

“The cumulative unfolding of corruption’s many paradoxes in China has, above all, built up momentum and public support to improve state capacities, rather than further weaken them. Beijing does not suffer a legitimacy deficit despite corruption’s staying power as a top public concern.”

Corruption, Growth, and Reform: The Chinese Enigma

YAN SUN

Corruption, an epidemic afflicting almost all postsocialist societies, is often blamed as the major factor undermining transitions to market economies. China after Mao is no exception. Long before the recent “colorful” revolutions to overthrow corrupt leaders in three post-Soviet states, the Chinese people in 1989 staged their famous Tiananmen protests. Though typically portrayed in the Western media as a pro-democracy movement, the protests in reality were fueled by public outrage at the unprecedented corruption that had arisen out of economic liberalization in the 1980s.

CORRUPTION

First in a series

Yet this corruption, which has continued to grow, seems hardly to have hampered China’s economic strides over the past two decades. Annual growth rates have averaged 8 to 9 percent during this period, the highest in the world. A country of such enormous size and complexity, and without fundamental political change, has been able to successfully make the transition to a market environment and achieve record economic growth despite massive, widespread corruption.

This may be one of the most enigmatic developments of our times. Indeed, corruption in reform-era China presents a number of paradoxes that defy conventional wisdom and require nuanced assessment. The key to the Chinese enigma is that corruption has varied, in breadth and intensity, across reform periods, economic sectors, and regions. And the nature of this variation has made the difference, economically and politically.

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THE ECONOMIC-REFORM PARADOX

The first paradox is that more economic liberalization has led to more corruption in China over the past two decades. This fact has cast doubt on the neoliberal logic that economic liberalization will automatically reduce bureaucratic intervention, open up competition, and bring about free markets. Since economic reform began there has been a steady rise in the number of Chinese cadre disciplined for abuses, especially at senior levels. The increase has occurred even though the bar for disciplinary action and legal proof in the courts has been raised over the years. In the 1980s, illicit proceeds amounting to the equivalent of a few thousand US dollars were considered major cases and entailed criminal punishments. Since the mid-1990s they would likely result in dismissals. Among the highest officials disciplined for official corruption—those at the deputy governor or minister level and higher—the average take in the 1980s was about \$5,000. Since the 1990s, the average has approached \$250,000, or 50 times as much. This surge of corruption has stemmed from a continuing expansion of incentives and opportunities created by economic liberalization. Correspondingly, the forms and scale of abuse have worsened over time.

In the early period of economic reform from 1984 to 1992, corruption largely resulted from the exploitation of loopholes in China’s “dual-track” reform policy. Created to encourage flexibility and initiative outside the planned economy, the dual-track system allowed central planners to continue to set commodity prices and production quantities and decide who benefited from them. State-owned enterprises (SOEs) that fulfilled their quotas could, however, sell in the marketplace. The price differential between planned and market sales spurred an explosion of profiteering

activities. Shrewd individuals sought production quotas and goods at state prices, often by offering bribes to officials and managers in charge of those items, then sold them in the market at prices several times higher.

A parallel dual-track policy spurred a robust demand side for corruption. Non-state small businesses now were allowed to coexist with SOEs and operate outside central plans. To offset their lack of access to state prices and allocations, these new players readily offered inducements to snatch raw materials, financing, and distribution channels. For a while in the late 1980s, China seemed to be on a profiteering frenzy. Middlemen and speculative businesses proliferated. The children of party leaders became involved, giving rise to the “princely party” label. And officials in various state functions caught on. Whether it was in licensing new businesses or regulating new commercial activities, they found fresh opportunities for rent seeking—that is, exchanging official power for material gain.

The public backlash came vehemently in the form of the 1989 Tiananmen protests.

While many blamed the incomplete market under the dual-track system for inviting corruption, the scrapping of central planning after 1992 did not halt or reduce it. On the contrary, this second phase of economic liberalization set off a new wave of corruption unprecedented in scale and kind. The end of central planning devolved economic and fiscal power to localities and markets. Today, in place of central planners and administrators, local officials make decisions and assume rights over factors of production (land, assets, and personnel); capital markets allocate loans and investment; SOE managers implement shareholding reforms; local offices interpret tax liabilities; and regulatory officials arbitrate rule compliance. The central government retains its developmental role over infrastructure, dams and waterworks, poverty reduction, and rural relocation, but local agencies administer the projects. In each of these areas, local officials have found new and more lucrative opportunities for self-enrichment. In place of profiteering, the post-1992 period has witnessed the rise of grand-level corruption, involving major government projects, land, loans, and privatization processes. No longer is rent seeking the prerogative of executives in state economic agencies or manufacturing SOEs, nor does

it involve only the planned-from-above portion of the economy.

Instead, corruption has exploited the void vacated by the planned economy and has shifted to broader layers of officials, mostly at subnational levels: chief executive offices and officers, executives in capital-intensive sectors and SOEs, and regulatory and law enforcement personnel. If, in the 1980s, officials collected small bribes for doling out manufactured goods, now they collect huge bribes for signing off on a variety of capital-intensive goods: land, property rights, investment funds, loans, SOE shares and assets, construction and infrastructure projects, commercial judgments, tax breaks, and developmental aid. Cheng Kejie, the former governor of Guangxi autonomous region and the highest-ranking official executed for corruption, accepted \$5 million for interceding on behalf of businesspeople to secure land, loans, contracts, and official appointments. His deputy governor took in \$100,000 in 53 separate bribes to provide loan

guarantees and intervene in smuggling investigations for private entrepreneurs.

On the demand side, favor seekers are no longer predominantly small-scale businesses and individuals. They may be ambitious developers, dubious construction contractors, land speculators, public office buyers, struggling SOEs, organized smugglers, or any business trying to grab a project or loan. Besides such two-way exchanges, opportunities have also arisen for officials to pillage public resources directly. It is not uncommon for executives at smaller SOEs to strip their firms of substantial assets, or to engage in stock flipping by reselling initial public offerings of their firms in the market for personal profits. Local state agencies can hike fees on public services so they can set up slush funds for various amenities.

The economic consequences of corruption are significant. Authoritative Chinese estimates put corruption-related losses of state revenue at around 4 percent of GDP annually, and corruption-related capital flight at around 2 percent of GDP. The economist Fan Gang estimated that capital flight in 2000 surpassed China's capital inflow for the year, \$48 billion versus \$41 billion. This capital flight often takes the form of private tuition in Western countries for the offspring of corrupt officials. Another top destination is gambling houses in Las Vegas and

Family members and cronies of top leaders are no longer seen as running or profiteering from connection-based businesses.

China's neighboring countries. Chinese gamblers account for an estimated 5 percent of annual earnings by the world's gambling businesses.

HIGH CORRUPTION, HIGH GROWTH

Another paradox presents itself. If the combined corruption-related capital losses at home and overseas could be, at worst, large enough to cancel out the advantages of China's famed capital inflow, why has China sustained phenomenal economic growth? The most important reasons are that China has avoided the most destructive kinds of corruption at the national level and the worst types in the most productive sectors.

So-called kleptocracy and bilateral monopoly are the most destructive forms of corruption at the national level. In the first model, which is found in many African states, the ruler monopolizes his ability to use personal power for material gain. In the second model, the ruler and a few private interests share in the spoils. The latter approximates the arrangements between Boris Yeltsin's political cronies and the new economic oligarchs during Yeltsin's presidency in Russia in the 1990s. Even Yeltsin came to depend on economic power-brokers—the oligarchs—for his electoral fortunes, rendering his government vulnerable to the group's demands for economic and political concessions. This pattern was repeated in Russia's regional governments.

In post-Mao China, the top leadership at the national level has been clean and devoted to national development, as has most of the top leadership at the provincial level. The children of Deng Xiaoping, the man who instituted China's reform program, and party leader Zhao Ziyang were tarnished during the period of "official profiteering," a main complaint of the Tiananmen protesters. But the leaders themselves remained credibly clean and firmly willing to ban family members from doing business, unlike Yeltsin or Indonesia's Suharto. The difference may be attributed to Chinese Confucianism, nationalism, and communism. Confucianism has instilled an ethos of rule by moral mandate. The country's top communist leadership has been at its core a group of nationalists devoted to national modernization and revival. And the communist ethic has reinforced discipline.

Below the top leadership, several deputy ministers of central ministries, along with dozens of deputy provincial governors, have been brought down by corruption. But just one central minister—of the Ministry of Land and Resources, established

in 1998—has been stained. (Cheng Kejie was a deputy chair of the National People's Congress when he was exposed and eventually executed for corruption in 2000, but his misdeeds occurred prior to his promotion to the center.) Four governors and one provincial party secretary have fallen because of corruption. All but one ruled in regions remote from Beijing's control: Hainan, Yunnan, Guangxi, Guizhou, and Liaoning (later Hunan). Hainan was a free economic zone, while Yunnan and Guangxi were ethnic regions with greater autonomy. In short, the Chinese state is not itself organized for rent seeking, nor does it depend on the exchange of official favors for political survival.

A competitive model, instead, characterizes the dominant patterns of Chinese corruption, with rent seeking shared among multiple officials and private interests. The "competitive" nature of Chinese corruption is evident in the range of offenders and in the absence of concentrated rent capture among political or economic elites. The type of competitive corruption, moreover, has also made a difference. During the era of dual-track reform policies before 1992, competition was for a fixed supply of government benefits: state-priced and -regulated commodities. In this situation, illegal payoffs for goods should ideally act like market prices in an efficient market. In reality, insider dealings rendered official profiteering less competitive, but it still served a sort of "market clearing" function and helped to erode central planning eventually.

Since the end of central planning, competitive corruption has sought a variable supply of government benefits. With no more commands from on high, local officials now enjoy discretion over the quantity and quality of services they provide. Their greater autonomy has entailed a greater ability to manipulate rents. They can arbitrarily decide whom to award land, projects, or contracts and at what prices; whom to grant loans, shares, and services and on what terms; or how much in fees and levies to demand or absolve. Because the stakes are so much larger now, involving capital goods rather than manufactured goods, the payoffs for officials and the costs for businesses escalate as well. This entails greater waste and burden on the economy. Which raises the question: Why then has China's post-1992 economy managed to grow so fast?

WINNERS AND LOSERS

One important reason is China's avoidance of the worst types of corruption in its most productive sector: non-state enterprises. This is a significant point

because the non-state sector has been the larger and more efficient contributor to reform-era growth, especially since the 1990s. That so many SOEs are ailing is often linked to managerial corruption, and usually the most destructive kind: misuse of company funds, partial privatization or theft of SOE assets, hoarding of revenue, and appointment of cronies. This predatory abuse aggravates the problems of inefficiency and bankruptcy that already plague many SOEs, a third of which may be loss-making and another third latent loss-making. Credits and subsidies to prop up feeble SOEs have been responsible for much of the government's deficits. These loans often become nonperforming as SOEs fail to pay them back, which has caused China's infamous banking crisis. This in turn has seriously hindered the development of a sound financial system.

While non-state enterprises are not free of corruption, they only have incentives for the competitive kind: offering inducements to secure contracts, loans, or markets; evading taxes; or influencing regulatory decisions. These practices do not contribute to an orderly market. And bad contractors have accounted for many "tofu" (easily collapsible) construction projects. But, overall, corruption is far less detrimental to the non-state sector's productivity and growth.

There is also a cultural explanation for China's overall less-destructive corruption. The Chinese emphasis on *guanxi* (connections) is well known. Implicit in this idea is not only respect for social relations but also for reciprocity. The latter has meant that, despite a decline in affective incentives (that is, motives based on social or emotional ties) in corrupt exchanges, services are still performed after payoffs are offered or made. Defrauding would amount to unpredictability, extortion, or absolute losses for businesses. Indeed, in thousands of actual cases I have surveyed from corruption casebooks published in China, defrauding or outright extortion (both of which are common in post-Soviet Russia) is rare. The predictable delivery of services, along with rather predictable levels of payoffs, has ensured a stable, if less than optimal, business environment.

More harmful corruption still abounds. And where it does, growth suffers. In addition to the

SOEs, the economies of remote, underdeveloped, and often rural regions are seriously afflicted. These regions, like the SOEs, tend to have public funding and "soft" budgets, cushioned by funds for development, infrastructure, poverty relief, and resettlement, usually from the central and provincial governments. Lacking the alternative routes to enrichment available in booming regions and often far from the higher administrative and disciplinary agencies of the state, many local officials have resorted to raiding developmental funds. A National Audit Office investigation in 2003 found that \$7.7 billion worth of government funds had been misused and some \$580 million for poverty-alleviation projects had vanished. Some 40 million farmers may have lost their land to illegal confiscations by officials who resold the land to developers, a transaction that often involves kickbacks. In these sectors, a cycle of corruption further

retards real reform and development.

Ultimately, the paradox of corruption and growth in the Chinese case must be weighed in terms of the distributional consequences obscured by overall growth rates. Although

per capita income has increased by tens of times since economic reforms began, not everyone's income has grown on such a scale, especially for SOE workers and rural residents. Many Chinese analysts and citizens view corruption as an important cause of unwarranted quick wealth and of social polarization. Although corruption no longer is seen as the main avenue to wealth, as it was a decade ago, these perceptions persist among many ailing SOEs and poor regions. Not surprisingly, displaced SOE workers and disgruntled farmers have largely fueled the periodic protests and unrest at local levels in recent years. They are most agitated when they see their plight as linked to local cadre corruption. Because SOEs still employ half of the national workforce, and poor regions still hold at least half of the nation's rural population, the impoverishment of even a third of these two sectors constitutes a significant distributional problem.

THE CENTRAL-AUTHORITY PARADOX

Why has the Chinese regime not been more effective at deterring corruption, given that the leadership cares as much about social stability as eco-

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conomic growth? Herein lies a third paradox from the Chinese case. Neoliberal orthodoxy dictates a reduction in the scope of the state, especially central authority, in the transition to the market. But the steady erosion of state authority has not reduced bureaucratic arbitrariness. Rather, it has weakened deterrence against it. Assertions of central authority, meanwhile, have helped to enhance deterrence.

Institutional continuity at the center is the reason deterrence against abuse has not deteriorated in China to the point that systemic collapse occurs, as in Russia and other post-Soviet republics. The Chinese state has preserved two fundamental capacities critical to anticorruption efforts: law making and institution building. In contrast to the parliamentary paralyzes and intra-elite polarization evident in other postsocialist states, the Chinese leadership has shown a strong consensus against corruption and an effectual capacity to create oversight laws and agencies. The central state has adopted a range of new laws to reduce irregularities in public tendering, project approval, and fiscal extraction. It has set up new institutions to increase the audit, inspection, and monitoring of administrative matters and personnel. It has elevated the importance and power of disciplinary agencies in local administrations and SOEs.

Without these efforts, corruption might easily have escalated to uncontrollable levels. China has avoided the state capture (buying off of politicians by economic oligarchs to shape the legal, policy, and regulatory environments in their own interests), the mafia rampancy, and the routine need for private security protection that have plagued, for example, Russia's transition to the market.

In the enforcement of anticorruption laws and bans, however, central authority remains seriously challenged. A major problem is the supervision of the chief executive at each local administrative level to which state authority has devolved. Local oversight mechanisms are ineffective because they are subordinate to, rather than independent of, the local chief executive office. In response, the Communist Party has formed a central inspection team, with power independent of localities, which conducts periodic and targeted scrutiny of local officialdom. This serves to channel upward grass-roots complaints and abuse cases.

An alternative anticorruption mechanism—popular control from below—can also suffer from insufficient state strength. Direct elections, first implemented at the village level, are now also held at township levels. Indirect elections are the norm

at other levels of the party, state, and people's congresses. However, where central authority and legal enforcement are weak, vote buying has become a problem in township, county, and even city-level elections. Shrewd operators have also managed to get elected through cultivated public images and private maneuverings, even at senior ranks. A former Hunan governor built a reputation as a tough corruption fighter and won overwhelming reelection in the provincial people's congress in 2001. Yet privately he garnered more than \$100,000 in bribes as governor of Liaoning and Hunan provinces. A former deputy mayor of Shenyang, who had ties to organized crime and was to gamble away millions in public funds in Macao, was elected by the provincial people's congress over another candidate who later died fighting floods as leader of a lesser city.

Although China does not yet have its share of oligarchs like those who have secured elections as governors and senators in Russia, vote buying by private businessmen has increased in local elections. On the promising side, direct elections have improved administrative and fiscal transparency in many villages. On balance the various problems do not discredit elections, but they do suggest that elections will not provide a panacea, and they will continue to require rigorous central oversight.

Assertions of state authority also seem necessary to bolster another liberal guarantor of accountability: the media. For the first time in its history, the party in April 2005 issued a decree to encourage and legitimize the monitoring and exposure of cadre abuse by the media. The decree urges all levels of the party and state to support the media's work in this area. The background to this new policy is the rise of corruption exposure in China's news media in recent years. Yet, without legal guarantees of their rights, the media have often encountered intimidation by local officials, or lost defamation lawsuits filed by exposed officials.

CORRUPTION AND POLITICAL REFORM

The realities of other postsocialist states have taught China's leaders and many of its intellectuals to be cautious about rapid democratization. Many of the new democracies not only have grown more slowly economically, but also have seen more corruption and have been ruled by corrupt "elected autocrats." Experience suggests that drastic political change may worsen rather than alleviate corruption. So far, incremental change has proved a workable strategy for China. It appears to be what

most Chinese want, and they likely will continue to rely on the state as the engine of change.

The cumulative unfolding of corruption's many paradoxes in China has, above all, built up momentum and public support to improve state capacities, rather than further weaken them. Beijing does not suffer a legitimacy deficit despite corruption's staying power as a top public concern. The government is still looked on as a solution to social ills. Family members and cronies of top leaders are no longer seen as running or profiteering from connection-based businesses. Indeed, they hardly run any of China's major corporations, in contrast with a good deal of the postsocialist world. Many ordinary Chinese have become successful and affluent entrepreneurs, making the "princely party" indistinct or even extinct. As corrupt exchange has become mostly materially based, it is also more accessible, thus less exclusive or inflammatory than in the early years of economic reform. Unlike the dual-track policies of the 1980s, moreover, contemporary corruption no longer is caused by central policies, but by errant officials at local levels. In fact, when local protesters and rioters complain about localized injustices, they are likely to demand that central policies be upheld.

An important segment of Chinese liberal intellectuals also supports strengthening central capacities. Unlike their counterparts in the former socialist regimes of Eastern Europe and Russia, Chinese intellectuals are not united around a liberal political agenda. They diverge into two broad camps: the liberal left (the so-called new left or social democrats) and the liberal right (the new right or neoliberals). For the roots of corruption, the new left faults the government's blind faith in the market, especially after 1992, pointing to the erosion of state authority and loss of control over local officialdom. In the new left's view, the Tiananmen crackdown made it safe for unbridled capitalism and a right-wing Communist Party.

The new right, by contrast, faults government power itself, rather than the way it is used. The reduction of corruption, in this view, requires the reduction of state power itself. If the new left blames the government for being too neoliberal, the new right blames it for not being neoliberal enough. As remedies, the new right proposes "property rights,"

or allowing SOEs to be "spontaneously privatized" by cadre abuse. Corruption's destructiveness here is seen as positive: helping to replace SOEs, giving rise to private ownership, and acting as a driving force for change. Yet who would benefit and lose from a bargain transfer of public enterprises? Would it, the new left asks, not simply benefit a class of bureaucratic capitalists and entrench crony capitalism? Rather than destroying state power, the new left sees an important role for government in correcting market failures and redressing social inequalities.

The emergence of new left intellectuals in China challenges the lingering American view of a monolithic and ruthless Communist Party pitted against pro-democracy and Western-oriented intellectuals. Rather than being socialist diehards, the new left thinkers have usually been educated in the West. Some were participants in the Tiananmen protests.

One participant and new left thinker, Wang Hui, has published an impassioned critique of the government's neoliberalism: *China's New Order: Society, Politics, and Economy in Transition*.

Wang blames ideological and partisan interests at home and abroad for a failure to appreciate the neoliberal bias of the Tiananmen crackdown, which allowed the state to impose more sweeping economic liberalization policies. He calls these policies neoliberal because they radically devolved economic and political power, promoted markets, and sought the economic withdrawal of the state in the midst of globalization—all of which have helped increase corruption after 1992. Still more revealing is Wang's view on the source of growing Chinese disillusion with the liberal democratic paradigm: the many crises of Chinese and Russian reform on the one hand, and American foreign policies and military hegemonism on the other. The attractiveness of the liberal model, for the time being, is not taken for granted.

The presence of a new left and a new right places the ruling party in the ideological middle. The two groups help legitimize the party in different ways. The new right helps the party explain away the rampant corruption and shirk its social responsibility. The new left helps the party justify strengthening its capabilities. One might add that both groups need the party as well: the new right needs it to continue devolving political power and pushing economic liberalization; the new left needs the party to curtail the

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excesses of this process. Given that not only efficiency but its own legitimacy is at stake, the ruling party has shown a consistent determination to fight corruption and introduce anticorruption reforms. These reforms have been along the lines that new left thinking has emphasized: state building. In other words, while the party proceeds economically in the direction desired by the new right, it proceeds politically in the direction urged by the new left on anti-corruption, though in neither case as much as each group would like to see.

CHANGING THE LANDSCAPE

Anticorruption reform is one area in which a US role could be constructive and welcomed in China. In contrast to their usual annoyance with US lecturing about democracy and human rights, the Chinese are impressed with America's efforts to bring its own companies to justice for illegally pursuing commercial advantages in China. Under the US Foreign Corrupt Practices Act of 1977, which prohibits US companies and their subsidiaries (including officers, directors, employees, and agents) from bribing foreign officials, the Chinese subsidiary of Lucent Technologies was forced to fire four top executives for commercial bribery in 2004. In 2005, Diagnostic Products Corporation was fined \$4.8 million by the US Justice Department for kickbacks to Chinese medical personnel. By punishing its own companies, the United States sets a credible example and demonstrates compellingly the paramount importance of rule of law. The Bush administration's tightened control of illegal monetary inflows can also be useful for deterring capital flight.

Beyond these steps, however, little concrete assistance for anticorruption efforts comes from the West, despite profuse public posturing and chas-

tening about China. In fact, thanks to mistrust of Chinese laws in the West, Chinese perpetrators have found Western countries a safe haven where they enjoy some measure of protection. Even those apprehended face little prospect of being extradited.

To fundamentally change its corruption landscape, China needs to learn from successful examples, including America. Singapore and Hong Kong offer realistic and effective models from China's own vicinity. The two city-states rank among the least corrupt states in the world according to Transparency International, and the best among non-Western governments. Both share China's cultural heritage yet have managed to change tenacious cultural attitudes—that is, weak respect for the rule of law and an emphasis on informal practices and social relations. Both instituted effective anticorruption mechanisms at developmental stages similar to China's. Both have relied on strong state capacities for strict enforcement and prevention, under authoritarian rule, yet have maintained highly independent anticorruption agencies and relatively independent legal systems. Even the democratic Philippines has recently tapped a top anticorruption official from Hong Kong to help with its anticorruption work.

China should embrace this approach the way it welcomes foreign investment. Along with the increasing role of the media, popular elections, and expanding privatization, greater initiative against corruption would serve well the building of what the Chinese themselves consider to be good government: accountable, just, and devoted to the welfare of the people. Memories of Tiananmen and periodic peasant rebellions in Chinese history will keep the regime on its toes in any event, because anticorruption is one battle it cannot afford to lose. ■