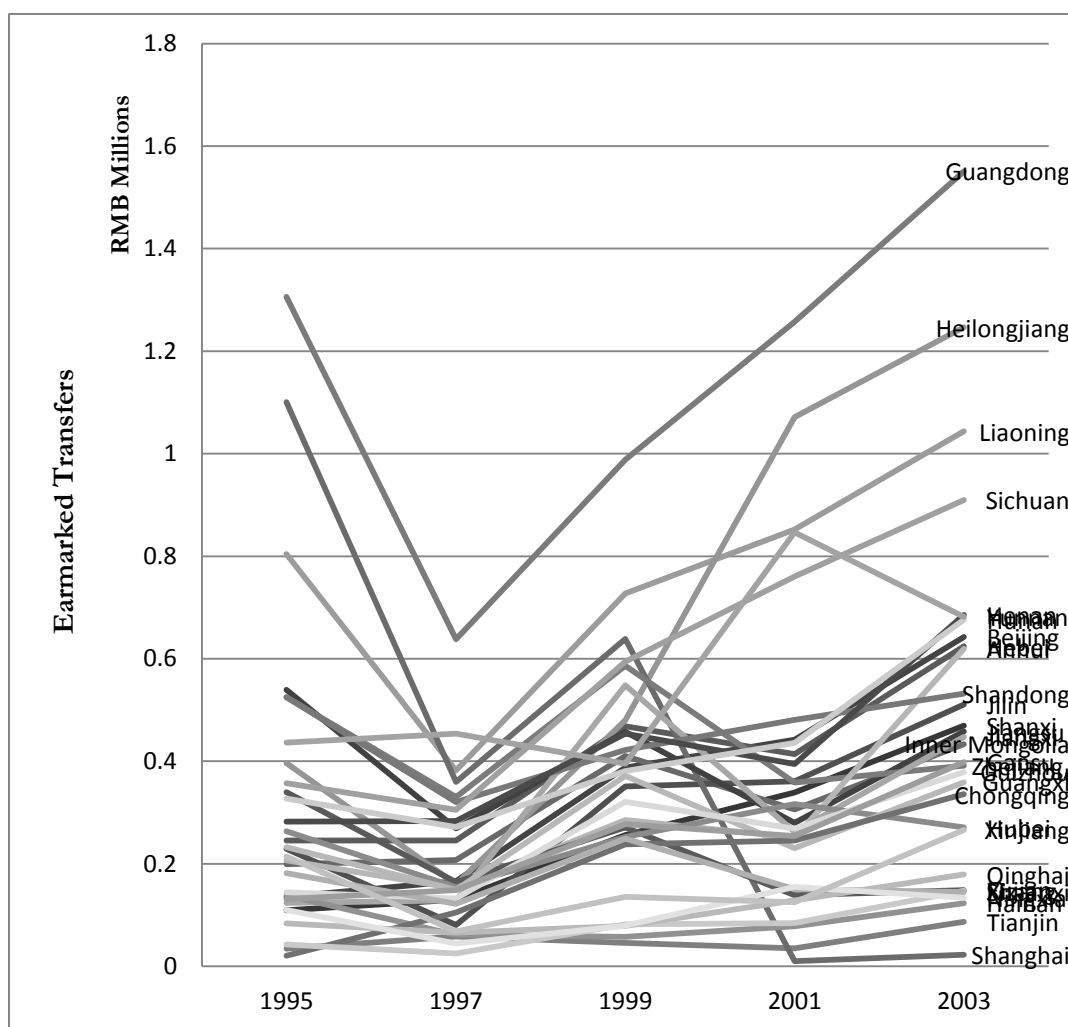
Figure 4.1 Province-level Variation in Earmarked Transfers, 1995-2003 (adjusted for inflation)

Earmarked transfers are of interest to this study because of their discretionary nature, which allows for policy-driven or politically motivated transfers. As Naughton(2007) terms, these are "ad-hoc discretionary transfers," or "discretionary central transfers"(Wang, 2005). Unlike other budget components, transfers are not conditional on revenue or based on a set formula. Because earmarked transfers are determined solely by policy-makers, and explicitly intended to further policy objectives, they provide a valuable measure of political will.

In addition, earmarked transfers serve as a major source of fiscal support to county level governments. Overall, county-level units and administrative levels below are particularly reliant on transfers, especially in comparison to the province or prefecture-level government. This dependence increases for poverty-stricken counties, especially in rural areas. In 1999, transfers financed fully one-third of aggregated expenditures at the county level, ranging upwards of 60 percent for nationally designated "poor" counties. As such, transfers play an important part in county and grassroots-level provision of goods and can serve as a suitable measure of government support to county and sub-county level localities.

4.3 Hypotheses

The discussion above necessitates one primary and two sub-hypotheses regarding intergovernmental fiscal relations in China:

H1: If an increase in foreign political risk occurs, we will observe greater earmarked transfers to counties proximate to the border with high TEM populations.

H1a: If an increase in foreign political risk occurs, province-level governments will give greater transfers to counties proximate to the border with high TEM populations.

H1b: If an increase in foreign political risk occurs, the central government will distribute greater transfers to provinces which have more counties proximate to the border with high TEM populations.

The following sections examine these arguments in the context of fiscal transfers to counties near the border with large TEM populations. How does center-to-province allocation differ from province-to-county? And how do we account for these differences? I use the results of statistical analysis to shed light on possible answers.

4.4 Empirical Strategy & Data

The empirical strategy employed in this chapter attempts to resolve issues inherent in the data and preceding analyses in the field. Among the key causal factors identified – TEM population share, foreign political risk, and proximity – data restrictions render two of these three factors time-invariant. The first, proximity, is clearly constant over time given constant geographical boundaries. The second, TEM population share, is problematic due to practical limitations in census-taking in China, in which detailed ethnicity data is only available at ten-year intervals. I simplify the problem by taking the 2000 minority population data measure

and using it to calculate a time-invariant measure of TEM population share of all counties in China[5].

A significant trend in the field has advocated yearly cross-sectional analysis with lagged dependent variables in cases of multiple time-invariant factors (see Goodrich, 2006; and response by Blaydes, 2006). But at the same time, we face the problem of unobserved heterogeneity – hidden factors of all kinds which influence transfers outcomes. Fiscal decision-making, like many other policy-making processes, is subject to influences that are often difficult to measure or quantify in the absence of institutionalized norms or regulations – for instance, personalistic ties between a locality and the leadership in the political center is often considered an influential factor in decision-making regardless of regime type, but difficult to capture or quantify accurately. Path-dependent budget allocation, again, can significantly influence outcomes but can be difficult to measure. The intricacies of bureaucratic decision-making are opaque (often intentionally so) to outside observers yet manage to change outcomes significantly. Yearly cross-sections with lagged DVs may fail to capture such hidden factors.

The spatial fixed effects approach employed in the following pages addresses these problems. Geographic fixed effects analysis proves appropriate in this situation because in an observational study such as this, we are faced with the problem of unit-level heterogeneity.

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[5] This method is a useful alternative to estimating and imputing missing data years. While we can hypothetically impute TEM population data based on waves in 1990, 2000, and 2010, the process requires using estimated year-data for almost all years between 1995 and 2003, a risky proposition. Given the relative constancy in ethnic minority population shares in most areas over the last few decades, using one wave to stand as a representative measure will likely yield greater accuracy in results.

For example, factors specific to administrative areas such as local government, special administrative area status, history, and other unique factors have the potential to create severe omitted variable bias. A unit-based fixed-effects approach is a particularly well-suited method of resolving this issue. By comparing counties and provinces over time, I automatically eliminate stable factors specific to these units which are consistent throughout the series. As we shall see, results of additional tests and robustness checks provide further support for using a fixed effects approach versus other methods of analysis.

The issue of time-invariant factors, which drop out in fixed effects analysis, is addressed by "blocking" data into three sections and testing for time-variant factor effects: a) high TEM counties on the border; b) high TEM counties inland (not on the border); and c) non-TEM counties. While this approach does not entirely solve the problem of time-invariant factors[6], it sheds further light on the results at hand. Simultaneously, the analysis tests for a three-way interaction of the main causal variables: TEM population, foreign political risk, and proximity to the border. The one time-variant causal variable of foreign political risk is varied over several measures.

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[6] Another widely known alternative to Blaydes'(2006) approach is the Fixed Effects Vector Decomposition method introduced by Plumper and Troeger (2007). However the method is difficult to use in cases of severely imbalanced panel data.

Table 4.2 Summary Statistics of Panel Data Variables

Variable	N	Mean	SD	Min	Max
Dependant Variable					
Earmarked Transfers	11371	103.155	151.142	-46.42051	6877.326
Causal Variables					
TEM Pop (% of Total)	11530	0.13133	0.27565	0	0.997226
CV1: State Fragility Index	11530	0.45419	0.14122	0.32	0.84
CV2: ONDD Political Risk	11496	0.67787	0.15896	0.3571429	1
CV3: ONDD Transfer Risk	11496	0.66899	0.22349	0.1428571	1
Proximity	11530	0.00105	0.03225	0.000000775	1
Controls					
GDPpc (per capita)	11530	300127	1666442	0	75600000
Urban Dummy	11530	0.16123	0.36776	0	1
Regime	11530	1.20555	0.60736	1	3

Data on the dependent variable is drawn from an original dataset which covers fiscal revenue and expenditures for all administrative units in China down to the county level, including 31 province-level units and 2,109 county-level units embedded within provinces[7], from 1995 to 2003, as well as a set of economic indicators. The current data is gathered from official compilations by the Ministry of Finance (*caizhengbu*) and the China Finance Yearbook (1996-2004), and highly valuable in that it is based on internal (*neibu*) sources not readily available to foreign researchers. In order to examine fiscal transfers to the county-level, I clean the data of all province and prefecture-level units. All figures are adjusted for inflation (national level deflator, base year = 2000). I discuss other aspects of the dataset and preparation process in the next section.

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[7]Excluding Special Administrative Regions(SARs) such as Hong Kong, Macao and Taiwan.

4.5 Causal Variables

Table 4.3 Description of Panel Variables

Variable	Measure	Source
Earmarked Transfers	County-level earmarked transfers from central government (*zhuanxiangbuzhu*) rmbyuan, adjusted for inflation, per capita, 1995-2003	Ministry of Finance, China (source: Victor Shih & Mingxing Liu)
TEM Population	County-level % of transborder minority corresponding to closest foreign neighbor, %, 2000 data (time-invariant)	China Statistical Bureau
CV1: State Fragility Index	Country-level composite measure of state fragility based on political, economic indicators, lagged	State Fragility Index (Polity IV Project)
CV2: ONDD Political Risk	Country-level direct investment risk ratings, composite measure, scale 1 to 7, 1995-2003, lagged	ONDD Credit Risk Data
CV3: ONDD Transfer Risk	Country-level direct investment risk ratings, transfer risk for 1yr, scale 1 to 7, 1995-2003, lagged	ONDD Credit Risk Data
Proximity	$1000*1/(1 + $ Distance from county center to closest foreign border), km, time-invariant, computed using GIS mapping software(ArcGIS) & China in Time and Space (CITAS) project maps	CITAS maps: Chinese Academy of Surveying and Mapping (CASM), University of Washington
County GDPpc	County-level GDP per capita, adjusted for inflation, 1995-2003, logged & lagged	Ministry of Finance, China
Urban Area Dummy	Dummy variable indicating districts in urban areas and county-level cities, 1995-2003	Ministry of Finance, China
Regime Type	Country-level coding of regime type (civilian, military-civilian, military, other) , 1995-2003, captures regime change and authoritarian-democratic divide, lagged	CNTS (Banks) Dataset
Trade	Country-dyad amounts of trade, 1995-2003, captures economic interdependence, lagged and logged.	CNTS (Banks) Dataset

The main time-variant causal variable in this study is **Foreign Political Risk**. As previously discussed, the main problem with current political instability measures is that these measure *after* the outbreak of violent or regime-changing events. I propose using a measure that captures risk *prior* to outbreaks. Here, the primary causal variable of foreign political risk is measured using CV1: State Fragility Index (SFI), a composite risk measure based on the Polity IV project which is used to forecast breakdown or averse changes in government. The data is extensive and covers both the time period of this study (1995-2003)

as well as the entire sample of countries involved. This measure includes but is not limited

to previously discussed measures in the literature, such as the Polity IV durability index

(Morrison, 2009) and has been gaining in use in the political science literature.

I vary this measure by using of foreign credit risk ratings (Jensen, 2008), country-

level political risk data[8] provided by the Office National du Ducroire (ONDD), a Belgian

public credit insurer and head of OECD country-risk expert working group activities[9]. I use

a composite measure of these risk factors[10] represented as "CV2: ONDD Political Risk." I

also look to transfer risk as an alternate measure and test my hypotheses using "CV3:

ONDD Transfer Risk." All of these measures are scaled from 0 to 1. Overall, political risk

ratings for 14 surrounding countries over 10 years (1994-2004) are used to test for a causal

effect upon transfers to corresponding neighboring provinces.

Foreign political risk is interacted with **TEM population share** and **Proximity**.

First, I use official Chinese census waves which include ethnic group identification to extract

---

[8] Data and files for preliminary data cleaning kindly provided by Benjamin Graham.

[9] Office National du Ducroire (ONDD) yearly data is based on assessments collected by the ONDD and the OECD country-risk expert group. While the ONDD data is based on OECD credit premiums, which draw on political and commerical risk assessments, the two are distinct in that the ONDD group may raise the credit risk rating of a country when needed, and provide individual assessments for states not included in the OECD risk assessment set.

[10] In the ONDD dataset, political risk is divided into seven different levels, ranging from 7 (highest) to 1 (lowest). The measure is also broken down into war risk, transfer risk, and risk of expropriation and government action. War risk, in particular, incorporates the probability of external and domestic violence, including but not limited to "civil war, domestic political violence also covers risks of terrorism, civil unrest, social-economic conflicts and racial and ethnic tensions" (ONDD website, 2009). Risk of expropriation and government action includes possible dysfunction on the part of the judiciary as well as government action. These assessments appear to be highly relevant to the project at hand. (http://www.ondd.be/WebONDD/Website.nsf/weben/Country+risks?OpenDocument accessed November, 2010)

transborder ethnic minority (TEM) shares in each county unit.[11] Chinese census figures on

ethnic minority populations have been released at 10-year intervals. Here I use year 2000

minority population figures as a time-invariant measure to easily obtain outcomes.[12]

TEM shares are extracted by constructing dyads between China and its neighbors

which identify the corresponding TEM groups for each country. For each county-unit in

China, I identify the closest land neighbor and sum the TEM populations assigned. For

example, counties closest to the North Korean border were assigned only the Korean

transborder minority population; other minorities who do not correspond to North Korea

(such as Manchus) were excluded. When multiple TEMs exist on either side of the border

the sum of such groups was assigned; for example, counties closest to Laos are assigned the

total sum of Bouyei, Dai, Hani, Jing, Lahu, Miao, and Yao ethnic groups (all of which are

TEMs corresponding to Laos) in each unit. All transborder minority population measures

are presented as a percentage of total county population[13].

Second, the **_Proximity_** of each county unit to the closest land border is included.

The effects of diffusion within geographically proximate units or regional clusters have been

---

[11]It is necessary to note China's 55 officially recognized minority groups do not follow divisions of self-identification common among certain minorities. For example, the Dai ethnic group in China includes sub-groups of Tai Lue, Tai Shan, etc which identify with distinctly separate groups of minorities in Thailand. For simplicity's sake this study simply aggregates all ethnic groups which correspond to the official Chinese definition of ethnic minorities. Issues of identity, self-identification versus imposed identity and possible complications will be discussed in future versions of this project.

[12]As an alternate specification, I also use 1990 and 2000 census ratios to estimate population percentage points in each year throughout the time-period of this study. Imputed results are roughly similar to results reported below. See chapter conclusion for a brief discussion of the implications of adding imputed data.

[13] I exclude populations under 1,000 persons.

previously identified in the literature. While distance data between neighboring states exists,

such data generally measures distance between capital cities or distance from capital to

border (Gleditsch, 2002). The use of capital cities as a starting point skews measures because

capital cities are rarely located at the geographic center point of a unit[14]. I resolve this

problem by creating a new measure of proximity. Using GIS spatial mapping methods, I

derive estimates of the geographic center of each county unit in China, and estimate linear

distance to the closest land border using maps of China and its administrative units (map

date: 1990)[15]. Thus, a county far inland would have low proximity score to its closest

neighbor and a county on the border would have a high proximity score. In order to control

for distances of 0, which when invert to infinity, I add 1 to the distance measure and

standardize by multiplying the final scores.[16]

4.6 Covariates

A set of covariates is added to control for effects not captured in the interaction or

fixed effects analysis. Among domestic variables, a primary control is **GDP per capita.** As

discussed earlier, a major factor discussed in the literature is that of redistributive

government. In this argument, rather than allocating according to political bargains, leaders

are expected to have incentive to allocate to the poor in society for reasons of socialist

---

[14]In the case of particularly large countries (such as Russia, for example) we find this type of measure ill-suited for the purpose of this project because they provide an inaccurate assessment of a county's actual distance to the border. Sources are based on official maps and geographic data provided by the Chinese Academy of Surveying and Mapping

[15]Chinese Academy of Surveying and Mapping (CASM), University of Washington China in Time and Space (CITAS) and Center for International Earth Science Information Network (CIESIN) (1996). China Administrative Regions GIS Data: 1:1M, County Level, 1 July 1990. From: China Dimensions Data Collection. Palisades, NY: CIESIN.
http://sedac.ciesin.columbia.edu/china/admin/bnd9071/bnd9071.html, retrieved Spring, 2010.

[16]Islands and special administrative areas such as Hong Kong, Macao, etc excluded.

legitimacy, public mandate, or expectations of rising challenges – regardless of regime type –

in the event of severe economic disparities and cleavages. Another competing argument cites

the opposite phenomenon: that low income or less developed areas simply receive less and

high income areas receive more, due to extraction potential or other reasons which support a

purely rent-seeking, repressive government.[17] In this image economic disparities are

increased rather than decreased by fiscal policies.

I use GDP per capita data[18], to serve as a proxy for development. County GDP per

capita is expected to be correlated with both dependent and causal variables. Minority

populations are on average poor compared to other social groups in China; border

populations are also traditionally less economically developed than central areas. Nationally

designated poverty areas[19], for example, are heavily minority-oriented and are also

concentrated in border regions. If income, not foreign political risk or transborder minority

population, were to determine allocation of transfers, one expected outcome is that we

should see support for a theory of "benevolent" or "redistributive" government – thus less-

developed areas should simply receive more transfers[20].

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[17]Shih et al, 2008

[18]It is necessary to acknowledge figures of publicly available estimates of income in China have been noted to be problematic for some time. Income reports rely on official data from the National Statistics Bureau of China (NSB) based on the annual Urban Household Survey (*chengshijiatingdiaocha*), which covers all 30 provinces and includes 30,000 to 40,000 households in urban areas and 60,000 to 70,000 in rural areas (Wu & Perloff, 2005). Publicly available statistics separate income into urban and rural income, and further provides income data at only intervals, rather than overall summary statistics for the entire sample. Distinctions between urban and rural areas and populations are not clearly delineated and may be subject to change by year or by administrative area. Thus, it is difficult to produce an accurate estimate of province or national income averages. Also incentives to inflate data for self-advancement purposes have been widely noted.

[19]Transfer subsidies to Nationally Designated Poverty Areas are literally, "Border Area Subsidies (*bianjiangdiqubuzhu*)." (Shih et al 2008: 27).

[20]Here I use adjusted county GDP per capita figures (base year = 2000), in Chinese RMB yuan.

Another competing hypothesis points to urban areas which may receive the lion's share of fiscal transfers, versus rural areas, due to government policies which tend to favor urbanization and industrial centers over agricultural farmlands. Also because urban districts in large cities have only small amounts of fiscal independence compared to their rural or small-city counterparts[21], inclusion into the sample presents difficulties in interpreting outcomes. I therefore follow the convention in the literature by distinguishing counties that are county-level cities or districts in major urban areas[22], constructing an **Urban Dummy** variable in order to capture the effects of urban districts upon transfers[23]. Given the rapid urbanization and administrative changes over the years of this sample, I assume this variable is time-variant.

Finally I take foreign country-level variables into consideration. The **Regime** type of the neighboring country is often argued to be related to both the causal and outcome variables in question. Military regimes are argued to be more unstable – higher foreign political risk – and areas next to certain regime types may attract policy-driven transfers because of traditional close trade and diplomatic ties between former communist regimes. By including this variable, I hope to control for regime effects.

In addition, I control for time-invariant county and province-level factors cited in the literature such as general administrative designations, special national poverty county or

---

County GDP per capita data is taken from our dataset, originally based on Chinese government data. While official government GDP data is acknowledged to be problematic it is the most appropriate measure we have at the moment which meets the purpose of this study.

[21]Shih et al 2008

[22]Shih et al 2008

[23]Dummy codes 1 for districts embedded in urban areas, and 0 for others.

minority autonomous area status, geography, size, history and natural resources, by using fixed-effects analysis. This technique conveniently allows us to control for a large cohort of variables, eliminating most confounding factors.

The correlation matrix is provided in Table 4.4 (see following pages). Beyond the expected correlation levels, we note CV2 and CV3 are particularly highly correlated at 0.93, yet results for tests in the following pages differ dramatically. We take this to denote that CV2 and CV3 differ primarily for TEM counties on the border. Results for transfer risk and political risk diverge sharply in size and occasionally direction only for this bloc of data in comparison to other counties. While this point bears further investigation, it is possible that any limited difference between the two CV measures is concentrated in a few countries. Block A sample regression results in the next section shed further light on this distinction.

Table 4.4 Correlation Matrix of Independent Variables

	TEM pop	CV1	CV2	CV3	Proximity	GDPpc	Urban Dummy	Regime	Trade
TEM pop	1								
CV1: State Fragility Index	0.0819	1							
CV2: ONDD Political Risk	-0.2844	0.3531	1						
CV3: ONDD Transfer Risk	-0.3703	0.2215	0.9387	1					
Proximity	0.0992	0.0273	-0.0544	-0.0623	1				
GDPpc	-0.0458	0.0229	0.043	0.0623	-0.0058	1			
Urban Dummy	-0.1318	-0.0624	0.0656	0.0952	-0.0141	0.0543	1		
Regime	-0.0744	0.8965	0.2733	0.1325	-0.0109	0.0025	-0.0777	1	
Trade	0.1824	-0.0443	-0.41216	-0.3371	0.0738	-0.0178	0.0188	-0.148	1

4.1 Findings

In the following section, I use county and province-level fixed effects analysis to test the 3-way interaction on fiscal transfers. The transfers data was prepared by first cleaning the data of missing observations.. In order to first carry out the county fixed–effects analysis I restrict my sample to county-level units.[1] I vary the causal variables and controls for added scope and depth, and show additional tests for the center-province distributional relationship.

County Fixed Effects

Do we observe an increase in fiscal transfers to TEM areas near the border following an increase in foreign political risk? The results and evidence provide considerable support for H1, and the county-level fixed effects results support H1a. As Table 4.3 illustrates, the county-level fixed effects regression analysis shows positive and significant coefficients on the 3-way interaction between foreign political risk, TEM population and proximity to the border, for two out of three causal variables (CV1 and CV3). The results for CV1: State Fragility Index show a large 24,248.984 RMB yuan increase in transfers for a 1-standard deviation increase in the interaction (TEM pop*CV*Proximity). GDP per capita is negatively and significantly associated with transfers each time, although the effect is very small – approximately 6 yuan per capita for each standard deviation decrease in GDP. This lends support to the argument that earmarked transfers have only a very slight redistributive effect, if any.

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[1]The county-level transfers dataset was then merged with data on county-level minority population and proximity to the border. Because each set of data follows a different format of standardization we face an inevitable loss of observations in this process, and the net total of remaining observations is approximately 16,000.

These results remain constant over different measures of the causal variable. I vary the measure for **_Foreign Political Risk_** using CV2: ONDD Foreign Political Risk, which shows an 11**,**540.073 RMB yuan increase in fiscal transfers following a 1-standard deviation increase.[2] CV3, which is a measure of economic transfer risk taken from ONDD risk measures, shows an equally strong relationship, with an 8**,**195.076 RMB yuan increase in fiscal transfers following a 1-standard deviation increase in the interaction.

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[2]Calculation of significant coefficients involving the main CVs: (512252.120 - 500712.047) = 11 540.073. Note coefficients are not scaled in this version; future versions will show transfers in units of 10,000 RMB yuan.

Table 4.5 County Fixed Effects Results

	CV1 **State Fragility Index**	CV2 **ONDD Political Risk**	CV3 **ONDD Transfer Risk**
logged CV	-91.429	-7.360	8.479
	(48.21)	(51.92)	(13.12)
TEM Pop * CV	160.798	-85.395	-135.718***
	(198.21)	(107.39)	(33.99)
CV * Proximity	-1129173.777***	-517449.537***	-368303.964***
	(277096.07)	(122240.80)	(17542.25)
TEM Pop * CV	1153404.487***	529406.628***	376633.609***
** * Proximity**	(283564.91)	(125091.04)	(17950.39)
logged County GDP	-3.968***	-4.669***	-4.550***
	(0.82)	(0.70)	(0.61)
Regime	-35.852	-36.156	-30.695
	(29.28)	(29.41)	(29.33)
logged Trade	53.077***	48.466***	50.598***
	(9.77)	(11.85)	(9.39)
Constant	26.139	29.059	4.608
	(53.84)	(82.89)	(54.92)
N-grps	1695	1695	1695

* p<0.05** p<0.01*** p<0.001; Robust standard errors in parentheses

Because the models incorporate 3-way interactions, I utilize a set of graphing

methods which depict each causal variable's marginal effect upon the dependent variable

(earmarked transfers) as conditioned by interacting variables (Brambor, Clark and Golder,

2006). For example, the first graph represents the marginal effect of foreign political risk

CV1: State Fragility Index on transfers, in relation to TEM population share increase (shown

on the horizontal axis). The multiple lines are set at different levels of proximity, with a thick

black line representing counties close to the border (proximity>75% (fourth quartile)) and

thinner lines representing counties further away from the border. Stars above lines indicate a

significant relationship. As we can see, for all three measures of foreign political risk, areas

close to the border show a markedly stronger relationship. Counties close to the border

experience overall positive effects, and the MEs increase as TEM population share increases.

Counties far from the border show less change or even negative marginal effects despite

increasing foreign political risk. These results again support my theory: counties close to the

border with high TEM share receive more transfers after an increase in foreign political risk,

while counties far from the border see little to no effect.
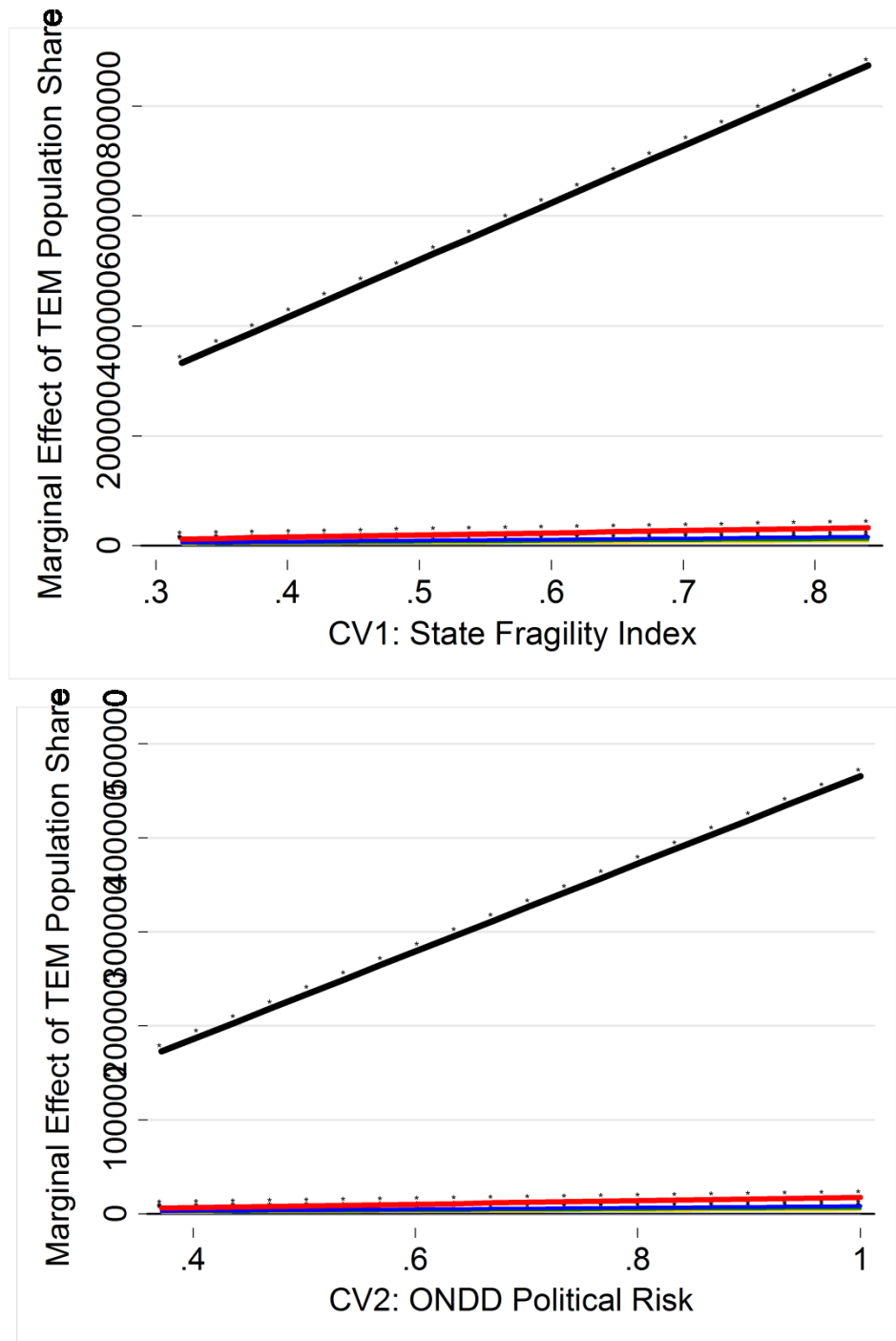
Figure 4.2 Marginal Effect of TEM Population Share upon County Fiscal Transfers as CVs 1~3 Increase

Starred line (******) indicates significance at the 95% level
Bold line: proxn>75%   Thin line: proxn<75%
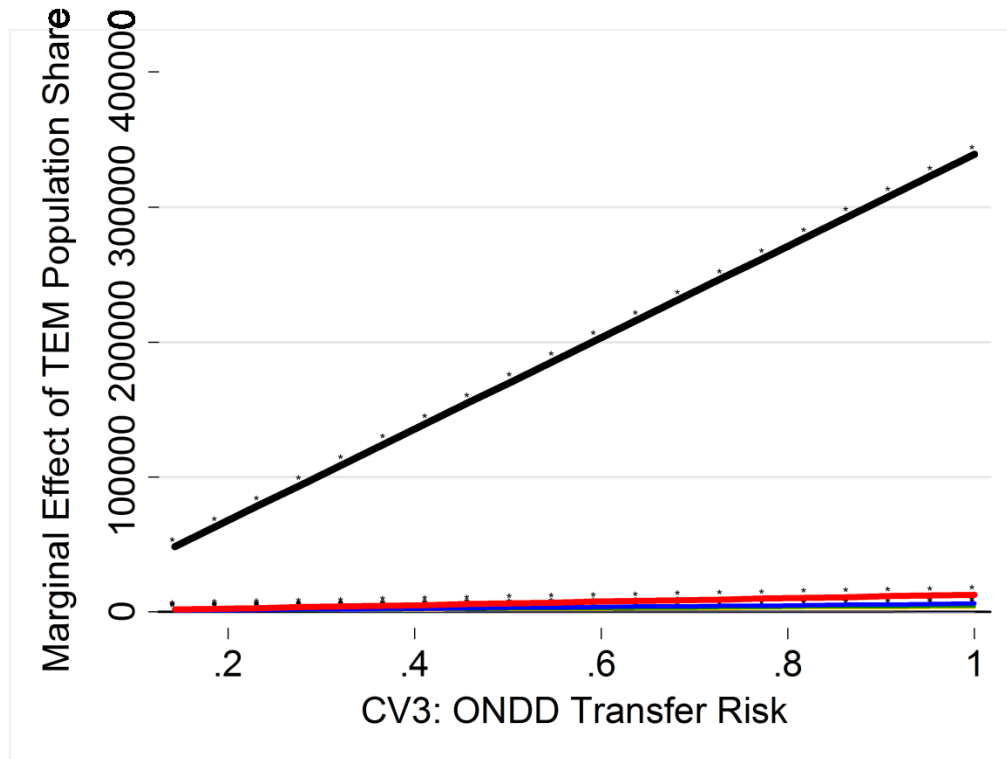
Figure 4.2 Marginal Effect of TEM Population Share upon County Fiscal Transfers as CVs 1~3 Increase (figure continued from previous page)
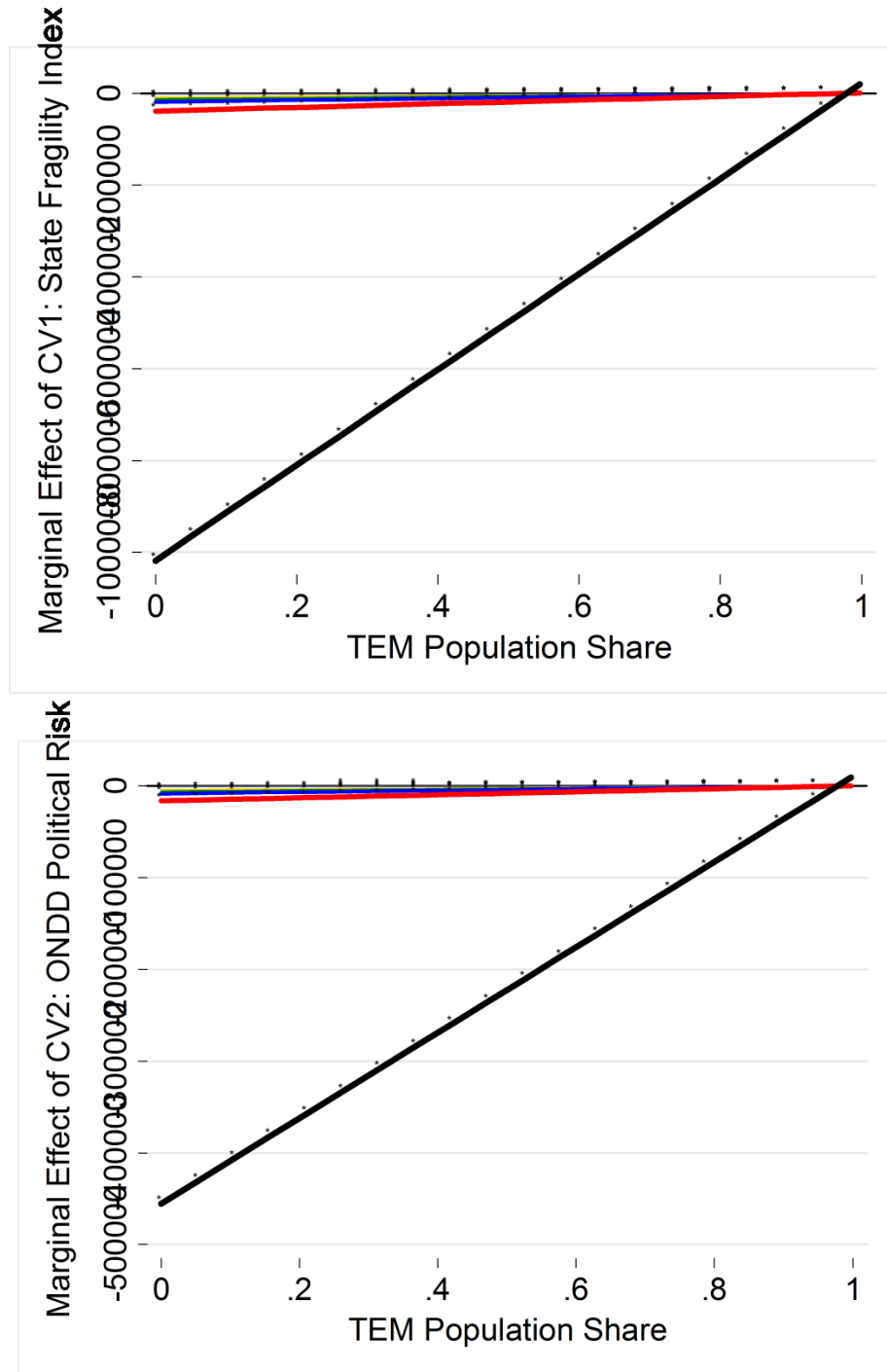
Figure 4.3 Marginal Effect of CVs 1~3 upon County Fiscal Transfers as TEM Population Share Increases

Starred line (******) indicates significance at the 95% level
Bold line: proxn>75%   Thin line: proxn<75%
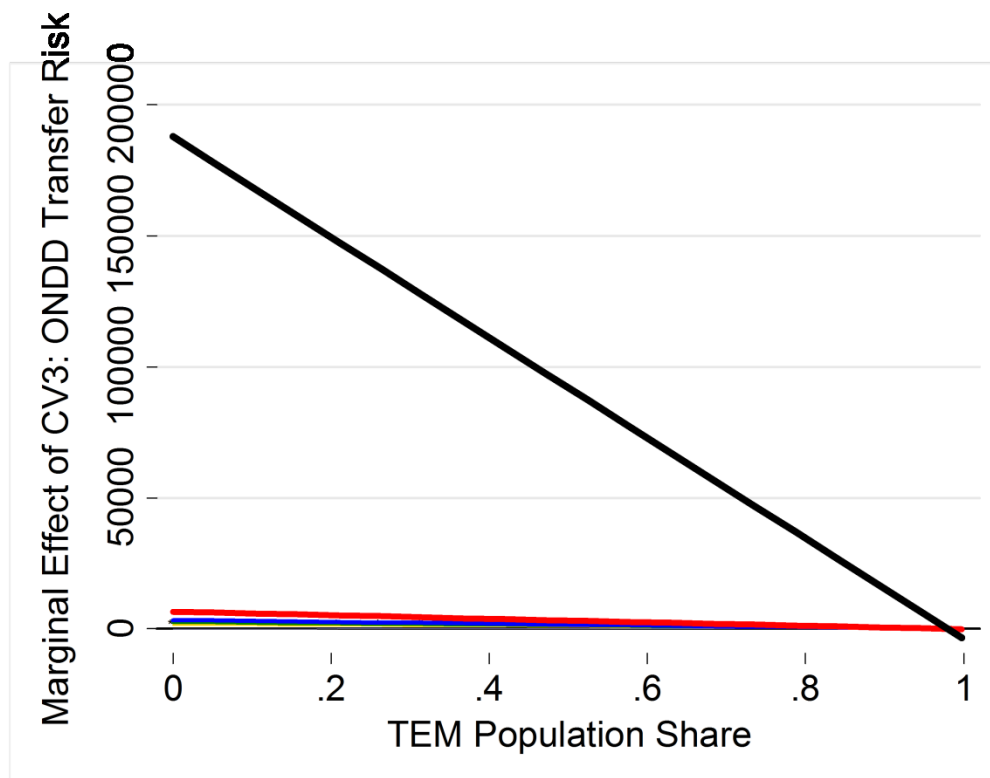
**Figure 4.3 Marginal Effect of CVs 1~3 upon County Fiscal Transfers
as TEM Population Share Increases (figure continued from previous page)**

From the coefficients shown above we can see that the interaction between foreign political risk and proximity is significant and also negative. Therefore counties close to risky borders in general receive lower levels of transfer grants, and TEM presence simply increases their received transfers back to comparable levels. This is likely explained by aggregate levels of "political distance from the center" in areas bordering states with high foreign political risk. Traditionally border areas in China (*bianjiang diqu*) have been associated with political marginalization, poverty, lawlessness, and general "backwardness." Thus border areas are on average less important to central government, or politically distant, compared to other areas of the country (regardless of actual geographic distance from Beijing). It is possible that fiscal transfers to TEM areas on the border have a more "equalizing" effect. That is,

counties on the border who would otherwise be disadvantaged by the center receive a boost

in transfers because of TEMs who channel rising foreign political risk.

Province Fixed Effects

At the province level, the results are mixed. Statistical analysis with province fixed

effects produces coefficients which show a similarly significant and positive relationship for

the three-way interaction using CV1 State Fragility Index. For CV2 and CV3, however, the

relationship is not as strong.

Based on calculations of coefficients, we can see that the overall coefficient for the 3-

way interaction involving CV1 is 36,169.943,[3] or a 36,169.943 RMB yuan increase in

transfers for every 1-standard deviation increase in foreign political risk. Interaction terms

involving CV2 and CV3, however, do not seem significant. County GDP is also negatively

and significantly associated with earmarked transfers. Here the redistributive effect is even

smaller than the county model – approximately 4 to 5 yuan per capita.

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[3] -3388086.899-2000832.844+1952545.816+91.435-166.927+3472619.362 =36169.943

Table 4.6 Province Fixed Effects Results (Province Dummies)

	CV1 Model1.3	CV2 Model2.3	CV3 Model3.3
<u>Causal Variables</u>	**Earmarked Transfers**		
State Fragility Index	-166.927**		
	(57.57)		
ONDD Political Risk		-74.829	
		(39.13)	
ONDD Transfer Risk			-61.997***
			(16.24)
TEM Pop	91.435*	67.390	41.864
	(36.40)	(53.41)	(22.34)
Proximity	1952545.816**	-412839.369	-40171.766
	(621079.64)	(336642.62)	(65055.86)
TEM Pop * State Fragility Index	22.188		
	(81.51)		
TEM Pop * ONDD Political Risk		40.102	
		(84.79)	
TEM Pop * ONDD Transfer Risk			90.409*
			(41.15)
TEM Pop * Proximity	-2000832.844**	422333.905	41366.638
	(634462.62)	(344502.83)	(66509.77)
State Fragility Index * Proximity	-3388086.899**		
	(1111660.77)		
ONDD Political Risk * Proximity		1027309.729	
		(797879.40)	
ONDD Transfer Risk * Proximity			217688.099
			(319778.77)
TEM Pop * State Fragility Index * Proximity	3472619.362**		
	(1135631.23)		
TEM Pop * ONDD Political Risk * Proximity		-1049958.635	
		(816511.98)	
TEM Pop * ONDD Transfer Risk * Proximity			-222134.474
			(327157.85)
<u>Controls</u>			
Domestic			
County GDP	-4.662***	-5.258***	-4.951***
	(1.10)	(1.04)	(1.20)

Table 4.6 Province Fixed Effects Results (Province Dummies)
(table continued from previous page)

Foreign			
Regime	77.276***	46.634***	43.981***
	(12.32)	(9.60)	(4.20)
Constant	771.345*	797.772***	787.451*
	(352.17)	(41.52)	(351.68)
N	12633	12598	12598

* p<0.05** p<0.01*** p<0.001; Robust standard errors in parentheses
All time-variant IVs lagged; Drops omitted variables (Urban Dummy, etc)

Province-level graphs, again, show mixed results in comparison to county-level graphs. The marginal effect of TEM population share is consistently positive and significant over CVs 1~3. In particular, the figure for CV3; State Fragility Index shows the marginal effect of TEM population share increases with risk increase *only* if the province is close to the border; in all other provinces , the marginal effect is positive but shows little change in spite of risk increase.
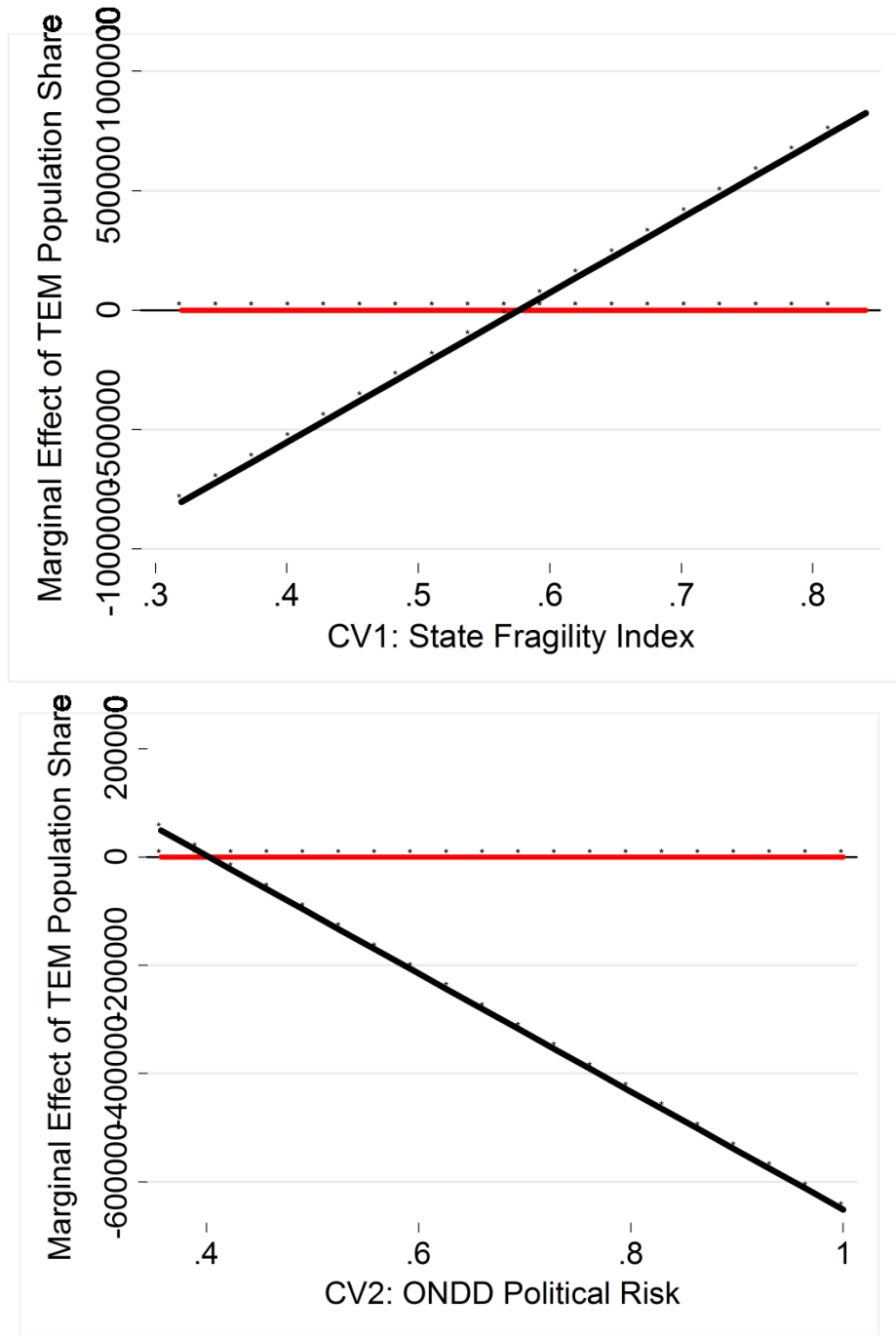
Figure 4.5 Marginal Effect of TEM Population Share upon Provincial Fiscal Transfers as CVs1~3 Increase

Starred line (******) indicates significance at the 95% level
Bold line: proxn>75%   Thin line: proxn<75%
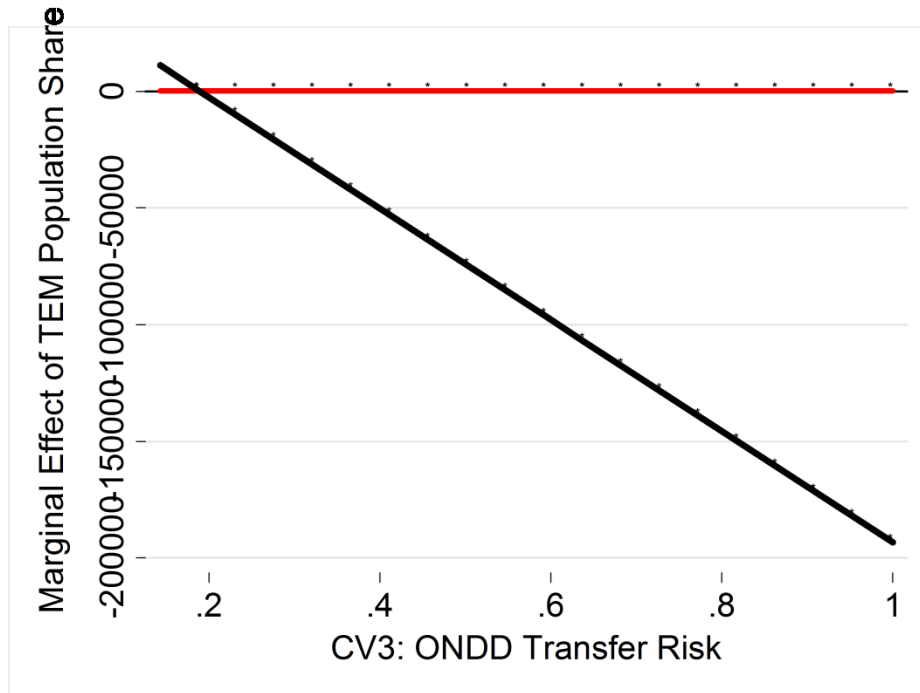
Figure 4.5 Marginal Effect of TEM Population Share upon Provincial Fiscal Transfers as CVs1~3 Increase (figure continued from previous page)
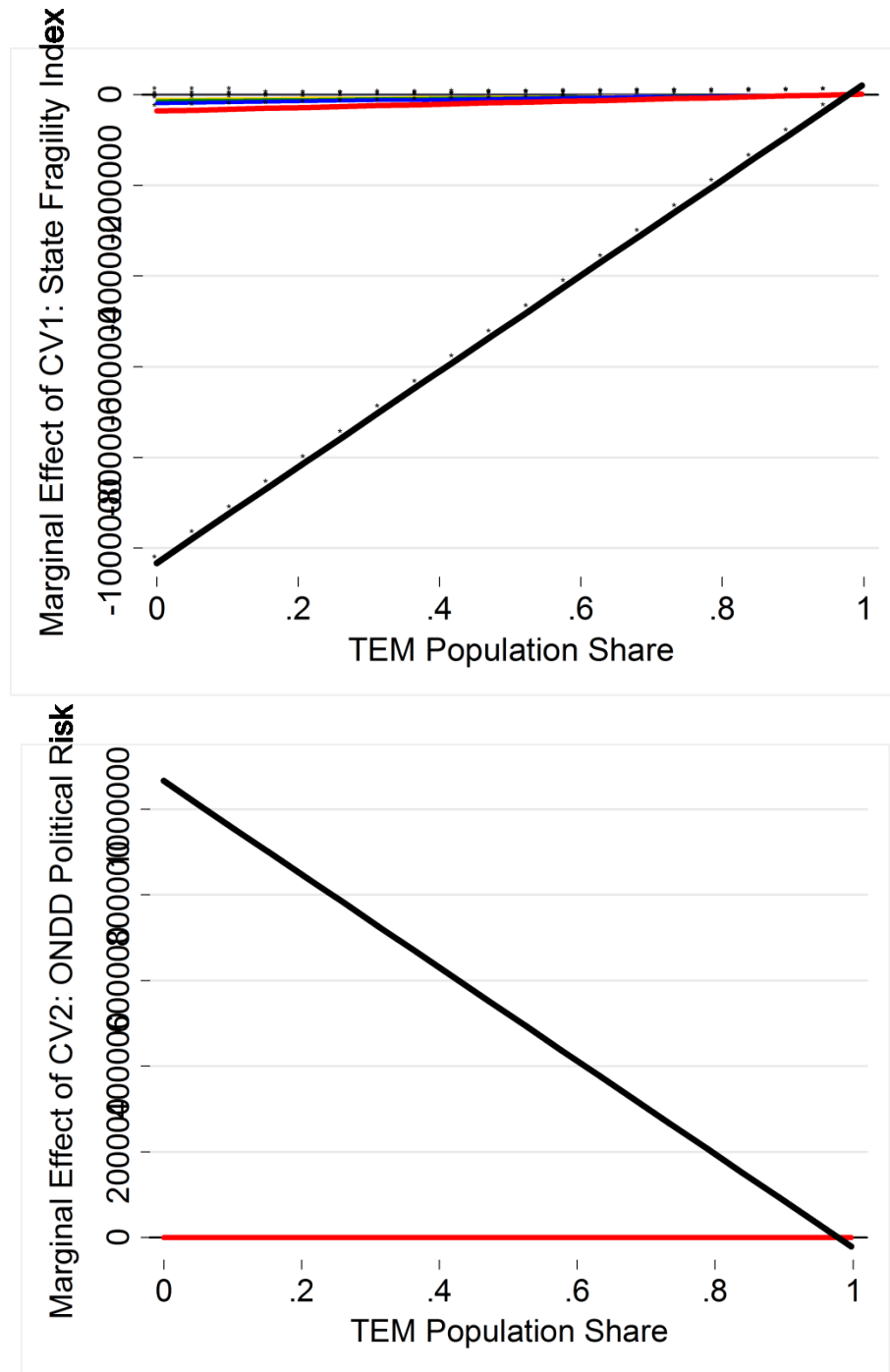
Figure 4.6 Marginal Effect of CVs 1~3 upon Provincial Fiscal Transfers as TEM Population Share Increases

Starred line (******) indicates significance at the 95% level
Bold line: proxn>75%   Thin line: proxn<75%
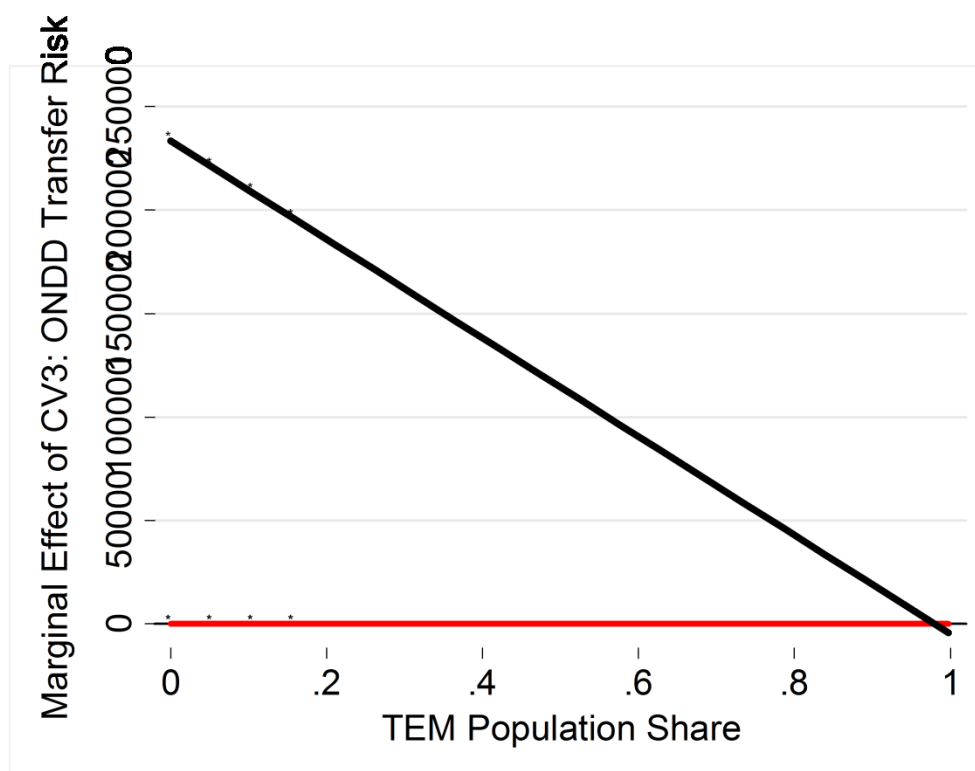
**Figure 4.6 Marginal Effect of CVs 1~3 upon Provincial Fiscal Transfers
as TEM Population Share Increases (figure continued from previous page)**

"Blocked" County-level Fixed Effects

The 3-way interaction with fixed effects is further complicated by the two time-invariant factors, proximity and minority population. Time-invariance does not compromise the integrity of the data itself, since proximity of a county to a neighboring country is obviously static given borders have been constant, and statistics on minority population shares have changed very little over the entire country through the time period of this study. However, time-invariant factors are problematic because fixed-effects analysis omits these factors (see discussion between Goodrich, 2006 and Blaydes, 2006). In order to bypass the interaction and avoid using time-invariant factors I test foreign political risk on "blocks" of

data: a. TEM counties on the border, b. non-border TEM counties, and c. non-TEM counties. Again, the findings hold: I find a significant and positive relationship between foreign political risk and grant transfers in block a, and negatively significant relationships for b and c.

Table 4.7 County-level Fixed Effects, Block A: Border TEM counties
Block A Cutoff: TEM pop share > 30%
Proximity>90%

	CV1 State Fragility Index	CV2 ONDD Political Risk	CV3 ONDD Transfer Risk
*ln*CV	450.932*	-45.995	4.327*
	(195.17)	(52.62)	(117.53)
*ln*GDPpc	-3.048	-3.522	-4.131
	(3.73)	(4.19)	(4.10)
Regime	.	.	.
	.	.	.
*ln*Trade	-81.486***	-73.085***	-75.558***
	(3.55)	(3.98)	(2.33)
Constant	121.458**	132.304**	128.958**
	(37.07)	(39.42)	(38.28)
N-grps	112	112	112

* p<0.05** p<0.01*** p<0.001
Robust standard errors in parentheses

The current regressions for Block A show the top 10% of counties (>90%) by proximity to the border, with TEM share > 30%. The sample is roughly 112 counties. As can be seen, results are positive and significant for CV1 and CV3. Trade has a strong negative impact on the dependent variable for all three measures of foreign political risk. The

trade variable is a country-level indicator of trade with China, leading us to infer lower levels

of transfers to areas next to countries that trade more with China. Results are also as

expected for Blocks B and C.

Table 4.8 County-level Fixed Effects, Block B: Non-Border TEM counties
Block B Cutoff: TEM pop share>30%
Proximity<90%

	CV1 State Fragility Index	CV2 ONDD Political Risk	CV3 ONDD Transfer Risk
*ln*CV	-95.065	-409.356**	-242.673***
	(175.43)	(122.69)	(46.31)
*ln*GDPpc	-0.671	2.676	4.708
	(4.55)	(5.21)	(5.25)
Regime	2.136	-2.339	5.949
	(5.38)	(5.24)	(3.85)
*ln*Trade	76.511	72.530	95.433
	(49.32)	(49.06)	(51.77)
Constant	-231.861	26.825	-219.664
	(280.98)	(235.50)	(272.08)
N-grps	166	166	166

* p<0.05** p<0.01*** p<0.001
Robust standard errors in parentheses

Table 4.9 County-level Fixed Effects, Block C: Non-TEM counties
Block C Cutoff: TEM pop share<30%

	CV1 State Fragility Index	CV2 ONDD Political Risk	CV3 ONDD Transfer Risk
*ln*CV	-117.671	-212.704	-91.232
	(60.80)	(138.02)	(56.94)
*ln*GDPpc	-5.104	-6.774*	-5.527*
	(2.64)	(2.83)	(2.16)
Regime	.	.	.
	.	.	.
*ln*Trade	27.980	-1.693	13.368
	(24.39)	(37.78)	(28.23)
Constant	105.131	325.717	174.306
	(104.42)	(258.35)	(158.76)
N-grps	1620	1620	1620

* p<0.05** p<0.01*** p<0.001;
Robust standard errors in parentheses

Random Effects

Finally, I follow Shih et al (2008, ms) in also using GLS random-effects analysis to obtain results. Province-units are likely to be interrelated, causing problems in our previous OLS analysis. GLS analysis solves for this issue by serving as a foil for the OLS fixed-effects results presented earlier. The relationship shown here is again strong for CV1, and mixed for CV2 and CV3.

Table 4.10 Province GLS Results

	CV1 Model1.3	CV2 Model2.3	CV3 Model3.3
<u>Causal Variables</u>	**Earmarked Transfers**		
State Fragility Index	-204.974**		
	(73.67)		
ONDD Political Risk		-107.058*	
		(47.07)	
ONDD Transfer Risk			-85.010**
			(25.85)
TEM Pop	91.748	52.026	23.589
	(57.81)	(70.71)	(33.37)
Proximity	1695757.754***	-158609.358	14968.945
	(332837.48)	(374313.42)	(25045.97)
TEM Pop * State Fragility Index	21.950		
	(121.71)		
TEM Pop * ONDD Political Risk		64.476	
		(111.22)	
TEM Pop * ONDD Transfer Risk			121.784*
			(59.47)
TEM Pop * Proximity	-1737978.042***	162162.132	-15058.688
	(340835.09)	(383053.16)	(25629.24)
State Fragility Index * Proximity	-2942090.390***		
	(567224.07)		
ONDD Political Risk * Proximity		415823.767	
		(880958.40)	
ONDD Transfer Risk * Proximity			-4481.444
			(146687.62)
TEM Pop * State Fragility Index * Proximity	3016081.052***		
	(580872.72)		
TEM Pop * ONDD Political Risk * Proximity		-424181.654	
		(901531.36)	
TEM Pop * ONDD Transfer Risk * Proximity			5220.948
			(150118.35)
<u>Controls</u>			
Domestic			
County GDP	-4.516***	-5.318***	-4.897***
	(1.08)	(0.97)	(1.20)

Table 4.10 Province GLS Results (table continued from previous page)

Regime	82.942***	49.848***	45.164***
	(16.23)	(13.04)	(7.26)
Constant	786.031	824.978***	808.633*
	(403.19)	(55.24)	(405.32)
N	12633	12598	12598

* p<0.05** p<0.01*** p<0.001; Robust standard errors in parentheses
All time-variant IVs lagged; Omitted variables excluded

4.2 Implications for Theory

The results lead to interesting implications for my theory. First, as previously discussed, it shows strong support for an association between foreign political risk, TEM presence and transfers to areas in China near the border. The relationship remains prominent throughout a variety of tests, and corroborates my account of greater government handouts to ethnic minority areas with high risk of spillover of political instability. The results force us to think differently about central government expectations of foreign political risk diffusion and co-ethnicity in China and its effects on domestic policy. While domestic and foreign policy are often considered separate realms in studies of Chinese politics, here we find strong evidence foreign political risk is a driver of fiscal policy-making within China's borders.

Second, TEM effects are pronounced. In fact the results appear to be driven by TEM presence relative to other variables; that is, while the overall interactive effect drives transfers, TEM increase has the largest and most pronounced marginal effect upon the

dependent variable. Proximity in particular shows a sharp falling off in effect as we move farther away from the border (see Figures 4.1~4.2).

This implies new avenues of research and factors of consideration in not only fiscal policy studies but also studies of minority politics in China. Despite much political rhetoric and even scholarly research (Zhan, 2011) to the contrary, ethnic minorities are demonstrably attracting greater handouts from the government. Further, a certain *type* of ethnic minority appears to be receiving more: transborder ethnic minorities near countries with high political risk. By identifying this within-group variation, we find that the risk factor of a set of individuals, or viability of its challenge to the central leadership, determines its salience to government policy. This distinction has the potential for further implications for other types of government-minority relations in China and elsewhere.

In terms of distributional outcomes, TEM presence serves as an "equalizing mechanism," ensuring transfers to otherwise disadvantaged minority border areas. This is illustrated by the fact that areas close to the border with high foreign political risk usually receive *less* than other counties– as we have discussed, due to poverty and other issues – but actually receive *more* when they have high levels of TEM population share. Again, by demonstrating how the leadership targets handouts to these areas, I show how the causal variables identified here are salient to fiscal policy outcomes and in addition, shed light on the logic of allocation of goods in the context of an authoritarian regime.

Third, a comparison of results at both the county and province levels offers support for the main hypothesis at multiple administrative levels, but also highlights differences in incentives at center-province versus province-county distributive levels. From the strong findings at the county level, we can see that provincial officials have incentive to distribute to TEM counties near high-risk borders. A possible explanation is that province-level officials have incentives to prioritize ethnic stability even in situations where the center does not distribute with the goal of supporting such areas. Provincial officials face strong career incentives to prevent ethnic unrest: following severe and widely publicized ethnic demonstrations and riots in Xinjiang province in 2008, provincial party secretary Wang Lequan was removed by the central leadership and several officials were subsequently demoted (Fairclough, 2010). Given the nature of punishment, it is logical to expect province-level governments to prioritize stability by preventing spillover of foreign political risk via TEMs. It is also possible to argue province-level payroll funds or other types of transfers confound these results. Further measure of foreign political risk and additional controls, in particular payroll impact at the province level, will be added to clarify this relationship, and the variation in these relationships provide the basis for research in Chapters 5 to 6.

Additionally, it is important to note that the center-province results are weaker than those at the county-level. Among the two data sources used for the foreign political risk variable, the State Fragility Index shows a positive and significant relationship while ONDD data does not. While this on surface points to dissimilarities between the two data measures, the difference between province and county also indicates greater heterogeneity at the

county level. As discussed earlier in this chapter, decision-making on budget allocation may be influenced by a number of factors not necessarily obvious to outside observers. Political affiliation based on personalistic ties or patronage, for instance, may influence province-county distribution. A locality that is politically "close" to Beijing may receive more while the current leadership is in power. Historical path-dependence, sudden natural disasters, and other factors may attract funds from higher levels. More work is needed, again, to clarify and add factors in order to show the difference between province and county-level distribution.

4.3 Alternate Approaches

Yearly cross-sections with lagged dependent variables diverge markedly from fixed and random effects models, showing that the fixed effects model captures – and provides for – omitted variables otherwise undetected. In yearly cross-sectional models, the relationship between key causal factors and the DV no longer appears significant and on occasion, appears negative rather than positive. It appears that earmarked transfers are correlated in general with pension spending, and redistributive in nature – transfers are positively correlated with county GDP. Adding fixed effects produces dramatically different results, which leads to strong support of the idea that county-specific characteristics are responsible for the initial findings.

The gap points to heterogeneity at the province and county level that cannot be captured through any other model or method. The nexus of fiscal decision-making lies with the central government; however the factors that determine how the center, provinces and

counties dole out money are myriad, and this study identifies TEMs on the border next to foreign political risk as one of many determinants, rather than the whole or even ranked first among many. The methods outlined here prove an efficient means of controlling for such factors because many are specific to administrative units, such as provinces or counties. [4]

A comparison of fixed and random effects results as shown in Tables 4.11 to 4.13 (see following pages) also serves to illustrate this differences between models. The net for CV1 is positive in RE Model2 (1020656.31 +308.221-1042689.006-1683415.15 + 1720281.387 = 15141.762). For CV3 RE Model2 the net is again positive: the calculation is 189.242 + 121643.544 -150.409 - 124029.682 -229934.972 + 235046.835 = 2364.558.

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[4] Note the current cross-section analysis can only be performed on data from 1998-2002 because I use an unbalanced panel based on data taken from the original source, without imputation. I expect the results to hold and possibly even show a stronger relationship on the key variables after imputation. Pooled OLS leads to results similar to the cross-sectional analysis, and further demonstrates the effectiveness of the fixed-effects specification.

Table 4.11 Fixed-Effects and Random-Effects Results using CV1: State Fragility Index

CV1: State Fragility Index

	Fixed-Effects			Random-Effects		
	Earmarked Transfers					
	Model0	Model1	Model2	Model0	Model1	Model2
TEM Pop	.		.	134.388***	115.415***	-35.469
				(12.59)	(14.12)	(51.27)
CV	-281.953***	-82.886	-91.429	14.454	34.152	-6.098
	(36.24)	(45.36)	(48.21)	(22.32)	(42.81)	(44.89)
Proximity	.	.	.	500.922***	405.366***	1020656.310**
				(39.13)	(31.60)	(365055.70)
lnGDPpc		-4.011***	-3.968***		-7.601***	-7.388***
		(0.79)	(0.82)		(0.58)	(0.61)
Urban Dummy					-26.186***	-27.016***
					(6.25)	(6.21)
Regime		-37.771	-35.852		28.762**	34.428**
		(29.16)	(29.28)		(10.83)	(11.10)
lnTrade		52.149***	53.077***		-0.990	-0.541
		(9.46)	(9.77)		(2.63)	(2.61)
TEM Pop * CV			160.798			308.221**
			(198.21)			(108.36)
TEM Pop						-1042689.006**
						(373575.31)
CV * Proximity			-1129173.777***			-1683415.150**
			(277096.07)			(603975.48)

* p<0.05 ** p<0.01 *** p<0.001

Table 4.11 Fixed-Effects and Random-Effects Results using CV1: State Fragility Index
(table continued from previous page)

	CV1: State Fragility Index					
	Fixed-Effects			Random-Effects		
	Model0	Model1	Model2	Model0	Model1	Model2
	Earmarked Transfers					
TEM Pop * CV * Proximity			1153404.487***			1720281.387**
			(283564.91)			(618070.48)
Constant	229.806***	35.622	26.139	73.927***	128.369***	135.960***
	(16.83)	(50.16)	(53.84)	(10.16)	(14.41)	(14.27)
N	13337	9785	9785	13337	9785	9785
N-grps	1698	1695	1695	1698	1695	1695

* p<0.05 ** p<0.01 *** p<0.001

Table 4.12 Fixed-Effects and Random-Effects Results using CV2: ONDD Political Risk

CV2: ONDD Political Risk

	Fixed-Effects			Random-Effects		
	Model0	Model1	Model2	Model0	Model1	Model2
	Earmarked Transfers					
TEM Pop	.	.	.	121.418*** (12.90)	114.204*** (12.98)	176.744*** (41.72)
CV	-171.803*** (16.76)	-23.316 (43.13)	-7.360 (51.92)	-103.510*** (13.04)	-47.049** (15.68)	-37.111* (17.26)
Proximity	.	.	.	488.023*** (38.95)	408.472*** (30.69)	-43109.232 (207415.47)
lnGDPpc		-4.725*** (0.67)	-4.669*** (0.70)		-7.372*** (0.45)	-7.349*** (0.46)
Urban Dummy	.	.	.		-24.430*** (6.14)	-24.551*** (6.13)
Regime		-36.360 (29.53)	-36.156 (29.41)		38.465*** (5.54)	38.447*** (5.53)
lnTrade		47.592*** (11.38)	48.466*** (11.85)		-3.603 (2.83)	-4.147 (2.87)
TEM Pop * CV			-85.395 (107.39)			-105.264 (61.23)
TEM Pop			.			44561.362 (212255.64)
CV * Proximity			-517449.537*** (122240.80)			240846.859 (541424.54)

* $p<0.05$ ** $p<0.01$ *** $p<0.001$

Table 4.12 Fixed-Effects and Random-Effects Results using CV2: ONDD Political Risk
(table continued from previous page)

CV2: ONDD Political Risk

	Fixed-Effects			Random-Effects		
	Model0	Model1	Model2	Model0	Model1	Model2
	Earmarked Transfers					
TEM Pop * CV * Proximity			529406.628***			-246568.648
			(125091.04)			(554058.88)
Constant	218.537***	36.153	29.059	154.545***	171.700***	166.280***
	(11.67)	(80.52)	(82.89)	(10.28)	(18.50)	(19.55)
N	13337	9785	9785	13337	9785	9785
N-grps	1698	1695	1695	1698	1695	1695

* $p<0.05$ ** $p<0.01$ *** $p<0.001$

Table 4.13 Fixed-Effects and Random-Effects Results using CV3: ONDD Transfer Risk

CV3: ONDD Transfer Risk

	Fixed-Effects			Random-Effects		
	Model0	Model1	Model2	Model0	Model1	Model2
	Earmarked Transfers					
TEM Pop	.	.	.	110.650***	112.994***	189.242***
				(12.81)	(12.94)	(21.47)
CV	-106.556***	-16.188	8.479	-95.148***	-24.653**	-3.423
	(6.40)	(12.31)	(13.12)	(5.96)	(8.46)	(8.41)
Proximity	.	.		485.998***	407.885***	121643.544***
				(38.83)	(30.66)	(4843.01)
lnGDP County		-4.546***	-4.550***		-7.138***	-7.152***
		(0.61)	(0.61)		(0.47)	(0.47)
Urban Dummy		.	.		-24.958***	-25.181***
					(6.10)	(6.11)
Regime		-35.724	-30.695		36.757***	37.559***
		(29.42)	(29.33)		(5.54)	(5.51)
lnTrade		48.669***	50.598***		-2.377	-2.182
		(9.31)	(9.39)		(2.76)	(2.75)
TEM Pop * CV			-135.718***			-150.409***
			(33.99)			(30.87)
TEM Pop			.			124029.682***
						(4956.16)
CV * Proximity			368303.964***			-229934.972*
			(17542.25)			(105993.37)

* p<0.05 ** p<0.01 *** p<0.001

Table 4.13 Fixed-Effects and Random-Effects Results using CV3: ONDD Transfer Risk
(table continued from previous page)

CV3: ONDD Transfer Risk

	Fixed-Effects			Random-Effects		
	Model0	Model1	Model2	Model0	Model1	Model2
	Earmarked Transfers					
TEM Pop * CV * Proximity			376633.609***			235046.825*
			(17950.39)			(108467.24)
Constant	177.221***	24.629	4.608	153.847***	151.737***	135.915***
	(4.70)	(54.32)	(54.92)	(6.18)	(14.19)	(14.64)
N	13337	9785	9785	13337	9785	9785
N-grps	1698	1695	1695	1698	1695	1695

* p<0.05 ** p<0.01 *** p<0.001

4.1 Conclusion and Possible Critiques

In terms of the empirical approach, as a future robustness check fixed-effects vector decomposition (FEVD) is an effective procedure for testing panel data with time-invariant variables and correlated unit effects (Plumper and Troeger, 2007). However, the current unbalanced dataset in its original state does not allow for this procedure. Imputation of missing observations may solve this problem. Future versions of this chapter will incorporate FEVD as a key empirical check of the current results.

I also plan to further control for several key covariates as the data allows. Payroll data at the county and province levels will be added to control for key administrative expenses embedded in the current grant transfers data. I fully expect results will match with recent literature (Shih et al, 2008 ms). Additional foreign trade and economic variables are also under consideration. Because the CNTS dataset omits several years, country-level GDP and income data will be added in the future from another source.

CHAPTER FIVE

THE CHINA-NORTH KOREA BORDER

5.1 Introduction

The China-North Korea border has been the object of foreign media attention in the past decade, as North Korea has increasingly taken the spotlight as one of the world's most volatile regimes. In this chapter, I look to the border area and its Korean minority population as a case study example of my theory. An examination of China's northeast border unearths a puzzle: the Korean ethnic group is widely recognized as a "model minority," highly assimilated, with income and education levels comparable to Han neighbors. Contrary to theories of redistribution to poor or marginalized areas, minorities in this region appear to show little need for extra government support. Yet the Korean minority appears to receive abundant amounts of funding. Why is this the case?

I posit government handouts to this area are driven by the local TEM population and its relationship with a political risky regime across the border. The China-North Korea border is subject to high political risk on the North Korean side. A large overlapping transborder ethnic minority exists, with deep social and economic linkages crossing the border. Specifically, I show how the theory tested in previous chapters applies to this case and also expand the analysis to further demonstrate evidence for a causal relationship. Are increased transfers actually a function of the interaction between TEM population share, proximity to the border and foreign political risk? Is a jump in risk followed by increased transfers in these areas? And if so, what is the specific target of transfers?

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Using a variety of tests, I show evidence for my hypotheses. I limit the fiscal transfers data to the two provinces of Northeast China, Jilin and Liaoning, which border North Korea, demonstrating that the results are again replicated at a regional level. A difference-in-differences test on county areas within one province (Jilin) is used to show transfers increase dramatically following two critical periods in North Korean political risk, one in 1997 and one in 2001. The outcomes shown here not only lend support to my theory as a whole but also demonstrate stronger foreign political risk effects upon distributive outcomes.

5.2 The Korean Minority in China

5.2.1 The Korean TEM on the China-North Korea Border

The China-North Korea border runs through an area reflecting the experiences and contradictions shared by much of the minority population in China. On one side, the three northeast provinces situated close to North Korea – Liaoning, Jilin, and Heilongjiang[1] – are home to a large ethnic Korean population (*Chaoxianzu*). The Korean minority is estimated at approximately 2 million persons and is one of the ten most populous minorities in China (according to the first census of China, carried out in 1953, these ten were those with populations of more than 1 million). An extensive Korean minority is concentrated in the northeast, with 92.3% of ethnic Koreans, or 1.92 million living in the three provinces of Liaoning, Jilin and Heilongjiang. Jilin is the center, with a highly concentrated population of 875,000 Koreans (45.3% of the entire Korean minority population) in the Yanbian Korean

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[1]Heilongjiang Province does not share a land border with North Korea, but is in close proximity; a small county separates the Heilongjiang border from NK.
[2]Statistics from Chong (2004), p.37
[3]Chong (2004), p.33
[4]North Korea, like South Korea, has historically argued for a national image based on high levels of

Autonomous Prefecture (*Yanbian Chaoxianzu Zizhiqu*) and Changbai Korean Autonomous County not far from the North Korean border. In these areas, Koreans often comprise up to 60% or more of local county populations.[2]

Ethnic Koreans have had a continued presence in the area of Northeast China, but their numbers increased dramatically in the late 19th and early 20th century with Koreans refugees and migrants fleeing political oppression and economic deprivation during Japanese colonization of the peninsula. At the peak of colonization in 1944 their numbers reached 1.65 million, and even after Japanese defeat in World War II and subsequent refugee returns to the homeland, as of 1953 1.11 million remained in Manchuria[3]. Eventually these were joined by waves of settlers from subsequent political upheaval in the peninsula, and the Korean War (1950-53). The current population derives from descendants of these groups.

On the other side of the border, Koreans are the dominant ethnic group, making up 99% of the total population of North Korea[4]. At the same time North Korea is a highly volatile regime, where political risk levels have increased over the years. Since the Soviet bloc disintegrated in 1989 it has endured increasing levels of economic and political isolation, culminating in a disastrous and lengthy period of famine throughout the late 1990s[5]. Its totalitarian regime has reacted to the challenge of regime instability by increasing control, leading to greater levels of human rights violations and barriers to trade and production in a

[2]Statistics from Chong (2004), p.37
[3]Chong (2004), p.33
[4]North Korea, like South Korea, has historically argued for a national image based on high levels of ethnic homogeneity (see Myers, 2010). While subject to some controversy, scholars generally acknowledge Koreans are the dominant ethnic group in both North and South Korea and few, if any, other sizeable ethnic groups exist or have become a politically viable force.
[5]Haggard and Noland (2007)

regime already crippled by poverty and economic instability. A set of international standoffs over development of nuclear weapons capability in North Korea added to its problems, particularly after economic sanctions were imposed, further damaging productive capabilities. Overall, any measure of political risk indicates risk in North Korea has increased and fluctuated from 1995 to the present.

Such phenomena are met by a corresponding increase of concern on the part of authorities in China. Media accounts show increasing levels of overall security in areas near the border from 1995 to the present. Reports indicate periodic sharp increases in border patrol and heavy crackdowns on illegal migration in the border provinces of Jilin and Liaoning, which tend to experience greater numbers of refugees. Reports also show the People's Liberation Army (armed police) forces have been dispatched to border areas rather than normal border patrol, showing that these security-related decisions have been directed by decision-makers in the central government in Beijing, as opposed to usual processes of delegation to provincial authorities.

Finally, high levels of economic and social integration across the border have increased concerns of cross-border flows. Since 2000, trade between North Korea and Jilin province, especially the Yanbian area, has increased dramatically. In particular, aside from a few large-scale projects from inland areas, direct investment and business ventures in North Korea are heavily dominated by actors in Northeast China. These economic linkages have benefited both sides, particularly North Korea, which has been viewed in recent years as increasingly dependent upon Chinese actors for foreign goods, currency and energy sources.

Economic sanctions by the UN have only increased the strength of this relationship. With pre-existing ethnic linkages, these economic ties have served to connect the economies of both areas together and create potential for fallout should political risk in North Korea rise to unmanageable levels.

5.2.2 The Korean TEM on the China-North Korea Border: Characteristics

The Korean minority in China has been widely perceived as being more "sinicized" or "assimilated" in comparison to other minorities in China. Relatively high income levels among minorities in the Northeast and overall educational advnaces, and political and social integration has played a role in this perception of a "model minority." The province of Yunnan, heavily populated by minorities, had the highest number of rural poor people – 7.7 million – in 1996, and at least 22.9% of the total population was living in poverty as of 2001 (Mackerras, 2003, 67). Rural poverty is also a serious problem in Xinjiang and Tibet, which are also home to minorities – at 27.4% for the former (Mackerras, 2003, 68). Given that we know rural populations in these provinces are much more likely to be of minority ethnic descent and minorities are overall more heavily rural than urban in these areas, we can safely assume minority populations share equal or higher rates of poverty here. In contrast rural parts of ethnic autonomous areas in Jilin, heavily populated by Korean minorities, have shown the highest per capita net income among provinces with significant minority populations, while Gansu and Yunnan are at the other end of the scale (Mackerras, 2003, 69).

While the economic development projects targeted at the northeast have been argued as the cause of Korean and Manchu prosperity, a similar significant Western Development Project has been undertaken in minority-heavy provinces in inland China with less marked results. Moreover, the severe inequalities in income between Northeast and inland minorities has been a marked feature of minority economic development since long before the initiation of these projects. More likely differences in income and also structure of economies are due to regional differences in industrialization across China. The development of heavy industry in the northeast, where coal and iron ore are located and have been extensively mined and developed over the last few decades, has contributed to general prosperity in the three northeast provinces of Jilin, Liaoning and Heilongjiang in spite of recent decline, and is likely a good explanation as any for such overall higher averages among Koreans and Manchus.

Employment levels are high, and the Korean minority is not only on average wealthier but also more heavily employed in second and third sector industries in comparison to minorities in Western China (Wang ed, 2006). Since the 1990s, Koreans have been moving from agriculture to service and manufacturing jobs in the cities. The 2000 census lists service sector employment as the second highest employment category for Korean minorities, after agriculture (Kim, 2010). This movement in population is noticeable throughout the 1990s and early 2000s, where we see a shift in urban-rural population breakdown within minority populations. In addition, Korean minorities have conformed strongly to central one-child policy directives, leading to lower minority population levels

overall (Kim, 2010). Han migration has taken up the slack, so that Korean minority population percentages in many areas do not exceed the majority 50%.

The Korean minority has also shown higher education and literacy rates among minorities. In education, Koreans remain among those most likely to use native-language textbooks and preserve native Korean language classes and early primary Korean-language education in the classroom, along with Tibetans and Mongolians in their respective contexts. However literacy rates for Chinese (Mandarin) are much higher in Korean minority areas, with hardly any illiteracy among those 15 and older (excluding very old people). In addition overall education rates among Koreans are particularly high, with 96.9% of children graduating from junior middle school in the Yanbian Korean autonomous area in 1998. As Mackerras points out, these numbers point to a general achievement of the national aim of compulsory 9-year education (Mackerras, 2003: 129)

Finally, Koreans show a higher number of minorities among party cadres, in comparison to other minority areas in China. This fact is striking when we realize the CCP of Xinjiang province, which is 69% minority, has only 39% minorities among its cadres. High-ranking party cadres of Korean descent in the Northeast area are not uncommon, and local government officials are often of minority descent as well. Aside from a brief period of conflict during the Cultural Revolution, when local minority leaders were accused of colluding with North Korea to hand over large amounts of Chinese territory, friction between the CCP and the Korean minority has been rare. Many authors have noted high

levels of cooperation with the CCP has helped stabilize Korean minority communities and contributed to economic prosperity (Kim, 2010).

5.3 Transfers to Northeast China & Hypotheses

These characteristics of the Korean minority population rule out a number of existing hypotheses regarding transfers distribution. The theory of redistributive transfers falters in the face of relatively high income levels and economic development. Theories which note grant transfers encourage minority integration also fail to hold weight with the high level of assimilation ("Sinicization") of the Korean minority group.

In addition, transfers to "restive" minorities are difficult to imagine in this case. The Korean minority has had very few instances of mass action or restive behavior, and high levels of political integration also add to the evidence. The term "model minority" refers to not only socio-economic indicators but also levels of political assimilation or compliance; as examined earlier, Korean minorities were active in the CCP from the beginning of the current regime, and continue to show a high percentage of participation in the party. It is difficult to argue political co-optation of a secessionist group in a case in which the group is neither restive nor politically marginalized.

We can hypothesize that transfers to this group, therefore, are based on factors not yet examined in the literature. The theory discussed in previous chapters is applied here, as a case study of the larger country-level findings.

H1: Counties with high TEM population share on the border will receive more transfers in periods of higher foreign political risk in North Korea.

An additional component is an expected strong effect of foreign political risk. In previous chapters, foreign political risk does not necessarily drive transfers; in most cases TEM population share has been shown to have a stronger marginal effect on transfers outcomes. In the case of the North Korea-China border, however, severe fluctuation in risk and the absence of domestically-driven "restiveness" in the TEM population creates conditions in which foreign political risk may be the main driver of outcomes. Moreover, we expect the effect to be stronger for Jilin province, which is closer to North Korea and given the theory explained previously, should be the recipient of stronger North Korean political risk effects.

H2: Foreign political risk will have a significant, positive and increasing effect on transfers outcomes.

5.5 Empirical Strategy

The empirical strategy employed here incorporates two broad approaches: a fixed-effects analysis which replicates the results of previous country-wide tests in Northeast China, and a difference-in-differences analysis. The first portion demonstrates the applicability of previous fixed-effects tests to the China-North Korea border by limiting the sample to the immediate geographical area of Northeast China. In the first version, I choose

only areas that correspond to North Korea. Both center-to-province and province-to-county

tests are used, as in previous samples, to see if the theory holds at both central and local

government levels. Because the analysis again suffers from problems of time-invariant

factors (see Chapter 4 for details), additional tests on "blocks" of data specifically test for

and isolate foreign political risk effects. The blocks here mirror Chapter 4: a) Korean

minority counties on the China-North Korea border, b) Korean minority counties away

from the border, and c) non-Korean counties.

In the second version I apply the test to Jilin province, which among the three

provinces located close to North Korea – Jilin, Heilongjiang, and Liaoning – has the highest

concentration of Korean minorities, shares the longest border with North Korea, and is in

general most influenced by North Korea due to its geographic location.[6] County-fixed

effects are employed to demonstrate results are again replicated at a local scale, and standard

robustness checks applied.

The second portion focuses specifically on foreign political risk effects. North

Korea, widely considered one of the world's most risk-prone regimes, has also shown a wide

range of variation in risk over the period of this study, 1995 to 2003. In particular we focus

on two periods of increased risk: 1997 and 2001. Sharp upward spikes in political risk in

these years – and sharp drops afterwards – create ideal conditions for difference-in-

differences analyses which compare transfers before and after these cutoff points. In

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[6]In comparison Heilongjiang shares most of its land border with Russia, while Liaoning's access to
the sea and sea neighbors such as South Korea, etc, and close proximity to major eastern cities such
as Beijing and Tianjin diversify its sources of influence considerably.

addition, a diff-in-diff model enables us to make within-province comparisons of transfers to counties, thereby controlling for province-level governance effects and variation. If counties within Jilin province are equally subject to distributional priorities and decision-making at the level of provincial government, a within-province diff-in-diff analysis will allow us to automatically rule out province-level effects. This analysis strengthens the implications of the previous test while allowing us to isolate out foreign political risk effects.

5.6 Results

5.6.1 Fixed Effects: Areas Proximate to North Korea

Table 5.1 Areas Proximate to North Korea, Summary Statistics

Variable	N	Mean	SD	Min	Max
DV					
Social Welfare Spending	2166	0.001435	0.004034	-0.14461	0.031575
Education Subsidy Spending	727	0.00074	0.000866	0	0.006055
CV					
TEM pop (%of total)	3294	0.010035	0.061973	0	0.654282
CV1: State Fragility Index	3294	0.466667	0.056577	0.36	0.52
CV2: ONDD Political Risk	3294	0.887831	0.063148	0.8	1
CV3: ONDD Transfer Risk	3294	1.044444	0.125727	1	1.4
Proximity	3294	3.61E-06	1.09E-05	7.80E-07	0.000126
Controls					
GDP (per capita)	2460	500396.2	2235682	1	6.59E+07
Urban	3294	0.254098	0.435419	0	1
Regime	3294	1	0	1	1
Trade	3294	21.33333	2.160575	19	27

Fixed-effects analyses of areas proximate to North Korea support the country sample findings in Chapter 4. Again, I find through county-fixed effects analysis that province-to-county transfers appear to be significantly impacted by the interaction of three factors: TEM population share, proximity, and foreign political risk. In the case of counties corresponding to North Korea, a 1-standard deviation increase in the interaction term leads to a 16,800,968.7 yuan increase in transfers per capita for CV1: State Fragility Index and a 5,262,224.01 yuan increase for CV2: ONDD Political Risk. The results are clearly consistent with the original findings, and only a slightly smaller amount of distribution differentiates the Northeast area adjacent to North Korea from the rest of the country. Again, GDP per capita is negatively and significantly associated with transfers each time, although as expected the redistributive effect is very slight.

Table 5.2 Areas Proximate to North Korea: County-Level Fixed Effects Analysis

	CV1 Model1.3	CV2 Model2.3
Causal Variables	**Earmarked Transfers**	
State Fragility Index	-91.859	
	(52.48)	
ONDD Political Risk		-258.207***
		(21.01)
TEM Pop * State Fragility Index	-2688.423***	
	(573.68)	
TEM Pop * ONDD Political Risk		-992.587*
		(429.82)
State Fragility Index * Proximity	-1.528e+07***	
	(2938251.38)	
ONDD Political Risk * Proximity		-9157114.605**
		(3196634.61)
TEM Pop * State Fragility Index * Proximity	32083657.159***	
	(6390242.99)	
TEM Pop * ONDD Political Risk * Proximity		14420193.952*
		(7011761.39)
Controls		
Domestic		
County GDP	-2.689***	-6.401***
	(0.59)	(0.78)
Constant	170.500***	401.860***
	(20.68)	(20.22)
N	2068	2068
N-grps	364	364

Below, each graph shows the marginal effect of one causal variable in the interaction conditioned by the remaining two interaction variables. For example, the first graph in Figure 5.1 represents the marginal effect of TEM population share on transfers, as represented over an increase in foreign political risk CV1: State Fragility Index (x-axis). The multiple lines represent different levels of proximity, with a bold black line representing counties close to the border (proximity>75%, fourth quartile). Thin lines represent lower level quartiles – 50%, 25%, etc. Stars on these lines indicate a significant relationship. For CV1: State Fragility Index, the marginal effect of TEM population share increase on transfers is consistently significant, positive and increasing at all levels of proximity, with a markedly stronger effect evident in the border area proximate to North Korea. The marginal effect of foreign political risk is positive when TEM population share is high – approximately 50% and overall increasing, with again stronger effects for border areas. These results are much stronger than original findings for the country-wide sample. In particular, the effect of foreign political risk upon transfers is much more marked in the Northeast, with a positive marginal effect apparent at 50% TEM share rather than 0.8 in the original sample and the effect more marked in the border area.
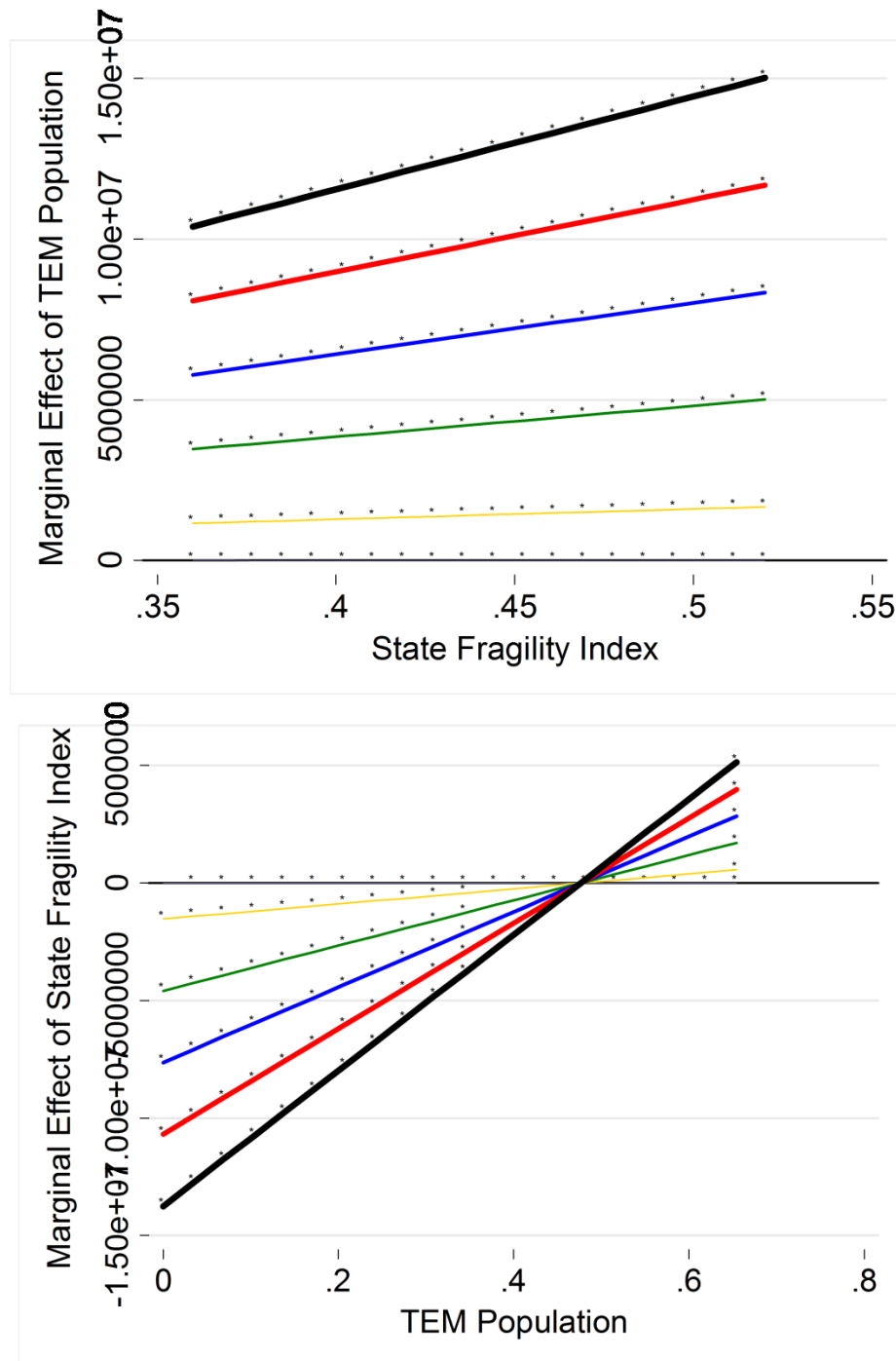
Figure 5.1 Areas Proximate to North Korea: County-Level Graphs for CV1
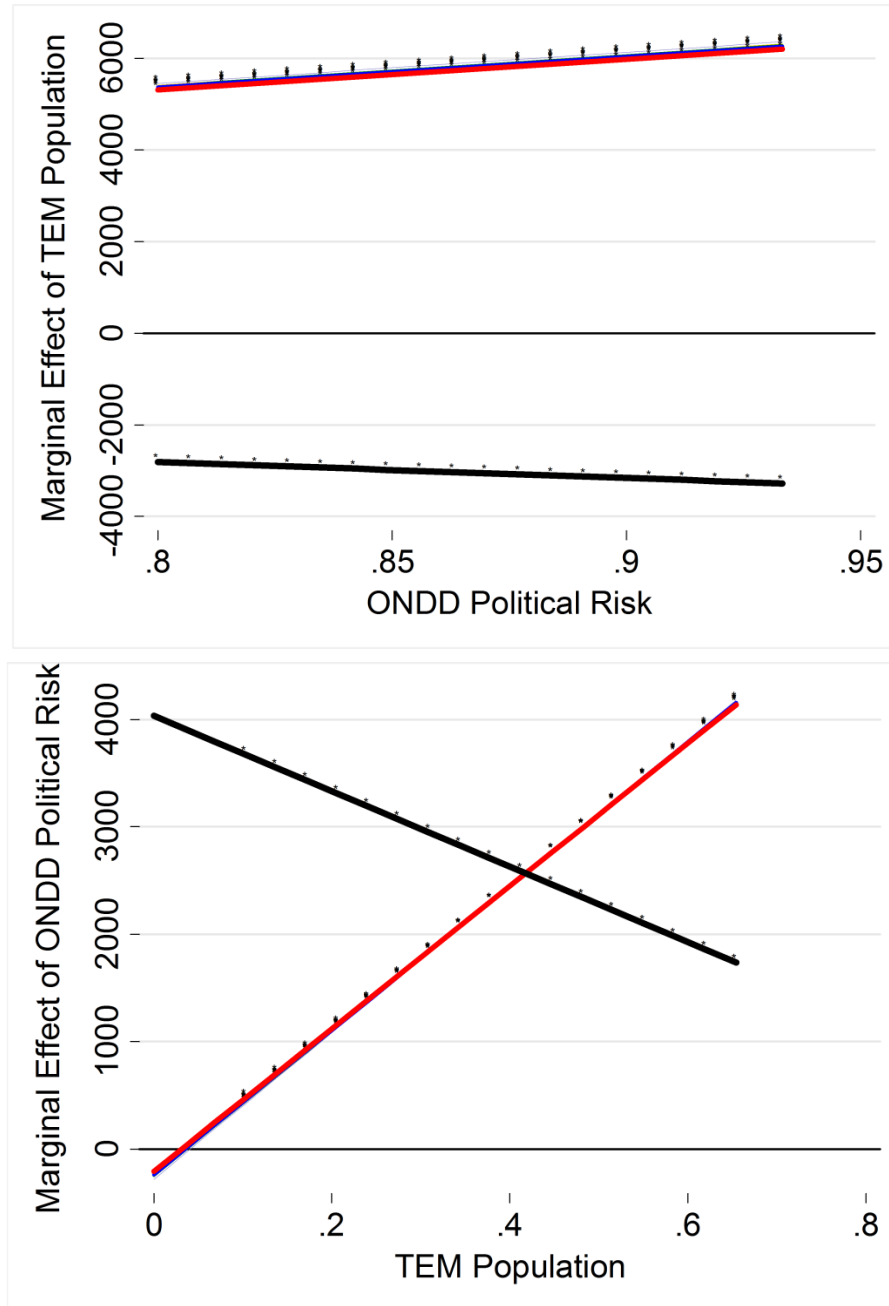CV1:SFI has a significant and increasingly positive effect

Figure 5.2 Areas Proximate to North Korea: County-Level Graphs for CV2
CV2: ONDD Political Risk does not have increasingly positive effect

For CV2: ONDD Political Risk, results are mixed. The marginal effect of foreign

political risk is again significant and positive, in this case positive throughout all levels of

TEM population share, indicating a very strong foreign political risk effect. For areas closest to the border, however, effects appear to decrease as TEM population increases, although overall the effect remains consistently positive. For areas farther away from the border, effects are positive, increasing and significant throughout. In fact when population makeup is 40% TEM or higher, counties away from the border experience a greater marginal effect of risk increase upon transfers than counties close to the border. In comparison, the marginal effect of TEM population on transfers is strongly positive in areas far from the border, while areas close to the border appear to receive less with TEM population increase. While the results shown here do not offer a clear explanation for these findings, it seems likely that transfers to relatively inland counties with high TEM populations – such as the Yanbian Korean autonomous area in Jilin, which is several counties inland from the border – account for these findings. Thus although counties directly on the border may have higher TEM populations, inland counties receive more transfers because government directs transfers to major TEM cities or autonomous areas under the assumption that effects will trickle down to the TEM group as a whole.

A province-level analysis again mirrors the original findings, in that center-to-province transfers are impacted by the three-way interaction but to a lesser extent than province-to-country transfers. For CV1: State Fragility Risk, we see a 10,734,032.2 yuan increase in transfers for a one-standard deviation increase of the interaction term. For CV2: ONDD Political Risk, findings are not significant, leading to mixed results. It is noticeable that for CV1, the coefficient on GDP per capita is positive and significant, while the same coefficient for CV2 is not significant at all. This differs from previous findings and opens the

possibility of less-than-redistributive earmarked grants in areas proximate to North Korea, although as noted earlier the effects – either positive or negative – are extremely small.

Table 5.3 Areas Proximate to North Korea: Province-level Fixed Effects Analysis

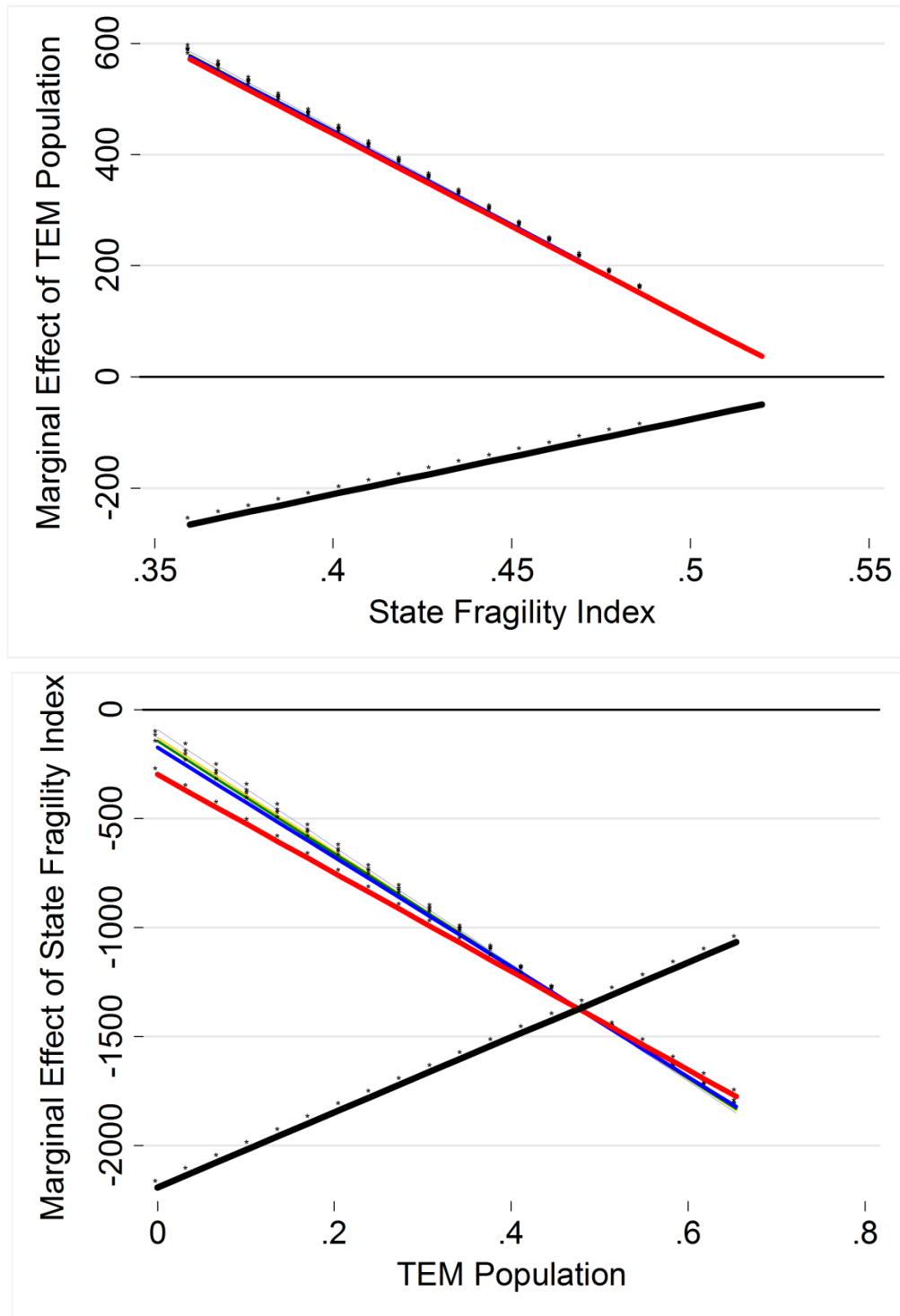|	CV1 Model1.3	CV2 Model2.3
<u>**Causal Variables**</u>	**Earmarked Transfers**	
State Fragility Index	-223.406***	
	(54.93)	
ONDD Political Risk		94.324
		(48.81)
TEM Pop	1818.302***	202.932
	(365.56)	(1020.64)
Proximity	8424132.647***	-1.238e+07*
	(1868492.90)	(6036344.46)
TEM Pop * State Fragility Index	-3423.276***	
	(793.59)	
TEM Pop * ONDD Political Risk		61.529
		(1117.68)
TEM Pop * Proximity	-2.034e+07**	22551454.137
	(6317477.35)	(19819106.05)
State Fragility Index * Proximity	-1.513e+07***	
	(4189405.33)	
ONDD Political Risk * Proximity		15604965.415*
		(6690662.45)
TEM Pop * State Fragility **Index * Proximity**	37781501.704**	
	(14442574.22)	
TEM Pop * ONDD **Political**		-2.885e+07
Risk * Proximity		(21780589.43)
<u>**Controls**</u>		
County GDP	2.850**	-0.182
	(1.05)	(0.71)
Constant	-28.247	123.307***
	(46.07)	(16.39)
N	2389	2389

Figure 5.3 Areas Proximate to North Korea: Province-Level Graph for CV1: SFI
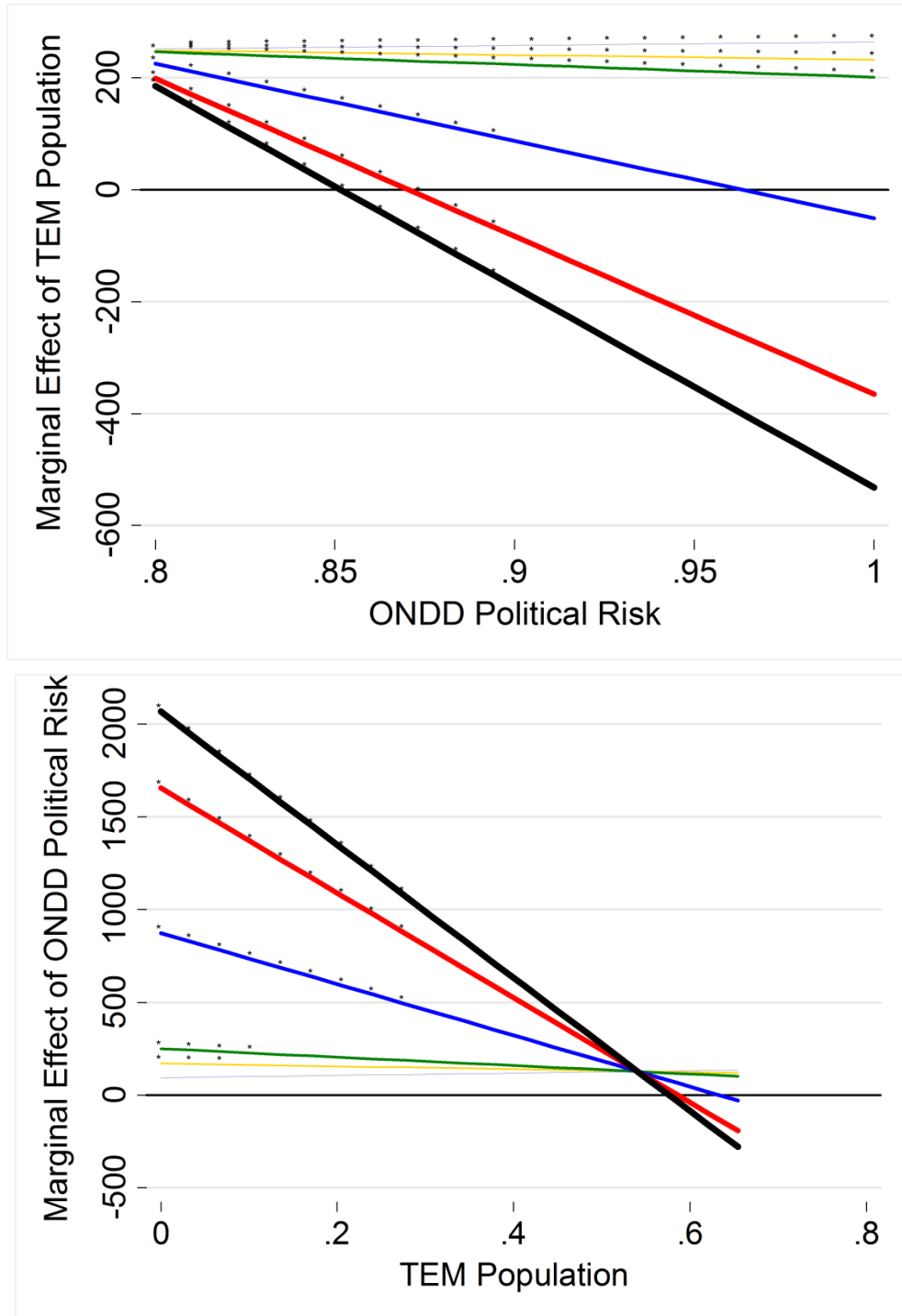CV1 has an increasing but negative effect

Figure 5.4 Areas Proximate to North Korea: Province-Level Graph for CV2: ONDD Political Risk

CV2 has a positive effect but decreasing

Results from marginal effects graphs are also mixed. For CV1, in border areas the marginal effects of TEM population share and foreign political risk upon grants are both negative. However, the marginal effect of TEM population share upon transfers is positive in areas farther away from the border, although the effects tend to decrease rather than increase as foreign political risk levels rise. For CV2, the marginal effects of both TEM share and foreign political risk are positive for certain conditions, albeit decreasing as key indicators increase. These results are relatively similar to the original findings; again we find tests on center-to-province transfers are less than clear, although there is some indication that the key indicators of TEM population share, proximity and foreign political risk have a significant and positive impact on transfers. These results may, like county fixed effects results, have been influenced by counties which are relatively inland but act as key hubs for TEMs, such as capital cities of autonomous areas. Given that the range of geographical distance to the border is much smaller in the current sample than the country-wide sample, such relatively small differences in distance/proximity may have an exaggerated impact on outcomes.

Finally, in this chapter, I again test foreign political risk on "blocks" of data: a. Korean minority counties on the China-North Korea border, b. Korean minority counties away from the border, and c. non-Korean counties. The standard for proximity to the border is set at the top 25%, while the standard for a Korean minority county is set at a population share of 30%. The findings are mixed: I find a significant and positive relationship between foreign political risk in CV1: State Fragility Index and grant transfers, but ONDD measures CV2 or CV3 show a negative relationship. Few Korean minority

counties exist in inland areas; even if we adjust the cutoff to 10% minority, the sample is too

small to test, eliminating block b. Results for block c are shown below, and we find foreign

political risk negatively associated with transfers outcomes for all non-Korean counties.

Table 5.4 Areas Proximate to North Korea County-level Fixed Effects
Block A: Korean Minority Counties near the Border

	CV1 State Fragility Index	CV2 ONDD Political Risk	CV3 ONDD Transfer Risk
logged CV	3860.021**	-485.860***	-1175.843**
	(705.38)	(69.53)	(225.33)
logged County GDP	10.653	-18.212**	-3.815
	(8.88)	(4.67)	(5.66)
logged Trade	600.833**	261.953	757.715**
	(135.93)	(152.77)	(170.75)
Constant	-1510.231**	116.042	-1488.710*
	(919.76)	(467.30)	(487.32)
N-grps	7	7	7

* p<0.05** p<0.01*** p<0.001; Robust standard errors in parentheses

Table 5.5 Areas Proximate to North Korea, County-level Fixed Effects
Block C: Non-Korean Minority Counties

	CV1 State Fragility Index	CV2 ONDD Political Risk	CV3 ONDD Transfer Risk
logged CV	-299.576***	-110.738***	-229.934***
	(23.30)	(9.73)	(56.22)
logged County GDP	-2.747***	-0.223	3.187**
	(0.50)	(0.49)	(0.98)
logged Trade	187.544***	190.514***	316.819***
	(41.34)	(42.00)	(53.98)
Constant	-203.124	-393.348**	-822.606***
	(133.39)	(131.37)	(149.38)
N-grps	430	430	430

* p<0.05** p<0.01*** p<0.001; Robust standard errors in parentheses

5.6.2 Fixed Effects: Jilin Province

Jilin province is interesting to this case study, and worth examining as a separate sample, for a variety of reasons. Jilin is the main province bordering North Korea, sharing its longest land border. As noted previously it has a high concentration of Korean minorities in general, both in the Yanbian Korean autonomous region and its outlying areas. In addition Jilin is relatively insulated from other foreign effects, unlike its neighboring provinces; Heilongjiang's longest border is with Russia, and is widely recognized as subject to Russian influence, while Liaoning's proximity to the eastern coast and its economic ties with major cities such as Beijing and Tianjin act to counter any foreign political risk effects. In comparison Jilin's cross-border economic activities are concentrated on North Korea.

Overall Jilin's foreign political risk is chiefly influenced by North Korea, and is in this sense an ideal case to examine the effect of interaction between foreign political risk, TEM population share, and proximity.

Table 5.6 Jilin Province, Summary Statistics

Variable	N	Mean	SD	Min	Max
DV					
Social Welfare Spending	220	0.004544	0.004959	1.76E-05	0.028106
Education Subsidy Spending	97	0.000857	0.000328	0	0.001325
CV					
TEM pop (%of total)	333	0.093722	0.060248	0.000184	0.654282
CV1: State Fragility Index	333	0.45946	0.056577	0.32	0.52
CV2: ONDD Political Risk	333	0.873802	0.079445	0.619048	1
CV3: ONDD Transfer Risk	333	1.021536	0.153236	0.571429	1
Proximity	333	1.92E-05	2.91E-05	2.56E-06	0.000126
Controls					
GDP (per capita)	252	248560.1	708255.9	3	7.98E+06
Urban	333	0.297297	0.457756	0	1
Regime	333	1	0	1	1
Trade	333	20.27928	4.125672	7	27

Summary statistics of Jilin province show a much smaller sample compared to the entire amount of counties corresponding to North Korea. We find only 220 observations on the main dependent variable, social welfare spending, compared to 2,166 for the earlier sample. Mean spending is higher in Jilin province compared to the entire sample, approximately 4 times higher for social welfare spending and also slightly higher (approximately 0.0001 point) for education subsidy spending as well. Jilin's much higher

proportion of Korean minorities – 9 times the entire sample – may explain these outcomes, but it is also worth noting Jilin's mean GDP per capita is twice that of the larger sample.

Table 5.7 Jilin Province: County-Level Fixed Effects Regression Results

	CV1 Model1.3	CV2 Model2.3
<u>**Causal Variables**</u>	**Earmarked Transfers**	
State Fragility Index	-154.830*	
	(70.77)	
ONDD Political Risk		-409.442***
		(104.14)
TEM Pop * State Fragility Index	-2192.288**	
	(615.06)	
TEM Pop * ONDD Political Risk		-1105.841
		(552.44)
State Fragility Index * Proximity	-1.349e+07***	
	(3096581.13)	
ONDD Political Risk * Proximity		-8773919.120*
		(3274513.93)
TEM Pop * State Fragility Index * Proximity	27920569.626***	
	(6764346.86)	
TEM Pop * ONDD Political Risk * Proximity		13926054.134
		(8004559.00)
<u>**Controls**</u>		
County GDP	-7.259***	-17.797***
	(1.59)	(2.50)
Constant	432.977***	864.940***
	(27.19)	(99.31)
N	213	213
N-grps	37	37

A within-province application of previous tests allows us to examine this geographical area more closely without the additional problem of dealing with sub-national level variation in administration of fiscal transfers. The results are replicated: for CV1, a county-level fixed effects analysis of Jilin shows a 14,428,648.2 yuan increase in transfers for each one-standard deviation increase in the interaction term. The amount is even higher than previous tests, showing the strength of effects upon immediate areas affected by North Korean political risk. While CV2 does not show similar results, the coefficient on the interaction term is again positive. Further, graphs of marginal effects show strong support for the original hypothesis: the marginal effect of TEM population upon transfers is high, consistently positive and increasing for border areas, and the marginal effect of foreign political risk upon transfers to border counties is increasing and positive at levels as low as 2% TEM population share. In particular the very low threshold for TEM share compared to previous tests indicates a strong effect in the case of Jilin.
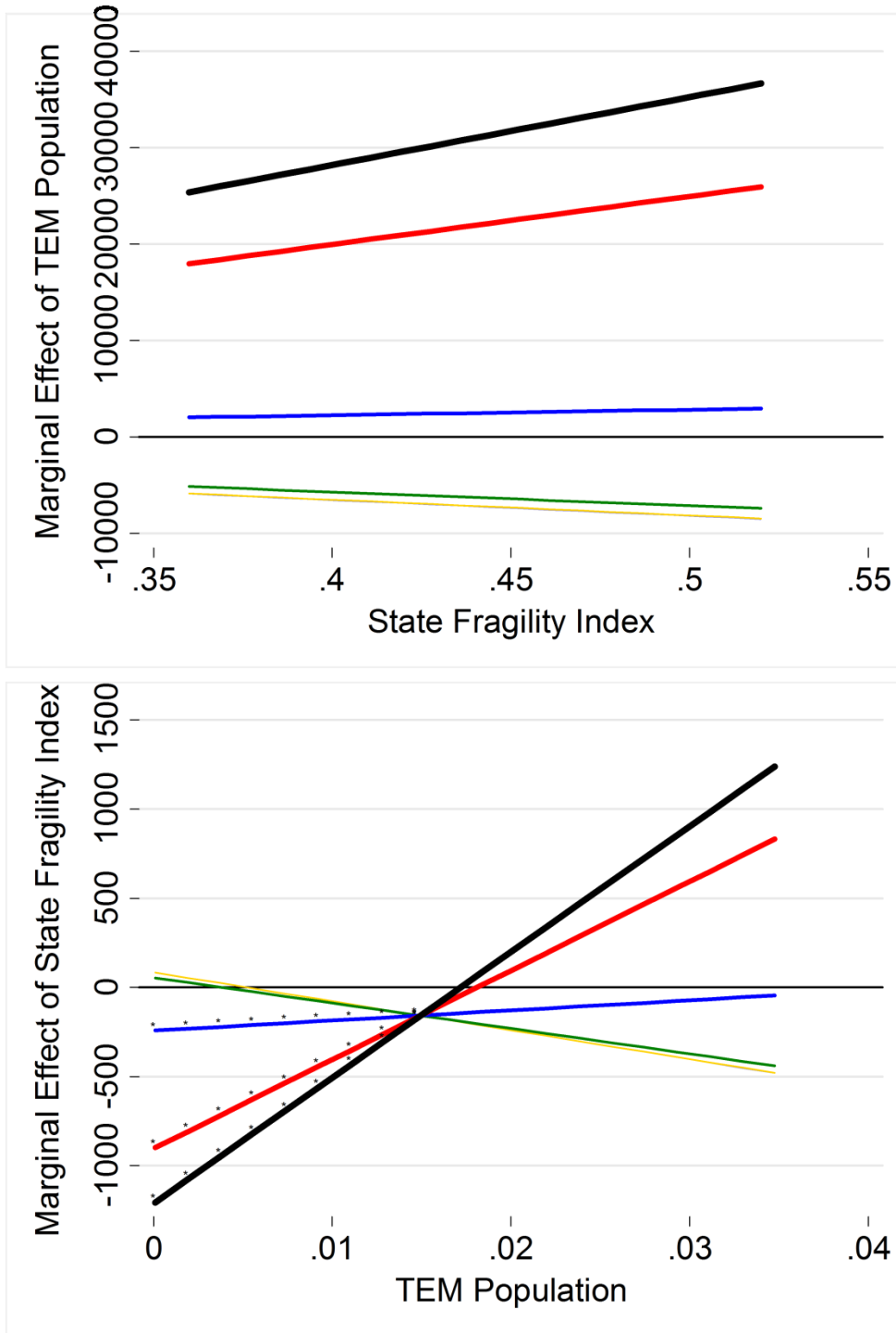
Figure 5.5 Jilin Province: County-Level Graphs for CV1: SFI
CV1 has a significant and increasingly positive effect

5.7 Theoretical Implications

Overall the outcomes imply strong support for the theory and hypotheses. Results from country-wide tests are replicated at a smaller scale on a case study basis, and to a certain degree appear even stronger. The added contributions of this case study are twofold: first, the foreign political risk effects upon outcomes are more pronounced in comparison to Chapter 4 and markedly strong. In the previous country-wide study, foreign political risk was found to have a relatively small, additive effect – grants distribution was driven mainly by TEM population share and proximity to the border, while foreign political risk effects were relatively small and only positive when the interaction between TEM share and proximity was above a certain threshold. However, in this study we find the threshold to be markedly lower for a sample of all counties that border North Korea, and almost non-existent for counties in Jilin province. Thus we can argue the area near the China-North Korea border is overall much more politically sensitive to the effect of foreign political risk increase in comparison to the rest of the country. This implies an added sensitivity for high-risk areas, a result which can be tested and replicated in further case studies.

One problem is that the results show the limitations of the measures used. The results for CV1, 2 and 3 are markedly different, and the difference seems more apparent than in the country-wide sample. This is partly due to low covariance between CVs. A simple graph comparison of CV1, 2 and 3 for North Korea shows risk estimates differ drastically between the 3 measures. This difference highlights the problems inherent in the foreign political risk measure – does it hold under scrutiny?

5.8 Conclusion

The results derived in this chapter support and strengthen previous findings, overall establishing the connection between proximity, TEM share and foreign political risk, and transfers distribution. In terms of the theory, however, we need another link in the chain to further substantiate this story. Does distribution actually equate with spending? Do funds given to TEM areas on the border translate into greater provision of goods to local TEM populations? The next chapter addresses these questions.

CHAPTER SIX

LOCAL SPENDING ON THE CHINA-NORTH KOREA BORDER

6.1 Introduction

The conventional wisdom on local governance in China suggests distribution of grants alone does not ensure spending for corresponding purposes. Due to fiscal and administrative decentralization during and after economic reform, since the 1990s local-level governments in China have greater autonomy, are subject to less monitoring, and correspondingly, retain less incentive to use allocated funds for designated purposes. It follows that we are faced with another link in the chain in providing evidence for the overarching theory: do counties, given grant transfers, actually spend in ways that benefit TEMs.

In this chapter I establish the link between distribution of grants and actual use of funds at the county level. Once again focusing on the case of the North Korea-China border area, I use data on county-level spending to determine whether my theory holds across actual use of funds as well as distribution from higher to lower levels of government. A brief overview of local fiscal governance in China and social spending at the county level in Jilin province informs this section. Does distribution equate greater spending in this case? And if so, what types of spending do we see, and how does variation in spending types inform the overall theory? These questions, and others, are addressed in the following sections.

6.2 County-Level Finance in China

Previous work on local finance in China points to incentives at the level of county government to deviate from the original goals of earmarked grant transfers. Increasingly, structural changes and problems in fiscal and administrative systems since economic reform have encouraged local county officials to allocate funds away from intended purposes to other uses, ranging from illegitimate graft and corruption to more need-based re-allocation.

Structural changes stemming from fiscal reform in 1994 and administrative decentralization underlie most arguments. Such changes have enabled greater autonomy in fiscal matters at all levels of subnational government, from the province down to county, township and village (Sheng, 2010; Brean, 1998; Guo, 2009; Pei, 2006). The leeway given to provincial governments in determining budgets, allocation and distribution within the province creates a situation in which provinces are able to pressure lower levels of government, to the detriment of local fiscal budgets. On the one hand, provincial governments increasingly demand greater revenue from county and lower level governments. On the other, delegation of public goods responsibilities – both goods provision and the creation of funds for provision – from upper to lower level governments creates an added burden upon local budgets, and shirking at higher levels creates a situation where governments at the bottom of the chain are the recipients of most costly responsibilities (Pei, 2006). As a result, local fiscal budgets are subject to pressures at a level at which many are no longer able to meet basic budgetary needs. A primary problem noted in the literature on local governance in China is a continuing fiscal crisis in the localities. According to Pei (2006), in the mid-1990s the Ministry of Finance conducted a survey of

county finances and reported over half struggled with large deficits and had difficulty
meeting basic administrative needs. Half of debts in rural townships and villages were over
three years overdue.

Further, administrative decentralization and changes in nomenklatura power have led
to reduction in the monitoring capabilities and incentives of upper level governments.
Because county officials are now appointed by, and subject to, oversight from province or
municipal-level governments rather than the center, province-level government priorities
often take precedence over central incentives. Provincial officials may choose to prioritize
their own financial and career interests over provision of social goods and projects which
benefit the general public. Monitoring capabilities are weak and province-level governments
have little incentive to monitor effectively with what resources they possess (Pei, 2006). In
addition, at the local level a host of problems such as mismanagement, lack of expertise, and
malfeasance contribute to perverse incentives in fiscal spending (Pei, 2006).

We find the results of such perverse incentives in a wide range of literature covering
local governance in China. Corruption is an endemic problem noted by many. Increasing use
of official positions to accumulate financial gain via bribes for official favors and positions
(*maiguan*), illegitimate business practices, and other methods have been well documented
throughout all levels of government (see Pei, 2006; Manion, 2004), and are often found at
the county level and below. On the fiscal side, widespread use of off-budget revenue
(*yusuanwai zijin*) reduces revenue streams from the original tax base, while the opaque nature
of such revenue facilitates illegitimate activities (Pei, 2006; Wong & Shue, 2007). In addition,

officials have an incentive to increase the size of local government, creating more job positions and administrative spending in order to gain additional payroll funds (Shih & Liu, 2007; Pei, 2006). While low morale among officials with budgets insufficient to cover even basic payroll expenses is one problem (Pei, 2006), rural resistance in response to local-level corruption and deviation from central government promises has been well documented (O'Brien & Li, 2006) and serves to erode revenue sources even further through widespread tax resistance among local population.

Among other problematic outcomes, one result is that overburdened local officials have little incentive to allocate spending in ways that benefit the general public. A number of authors have argued that provision of public goods such as health care, education and social welfare are of low priority to local government, whose careers depend upon results prioritized by province or prefecture-level governments (Pei, 2006; O'Brien & Li, 2006; Duckett, 2007). High-priority goals are economic development, enforcement of one-child and other birth control policies, and what Minxin Pei (2006) terms "showy" projects, such as large-scale construction or infrastructure projects involving roads, bridges, and urban development. While the incentive for local government officials to invest in areas that carry short-term impact and career benefits has been well documented in developed as well as developing countries, counties in China face a particular situation in that the local government faces few functional constraints from ground-level publics, and increased decentralization has heightened budget constraints while reducing monitoring. The result is that low-priority social spending becomes the victim of circumstance. Costly social spending such as education, provision of health care, and improvement of labor conditions is less

visible, and loses ground to immediate budgetary needs such as wages, garnished payrolls, corruption, and career projects.

Therefore, given the background we expect little incentive for officials at the county level to spend on social goods and services in TEM areas. As we have seen previously, TEMs are poor, marginalized and outnumbered, with little political representation and/or power. Many minority groups are underrepresented in local governments and party organizations. In addition, due to migration policies encouraging Han movement to minority areas, ethnic minorities often do not hold absolute majorities in their immediate administrative districts. The resulting combination of circumstances places TEMs at a disadvantage in receiving already scarce funds. Social spending on education, health care and general public goods which benefit local populations are low priority in any locality, and TEM populations simply decrease the incentive to spend on such projects.

6.3 Public Goods Spending

In terms of public goods provision, I focus on two broad components of spending on public goods in the China-North Korea border area: social welfare, which includes both unemployment and health insurance, and education spending. These categories are not only some of the most broadly recognized indicators of spending on public goods which directly impact citizens, but also serve to distinguish "real" public spending from "show" projects such as urban remodeling and beautification, large-scale construction and rural roads projects, etc. The latter may command large budgets but is widely considered to serve local officials' career interests rather than provide public services (Pei, 2006). The former is more

indicative of services which affect citizens' daily lives. Further, Northeast China is a relatively developed area of the country, where spending on large-scale roads or infrastructure is less likely to have a significant impact on the economic well-being of citizens in comparison to less developed areas such as Western China – and more likely to benefit local officials, who reap the rewards of career advancement and lucrative payoffs from businesses involved in the process.

Overall, both categories have undergone considerable changes in administration since economic reform. Like all social services, both have been subject to fiscal and administrative decentralization trends, which have shifted the burden of financing social services to county-level, township and village governments, to the detriment of public goods benefits in general. Both have been affected by an increasingly privatized economy, which has demolished the traditional work-unit-based provision of social services and replaced it with multiple different mechanisms, often bypassing the most vulnerable in society. The increasing rural-urban divide in economic development, and trend of (often illegal) rural-urban migration impacts both.

Social welfare spending covers a wide range of expenditures: both social insurance and social assistance (Hussain, 2007), including pension, medical insurance, unemployment insurance, work-related injuries and birth-giving insurance. Post economic reform, the burden of provision of social insurance has shifted away from the traditional work unit (*danwei*) to fall mostly on the individual, as private enterprises rarely cover social welfare. Even SOEs do not fully cover all categories (Hussain, 2007). In conjunction with fiscal and

administrative decentralization, this trend has resulted in a squeezing of local government and a greater burden upon individual taxpayers and families. Additional factors include the sharp regional and urban-rural divide in economic development, which has increased the variation in provided services across areas.

From a social welfare standpoint, more worrisome to many is the limited and even shrinking population covered by government welfare. The size of recipients has been affected by factors such as overwhelming rural-urban migration, privatization, and the breakdown of health care in rural areas. Because social services are tied to household registration (*hukou*) rather than the actual location of residence, aside from a few exceptional cases migrants are excluded from social services in cities. On the other hand in rural areas, the collapse of the previous system of medical care (see Duckett, 2007) left many without access or economic means to receive adequate medical services, and other social services are in a similar situation. Combined with the transition to a market economy and the breakdown of the work unit as a central provider of social welfare in urban areas, this development has resulted in a large population with no coverage, or only partial access across the nation.

Education spending mirrors trends in public spending in general, and appears subject to the same societal factors. Again fiscal and administrative decentralization have shifted the burden of spending to lower-level local government. The gap between education in rural and urban areas is marked, in enrolment and quality of education as well as graduation rate and final level of education achieved.

However, education tends to be more heavily reliant on local budgets. Even more so than other public goods in rural China, education is dependent on lower-level government funding; for instance, in some areas 78 percent of education spending was obtained from local townships, compared to 9 percent from the county and 13 percent from province and center (Murphy, 2007). Unlike social welfare spending, the percentage of central support is low. Instead local governments rely on a mixture of local budget, extra fees and taxes, and other resources to obtain funding for education, which is often a disproportionately large expenditure at the county, township and village level. Generally, education spending enjoys strong public support, and corresponding willingness to comply with taxation, although the burden is large. Thus the burden of social service provision is shifted to individuals and families.

Therefore, in this study I focus on a sub-category of education spending, "subsidy for education spending," which is limited to spending of higher-level subsidies for education purposes. I use this measure chiefly because the localized nature of education budgets make it difficult to properly tease out higher-level versus local revenue sources, or connect grant allocation with spending outcomes. By using this limited measure, I test the causal factors in my theory upon spending of higher-level government transfers only.

6.4 Hypotheses

Theories of democratic welfare states suggest greater development automatically lead to greater public spending. However, studies of authoritarian regimes show public goods provision – including social welfare, education, health insurance, etc – are less likely to

groups who hold little political power in selection of leadership, or who are not necessary for maintenance of power. As we have pointed out previously, authoritarian regimes are widely perceived as providers of private rather than public goods.

In all regime types theories of redistributive spending hold weight. In democracies, a wider selectorate can drive public spending (BDM et al, 2003) but also contribute to more equalizing fiscal policies which deliver votes. In non-democracies, concerns of legitimacy and long time horizons can temper the rent-extracting urges of dictators, who are likely to redistribute to groups in need to maximize support. In particular authoritarian regimes holding elections are more likely to cater to the public, creating political budget cycles (Hyde, etc). However, as we have already seen, the Korean minority is considered particularly "Sinicized" and enjoys relatively high income levels. This leads us to early rejection of any argument involving redistributive fiscal policies in the case of the North Korea-China border area.

If local government in China does not have incentive to provide goods, why would we expect to see a deviation from the norm on the North Korea-China border? First, the theory outlined in previous chapters suggests TEM unrest, and especially fear of foreign political risk spillover, drives distribution as well as spending in this area. Second, as we have examined in previous chapters, career incentives at the county as well as province level drive spending in categories that would otherwise be subject to graft on the part of local officials. Because local officials may lose their jobs or suffer severe penalties as a result of ethnic

unrest, social spending in TEM areas with foreign political risk become high-priority tasks. The theory leads to the following hypotheses:

H1: Social spending in areas proximate to the border will increase with greater foreign political risk.

H2: Social spending in areas proximate to the border will increase with greater TEM population share.

H3: Social spending will be targeted at areas that are important to minority unrest due to cross-border spillover of foreign political risk, such as education.

6.5 Tests and Results

The empirical strategy employed in this chapter is as follows: I use fixed effects analysis on county-level social spending data from 1995 to 2003 in two geographical area samples, Jilin province and all counties adjacent to North Korea. I utilize both county and province-level fixed effects as well as GLS analysis when applicable, and again employ a battery of controls and robustness checks to provide empirical rigor. I test the essential causal variables demonstrated in previous chapters – the interaction between proximity, TEM population share and foreign political risk – upon spending in various categories of social spending which are likely to impact TEMs. The following provides an overview of the results and a discussion of the theoretical implications of my findings.

Table 6.1 Areas Proximate to North Korea, Summary Statistics

Variable	N	Mean	SD	Min	Max
DV					
Social Welfare Spending	2166	0.001435	0.004034	-0.14461	0.031575
Education Subsidy Spending	727	0.00074	0.000866	0	0.006055
CV					
TEM pop (%of total)	3294	0.010035	0.061973	0	0.654282
CV1: State Fragility Index	3294	0.466667	0.056577	0.36	0.52
CV2: ONDD Political Risk	3294	0.887831	0.063148	0.8	1
CV3: ONDD Transfer Risk	3294	1.044444	0.125727	1	1
Proximity	3294	3.61E-06	1.09E-05	7.80E-07	0.000126
Controls					
GDP (per capita)	2460	500396.2	2235682	1	6.59E+07
Urban	3294	0.254098	0.435419	0	1
Regime	3294	1	0	1	1
Trade	3294	21.33333	2.160575	19	27

In the first sample of all counties proximate to North Korea, fixed effects analysis at both county and province levels yield results that are consistent with several hypotheses. A county-level fixed effects analysis finds a strong relationship between the interaction term and social welfare spending for CV1: State Fragility Index and CV3: ONDD Transfer Risk. With each standard deviation increase in the interaction, we expect a 1,321.906[1] yuan increase in social welfare spending for CV1, and a 107.187[2] yuan increase for CV3. Graph analysis also reveals that for CV1 and CV3 in particular the marginal effect of TEM population share on the dependent variable is positive and increasing for border areas as foreign political risk increases. Thus TEM population effects drive social welfare spending.

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[1] 1963.07-640.989-0.175

[2] 355.394 -248.168 -0.039 107.187

Table 6.2 Areas Proximate to North Korea, County FE, DV: Social Welfare Spending

	CV1	CV2	CV3
Causal Variables	**Social Welfare Spending**		
TEM pop	.	.	.
	.	.	.
CV	-0.005***	-0.001	-0.001
	(0.00)	(0.00)	(0.00)
Proximity	.	.	.
	.	.	.
TEM pop * CV	-0.014	-0.039***	-0.175***
	(0.01)	(0.01)	(0.02)
TEM pop * Proximity	.	.	.
	.	.	.
CV * Proximity	-173.057***	-248.168***	-640.989***
	(34.08)	(30.74)	(77.52)
TEM pop * CV * Proximity	-231.606	355.394***	1963.070***
	(146.85)	(96.75)	(233.01)
Controls			
Domestic			
*ln*GDP	-0.000***	-0.000***	-0.000**
	(0.00)	(0.00)	(0.00)
Urban	.	.	.
	.	.	.
Foreign			
Regime	.	.	.
	.	.	.
*ln*Trade	-0.005	-0.005	-0.003
	(0.00)	(0.00)	(0.00)
Constant	0.024**	0.020*	0.013
	(0.01)	(0.01)	(0.01)
N	2070	2070	2070
N-grps	365	365	365

* p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses
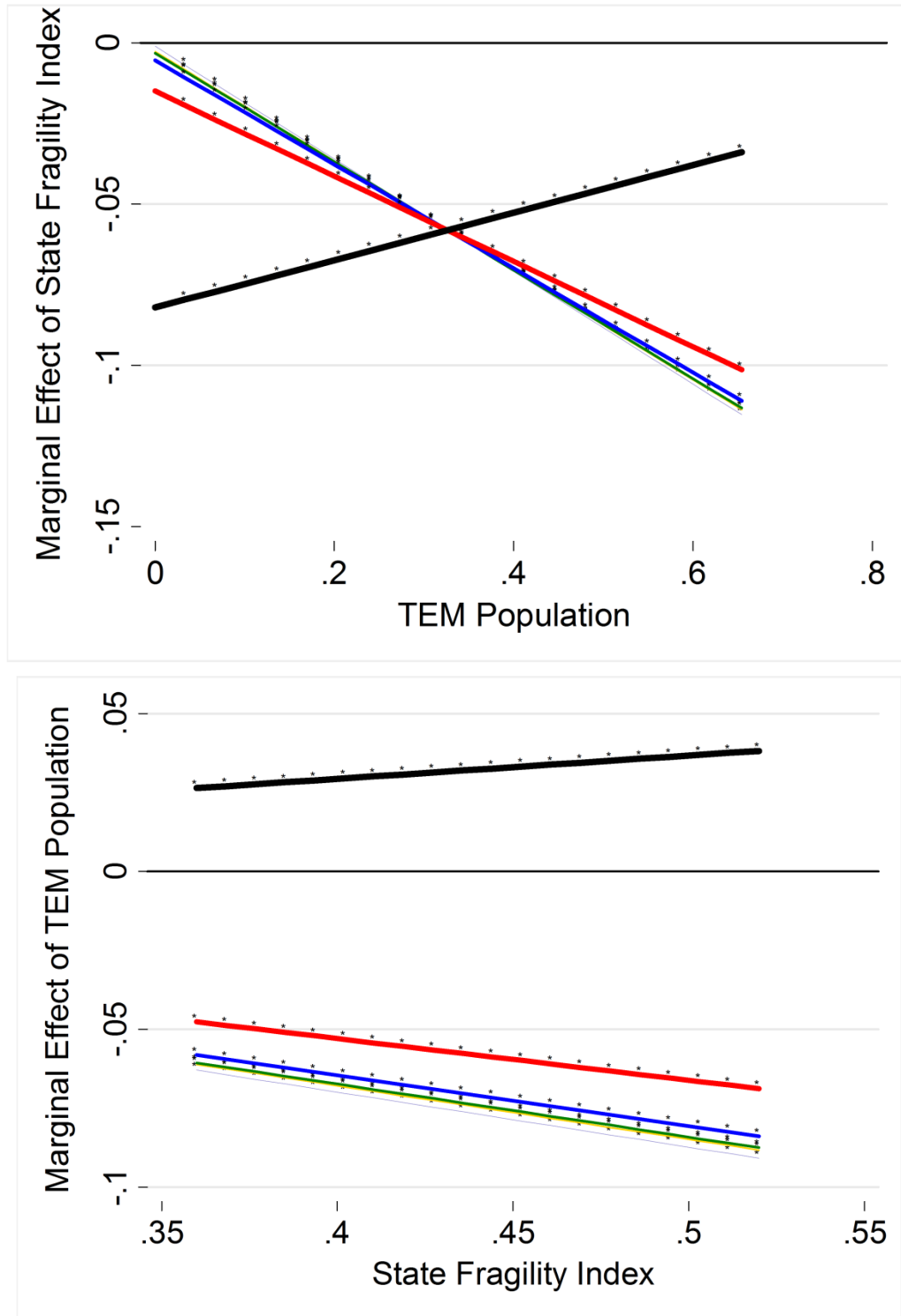
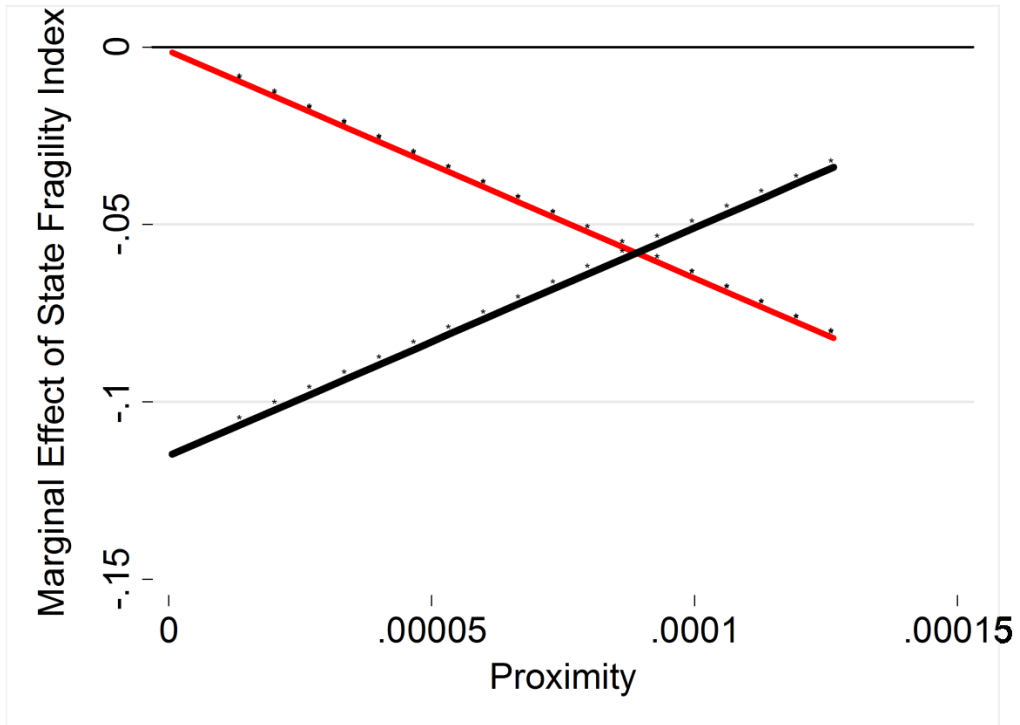**Figure 6.1 Areas Proximate to NK County FE, DV: Social Welfare Spending, CV1: State Fragility Index Graphs**

Figure 6.1 Areas Proximate to NK County FE, DV: Social Welfare Spending, CV1: State Fragility Index Graphs (figure continued from previous page)
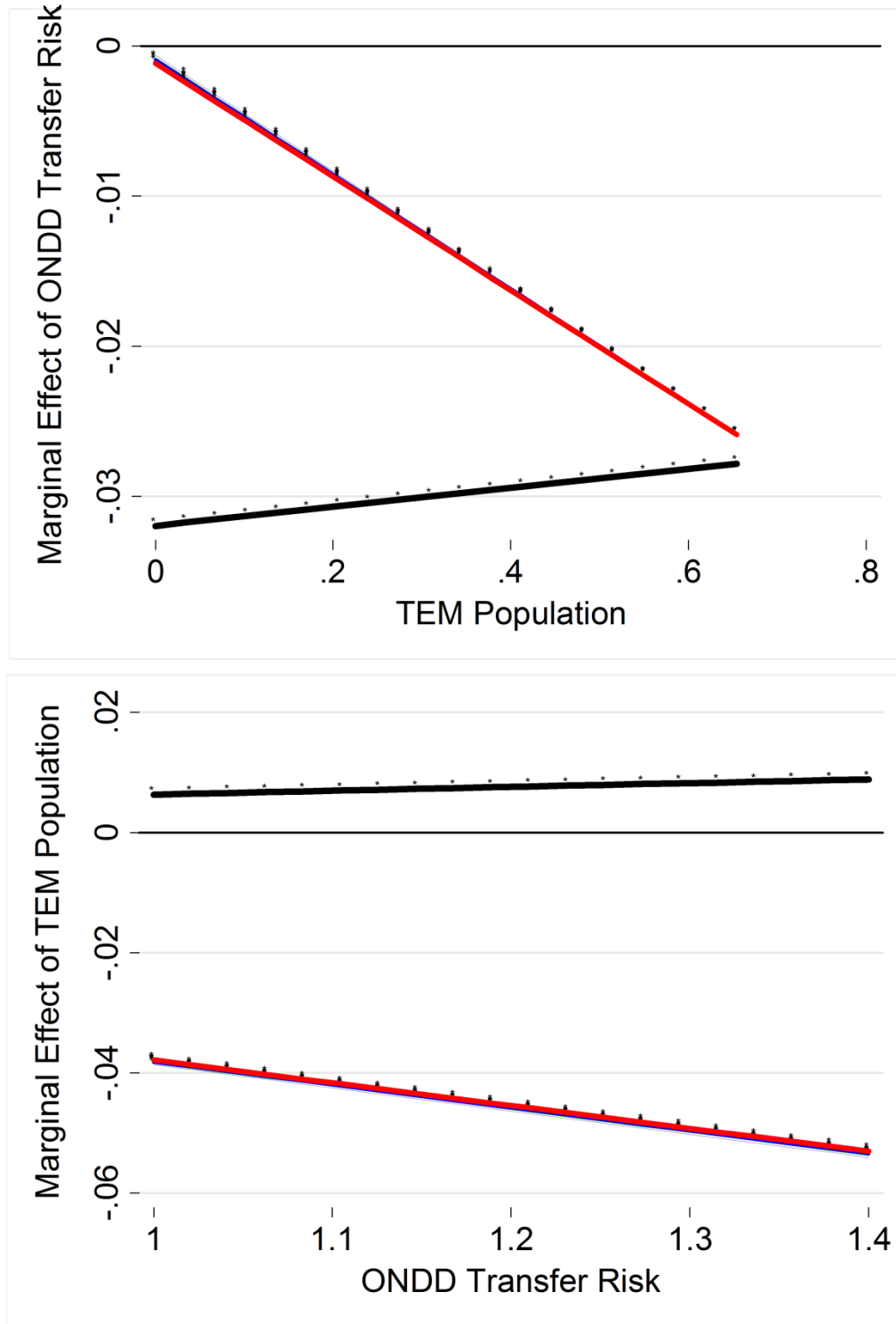
Figure 6.2 Areas Proximate to NK County FE, DV: Social Welfare Spending, CV3: ONDD Transfer Risk Graphs
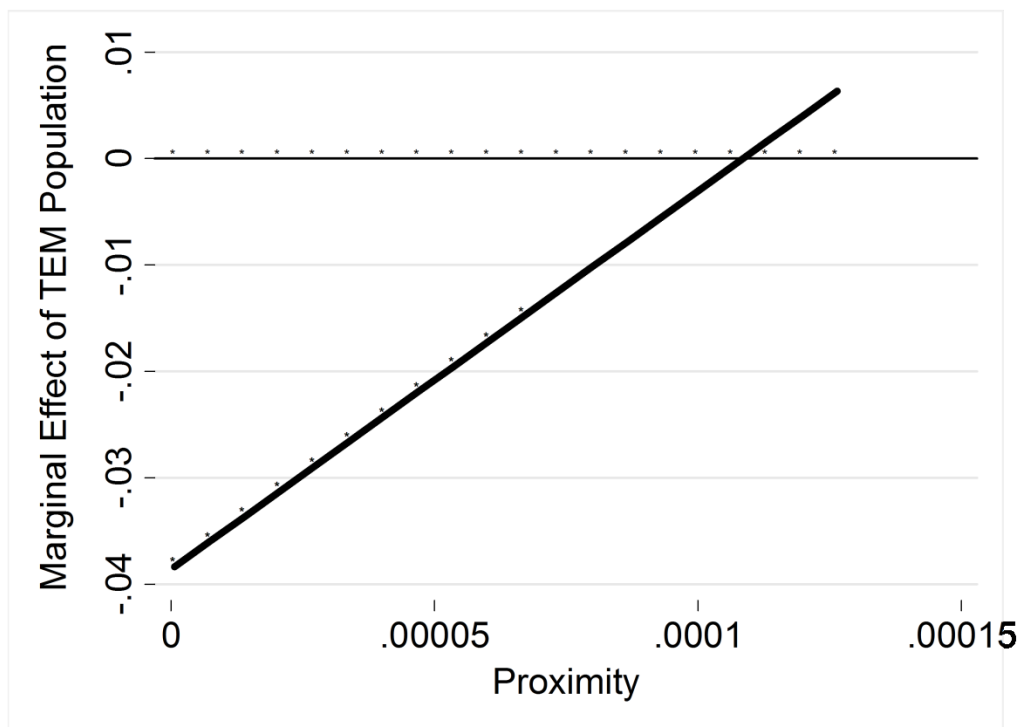
Figure 6.2 Areas Proximate to NK County FE, DV: Social Welfare Spending, CV3: ONDD Transfer Risk Graphs (figure continued from previous page)

The relationship between the interaction term and education subsidy spending is supported for CV1. As the following table shows, we can expect a 738. 974[3] yuan increase in transfers for each standard deviation increase in the interaction term. The graphs show a positive and increasing marginal effect of foreign political risk on the dependent variable, and the same for TEM population share. In both cases, GDP per capita effects are extremely marginal and much smaller than even the small effects observed in previous studies. Other controls, such as urban area status and neighboring country regime type, are insignificant or time-invariant.

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[3] 739.002-0.028

Table 6.3 Areas Proximate to North Korea, County FE, DV: Education Subsidy Spending

	CV1	CV2	CV3
<u>**Causal Variables**</u>	**Education Subsidy Spending**		
TEM pop	.	.	
	.	.	
CV	0.002	.	0.001
	(0.00)	.	(0.00)
Proximity	.	.	
	.	.	
TEM pop * CV	-0.028**	.	0.000
	(0.01)	.	(0.00)
TEM pop * Proximity	.	.	
	.	.	
CV * Proximity	-62.180	.	-12.610
	(40.02)	.	(23.06)
TEM pop * CV * Proximity	739.002*	.	11.129
	(304.81)	.	(159.54)
<u>**Controls**</u>			
Domestic			
*ln*GDP	-0.000	-0.000**	-0.000
	(0.00)	(0.00)	(0.00)
Urban	.	.	
	.	.	
Foreign			
Regime	.	.	
	.	.	
*ln*Trade	-0.000	-0.001	0.001
	(0.00)	(0.00)	(0.00)
Constant	0.001	0.003	-0.002
	(0.00)	(0.00)	(0.00)
N	726	726	726
N-grps	320	320	320

* p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses

Figure 6.3 Areas Proximate to NK County FE, DV: Education Subsidy Spending, CV1: State Fragility Index Graphs
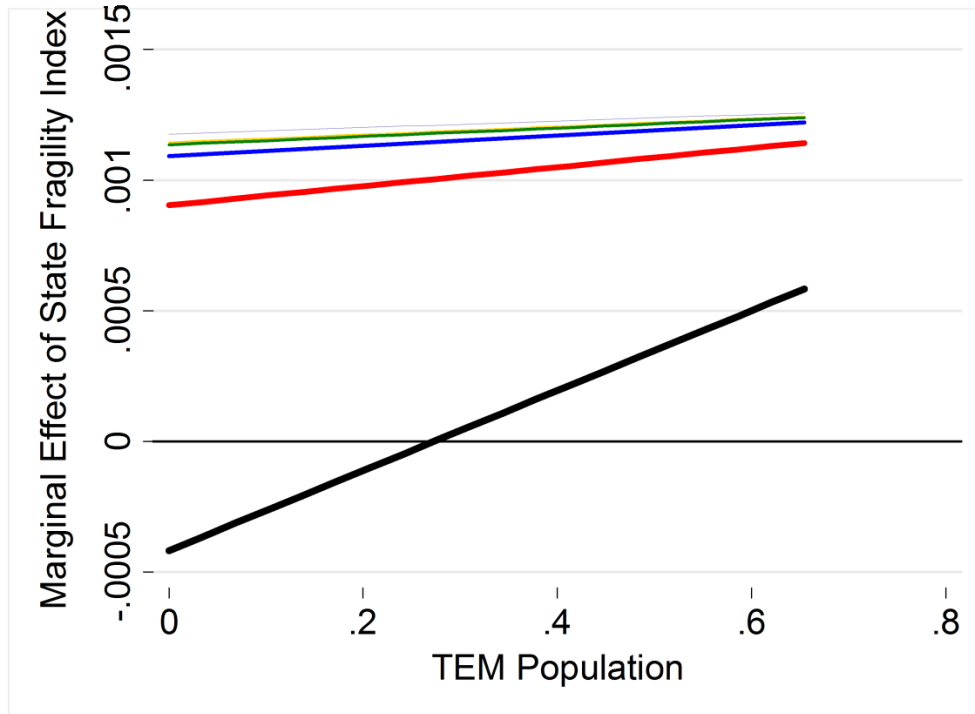
Figure 6.3 Areas Proximate to NK County FE, DV: Education Subsidy Spending, CV1: State Fragility Index Graphs (figure continued from previous page)
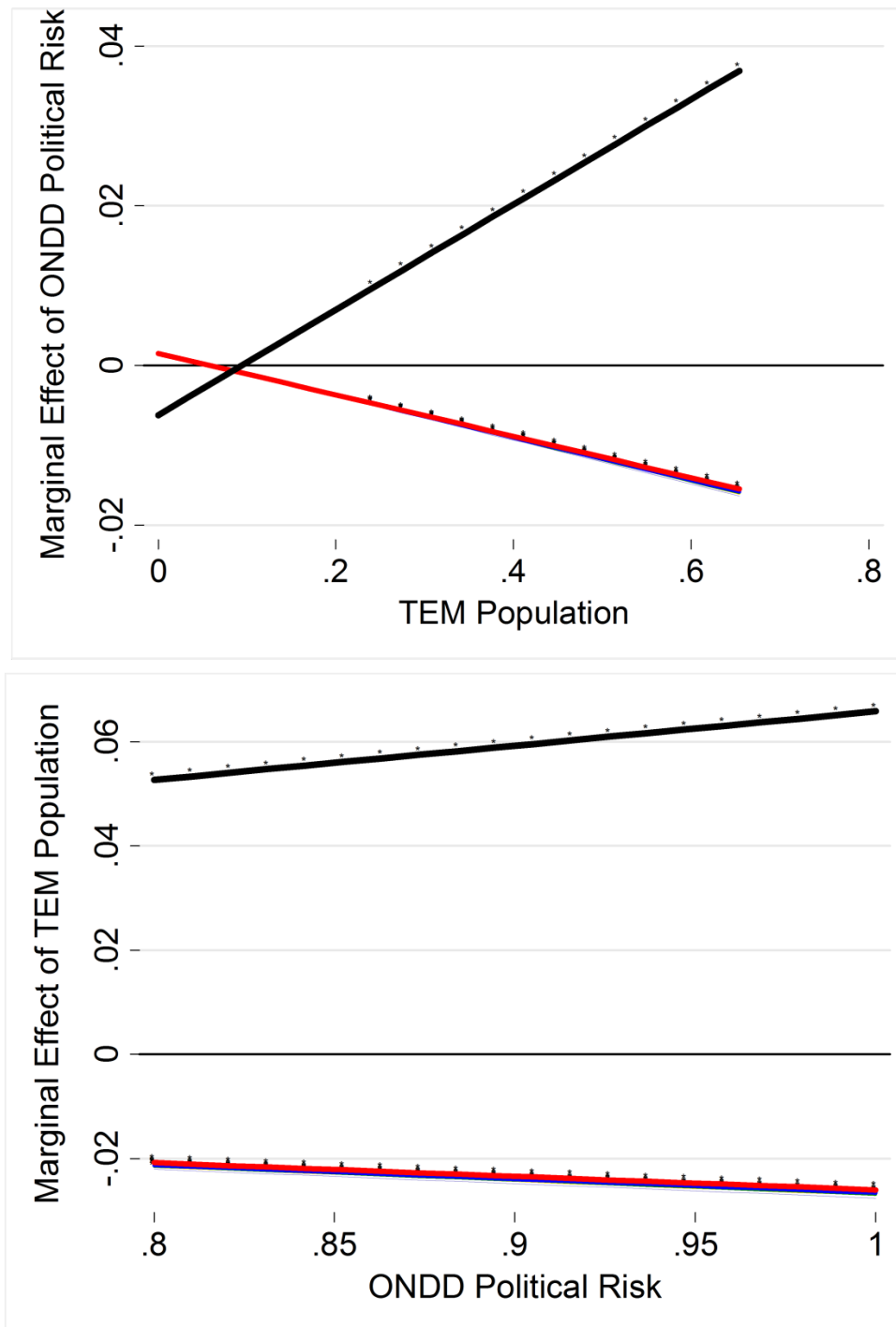
Figure 6.4 Areas Proximate to NK County FE, DV: Education Subsidy Spending, CV2: ONDD Political Risk Graphs
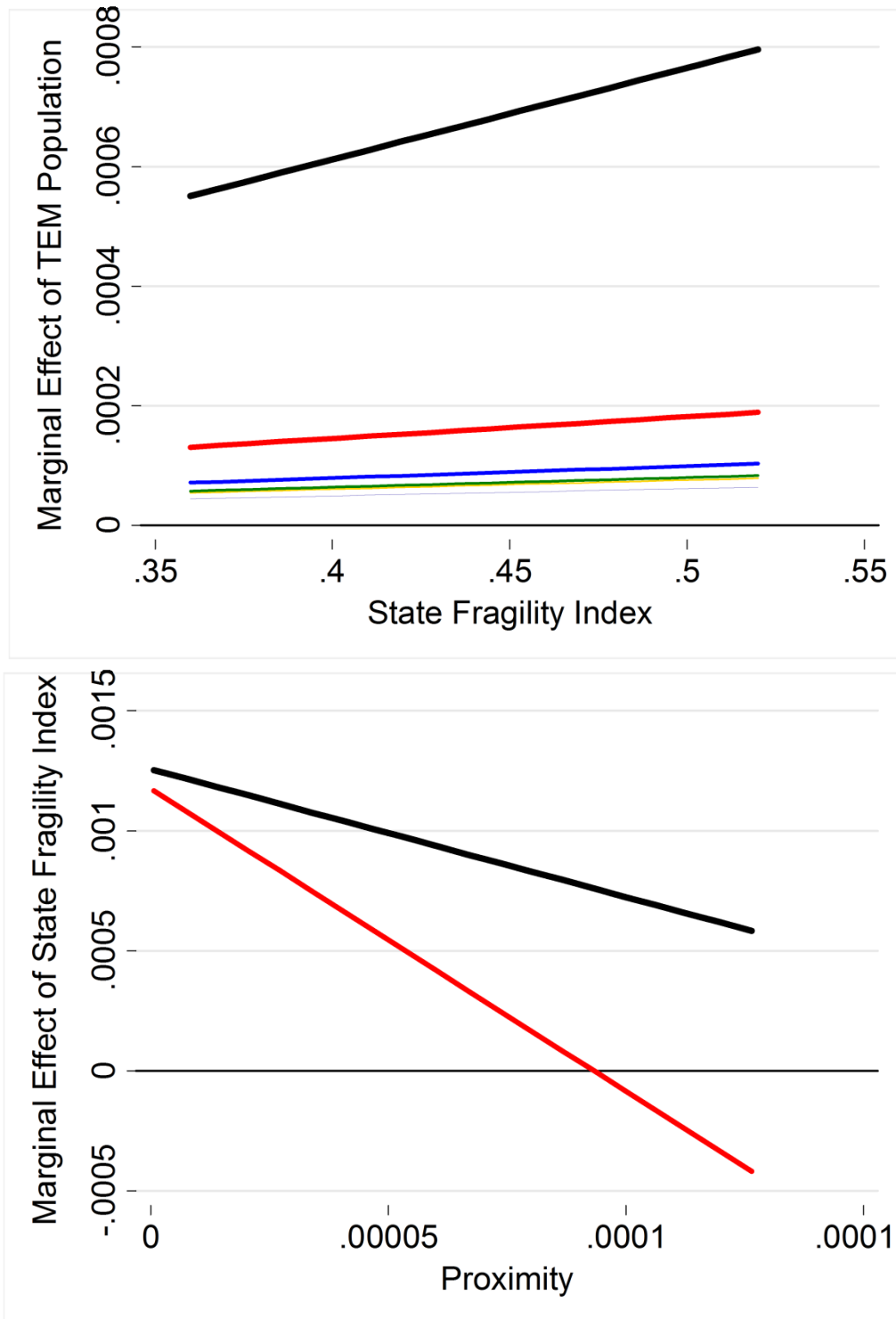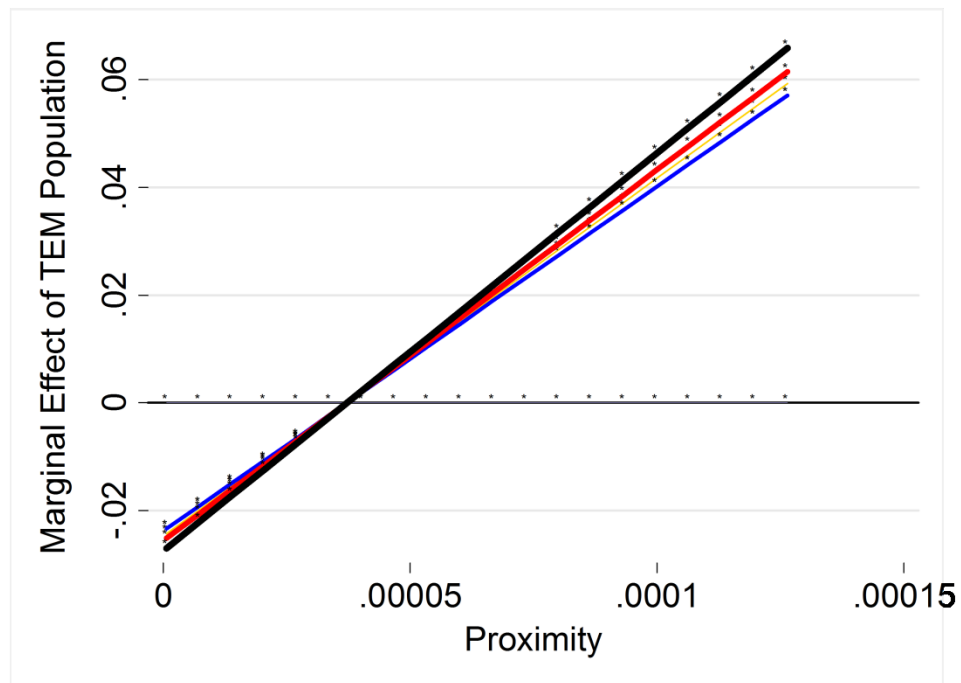
Figure 6.4 Areas Proximate to NK County FE, DV: Education Subsidy Spending, CV2: ONDD Political Risk Graphs (figure continued from previous page)

At the province level we find center-to-province transfers show similar results. Using OLS province-level fixed-effects, we can see that interactions involving CV1 and CV3 are positive and significant for social welfare spending, while the interaction for CV2 is positive and significant for education spending. Again controls appear to have only a slight effect or none at all. GLS tests show similar or stronger results.

Table 6.4 Areas Proximate to North Korea, Province FE, DV: Social Welfare Spending

	CV1	CV2	CV3
<u>**Causal Variables**</u>	**Social Welfare Spending**		
TEM pop	0.091***	0.022	0.051***
	(0.02)	(0.06)	(0.01)
CV	-0.001	-0.005***	-0.001***
	(0.00)	(0.00)	(0.00)
Proximity	366.005***	230.980	336.509***
	(94.66)	(330.97)	(64.87)
TEM pop * CV	-0.172***	-0.013	-0.038***
	(0.04)	(0.07)	(0.01)
TEM pop * Proximity	-955.403**	127.128	-446.586*
	(331.76)	(1083.29)	(213.62)
CV * Proximity	-614.996**	-168.177	-241.562***
	(192.31)	(377.76)	(45.90)
TEM pop * CV * Proximity	1873.510*	-229.638	342.696*
	(739.99)	(1219.86)	(152.33)
<u>**Controls**</u>			
Domestic			
*ln*GDP	-0.000***	-0.000***	-0.000***
	(0.00)	(0.00)	(0.00)
Urban	0.000	0.000*	0.000*
	(0.00)	(0.00)	(0.00)
Foreign			
Regime	.	.	.
	.	.	.
*ln*Trade	-0.001	-0.003	-0.003
	(0.00)	(0.00)	(0.00)
Constant	0.007	0.019***	0.015**
	(0.01)	(0.01)	(0.01)
N	2070	2070	2070

* p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses

Table 6.5 Areas Proximate to North Korea, Province GLS, DV: Social Welfare Spending

	CV1	CV2	CV3
Causal Variables	**Social Welfare Spending**		
TEM pop	0.091***	0.022	0.051***
	(0.01)	(0.01)	(0.01)
CV	-0.001	-0.005***	-0.001***
	(0.00)	(0.00)	(0.00)
Proximity	372.745***	230.980***	339.746***
	(42.45)	(36.67)	(39.20)
TEM pop * CV	-0.173***	-0.013	-0.038***
	(0.02)	(0.01)	(0.01)
TEM pop * Proximity	-976.041***	127.128	-453.011***
	(126.68)	(143.45)	(119.80)
CV * Proximity	-627.224***	-168.177***	-243.970***
	(79.61)	(35.01)	(30.67)
TEM pop * CV * Proximity	1914.880***	-229.638	347.924***
	(242.09)	(140.96)	(94.79)
Controls			
Domestic			
*ln*GDP	-0.000***	-0.000***	-0.000***
	(0.00)	(0.00)	(0.00)
Urban	0.000	0.000	0.000
	(0.00)	(0.00)	(0.00)
Foreign			
Regime	.	.	.
	.	.	.
*ln*Trade	-0.002	-0.003	-0.004
	(0.00)	(0.00)	(0.00)
Constant	0.009	0.019***	0.016**
	(0.01)	(0.01)	(0.01)
N	2070	2070	2070
N-groups	365	365	365

* p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses

Table 6.6 Areas Proximate to North Korea, Province FE, DV: Education Subsidy Spending

	CV1	CV2	CV3
Causal Variables	**Education Subsidy Spending**		
TEM pop	-0.000	0.040***	0.000
	(0.00)	(0.01)	(0.00)
CV	0.001	0.001	.
	(0.00)	(0.00)	.
Proximity	6.443	53.179	-5.128**
	(11.29)	(39.00)	(1.73)
TEM pop * CV	0.001	-0.045***	.
	(0.00)	(0.01)	.
TEM pop * Proximity	26.357	-1120.607***	-3.265
	(74.50)	(299.95)	(3.81)
CV * Proximity	-26.671	-67.289	.
	(25.90)	(44.47)	.
TEM pop * CV	-65.486	1283.982***	.
* Proximity	(169.44)	(346.22)	.
Controls			
Domestic			
*ln*GDP	-0.000**	-0.000**	-0.000***
	(0.00)	(0.00)	(0.00)
Urban	-0.000*	-0.000*	-0.000*
	(0.00)	(0.00)	(0.00)
Foreign			
Regime	.	.	.
	.	.	.
*ln*Trade	-0.001	-0.002*	-0.001*
	(0.00)	(0.00)	(0.00)
Constant	0.003	0.005	0.006**
	(0.00)	(0.00)	(0.00)
N	726	726	726
N-groups	320	320	320

* p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses

Table 6.7 Areas Proximate to North Korea, Province GLS, DV: Education Subsidy Spending

	CV1	CV2	CV3
<u>Causal Variables</u>	**Education Subsidy Spending**		
TEM pop	-0.000	0.040***	0.000
	(0.00)	(0.01)	(0.00)
CV	0.001	0.001	.
	(0.00)	(0.00)	.
Proximity	6.443	53.179	-5.128**
	(11.29)	(39.00)	(1.73)
TEM pop * CV	0.001	-0.045***	.
	(0.00)	(0.01)	.
TEM pop * Proximity	26.357	-1120.607***	-3.265
	(74.50)	(299.95)	(3.81)
CV * Proximity	-26.671	-67.289	.
	(25.90)	(44.47)	.
TEM pop * CV	-65.486	1283.982***	.
*** Proximity**	(169.44)	(346.22)	.
<u>Controls</u>			
Domestic			
*ln*GDP	-0.000**	-0.000**	-0.000***
	(0.00)	(0.00)	(0.00)
Urban	-0.000*	-0.000*	-0.000*
	(0.00)	(0.00)	(0.00)
Foreign			
Regime	.	.	.
	.	.	.
*ln*Trade	-0.001	-0.002*	-0.001*
	(0.00)	(0.00)	(0.00)
Constant	0.003	0.005	0.006**
	(0.00)	(0.00)	(0.00)
N	726	726	726
N-groups	320	320	320

* p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses

In the second sample of Jilin province, county-level fixed effects analysis show

similar results for social welfare spending. Interactions with CV1 and CV3 are both

significant and positive. As the graphs show, TEM population share appears to drive

outcomes. Again, controls are insignificant or exhibit only a very marginal effect.

Education subsidy spending, on the other hand, does not show the same level of

support visible in the earlier sample. I attribute this to already-high levels of educational

achievement in Jilin province. As discussed in Chapter 5, education rates have been less of a

concern in Korean minority areas due to the relatively high levels of achievement among

minorities in the Northeast. Given the situation, officials in Korean minority areas have less

incentive to allocate heavily to schools versus social welfare services.

Table 6.8 Jilin Province, Summary Statistics

Variable	N	Mean	SD	Min	Max
DV					
Social Welfare Spending	220	0.004544	0.004959	1.76E-05	0.028106
Education Subsidy Spending	97	0.000857	0.000328	0	0.001325
CV					
TEM pop (%of total)	333	0.093722	0.060248	0.000184	0.654282
CV1: State Fragility Index	333	0.45946	0.056577	0.32	0.52
CV2: ONDD Political Risk	333	0.873802	0.079445	0.619048	1
CV3: ONDD Transfer Risk	333	1.021536	0.153236	0.571429	1
Proximity	333	1.92E-05	2.91E-05	2.56E-06	0.000126
Controls					
GDP (per capita)	252	248560.1	708255.9	3	7.98E+06
Urban	333	0.297297	0.457756	0	1
Regime	333	1	0	1	1
Trade	333	20.27928	4.125672	7	27

Table 6.9 Jilin Province, County FE, DV: Social Welfare Spending

	CV1	CV2	CV3
Causal Variables	Social Welfare Spending		
TEM pop	.	.	.
	.	.	.
CV	-0.000	-0.016***	-0.002
	(0.00)	(0.00)	(0.00)
Proximity	.	.	.
	.	.	.
TEM pop * CV	-0.160***	-0.023	-0.035**
	(0.02)	(0.02)	(0.01)
TEM pop * Proximity	.	.	.
	.	.	.
CV * Proximity	-573.134***	-175.233**	-226.059***
	(71.31)	(52.55)	(32.38)
TEM pop * CV * Proximity	1929.857***	-126.127	377.267***
	(198.81)	(229.69)	(105.13)
Controls			
Domestic			
*ln*GDP	-0.001***	-0.001***	-0.001***
	(0.00)	(0.00)	(0.00)
Urban	.	.	.
	.	.	.
Foreign			
Regime	.	.	.
	.	.	.
*ln*Trade	-0.001	-0.009*	-0.008*
	(0.00)	(0.00)	(0.00)
Constant	0.020**	0.060***	0.045***
	(0.01)	(0.01)	(0.01)
N	213	213	213
N-grps	37	37	37

* p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses

Table 6.10 Jilin Province, County FE, DV: Education Subsidy Spending

Causal Variables	CV1 Social Welfare Spending	CV2	CV3
TEM pop	.	.	.
	.	.	.
CV	-0.001*	0.001	.
	(0.00)	(0.00)	.
Proximity	.	.	.
	.	.	.
TEM pop * CV	0.004	-0.018	.
	(0.00)	(0.01)	.
TEM pop * Proximity	.	.	.
	.	.	.
CV * Proximity	24.654	-64.821	.
	(17.67)	(49.20)	.
TEM pop * CV * Proximity	-144.610	525.948	.
	(132.08)	(411.81)	.
Controls			
Domestic			
*ln*GDP	-0.000	-0.000	-0.000
	(0.00)	(0.00)	(0.00)
Urban	.	.	.
	.	.	.
Foreign			
Regime	.	.	.
	.	.	.
*ln*Trade	-0.000	0.000	0.000
	(0.00)	(0.00)	(0.00)
Constant	0.001**	0.001	0.000
	(0.00)	(0.00)	(0.00)
N	97	97	97
N-grps	37	37	37

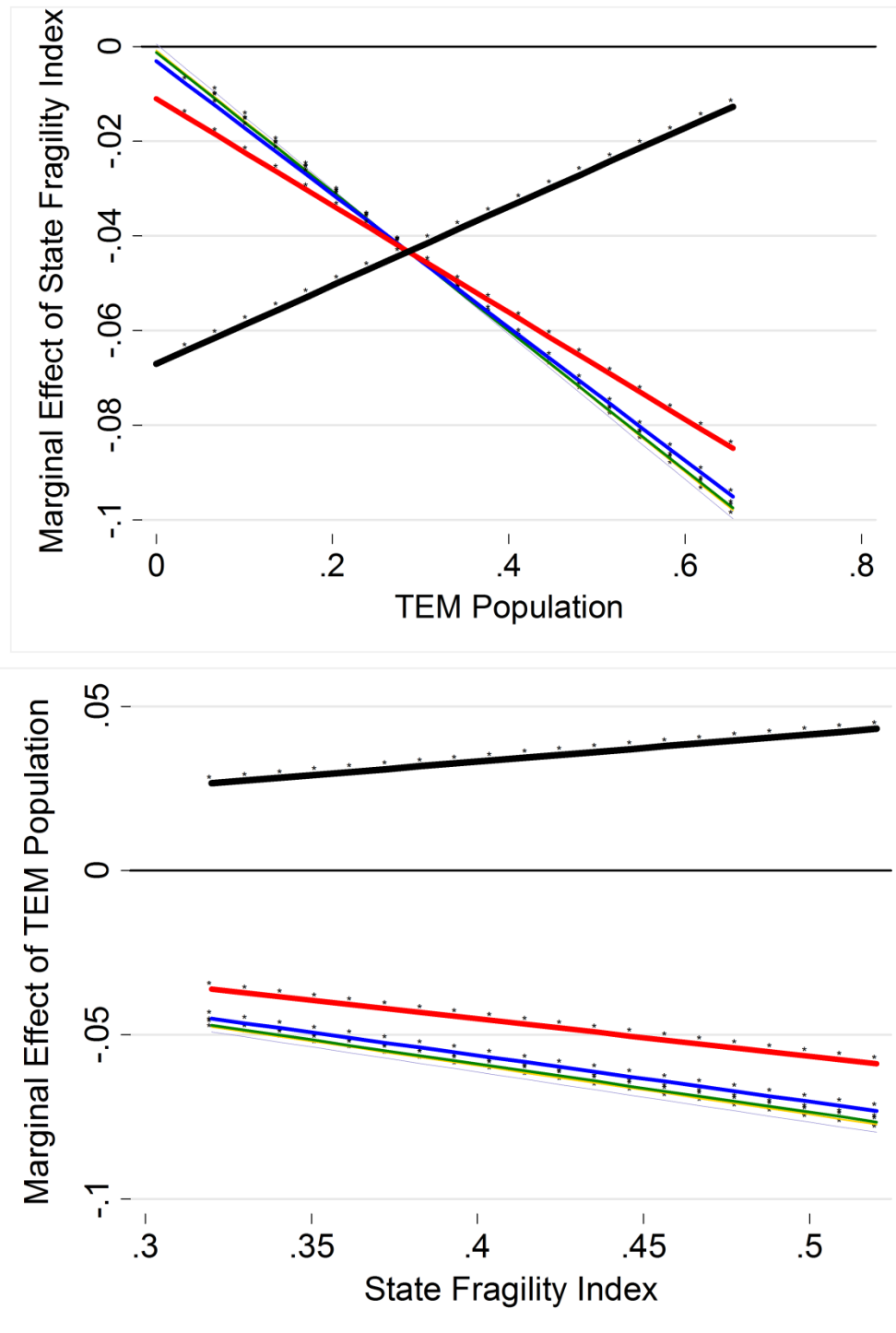** p<0.05, ** p<0.01, *** p<0.001; Robust standards errors in parentheses*

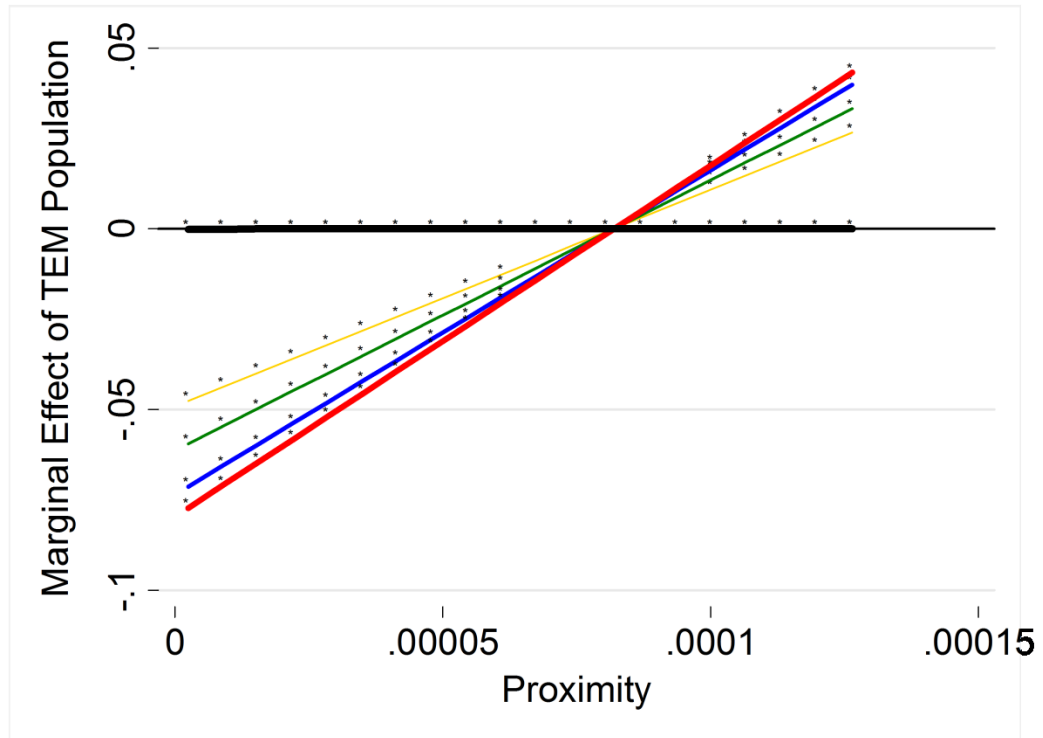**Figure 6.5 Jilin CountyFE, DV: Social Welfare Spending, CV1: State Fragility Index Graphs**

Figure 6.5 Jilin CountyFE, DV: Social Welfare Spending, CV1: State Fragility Index Graphs
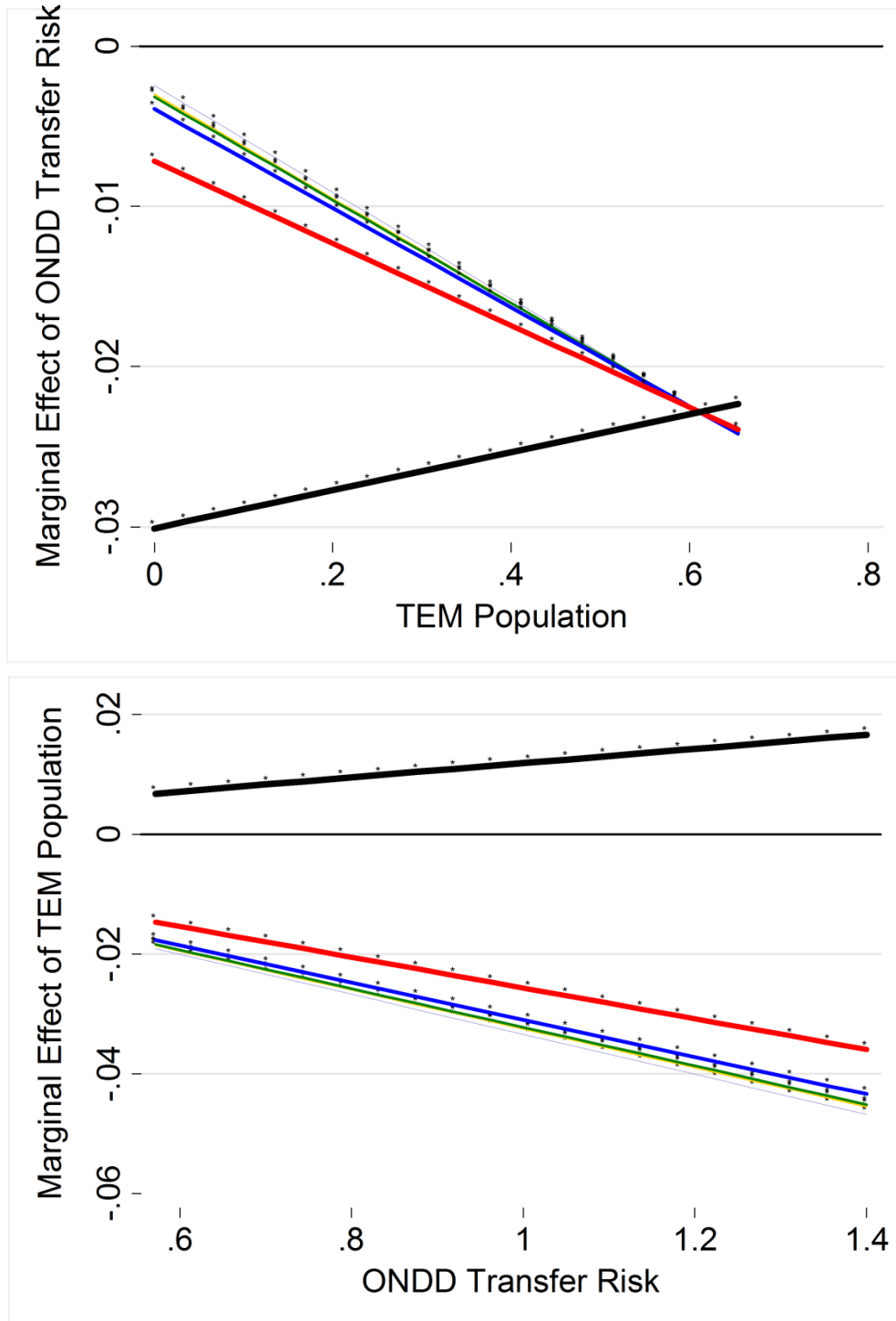**(figure continued from previous page)**

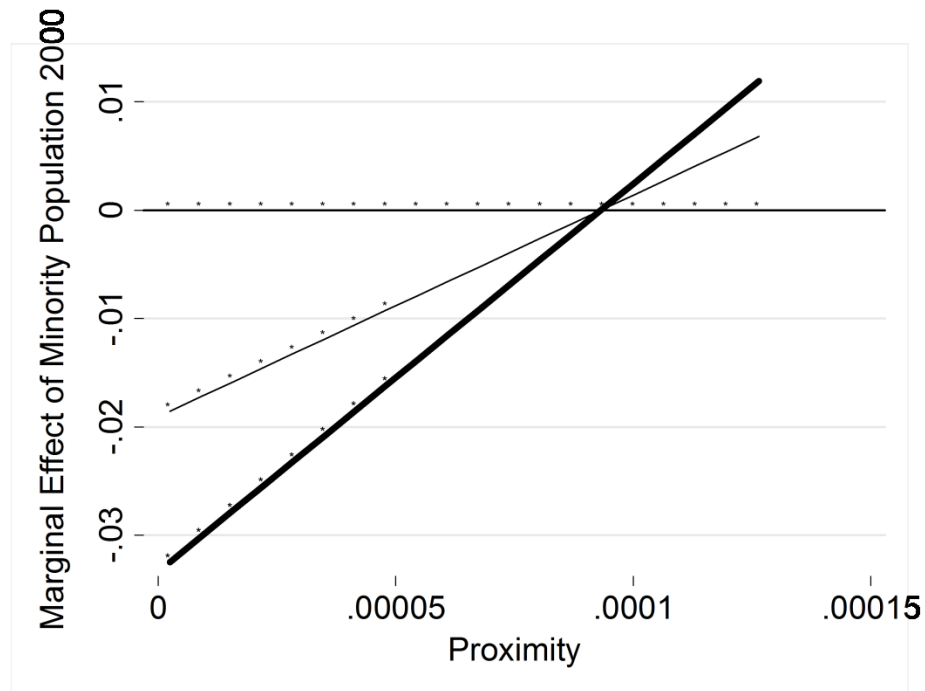**Figure 6.6 Jilin CountyFE, DV: Social Welfare Spending, CV3: ONDD Transfer Risk Graphs**

Figure 6.6 Jilin CountyFE, DV: Social Welfare Spending, CV3: ONDD Transfer Risk Graphs
(figure continued from previous page)

6.6 Theoretical Implications

The implications of these results for theory are evident. First, it highlights a case of authoritarian public goods provision in a least likely minority area outside the commonly assumed winning coalition. Assumptions of redistributive grant transfers do not account for transfers to average or high-income minority groups. In addition, theories have argued politically marginalized groups, such as largely outnumbered ethnic minorities in authoritarian regimes, receive less public goods and services. Given this background we would expect less-than-average transfers and less public goods spending in the China-North Korea border area. Yet the Korean TEM area receives more social welfare spending in both Jilin province and all areas close to North Korea, and more education spending in some of these areas as well.

Second, spending mirrors distribution at the local level. While earmarked grants distribution is intended, presumably, to lead to spending in corresponding categories, we have seen that this assumption does not necessarily hold in China's multi-level fiscal system. Possibilities for reallocation, graft, and corruption in general are rife in China's decentralized system of local governance, and public goods provision holds low priority with local leaders. This study shows a remarkable case in which county-level leaders, in spite of squeezed budgets, appear to follow higher-level government directives in spending transfers. This further supports the hypothesis that local level leaders have strong career incentives to prevent unrest in TEM areas by using transfers to provide public goods.

Third, TEM population share and foreign political risk seem to equally drive results. Unlike the previous chapter, TEM population share again has a strong marginal effect on spending outcomes in both samples. This leads us to conclude while distribution on the China-North Korea border appears largely driven by foreign political risk, spending actually mirrors country-level results. The gap between spending and distribution at this point is of interest. Although we do not have a clear explanation of this trend, it seems spending on public goods provision, at least, is more heavily driven by TEM population than distribution would warrant. This points to the fact that distribution of earmarked grants leads to spending over a broad range of categories, including but not limited to social welfare and education provision. We would expect certain categories to exhibit stronger foreign political risk effects in future case studies.

More broadly, the implications of these findings for governance at the local county level in China are of interest. The fiscal crisis at the local level – caused by structural problems of perverse incentives in local fiscal spending, increased demands on revenue and decreased returns from province-level governments – only grows worse as a variety of factors reduce local budgets even further. One such factor, we may hypothesize, is the preferential allocation of earmarked grant transfers to TEM areas. Because TEM areas take up resources that would otherwise be allocated to Han majority areas, rural Han areas may suffer from lack of funds on top of their current structural problems. Thus the central government faces a problem of over-distribution to TEMs, especially in periods of crisis, which may contribute to spirals of ethnic friction.

CHAPTER SEVEN

CONCLUSION

7.1 Summary of Findings

This dissertation explores the politics of distribution of grants, or "earmarked transfers" in China. Chapters 2 and 3 address the main puzzles: why do officials distribute to marginalized ethnic minorities on the border, and why do local-level officials comply with central level incentives to distribute? The two chapters lay out a theory of risk transmission across the border via TEMs, which spurs central officials distribute to these areas and use career incentives to force local-level compliance.

In Chapter 4, I find via a nation-wide study of grant transfers that areas with TEMs – transborder ethnic minorities – on the border receive greater amounts of grants in situations of foreign political risk. Analysis of transfers from the center to sub-national provinces, as well as from provinces to lower county-level units, support this argument. Stronger results in province-to-county findings suggest greater heterogeneity at the county level affects distribution outcomes; for example variance in corruption, political distance to provincial leaders, history, and a host of other circumstances at the county level can be responsible for affecting grant distribution. Also the country-wide study finds (per marginal effects graphs) among interacting factors, TEM minority share overall tends to drive outcomes slightly more than foreign political risk. These findings reflect and support the overarching theory and empirical examples introduced, which point to grants driven by both

widespread risk originating within China's borders – for example, unrest in Xinjiang in 2009 – and risk originating outside China's borders, such as the case of North Korea.

In Chapter 5, a study of grant transfers to the North Korea-China border area highlights a case in which foreign political risk overwhelmingly drives outcomes. The findings in Chapter 4 are replicated for this area, with the effects analysis showing a strong political risk effect versus TEM effects which were predominant in the previous chapter. Counties close to the border with high Korean ethnic minority levels – which, according to previous theories of domestic factors of distribution, are likely to receive less grant transfers – are shown to receive more during periods of foreign political risk.

Chapter 6 carries the case study of the North Korea-China border further through an analysis of spending, the next step after distribution. While distribution of grants serves to underscore higher-level motivations to benefit recipients at the local level, previous findings in the literature indicate spending in corresponding areas is not guaranteed. Corruption, malfeasance, and a host of other factors make it necessary to expand the analysis from distribution to spending in areas which benefit local TEM populations. By finding positive and significant relationships replicated for two key areas, social welfare spending and education subsidy spending, I expand my argument to both the process of *giving* grants to localities and actually *spending* monies in ways that consistently and tangibly benefit minority populations with ethnic kin across the border.

7.2 Contributions to Theory and Empirical Research

The findings have immediate implications for previous research. Contrary to conventional wisdom, we find ethnic minorities matter for distributional outcomes in China. While a few scholars have detected significant minority area effects in leadership efforts to deal with social stability in China (Wallace, 2009), much of the literature on fiscal distribution has either ignored minority presence or found it less than significant (Zhan, 2011). I investigate this gap in the literature by showing that minority presence alone may not be sufficient to show a significant effect upon grants, but certain *types* of ethnic minorities have a significant effect under circumstances of risk. Recent work has recognized *transborder ethnic minorities(TEMs),* or ethnic groups that straddle the border, as pertinent factors in conflict diffusion outcomes (Cederman, Girardin & Gleditsch, 2009). In the context of China, TEMs are particularly important to social stability because they channel foreign political instability on China's border into a domestic context via migration and economic ties. The possibility of ethnic unrest which results from this process motivates grants from the center down to TEM localities.

A second major factor in this study is foreign political risk, which points to the cross-border component of this project. The literature has examined how wide-scale exogenous shocks such as global economic crises and the fall of the communist bloc have affected regime turnover and democratization (Geddes, 1999). But political risk in a neighboring state – geographically limited, prior to breakdown or regime change – has yet to be examined as a factor. High risk creates a political concern because TEM areas act as "porous borders," transmitting risk flows into China. Foreign political risk threatens integrated cross-border

economies, creating economic fallout among co-ethnic kin, which in conjunction with attempted or successful migration and information inflows create shifts from the status quo in TEM areas. The possibility of ethnic mobilization resulting from such flows creates concerns of social instability for leaders, who give transfers to prevent outbreaks of mass action and unrest.

I also account for local-level variation in distribution, and differentiate between provincial and center-level leaders' incentives. Against the backdrop of current Chinese intergovernmental relations, we face two pertinent questions: 1) Given the low possibility of secession by minorities, why does the center have incentive to distribute to restive TEMs? And 2) given the fiscal autonomy enjoyed by the provinces (Guo, 2009), what incentive would they have to distribute to TEMs? As previously shown, I argue central government has incentive to give to TEMs in order to prevent social stability concerns. At the province-level, I argue career incentives induce leaders to comply with central directives. Because the center prioritizes social stability and has demonstrated political will to punish province-level leaders who allow outbreaks of unrest to occur, provincial leaders avoid loss of power by distributing heavily to TEM areas near restive borders.

In the context of previous debates on Chinese politics, findings which showcase the extent of central control over sub-national and local government officials (Montinola, Qian and Weingast, 1995) provide a strong counter to theories proposing ever-increasing decentralization and even the eventual "demise" or "falling apart" of China. While overall political and fiscal decentralization has characterized China's development since economic

reform, we find indications of clear and indisputable central authority alive and predominant; of controlled processes of decentralization and re-centralization. Career incentives are just one mechanism by which the central leadership exerts its control over local government when necessary. The empirical findings here serve to illustrate how the center can induce local compliance with central priorities in the case of TEMs bordering risky countries, in spite of clear and demonstrated incentives to act otherwise. China is certainly not falling apart, nor likely to do so in the near future.

From the perspective of cross-country research on democratic and non-democratic institutions, the results raise new questions and point, paradoxically, to the possibility of either more nuanced theories which provide further shading and gradation on institutional factors of governance outcomes, or more comprehensive, unified theories of political governance and policy-making across institutional types. Traditionally, much of the differentiation between democratic and non-democratic regimes in the literature has fundamentally rested on perceptions of institutionally endogenous outcomes. Regime type, many believe, dictates the beneficiaries of distributional policies and political tactics leaders used to retain power (Blaydes and Kayser, 2011). Democratic institutions have been thought to guarantee, via near-universal suffrage and electoral mechanisms, outcomes which benefit a wider population. In contrast, non-democratic institutions have been thought to benefit more select, smaller groups at the cost of the rest of the population (Buena de Mesquita et al, 2003). Both normative and non-normative conclusions have been drawn from this line of thought and have contributed to the development of a wide swath of the literature.

As we have seen previously, much recent research has been devoted to proving this distinction false. The results provided here contribute to this line of thought: we find significant redistribution in favor of minority groups with limited political power or representation. This begs the question, are democratic and non-democratic institutions no longer relevant in explaining distribution or any other outcomes? Or are the results we see here systematically caused by even more fine-grained variation in institutions than previously thought? While further research is necessary, an examination of sub-types of authoritarian regimes will likely provide the answer. The state capacity of the authoritarian regime – its ability to extract rents, provide goods and maintain regime stability – may be of importance in answering this question.

7.3 Future of the Project

In relation to the discussion above, this project will be expanded to include additional case studies within China which illustrate the findings of the country-wide statistical analysis. The China-North Korea border is an example of a case in which extreme foreign political risk affects grant transfers to TEMs in bordering areas, even though the TEM – the Korean ethnic group (*Chaoxianzu*) – is more affluent and less restive on average in comparison to other minorities and appears to require less in terms of redistribution. Within the context of the broader theme of central grants to TEMs, further cases highlight the diverse means and methods by which central policies toward ethnic minority groups play out in the context of modern-day China. The case of the Mongolia-China border is commonly viewed as a stable border with a large TEM presence (Han, 2011), in the form of the Mongol minority (*Mengguzu*) located in the province of Inner Mongolia. Conversely, the

case of the Xinjiang area, which is home to a large number of pan-Turkic TEMs and borders several countries in Central Asia, has been viewed as one of both high foreign political risk and high internal ethnic unrest.

In the empirical analysis, additional controls and robustness checks will be added as the data allows. Data on natural resource allocation by region, for instance, can be obtained. We also need to consider the role of regional development funding progress by the central government and how these programs interact with pro-minority or pro-TEM policies. The Western Development and Northeast Development Programs, for instance, are widely considered to have benefited minority areas. We expect that these programs fall under the umbrella of, or are driven by, pro-TEM policies, rather than "incidentally" benefiting TEMs as a side effect of programs aimed at benefiting underdeveloped regions as a whole. Further acquisition of data related to these programs is expected to shed light on this issue.

A variety of methods exist which can serve to refine and augment the existing minority population figures, ranging from regular household survey data to methods of imputing missing years from the current dataset. A time-variant TEM population variable can enable further analysis on par with current conventions in the literature. In addition, the current grant transfers data can be extended into more recent years, expanding the potential for continued research. Fixed-effects vector decomposition analysis with a more balanced dataset can be used to further support the findings of the current study.

7.4 Conclusion

Who gets what, how, and why? This question has been the focus of research in social science, with arguments pointing to a range of factors as diverse as regime types, ethnicities and group identities, culture, corruption, and clientelism. To political scientists, distribution matters because resource allocation is inescapably dictated by considerations of maintaining power, and ultimately drives important social and political outcomes.

This project contributes to research in political science on distribution and re-distribution in authoritarian regimes. It introduces new factors; it gives food for thought for future exploration. By linking debates on domestic institutions and internal factors of distribution, and discussion on foreign effects upon internal politics, I bridge disparate literatures, synthesizing oft-conflicting factors of explanation and presenting a more comprehensive theory of distribution policy in an authoritarian regime.

At the same time, China matters. Its domestic economy and politics attract media and scholarly attention. The 14 countries on its borders cover a wide range of regime types, economies, ethnic groups and societies. By highlighting ethnic politics in China, I draw attention to a less-developed research area within China's boundaries. The results derived from this process present novel, and at times surprising, conclusions which both support and also present evidence counter to previously held assumptions about Chinese politics. In doing so I hope to shed light on China's past and in the process, suggest possibilities for development in the future.

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