

# Anti-Corruption slows down economic growth in China

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## 1 China's Anti-Corruption Efforts and Economic Growth by Nie and Li in 2016:

It is widely believed that corruption stifles economic growth by undermining property rights, increasing transaction costs, and hindering technological innovation. This view has led many governments to implement anti-corruption campaigns, with the expectation that economic growth will accelerate as corruption decreases. However, in China, the situation has unfolded differently.

Following the 18th National Congress of the Chinese Communist Party in 2012, Xi Jinping launched an unprecedented anti-corruption campaign aimed at tackling corruption at all levels of government. This campaign has been extensive and long-lasting, targeting a significant number of officials. Data indicates that the number of officials prosecuted in 2014 and 2015 surpassed the total prosecuted during the entire previous decade. Despite these measures, economic growth in China has not accelerated; in fact, it has slowed down, showing a negative correlation between anti-corruption efforts and economic growth across provinces from 2011 to 2014.

Regulatory Reform and Economic Growth:

Economists have offered varying explanations for this outcome. Some suggest that corruption, under certain conditions, can stimulate economic growth by providing incentives for officials or helping businesses navigate burdensome regulations. Therefore, stringent anti-corruption measures might decrease officials' motivation, thereby slowing economic growth. However, Nie and Li argue that effective anti-corruption policy should be aligned with regulatory reform. Merely targeting corruption without addressing inefficient regulations is insufficient. For economic growth to improve, regulatory barriers that hinder private enterprise growth must be lifted simultaneously with anti-corruption measures.

The authors use China's banking sector as an example. Private enterprises, especially small and medium-sized ones, struggle to obtain loans due to strict regulations and lack of political connections. If corruption enables these enterprises to bypass such barriers through bribes, it can increase output and employment in the short term. However, if the government punishes bribery without

relaxing these regulations, private enterprises suffer, reducing overall output and employment. Therefore, Nie and Li argue that China's anti-corruption campaign must be coupled with regulatory reform to promote long-term economic growth. Reducing these restrictions would allow private enterprises to expand, ultimately increasing economic output and growth, even if it reduces the market share of state-owned enterprises.

## **2 The 2019 article in WSJ "What Hurt Chinese Growth in Last Decade? Corruption Crackdown, Research Suggests" discusses a recent study that argues China's reported economic growth since 2008 has been overstated by about 1.7 percentage points annually.**

This discrepancy, according to economists Chang-Tai Hsieh, Zheng Song, Wei Chen, and Xilu Chen in 2019, suggests that China's economic slowdown has been much steeper than official figures indicate. Their findings raise questions about the accuracy of China's GDP data and point to several underlying factors behind this overestimation.

The study focuses on two main analyses of China's economic data. First, it compares provincial GDP figures with those reported by the National Bureau of Statistics (NBS). Since 2002, provincial GDP figures have consistently been higher than NBS figures, which could be attributed to local officials inflating their numbers to gain promotions, which are often tied to economic performance. Second, the researchers used alternative measures, such as value-added tax data, to reassess GDP components. These alternative methods suggest that NBS overestimated growth, particularly since 2008.

The study points to two key turning points in China's economic trajectory. In 2008, when the global financial crisis hit, China implemented a large spending and lending program to counteract the downturn. At that time, the political pressure on NBS was likely to overstate growth to reflect the strength of China's economy, leading to inflated figures. For instance, China officially reported 9.4% GDP growth in 2009, but the researchers estimate it was closer to 8%.

The second significant shift occurred in 2013 when Xi Jinping consolidated power and launched an aggressive anti-corruption campaign. This crackdown had unintended economic consequences, according to the research. Local officials became increasingly hesitant to make investment deals, either due to the lack of monetary incentives or fear of being accused of corruption. The crackdown likely reduced the willingness of officials to support local businesses, further stifling investment.

This political context explains why NBS failed to capture the full extent of the economic slowdown, especially as local officials prioritized boosting their

own reported growth figures. According to Mr. Hsieh, provincial governors and party secretaries, whose promotions depend on economic performance, often have more political power than NBS officials, making it challenging for central statisticians to adjust the figures downward accurately.

In conclusion, the research suggests that China's anti-corruption drive and political dynamics contributed to an overestimation of economic growth, primarily by curbing local investments and distorting provincial GDP figures. This has led to a larger-than-reported economic slowdown over the past decade.

The paper "Special Deals with Chinese Characteristics" by Chong-En Bai, Chang-Tai Hsieh, and Zheng Michael Song in 2019 examines how "special deals" between local Chinese governments and private businesses have significantly contributed to China's rapid economic growth over the past few decades. The key argument is that local governments in China, due to their political power and administrative capacity, engage in preferential deals with select private firms. These "special deals" help private firms bypass restrictive state regulations and provide them with crucial support such as tax breaks, land deals, and political protection.

A critical insight from the paper is that these special deals have been instrumental in driving China's growth, particularly in sectors where private firms are officially restricted or banned from entering, like the aluminum and automobile industries. Despite formal rules that limit private or foreign participation in these industries, local governments facilitate private firm entry through these special arrangements, thus circumventing central policies that aim to monopolize these sectors for state-owned enterprises (SOEs).

The paper also highlights the risks associated with these special deals. Although they have spurred growth, they are highly dependent on local government officials' discretion, which makes the system prone to corruption and inefficiency. Furthermore, the reliance on informal arrangements rather than formal, transparent policies creates vulnerabilities in China's economic system. The authors caution that this model, while effective in the short term, could pose long-term risks to sustainable economic development as it lacks the stability and predictability of a more open and regulated market system.

In essence, the paper suggests that while these "special deals" were critical to China's growth, they create an unstable foundation for future economic progress due to their reliance on personal relationships, local discretion, and informal practices. This system could also exacerbate regional disparities and lead to inconsistent economic outcomes across different provinces and industries.

The Washington Post article, "Without corruption, some ask, can the Chinese economic system function?" by Simon Denyer, explores concerns over China's ongoing anti-corruption campaign. It suggests that without bribery, many officials are hesitant to approve projects, slowing economic growth. Denyer highlights that over 100,000 officials have been investigated under Xi Jinping's leadership, resulting in fear and reluctance among officials to act without corrupt practices. The article argues that this crackdown may have negatively impacted economic activity, with some sources estimating a 1% GDP loss in 2014.

If the anti-corruption campaign continues indefinitely, it could have a broad impact, causing widespread anxiety and shrinking consumption, which would hurt economic development. Some argue that the campaign may make officials overly cautious, leading them to protect themselves by avoiding taking initiative and being unwilling to perform their duties. This fear of being implicated may result in a "do nothing" attitude among officials, further stifling economic activity and slowing growth.

### 3 Why has China's rapid economic development coexisted with corruption?

In recent years, the issue of corruption in China has attracted widespread international attention, particularly the paradox of how sustained economic growth can coexist with significant levels of corruption. In his book *\*The Dual Paradox\**, Wedeman (2012) offers a highly anticipated explanation for this phenomenon. He argues that while corruption generally harms economic growth and has a severely negative impact on social development, China's situation is unique. In China, corruption has not eroded the core benefits of economic growth but has instead proliferated on the margins, where corrupt officials profit from new value created by reforms.

Wedeman introduces a practical conceptual framework to explore this core idea, categorizing corruption into two main types: "predatory corruption" and "developmental corruption." Through comparative analysis of these types and their impact in various countries or regions, he describes the complex interaction between corruption and economic growth. Wedeman contends that predatory corruption, which involves officials extracting wealth from the economy for personal gain, undermines economic development. In contrast, developmental corruption, though still unethical, can stimulate economic growth by facilitating business transactions and reforms.

Wedeman further analyzes China's "dual paradox." First, he notes the sequence of corruption and growth. In China, corruption spread after economic growth had already gained momentum. Corruption was not rampant enough to hinder growth before China's economic boom, but it worsened after the reform initiatives were already pushing economic development forward. Second, he highlights how corruption has become more commercialized during the process of marketization. In China, corruption often involves the exchange of interests between officials and illegal business ventures, making it parasitic rather than predatory. This "parasitic" nature means that corruption feeds off the economic value being generated without directly harming the core of the economy.

Lastly, Wedeman acknowledges that China's anti-corruption measures have been effective in controlling corruption to the extent that it does not inflict catastrophic damage on the economy.

Wedeman's work is an important contribution to the study of corruption and politics in China. His arguments are clear, well-structured, and supported

by empirical data. Readers interested in China's political and social development will find his analysis of the relationship between rapid economic growth and widespread corruption particularly insightful. Others will be drawn to his discussion of how China can understand and address its corruption issues. In any case, the book offers valuable insights and encourages deep reflection.

**4 Yukon Huang (2017), in *Cracking the China Conundrum: Why Conventional Economic Wisdom Is Wrong*, provides a nuanced and insightful perspective on the relationship between corruption and economic growth in China. He challenges the conventional belief that corruption universally inhibits investment and economic development. Instead, he argues that in China's specific context, corruption has had a more complex and even paradoxical role in driving growth.**

Huang explains that, in China, essential resources like land and energy are largely controlled by the state, but they tend to be less efficiently utilized compared to the private sector. Given the constraints of China's communist system, where full privatization of these resources is not feasible, corruption has emerged as an alternative mechanism. In this arrangement, private enterprises gain access to state-controlled resources through informal agreements with local officials. This system of "special deals" may be corrupt, but it has allowed the more efficient private sector to participate in the economy, thereby contributing to overall growth. Huang points out that this mechanism, while inherently flawed, has enabled China to sustain high levels of economic development by circumventing some of the inefficiencies associated with state-controlled resources.

Moreover, Huang addresses the broader debate over China's economic future, particularly the balance between investment and consumption. He refutes the popular notion that China's growth will falter unless consumption replaces investment as the primary engine of growth. Instead, Huang argues that China's high investment levels—driven by rapid urbanization—have been vital for its economic transformation. The move from rural, labor-intensive jobs to more capital-intensive urban industrial employment has increased corporate profits and wages, ultimately fueling consumption. Therefore, China's high investment-to-consumption ratio is a natural consequence of its development process, rather than a sign of economic imbalance.

However, Huang also acknowledges the darker side of corruption. While

it may have facilitated private sector growth in the short term, the long-term costs—such as rising inequality, inefficiencies, and social unrest—are significant. He argues that corruption has shifted from being a "productive" form that enables growth to one that threatens China's future prosperity. The anti-corruption campaign launched by Xi Jinping has been a necessary response to these risks. Still, Huang warns that it must be handled delicately. While the campaign has gained popular support by addressing the public's discontent with corrupt officials, there is a risk that it may inadvertently stifle the very economic risk-taking that has driven growth.

Ultimately, Huang emphasizes that to sustain growth, China will need to move beyond the stopgap of corruption and adopt deeper reforms. This includes introducing more rule of law, defining property rights more clearly, and enabling private businesses to access key resources without relying on illicit deals with local officials. Although China's growth rate may have slowed, Huang asserts that even a 6% growth rate over the next decade would still be impressive by global standards. He suggests that China's success in the future will depend on its ability to continue embracing pragmatic, reform-oriented solutions to its challenges.

## **5 The Gilded Age of America, spanning from the 1870s to the early 1900s, was marked by rapid industrial growth, economic expansion, and massive wealth creation, particularly for industrialists and financiers. However, it was also a period of widespread political and corporate corruption.**

Several factors contributed to this corruption:

1. **Weak Government Oversight**: During this era, regulatory frameworks were underdeveloped, and there was little government oversight of industries. This allowed powerful corporations to wield significant influence over politicians, often through bribery, to secure favorable legislation and policies.

2. **Monopolistic Practices**: Business magnates, such as John D. Rockefeller and Andrew Carnegie, created monopolies and trusts, which stifled competition and allowed them to control large portions of the economy. These monopolies were frequently sustained through unethical means, including manipulating markets and exploiting workers.

3. **Political Corruption**: Political machines, like Tammany Hall in New York, controlled urban politics through patronage systems and corrupt practices. Elected officials often exchanged government contracts, jobs, and favors for votes and bribes, allowing the wealthy elite to dominate political decisions.

4. **Laissez-Faire Economics**: The prevailing economic philosophy of the

time was laissez-faire, meaning minimal government intervention in business affairs. This allowed businesses to engage in corrupt practices without fear of legal repercussions or government interference.

5. **Exploitation of Labor**: The rapid growth of industries required a large labor force, and many workers, including immigrants, were subjected to poor working conditions, low wages, and long hours. While industrialists accumulated massive wealth, workers had little legal protection or recourse, leading to significant social inequality.

Despite the corruption, the Gilded Age laid the groundwork for modern capitalism, but it also sparked the Progressive Era, a movement that sought to reform many of the political and economic abuses of this period. This era of high growth, despite its prosperity for some, left a legacy of deep-seated inequality and exploitation.

**6 After the Great Chicago Fire of 1871, the city experienced both rapid rebuilding and widespread corruption. The fire destroyed much of the city, leaving space for extensive real estate speculation and urban development. Business interests, politicians, and organized crime figures often colluded to exploit the rebuilding process for personal gain. Political machines like the one led by "Big Jim" Colosimo and later by his successor Al Capone gained influence, blending criminal enterprises with political control. Bribery, graft, and backroom deals became a standard part of how Chicago operated during this period of urban growth.**

Key points of corruption after the fire include:

1. **Political Machines**: Political bosses dominated city politics, exchanging favors for votes and offering protection to businesses in exchange for kickbacks. This fostered a culture of patronage where loyalty was rewarded with city contracts and jobs.

2. **Real Estate Speculation**: With the city's expansion, real estate became a profitable industry. Corrupt politicians often facilitated the acquisition of prime land at unfair prices, making huge profits for themselves and their allies.

3. **Organized Crime**: Chicago saw the rise of organized crime that infiltrated the city's infrastructure. Crime bosses wielded immense power, manipulating politicians to ensure the survival and growth of their enterprises, especially as Prohibition came into effect.

4. **Police and Judicial Corruption**: Law enforcement was often on the payroll of criminals, looking the other way as illegal activities proliferated. Corruption extended to the judiciary, where cases were sometimes manipulated in favor of the wealthy or powerful.

These layers of corruption slowed down true reform efforts and entrenched Chicago as one of the most corrupt cities in America during its post-fire boom. This corruption continued for decades, blending politics, crime, and business in a cycle that was difficult to break.

## **7 The period from 1600 to 1850 in Great Britain was characterized by rapid economic growth, but also by significant corruption and exploitation, similar to the Gilded Age in America. During this time, Britain underwent the Agricultural Revolution and the early stages of the Industrial Revolution, transforming the country into a global economic powerhouse. However, these changes also fostered political and corporate corruption.**

1. **Monopolies and Trading Companies**: One major source of corruption was the dominance of large trading companies, such as the East India Company. These companies were granted monopolies by the British Crown, allowing them to control trade and resources in vast colonial territories. The East India Company, in particular, amassed enormous political and military power, influencing government policy through bribery and corruption. Company officials often engaged in corrupt practices abroad, exploiting resources and local populations while using their profits to bribe British politicians to protect their interests.

2. **Political Corruption and Patronage**: British politics during this period were also rife with corruption. The system of patronage allowed wealthy elites to control parliamentary seats, often through "rotten boroughs"—constituencies with few voters but significant political influence. Politicians and members of the aristocracy often bought or sold parliamentary seats, leading to widespread bribery and a lack of true democratic representation. This system persisted until the Reform Acts of the 19th century began to address some of these issues.

3. **Exploitation of Labor**: Like in the Gilded Age in America, Britain

saw the exploitation of labor during the Industrial Revolution. Factory owners amassed great wealth while paying workers, including women and children, extremely low wages for long hours in dangerous conditions. The absence of labor regulations or worker protections allowed factory owners to exploit their employees with impunity.

4. **Laissez-Faire Economics**: Britain adopted a laissez-faire economic approach during much of this period, with minimal government interference in business practices. This philosophy contributed to the concentration of wealth in the hands of a few industrialists and landowners, while the working class endured harsh conditions. It also fueled corrupt practices as businesses sought to maximize profits without oversight.

5. **Colonial Exploitation**: The expansion of the British Empire further contributed to corruption, as colonial officials and merchants took advantage of their positions to extract wealth from colonies. Corruption in the administration of colonies was rampant, with officials often acting in their own interests rather than for the good of the empire or the local populations.

Overall, Britain's rapid economic growth from 1600 to 1850 was accompanied by significant corruption and exploitation, particularly through monopolies, political patronage, and the exploitation of labor. Despite these challenges, this period laid the foundation for Britain's industrial and global dominance in the 19th century. However, the widespread corruption and inequality eventually led to calls for reform, similar to the Progressive Era in the United States.