

**The Political Economy of Corruption in China : Increased Corruption Despite
Economic & Bureaucratic Reforms Between 1992 – Present**

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I. Introduction

The economic tale of post-Mao China can be divided into two separate stories. On the one hand, it is an unprecedented successful economic story, with an economy that grew 8,75 percent on average every year between 1979 and 2010 (Wedeman 1, 2012). On the other hand, there is the story of China attempting to cope with increasing corruption when the economic miracle took off. While corruption can be defined throughout a wide variety of interpretations depending on a specific point of view, it is widely accepted that corruption is the improper use of public office or authority, for either personal or collusive gain, at the expense of the public (Sun 3) (Zhu 82). Corrupt behavior was not something unfamiliar to the Chinese people, it did however become more common and problematic with the start of economic reforms in 1978. With the introduction of the Criminal Law of the People's Republic of China¹, cases of economic corruption filed by the People's Procuratorate, China's highest agency responsible for prosecution of public cases, increased significantly with 28,000 cases filed in 1985 and 77,000 in 1989 (Wedeman 2, 2012).

Many economists argue that good functioning government institutions foster economic growth, and in turn make sure that corrupt behavior that could negatively alter economic growth are strictly regulated and checked. In other words, from a liberal economic perspective, there is a negative correlation between corruption and economic growth (Mauro 682). However, in the case of China, significant economic growth through reforms opening up the economy and decentralize the administrative bureaucracy of the Communist Party did not result in less corruption, in fact economic growth went hand in hand with increasing corruption (Wedeman 12, 2012). Part of China's economic success can be found in the fact that administrative decentralization gave local governments authority over economic activities within their jurisdictions. Furthermore, such authority came hand in hand with more regulatory and monitoring power on the local level, enabling officials on provincial and lower levels to experiment with certain economic policies and implementations without the intervention of central authority (Cai, Treisman 516). Such authority on the local level in implementing economic reforms can be seen as one of the main driving forces of economic success in China. However, while both decentralization and economic reforms had a positive effect on economic growth, it did not curb corrupt behavior. With increased local administrative, regulatory and monitoring authority, it seemed that incentives for corrupt

¹ Criminal Law of the People's Republic of China, Adopted by the Second Session of the Fifth National People's Congress on July 1, 1979 – <http://www.fmprc.gov.cn/ce/cgvienna/eng/dbtyw/jdwt/crimelaw/t209043.htm>

behavior increased with increased local power. However, part of the puzzle remains how economic growth could endure while corruption continued.

The case of China is of rather significance to theories of economic liberalization and political corruption, since it is an unusual case in comparison to other former socialist countries whom have embraced economic liberalization through reform (Sun 4). China's path to reform was deemed the "wrong" type of reform according to neoclassical economists, which would prefer rapid, comprehensive reform over gradual incremental reform. However, in the case of China gradual, incremental reform was indeed a success (Wedeman 2009). There have been several explanations for China's paradoxical success with incremental reform. Firstly, there are theorists that argue that China's success did not lie in their rejection of neoclassical ideas of economic reform, but rather the result of prior conditions. In other words, these theorists argue that China's economy was so underdeveloped, even incremental reforms would lead to economic growth for a period of time (Wedeman 2, 2009). Secondly, another group of theorists argue that China did not adopt a "wrong" form of reform, but that the incremental introduction of reforms allowed the Chinese economy to gradually shift from one system to another without completely destroying the fundamentals of the former system, arguing that this would create incentives for even more severe forms of economic and political corruption (Wedeman 3, 2009).

However, both schools fail to explain how and why China did not experience the same pitfalls that eventually succumbed many Post-Soviet states, where attempts to reform a socialist economy from an incremental point of view resulted in the creation of an oligarchic capitalist system, in which corrupt officials could thrive through rent-seeking, crony capitalism and left these economies in disarray (Wedeman 4, 2009).

Nevertheless, the study of corruption in transitional economies with a strong central institution such as the Communist Party can provide useful insights and possibly develop a new line of research within the existing academic work on the political economy of corruption. In this respect, China provides a very useful case, not only because its economy will surpass the United States², but especially because of its institutional regime structure which promotes economic reform and administrative decentralization, all which come from one central authority: The Communist Party.

² "China To Overtake U.S Economy By 2032 as Asian Might Builds", www.bloomberg.com, 26 December 2017

Secondly, with Xi Jinping as China's new strong ruler, it seems he will take a different path than his predecessors in combatting corruption. For instance, where administrative decentralization gave local authorities more flexibility to operate, it seems Xi Jinping will recentralize power back to the Party through newly established regulatory and supervisory institutions holding its Party members on all levels in line³. However, recentralization of power should focus on combatting corruption, since worsening corruption despite efforts to curb it would mean diminished public support and in the case of the Communist Party possible loss of economic assets and legitimacy. Therefore, this research thesis will critically assess the relationship between market transition, surging corruption and institutions through the following research question: Why did collusive corruption in China intensified despite reforms and efforts to curb corruption from 1992-onwards?

The first chapter will discuss the theory of corruption from a political economic perspective. Furthermore, the principal-agent framework will be discussed, since this framework quite adequately can show how market reforms and decentralization shifted relations among the principal and agent. The second chapter will discuss the key economic and bureaucratic reforms from 1978 onwards, since different types of reform measures have had different effects in terms of opportunities and possibilities for officials to conduct corrupt behavior. The deepening of market reforms introduced after Deng Xiaoping's Southern Tour in 1992, such as with property rights, created new opportunities for government officials to minimize their net income when conducting corrupt behavior. Furthermore, decentralization gave local cadres and administrations more flexibility in how to achieve their economic goals, which gave them room and incentive to conduct in corrupt behavior, as well as more self-regulating authority in terms of detection corruption from within. While the main focus lies on the period 1992 until the present day, one cannot understand the economic and bureaucratic implications of that time period without any knowledge of the economic reforms introduced by Deng Xiaoping. The third chapter will conduct a case study by analyzing the Xiamen Smuggling case, one of the most severe cases of corruption among Party members, government officials and private businessmen. The reason for doing a qualitative case study is that corruption is hard to measure. Therefore, this thesis will conduct qualitative research to analyze how administrative and economic reforms have given government officials the opportunities to conduct corrupt behavior. The fourth chapter will focus anti-corruption measures when market reforms and decentralization took off, as well as an analysis of how Xi Jinping's

3 'China's Future Under Xi Jinping' Edition 5, 2018 – www.teneoholdings.com

recentralization of state power might impact anti-corruption measures. Although it is too early to draw any conclusion from his newly introduced policies, cautious implications can be made.

II. Defining Corruption

In its most broad term, corruption entails a wide variety of human behavior and is thus, difficult to exactly pinpoint. Nevertheless, among scholars it is widely accepted that in general corruption means the misuse of public office for private gain (Lu 2). Yet defining what exactly “public power” and “misuse” mean differ per studied case, however corrupt behavior is seen as a violation of laws and morally unacceptable, thus open for punishment should people get caught in the act of corrupt behavior. Public power lies in the hands of bureaucrats who are appointed to their position, or in the hands of politicians who are elected to their position (Lambsdorff 12). These officials use their public power in a variety of different sectors, such as business regulation, the granting of permits, government services and public utilities (Lambsdorff 12). The term misuse has a twofold meaning, on the one hand it can relate to behavior that differentiates from the duties expected to be conducted when taking place in a public office. On the other hand, it can mean that personal interests are being pursued at the expense of the public’s interests, thus dissatisfying the public’s expectations (Lambsdorff 13).

According to Schramm and Taube, from corruption as a broad definition several considerations can be made when discussing corrupt behavior, namely personally appointed power exploited for personal gain, including monetary and non-monetary rewards that excludes one’s salary, an agreement or contract concluded via a specific transaction, such as the (illegitimate) transfer of property rights, which because of its illegal nature is not subject to any institutional regulatory of supervisory body, or in a contract including the transference of property rights, at least two economic agents interact (274).

Corrupt behavior often entails the provision of a service by a public officer in exchange for a bribe (Lambsdorff 59). This is often defined as a patron-client relationship, in which for example the patron can give the client preferential treatment to access a market protected by regulations or restrictions, and in return the patron will receive a part of the profits made by the client (Lambsdorff 59). However, these relationships can also work the other way around, where negative externalities are imposed on other clients, making them unsuccessful competitors in comparison to the bribe-paying client (Lambsdorff 60). Furthermore, markets distortions imposed by governments through intervention also provide opportunities for corrupt behavior, since government intervention prevents markets from reaching equilibrium. In turn, once bureaucrats are bribed, there is more incentive to turn a blind eye to these market distortions, since these distortions give bureaucrats the possibility to foster excess income.

From a political-economic perspective, excess income by bureaucrats is often explained through rent-seeking theory. Rent is defined as excess income, and in a perfect neoclassical

market, excess income should not be possible, since the market will move towards an equilibrium in terms of supply and demand (Khan 21). This does not imply that rents are always negative outcome. In fact, in many developing economies, excess rents can provide governments with the necessary assets to further develop markets which in turn would have a favorable outcome for the public in terms of public resources (Khan 25). The argumentation behind rent-seeking behavior is that corruption payments are being transferred on the basis of property rights or monopoly power created by institutional incentives, such as bureaucratic authority to grant certain preferences for entry in markets protected by i.e. tariff barriers (Schramm, Taube 276). Furthermore, underdeveloped institutions responsible for monitoring and supervising markets where either property rights or licenses are needed to enter the market are prone to corrupt behavior. Underdeveloped institutions often do not have the resources to effectively monitor and supervise their bureaucrats. This in turn enables bureaucrats to offer preferential treatment to whomever wishes to enter the market quicker by paying a bribe (Khan 26). Within bureaucratic institutions excess rents often end up in the pockets of bureaucrats pursuing personal interests, thus misusing their office at the expense of the public they ought to serve.

In the context of China and reforms rent-seeking theory is important, since administrative power of bureaucrats is rather strong (Feng et al 274). The exclusive power of government institutions, and subsequently officials working for these institutions in providing business licenses, makes them attractive subjects to bribing, should one consider starting a business venture. These business licenses can be obtained by offering a bribe in the form of rent towards the official, who will ensure the license will go to the business venture once the rent has been obtained (Feng et al 274). In this regard, rent-seeking plays an important role in understanding the principal-agent theory focusing on corruption, which will be elaborated on below

A Principal-Agent Theory of Corruption

One of the angles in the study of the political economy of corruption is that of neo-institutional economics, where the principal-agent theory derives from (Groenendijk 207) Neo-institutional economics is mainly concerned with institutions and how these institutions affect the decision making of individuals involved.

Institutions can be seen as working rules collectively binding everyone involved (Groenendijk 207). Institutions are set in place to distinguish the preferences of individuals of those of the

common good, by structuring and constraining the decisions made by individuals by binding them to collective working rules (Groenendijk 207). These institutional constraints can be separated, but related branches within the school of neo-institutional economics. The first branch is the property rights branch, which states that decisions made by individuals concerning certain goods does not depend on the goods themselves, but more by the level of property rights one individual can exercise on certain goods (Groenendijk 208). In the context of Chinese bureaucracy, a senior official responsible for providing certain business licenses has more authority, or property right to provide this good than a official on a lower level working in the same administrative branch (Yi et al. 276).

The second branch is the transaction costs branch, which focuses on the significance of transaction costs in allocating resources and as well as the economic structure an organization works in. Transaction costs include the costs on monitoring and regulation in order to make sure the collective working rules within institutions are met. Transaction costs will differ in scale depending on the degree of uncertainty faced by individuals as well as to which regard goods and transaction are geared in relation to one another (Groenendijk 702)

Third, the principal-agent branch combines elements of both property rights and transactions costs and is used to set out a framework for the relationship between the principal and the agent. In this framework, the superior (the principal) has a certain set of requirements for his subordinates (agents) which needs to be fulfilled in order for the agent to do his job correctly (Ackerman 6). Although principals would favor agents who fulfill the requested superior's objectives, agents generally have relative freedom to fulfill their own interests instead of the principal's interests. Furthermore, the costs for monitoring and regulating every agent is high, therefore the principal, to some extent, expects the agent to fulfill his objectives.

Within the principal-agent framework, there is often a third party involved in the form of a client, who seeks to benefits from the agent's authority by offering money in order to influence the agent's decision (Ackerman 6). Such monetary payment would not necessarily imply that the principal's goals are undermined by the agent when the latter accepts a small bribe, should the service delivered by the agent meet the requirements set up by the principal. However, the sum payed by third party clients to an agent are often higher than the required payment set out by a principal, which thus becomes a rent to the agent and is therefore corrupt (Ackerman 7).

Often the question remains if payments made to an agent legal practices or under illegal practices and are thus deemed criminal or corrupt. If a monetary transfer made by a client to an agent is deemed illegal, it would lower the former's willingness to make such a payment and subsequently lower the latter's willingness to accept such a payment (Ackerman 10). Should such payments made the actions of agents more efficient, despite being labeled as either a rent of corrupt behavior, it would still have a positive effect on the overall performance of the agent under the supervision of a principal (Zhang 252). This dynamic between principal, agent, and client and what is deemed legal or illegal is often divided by very thin boundaries. What is deemed corrupt behavior can change over time when new reforms are introduced or when decentralization is set in motion.

Different Types of Reform-Era Corruption in China

As mentioned above, what is deemed corrupt behavior by agents can change over time when new reforms are introduced. Since economic reforms and decentralization in China did not come in one all-encompassing move but gradual, definitions of corruption as well as forms of corruption changed over time with then introduced reforms. Furthermore, the combination of administrative decentralization and relative freedom for local governments in how to pursue economic goals, especially after 1992, gave way to new forms of corruption within the perspective of the principal-agent-client relationship. Therefore, a systematic delineation of corrupt behavior can provide a clear view on what type of corrupt behavior have been more prevalent since economic reform. Furthermore, by analyzing which type of corrupt behavior is more prevalent in a specific time period could implicate that certain economic reforms had fueled corruption more when implemented. (Sun 27). The types of corruption discussed below fall under the misuse of public resources, the general definition of corruption mentioned earlier.

Embezzlement (Tanwu)

In China's 1979 criminal law, embezzlement was considered a criminal offence when the perpetrator stole Y2000. However, new methods of embezzlement have been made possible through market reforms, with the introduction of independent contractors and private businesses. Through market reforms, several categories of what is deemed embezzlement have been included within the criminal code: First, theft through contract fraud, in which for example a SOE manager provides a construction contract to an independent contractor 20 percent higher than the normal price to obtain the construction project. In return, the SOE

manager indirectly receives shares in the construction project, thus embezzling part of state resources allocated (Sun 27). Secondly, theft through managerial fraud, in which a manager could put fictional costs in his books in the form of additional costs or bonus payments to employees. Administrative decentralization gave managers more managerial authority to facilitate such practices (Sun 28). Lastly, theft through property transfer. Here, a manager could transfer considerable portions of state assets under his supervision to private businesses, or part of state firm revenues, loans, or tax refunds into his own account. Again, before administrative decentralization, such practices were rather difficult to conduct since regulation and supervision by central state institutions was rather strong. However, with more authority for bureaucratic institutions on the lower level, such regulation and supervision was nominal or conducted by the manager himself, making this type of embezzlement easier (Sun 28).

Bribe Taking (Shohou)

Bribe taking is deemed a criminal offence if the bribe accepted is Y2000 (1979) and Y5000 after 1999. Where bribery first only included small gifts for personal use, however after economic reforms bribe taking became more creative and costly. Bribe taking differs from other categories discussed in that it always involved a two-way exchange between (several) agents and a client (Sun 28). As such, the most common way in which bribes are accepted comes through salaries and bonuses. In this case, bribe givers put government officials or their direct family members on the payroll of their private company, either as consultant or employees, in exchange for preferential treatment or to obtain licenses with a shortcut. Problems of detecting a bribe occur when a private company has a high turnover rate which at first hand does not show any irregularities in revenue and costs. As such, it becomes rather difficult for state supervisors to uncover such bribes and especially which official has accepted one at which government department (Sun 29). Bribes also come in the form of special occasion gifts, where before reforms a briber looked for occasions focused on either holidays, funerals or weddings, after reform special occasions also included officials children studying overseas. Again, such type of special gift occasions was made possible due to decentralization through which regulation and supervision on the more local levels was less strict (Sun 30).

Misappropriation (Nuoyong)

Misappropriation is the unauthorized use of public funds by individuals, but it differs from embezzlement in the sense that the appropriated funds are required to be returned later. Such

violations usually were small amounts to family or friends, however with market reform, the amounts and the way funds were misappropriated have changed in scale (Sun 31).

Furthermore, the process of decentralization introduced from 1992 and onwards shifted public resource allocation from the central government to local governments, thus transferring supervisory authority from the principal to agents (Sun 32). With less regulation and monitoring from the central government, agents were able to misappropriate funds rather easy without the risk and costs of detection. Misappropriation of funds often come in the form of loans for commercial use, usually this manifests itself in the form of a loan appropriated to a friend who needs a kickstart for his new business. However, should such a business fail or be illegal and the government official should now the risks beforehand, punishment could be grave (Sun 31).

The above described forms of corruption are not the only categories, however these forms have been the most common, but changed in severity in the 1990's, the reason why the criminal code for these types of corruption have been altered throughout the between the 80's and 90's. If one would divide these two decades in two time periods, roughly from 1980-1989 and 1990-1999, one can find differences in severity of corruption, as well as differences in perpetrators of corrupt behavior. From these differences, implications can be made in terms of how reforms in both time periods have altered corrupt behavior.

As mentioned earlier, corrupt behavior and its severity changed in the two reform time periods and the reason behind this change can be found by examining key reform policies. The first reform period and its forms of corruption were largely influenced by the introduced dual-track system (Sun 38). Introduced in 1985, the dual-track system was a inventive economic model which combined the centrally state-planned economy with the emerging market economy. State-firms had state-planned output requirements which had to be met through the allocation of resources at a fixed price. When these quota requirements were met, should state-firms still have resources that could be allocated, they could do so at the market track for market prices, which varied from the fixed prices of the state (Sun 39). Although the dual-track system was a significant factor in China's gradual transition to the market based system, it also fueled corrupt behavior by officials. Market prices were not fixed, thus officials could sell state resources on the market to the highest bidder (Sun 38). Usually these sort of payments came in the form of under the table agreements, in which a private company agreed to pay a higher price than the market price, thus creating excess income for a official in the form of a rent. These under the table agreements usually consisted relatively small sums

of money agreed upon by low ranking officials, and were often not detectable since state resources were only sold on the market once the state fixed output requirements were met (Sun 38).

From a principal-agent perspective, requirements set by the principal were thus met by the agent, and rents obtained by agents the economic performance of state firms and private firms. State-fixed output requirements were gradually not met, alerting the central state that either productivity of state firms began to halt, or that state resources were sold on the market for higher prices but that these profits were undetectable on the checks and balances of state firms, fueling the notion that rents in the form of embezzlement and bribery ended up in the pockets of officials (Sun 37). Although the dual-track system created incentives for officials to create rents in the form of embezzlement or bribery, since the monitoring and allocation of resources was done by the central authority as the principal, corrupt behavior by agents was rather easy to detect, resulting in a major anti-corruption campaign in 1988-1989.

The surge in corruption made possible by the dual-track system resulted in many state firms being unprofitable, but also culminated the Tiananmen Square protests of 1989. The dual-track system created incentives for state managers and officials to accumulate wealth through price discrepancies, however this pattern changed around the early 1990's (Sun 44). Reforms introduced in the beginning of the 90's shifted focus away from state-fixed input and output requirements for state manufacturing companies to more market-oriented nonmanufacturing companies (Sun 44) (Knight 7). These companies came from capital-intensive sectors and consisted of investment companies, property developers, state banks and insurance companies. Incentives for corrupt behavior shifted away from price discrepancies towards loan, revenue and assets (Sun 45). Furthermore, administrative decentralization gave governments institutions on the local level more freedom from a fiscal perspective, in order to retain revenue in the form of extra-budgetary revenue, which was believed to encourage economic development on the local level (Knight 5). This decentralization process gave local governments considerable power in terms of tax revenue, investments, and legislative powers.⁴

Where the first period of reforms largely fueled corrupt behavior in the form of embezzlement and bribery by low ranking officials, the second reform period can be characterized by more severe cases of bribery involving not only state-firm managers, but officials of high

⁴ 'New Trends in China's Administrative Reform', www.chinacenter.com, October 15 2015

administrative ranks, including deputy executives of cities, SOEs, government bureaus, and law enforcement institutions (Sun 48-49). Furthermore, where bribes in the reform period consisted of an average around Y5000 per bribe, while the average bribe in the second reform period was Y63,000 or higher (Sun 49). Lastly, where corrupt behavior by officials in the first reform period were largely individual transactions between an agent and a client, reform and decentralization in the second period encompassed agents from a variety of institutions, which gave way to a more coordinated form of corruption known as collusive corruption.

III. Institutional Changes Incentivizing Corruption 1992 – Onwards

As mentioned in the second chapter, reforms introduced after Deng Xiaoping's Southern Tour have played a significant role in allowing the Chinese economy to grow, but also gave way to opportunities for more severe corruption. Part of these reforms focused on the decentralization of administrative power from the central level to the local level, which gave local officials more authority in resource allocation and decision making (Cheng 74). Reforms focusing on decentralization changed the role of government institutions drastically, in terms of increased administrative authority in economic policy, as well as in monitoring and regulating officials within these institutions.

The connection between corrupt behavior and public ownership of assets lies at the heart of China's political economy, and a defining feature of this corrupt behavior is the looting of state-owned assets by colluding bureaucratic elites (Pei 23). From a conceptual point of view, corruption and collusion can be seen as two distinct concepts. Corruption is generally defined as misuse of public office for private gain at the expense of the public it ought to serve. Collusion can be defined as unauthorized cooperation among agents without the knowledge of a principal. However, although a principal would not be aware of collusion among different agents, such cooperation between the latter does not necessarily result in private economic benefit for the agents (Pei 23). However, when collusion benefits a small group of perpetrators at the expense of the public welfare, it can indeed be deemed as corrupt behavior, since it harms the public through illegitimate resource allocation since it ends up as rents for agents. Economies plagued by collusive corruption experience inefficient allocation of public resources due to the power wielded by bureaucratic elites within the institutional framework of the state (Pei 23).

One could argue that collusion among different agents within the institutional framework of China is a direct effect of economic and decentralization reforms from the 1990's onwards. Before the process of bureaucratic decentralization, governments or agencies on different levels all belong to the same bureaucratic system, with the higher authorities setting out the task of lower, local authorities (Zhou 56). As such, development policies and administrative regulations are intended to be applicable throughout all regions and provinces within the state. Central policies were intended to be implemented from a top-down approach throughout different levels of administrative and bureaucratic agencies, covering a wide variety of social, political and economic areas (Zhou 56). Such a top-down approach ensured uniformity in policy making and was a distinctive part of the Chinese political economic policy before the reform period of 1978 and onwards. However, the Chinese government found out that a

unavoidable consequence of uniformity in policy was that certain policies did not fit adequately in every locality within the bureaucratic and administrative framework (Zhou 57). As such, difficulties and challenges emerged for local officials to correctly implement these policies within their specific locality. These challenges and difficulties created by uniformity in policy made it difficult for localities to reach their economic goals, since local conditions for economic development in terms of resources and type of state (non)manufacturing companies varied per region.

In order to overcome these local challenges in implementing state policy, the Chinese government realized flexibility in policy implementation was necessary to ensure economic growth. Flexibility in implementation would ensure that local bureaucracies could adapt central policy better to fit their policy goals according to local conditions, in order to ensure the most efficient path to economic development (Zhou 57). Such flexibility meant that local bureaucracies were giving more authority from the central state, as principal, in the sense that the monitoring and regulating role of the principal was partially transferred to local governments to ensure their agents actions would carry out policy accordingly with local conditions. The argumentation behind flexibility in policy implementation is that local agencies are in a better position as supervisors to evaluate the performance of their own agencies and subordinate agencies. Thus, for the institutional framework to be at its most effective, supervising local agencies are allowed flexibility in policy implementation, as well as monitoring subordinate agencies to ensure the best possible economic outcome (Zhou 57). Flexibility changed the dynamic relationship between the principal and agents, and while flexibility was meant as a measure to ensure better policy implementation, it gave way to collusive behavior among agents on different local levels.

At the heart of collusive corruption lies the interaction between different actors, defined as the earlier mentioned principal-agent-client approach (Gong 87). In a corruption case, the roles and interests of those involved in corrupt behavior are determined by their relationship towards the others involved rather than external reasons. In other words, collusive corruption among agents of different administrative bodies means all their interests need to be in line with each other to ensure the most profitable outcome for all involved. This agency relationship includes a principal, or supervisor who embodies public interest, an agent who works on behalf of the task given to him by the principal, and a client, an individual whom the agents interacts with to meet their common interests (Gong 87). In essence, the principal should supervise the agent to make sure the agent fulfills his task accordingly to the

supervisor's demands, although the agent will have some freedom to maneuver more towards their own interests rather than the public's interest represented by the principal. It is exactly this freedom to maneuver that provides the client with the opportunity to offer the agent a form of monetary payment in return for preferential treatment. Should the agent accept, the net benefits outweigh the net cost, such as punishment or possible prosecution.

Ting Gong explains how from the principal-agent-client framework one comes to collusive corruption⁵:

“If we push this line of reasoning one step further by supposing that there are more than just one agent and these agents are willing to collude, then the pursuits of their individual interests and their betrayal of the principal, which would otherwise be separate efforts, may converge into collective behavior leading to more personal benefits. Corruption, in such a context, is no longer an isolated action corrupt in and on itself, but a network of interactions and exchanges among corrupt individuals”

When corrupt behavior becomes an action within a network of interactions and exchanges among corrupt individuals, not only will such a network assist in profit-maximization, but collusive corruption will also help in reducing the risk of detection. Not only are corrupt individuals able to increase the amount of corrupt income as much as possible, it is in the interests of all agents involved not to be detected, and thus to reduce the risk of detection by providing cover for each other (Gong 95) (Pei 28). As such, to the extent that collusive corruption involves a greater number of government officials, it would mean it is harder to detect than interaction between a single agent and client.

Surprisingly, Yong Guo found empirical evidence that supports the claim that collusive corruption in post 1992-China had a positive effect in terms of increased income and reduces risks for the officials involved in collusive corrupt behavior (Gui 353). Furthermore, this implies that post-1992 reforms changed the institutional framework in which Chinese officials operate in such a way it fostered collusive corruption. China's market-driven reform was introduced to create opportunities and incentives to foster economic growth, but also to decentralize the administrative bureaucracy, subsequently drastically shuffling the administrative and economic structures in place (Gong 90).

⁵ Dangerous Collusion: Corruption as a Collective Venture in Temporary China. Ting Gong, *Communist and Post-Communist Studies* 35 (2002) p.85-103.

Administrative decentralization, mainly flexibility in policy implementation, has been a critical link in fostering collusive corruption in China. Local government authorities are given almost all the resources, including the authority to hire and promote personnel, but most importantly to foster economic success (Gong 92). The financial health of an institution is the result of the decisions made by local authorities, who can make important decisions on matters concerning money, without significant interference of the central government, despite their attempts to hold local authorities accountable for their legitimate use of state resources to pursue economic development (Gong 92). So quite ironically, while the state's authority over the economy as a whole was loosened through processes of decentralization, it were exactly these processes that gave local government bodies and its officials increased authority to pursue economic goals and to gain the resources to do so.

Through decentralization, public officials only control a part of a particular department or step in the decision making process, and thus need to collude in order to overcome a mutual veto in their interaction with other public officials (Pei 28). Thus, a plausible explanation for collusive corruption can be found in the fact that the net costs of a veto will have a far reaching consequences for the net benefits of all agents involved, while collusion would prevent a veto from ever occurring (Pei 27-28). For example, government bureaucracies are divided in specific departments, who all have some sort of monopolistic authority in granting regulatory approval (licenses, no trade barriers etc.) or the allocation of public funds within a specific process, such as land leasing. These officials who all work in a different department, but are all part of the same process, gain significant benefits from using their administrative power in a collusive manner, by collectively helping the bribe-paying client to obtain all the required licenses (Pei 28-29). Should these individual officials not collude with each other, not only is it unlikely the bribe-paying individual will obtain all the necessary permits, all officials within the process will fail to realize any income from their administrative power (Pei 30).

Vertical, Outsider-Insider and Horizontal Collusive Corruption

Collusive corrupt behavior may give the actors involved many benefits, however this activity cannot occur undetectable without coordination problems including the risk of agents pursuing their own personal interest rather than the collective interest of all (Pei 37). Therefore, coordination among agents is needed and can either happen vertically or horizontally or through coordination from within a government agency with a client, often a private businessman or crime boss. While these three forms of collusive corruption all have

their own distinct aspects, they often overlap each other or are observed all three, as is the case with the Xiamen smuggling case discussed later in this paper.

When vertical collusion occurs, it involves a powerful superior often in the form of a local party chief who is responsible as the coordinator and enforcer of a corruption network within the government agencies under his jurisdiction and supervision (Pei 38). Within the institutional framework of the Chinese bureaucracy, local party chiefs are among the most powerful officials within local institutions, and are entrusted by the CCP with unconstrained authority in monitoring the localities under their supervision (Pei 38). Furthermore, local party chiefs have almost complete authority in the appointment and promotion of subordinate agents within their jurisdictions. Such authority is often used to coerce subordinate officials unwilling to cooperate in the corruption scheme of the local party chief (Pei 39). A local party chief thus has a unique ability to create an extensive network of coconspirators, either to coercive measure but mainly through prospect of promotion for subordinate officials should they agree to cooperate in such a corruption scheme (Pei 39). From the perspective of a local party chief, a corruption network consisting of loyal subordinates will greatly reduce the risk of detection in comparison to subordinates who are coerced to cooperate within the network.

A corruption network set up by a local party chief makes bribe-paying opportunities for private entrepreneurs rather easy, since such an entrepreneur only has to approach the person at the top of the network (Pei 40). Instead of having to bribe different officials in several agencies, which is rather time consuming, private entrepreneurs focus their attention on local party chiefs to ensure preferential treatment. From the perspective of a entrepreneur, this greatly reduces transaction costs and from the perspective of a local party chief, direct exchanges with a entrepreneur justifies a significant increase in monetary payment, since a party chief has to ensure his subordinates arrange the necessities for preferential treatment in exchange for either a part of the bribe, or in the form of promotion within the bureaucratic framework (Pei 41). Within a vertical collusion network, the local party chief has the dominant position in relation to his subordinates, but also towards his relationship to any entrepreneur wishing to offer a bribe for preferential treatment.

Within a pattern of outsider-insider collusion, the dynamic between officials and private businessmen is somewhat different. Businessmen approaching a local party chief often have the monetary means to offer a bribe large in size, however many other businessmen do not have the capacity to do so, and have to approach subordinate officials in order to gain favors (Pei 41). Within this framework, private businessmen have a more favorable position as a

coordinator, since they do not form a political threat as competitors within the bureaucracy, therefore it is easier for businessmen to gain the trust of officials they approach (Pei 41). Once a businessmen has gained the trust of several officials through bribes, he/she can gradually involve more officials within their network. A difference with a vertical collusion network lies in the fact that a businessmen often approaches officials individually, thus often officials are unaware that they are part of the network in the first place (Pei 44). Still, within this mode of collusive corruption, the main goal of a businessmen is to eventually approach the local party chief through its subordinates.

Horizontal collusion generally occurs in specialized government agencies and the respective officials working in these agencies. Successful execution of such a type of collusion depends on several requirements. First, cooperation among a small number of insiders within the same government agency is needed since they share the same administrative authority within their agency (Pei 42). It differs from vertical collusion in the sense that cooperation is not coordinated by a local party chief, but by mutual cooperation of subordinate officials working in the same department. As colleagues, they have direct knowledge of each other's work and know everyone has another administrative responsibility. Thus, to ensure successful horizontal collusion, they need to work together efficiently to ensure rents payed in the form of bribes (Pei 44). An important aspect that determines the success of a horizontal network lies in interpersonal relationship among insiders, as well as trust. It is in the interest of everyone involved that the principal remains unaware of the agents corrupt behavior, and that can only be ensured if the agents involved know their collusive organization is built on mutual trust.

Property Rights Reform

To understand the emergence of collusive corruption from the 1990's onwards, it is important to understand the overall institutional context in which market-driven reforms have fostered such behavior. While profit maximization and risk reduction are plausible explanations for the increase in collusive corruption after 1990, the Chinese case provides sufficient room for further explanation of the phenomenon. More specifically, why did the reform policies such as property rights reform introduced after 1990 created the incentives for collusive corruption?

The answer can be found by examining the early 1990 reforms, which introduced policy and institutional changes significantly altering the incentives and abilities for Chinese officials to collude with each other. After Deng Xiaoping's 1992 Southern Tour economic reforms rapidly

accelerated, and while these reforms focused mainly on liberalization, partial property rights reforms quickly became an essential part of this economic reforms (Pei 31) (Ho 397). The Chinese government already started cautiously with property rights reform from the mid 1980 onwards, but they did not expand these experiments because of strong opposition within the Party itself, which still consisted of many socialist hardliners which saw property rights reform as a measure too close to a capitalist market. However, such opposition weakened significantly after Deng's Southern Tour, with increasing numbers of senior state officials realizing that economic development could only continue with a more market oriented approach to property rights (Ho 398). Still, the Chinese government adopted a less radical approach to property rights reform, not pursuing complete privatization but to disentangle property rights from control rights (Pei 31). Decentralization measures included in the 1990 reforms drastically decentralized the government's monopolistic as owner and manager of state assets, including land, industrial lands and housing stock (Paik 73). Wooyeal Paik explains these decentralization measures in the following way⁶:

“Under the decentralization measures, local states gained substantial discretionary power over the allocation and commercial valuation of state assets within their geographical jurisdictions, along with the right to regulate local economic activity. In addition, along with the central state, local states (even down to rural collectives at the township and village level) tend to own and manage a large number of state-owned enterprises, which deeply embedded themselves in industries regardless of its economic effectiveness” (73).

The above citation embodies the significant changes Deng's economic reforms and administrative decentralization had on China's political economy. These reforms have caused a diffusion of power from the national level to local levels, and the greatest opportunities under these new measures in the context of marketization have been government bodies at the middle and lower levels of the system (Gong 91). Local party officials have the means, freedom and opportunity to maneuver beyond as well as within the state bureaucracy (Gong 91).

Under these new circumstances of decentralization, top-down supervision and regulation became nominal at best, making it easier for local officials to collude with one another and to include clients, in the form of entrepreneurs and their enterprises, embedded in the party state (Paik 73). Where decentralization enabled officials to collude one another, the reform of

⁶ ‘Land Developers, States, and Collusive Clientelism in Marketizing China. Wooyeal Paik, Inha Journal of International Studies

property rights was a mean to do so. If local officials are more intertwined with each other, the more they can cooperate and work towards mutual benefit for them all. With these economic reforms, entrepreneurial state-embeddedness increased in markets such as property rights, providing local officials with opportunities to pursue their own (collusive) agenda.

Land rights in China can be understood in the following manner according to Peter Ho⁷:

“The fundamental principle of land rights in China is the identification of the state (and less so, the collective) as the absolute power. All other rights are derived from this” (402).

Unlike land in other markets of the Chinese economy, the land-development industry is highly dependent on allocated state resources and bureaucratic discretion, therefore local authorities were more keen in actively pursuing cooperation or collusion (Paik 73). As mentioned above, land property ownership is in the hands of the state, while the right to use land is unevenly allocated with red-tape regulation and limitations, making access to local authorities rather important for both private and state-owned land developers (Paik 74).

Opportunities for government authorities to pursue their own agenda lay largely in the fact that most property rights reforms were rather vague and incomplete in nature (Pei 32).

Property rights reform separated ownership right from control right. While this separation created an effective market for revenue in the form of land sells by local governments, the incomplete nature of property rights reforms nurtured conflicts between the actual land owners (the state) and those who controlled it – local government authorities in name of the people (Pei 32).

Aside from the conflicts created by property rights reforms, it is important to mention that the gradual liberalization of control of the state over land use since the 90’s enabled local governments to acquire large amounts of revenue through what was before an asset fully in the hands of the central state – land. However, despite this partial liberalization, Minxin Pei mentions the following regarding property rights reform:

“However, like other key reforms in China, the reform of property rights in land was instrumental in purpose, partial in nature, and incremental in pace” (56).

The main goal of property rights reforms was to solve problems created by excessive control of the central state over land transfers and to generate revenue by allowing local governments

⁷ Who Owns China’s Lands? Policies, Property Rights and Deliberate Institutional Ambiguity. Peter Ho. *The China Quarterly*, No.166 (Jun., 2001), pp. 394-421

to do land sales for which they in return had to pay part of the revenue back to the central state (Pei 56). Still, despite transferring use rights of land to local governments, the central government remained the sole owner land, with the only desire to maximize government control (central and local) and to acquire maximization of revenue in the selling of land. Opportunities for corrupt behavior emerged from the continuation of the state's ownership of land rights, since as legal owners they could dispose the land in their desired manner (Pei 57). Corrupt behavior was made possible by the discretion given to local governments to whom they would sell the right to develop the land. In the first phase of property rights reform, most land transactions were conducted as nonpublic agreements between sellers and purchasers (Pei 57). Such nonpublic agreements made the central government suspicious that land was sold at lower price than what could actually be asked for the land. In nonpublic agreements, state officials could sell the land to businessmen who offered a bribe in exchange for the purchase of land (Pei 58). Therefore, the central government implemented a policy that made local governments sell the land rights via public bidding, in a bid to create more transparency. Still, even in public auctions, agreements could be made beforehand between officials and businessmen that would ensure the one paying the highest bribe would eventually obtain the land rights.

So how did property right reforms created incentives for officials to collude in corrupt behavior? The biggest incentive for collusive corruption is created by the complementary authority of land use transferred by the central state to local governments (Pei 59). Moreover, since land use was and is still in high demand, it is its contested nature which created incentives for collusive corruption. In order to dispossess the current land user in the form of a farmer or urban residents, state officials have to collude with agents in other agencies, such as regulation agencies, as well as with clients wishing to obtain the land rights of a plot of land (Pei 59) (Paik 78). Secondly, land right in China is in high demand, therefore they are multiple real estate developers keen to acquire such rights. As such, real estate developers try to collude with the most powerful official and its subordinates, in most cases a local party chief. Third, due to China's bureaucratic framework, multiple government agencies may lay claim to land right use. Therefore, officials from different government institutions first need to collude with one another to smoothen the transfer of land rights to the highest bidder (Pei 60-61).

While the institutional changes created by economic reforms and decentralization described above are certainly not the only changes implemented by the central government from 1992

onwards, they have played a very significant role in changing the dynamic of corrupt behavior by government officials. Flexibility in policy implementation for local governments, as well as further decentralization shifted the dynamic of the principal-agent-client relationship. Agents had more authority to implement policies as they saw fit, while higher state officials within local governments were tasked with supervising and monitoring their subordinate government agencies. The changing role of official within bureaucratic institutions created new incentives for corrupt behavior, especially in the form of collusion among agents.

IV. Case Study: The Xiamen Smuggling Case

With deepened market reforms private entrepreneurs were able to join markets previously protected by the Chinese State. Still, to obtain specific licenses, private entrepreneurs had to go through government agencies in an attempt to obtain such licenses and build his/her

enterprise. In such a situation, where a businessmen needs to go through several bureaucratic agencies in order to obtain all necessary licenses can provide opportunities for collusion in corrupt behavior between individuals, firms, and public agencies. One of the most severe cases of collusive corruption occurred in 1999 called the Xiamen smuggling case, arguably the biggest corruption case in that period of time (Shieh 68-69). As a Special Economic Zone in Deng Xiaoping's Southern tour, Xiamen enjoyed the full impact of deepening market reforms, such as a policy to function as an open-port. Furthermore, property rights reform created a construction boom that attracted foreign investors, but also gave rise to more hotels for the increasing number of tourists⁸. However, market reforms and administrative decentralization also gave way to incentives and opportunities for collusive corruption among agents and clients.

As mentioned earlier, collusive corruption consists of a network spanning (multiple) government departments, enterprises and individuals. Furthermore, the actors within this network are not restricted to enterprises and government officials, but also consists of individuals of private firms or organizations. The Xiamen smuggling case is an interesting case in terms of collusive corruption and the principal-agent-client model since 300 high ranking party and government officials, lower level officials working in government departments, as well as clients, in this case Lai Changxing, were involved in this massive smuggling case (Shieh 71). The severity of this corruption case showed how market reforms and decentralization, as well as increased autonomy for local authorities to create a checks and balances for corrupt behavior made collusive corruption such as this specific case so severe.

The size and complexity of the Xiamen smuggling case came to light in the last months of 1999, when, according to official accounts, The Yuanhua group smuggled in approximately 53 billion yuan worth of goods between 1996 and 1999. Through this smuggling scheme, Lai was able to evade for almost 30 billion yuan in taxes, which was almost 50 percent of the nationwide income on tariffs in 1998 (Shieh 71). The majority of the smuggled goods consisted of refined oil, being equivalent to a ship carrying 100,000 tons of oil every three days (Shieh 71). The amount of oil smuggled was so high that officials from the investigative team states that the amount of oils smuggled by Yuanhua seriously distorted oil prices nationwide and had a negative impact on oil production, which led to the bankruptcy of numerous enterprises throughout China (Shieh 71). Aside from the economic consequences of

⁸ "An Inside Look at The Xiamen SEZ", www.bjreview.com.cn, 10 August 2009

the Xiamen smuggling case, there was also another interesting aspect that was not seen on such a scale before. A large group of party members and state officials, on central, provincial and local level were part of this smuggling scheme. Lai Changxing (as client) was able to draw in these government officials (agents) through large amounts of bribes, but also through what is called his ‘‘pleasure house’’, in which flamboyant dinners and parties were given to lure in even more officials (Shieh 71).

The main instrument in Lai’s smuggling scheme was Yuanhua Group, which was registered in Hong Kong in 1993 and consisted of several companies focusing on real estate and trade. (Shieh 72). Soon thereafter, Lai established holdings on the mainland, which were based for the biggest part in Xiamen, with an exception for a container company in Shanghai. The board of Yuanhua consisted of Lai’s family, all of whom had the responsibility within the smuggling operation, with Lai responsible for the smuggling of refined oil, his wife in charge of the overall finances, and both his brothers responsible for the smuggling of cigarettes and cars respectively (Shieh 72).

The role of Yuanhua Group was to coordinate the smuggling operation within all different listed companies, but this could be only done by obtaining the right licenses or preferential treatment through government departments, as well as the protection of the smuggling scheme through government officials working in these respective departments to get the smuggled goods through customs (Shieh 72). However, the investigation team found out that the actual smuggling was not done through this listed companies, but was carried out by several state firms and enterprises in Fujian for a share of the profits in an attempt to cover up his tracks (Shieh 72). These state firms and enterprises were very significant companies within state sectors, such as Jiuzhou Group, one of the oldest and biggest provincial level enterprises in Fujian, as well as smaller enterprises solely responsible for either customs or the falsification of tax invoices (Shieh 72). This shows that there were a wide variety of agents involved, such as government officials working in state enterprises as well as public bodies such as customs departments. Furthermore, the way in which Lai, the client, obtained favors of these different type of agents varied from bribes to obtain licenses, to profits shares in state firms.

A large percentage of the money made by smuggling ‘cleaned through an underground bank, where the money was converted on the black market in a foreign currency, which was the transferred back to Lai’s Hong Kong listed companies, who used the money to buy property in Hong Kong and Xiamen, as well as using the products to expand its smuggling empire

(Shieh 74). However, what made his smuggling scheme differentiate from other corruption cases is not only the scale in terms of smuggled goods, but also in scale in terms of the network of officials that were involved. Below, several of the most important agents and their respective role will be discussed, as well as how these agents and their departments were able to set up such a collusive corruption network in relation to market reforms and decentralization.

In order for the smuggling operation to run smoothly, cooperation within customs agencies was needed. Lai had an extensive collusion network in Xiamen related to customs formalities, such as port management and commodity inspection (Shieh 75). Furthermore, there were even officials included in it's network that were responsible for combatting smuggling and corruption. Most interestingly is the fact that within the customs bureaucracy the head deputy of Xiamen customs was on the payroll of Lai (Shieh 75). This type of vertical collusion made it possible for Lai to bribe the man at the top of the local bureaucracy, who in turn was responsible for the subordinate agencies under his supervision and authority. Collusion was even so severe that the head deputy of Xiamen customs asked Lai for approval when promoting or removing subordinate officials within the network (Shieh 76).

Secondly, another layer of protection was made possible by Lai's connection to senior government and Party officials in Fujian province, which opened up various possibilities for approaching more state officials or corporate leaders who could provide assistance in his smuggling operation (Shieh 77). Collusion with senior Party members and state officials at the highest local level makes detection even more difficult. With decentralization, a significant part of power as principal is transferred to province-level agents. In some regard, senior officials on the province level act as principal within the jurisdiction of their province and are responsible for monitoring the activities of the agents under their administrative jurisdiction. If the principal is included in the collusion network, detection becomes rather difficult. An example from Lai's network can be found in Liu Feng, a deputy Party secretary in Xiamen who oversaw law enforcement in the city as well as anti-smuggling operations (Shieh 77). A senior state official which such administrative jurisdiction can make it rather easy for bribe paying individuals as Lai to operate a collusion network.

In light of reforms and collusive corruption, a high profile case such as the Xiamen smuggling case is significant for two reasons. First, cases like this show that while market reforms may have helped economic development throughout China, the fact that government institutions still have considerable authority in the implementation of economic policy, creates

opportunities for corrupt behavior for both agents and external clients. An example can be found when looking at the Xiamen customs offices, who have considerable say in terms of which goods can be shipped freely or when extra tariffs need to be paid. A client can offer agents within a government agency a bribe in order to overcome such tariffs, however the question remains to what regard this damages economic development on a local level. Nevertheless, the fact that a client is able to overcome local administrative jurisdiction by offering bribes to clients in various agencies shows that monitoring of corrupt behavior is nominal at best.

Secondly, the Xiamen smuggling case shows how severe collusive corruption can become after market reforms and administrative decentralization. Corruption in China evolved in a more sophisticated and complex form, including large-scale collusion with senior level state officials and their subordinates, private entrepreneurs and multiple enterprises (Shieh 89). Cases like these show how a shift in administrative power from the central level to the local level enabled senior officials to become partial principals responsible for overseeing their subordinate agents. However, when a principal and their agents are approached by a client and agree to collude in a corruption scheme, detection within the local bureaucracy becomes rather difficult. The only reason why a case as this comes to light is that at one point Lai became too reckless and trusted the officials within his collusion scheme too much when it came to quantities of smuggling goods difficult to hide (Shieh 89). When such a large corruption scandal comes to light, one can argue that the Chinese state still has the means and capabilities to fight back (Shieh 90). Still, in terms of damage to local economies as well as curbing corrupt behavior by state officials, it could be argued that implementing anti-corruption measures focused on detection and prevention would help in eliminating the incentives for corruption among agents and clients in the first place.

V. Anti-Corruption Efforts : An Institutional Approach

Anti-corruption efforts 1980's-00's

Already in 1980, Deng Xiaoping stressed the importance of the role of law and institutions in fighting corruption. When referring to corruption within the process of reform, he made clear that the fight of corruption was a political one, which had to be fought within the framework of the law (Zhu 83). Party cadres should uphold their duties according to laws and regulations,

but should also learn how to use legal as well as economic measures such as fines to protect the Party against increasing corruption (Zhu 83-84). However, the CCP's approach to fight corruption was characterized as campaign-style enforcement and influenced by the personal interest of individual top leaders, rather than guided by institutions monitoring and regulating corruption (Zhu 84). As such, anti-corruption campaigns were difficult to uphold in every province, city, or country level throughout China, since there was no coherent line from within institutions applicable over the whole nations. In this regard, the principal (top official in charge of an anti-corruption campaign), will focus on one specific cadre within a province, which gives the agents and their respective clients in other cadres the opportunity to continue their corrupt practices.

Since the reforms introduced in 1978, the Chinese government every once in a while introduces new anti-corruption campaigns. Every anti-corruption campaign, the Chinese government uses harsh rhetoric and strong words, and such anti-corruption campaigns usually end up in a significant amount of cadres either being jailed, arrested, convicted, or penalized to death (Wedeman 93, 2005). Eventually, each campaign ends and the efforts of the CCP are praised in their fight against corruption. However, eventually a new anti-corruption campaign will be introduced with similar results, raising the question if the CCP's anti-corruption efforts are effective, considering the fact that such anti-corruption campaigns do not seem to halt the results as anticipated. According to Andrew Wedeman, these repeated campaigns do not have the intent or the capacity to completely eradicate corruption, but rather are used as a mechanism to curb corruption back towards acceptable levels (94, 2005).

There are two reasons for this type of anti-corruption campaigns. First, the Chinese government does not have the resources to effectively eliminate corruption, considering market reforms acquired quite some (state) capital. Thus, during time periods when corruption seemed to spiral out of control, such as was the case in the 1980's and 1990's, when four major anti-corruption campaigns were started, the main concern of the government was to curb corruption under the tipping point. Should it go beyond the tipping point, the Chinese government would not have the necessary resources to curb such a crisis of corruption, seriously threatening the legitimacy and future of the regime (Wedeman 94, 2005) (Manion 90). Secondly, through decentralization, regulation and supervision became more difficult due to decreased top-down power, which made it more difficult for the principal to effectively supervise its agents (and possible clients), which not only made anti-corruption efforts more difficult, but gave local agencies more room for collusive corrupt behavior.

Furthermore, the real rate of corruption (RRC) fell significantly after a 1989 anti-corruption campaign (60,000 cases per year), mainly due to a revision of the Criminal Code, with several changes made in terms of what was deemed economic criminal behavior, which led to a reduction of 35,000 cases per year until 1997⁹. As mentioned earlier, while there was a decrease in quantitative terms, in qualitative terms corruption became more “intense” in the sense that the officials involved were holding positions above country level, and corrupt monies identified through anti-corruption campaigns increased from 90 million renminbi in 1984, to 41 billion renminbi in 2001 (Wedeman 95, 2005). This shows that anti-corruption campaigns were relatively effective in curbing quantitative corruption, it did not have the same effect in terms of more qualitative corruption. And while market reforms and decentralization intensified after 1992, anti-corruption campaigns did not seem to evolve in response to these reforms, possibly since extensive networks of collusive corruption were rather difficult to detect due to the shift of power as principal from the central levels to the more local levels.

As mentioned earlier, there are several reasons for what Wedeman calls campaign-style enforcement (96, 2005). Given the fact that enforcement resources are scarce and costly, it is doubtful if a regime has the capacity to deploy sufficient resources to strictly regulate and control corruption, especially when local government authorities, as agents, are less regulated by the principal and thus have more autonomy and authority in a given county or province (Wedeman 96, 2005). The logic of campaign-style enforcement lies not in increasing short term detection rates, but to create a narrative in which psychological warfare is the main instrument in trying to induce fear in officials in possible crackdowns. Assuming that officials make a rational choice in terms of accepting or rejecting a bribe, thus thinking about the possible risk of getting caught, but also the risk of continuing to conduct in corrupt behavior (Wedeman 96, 2005). Campaign-style enforcement thus attempts to alter the rational choice of officials, in the sense that in the end the state will find ways to detect corrupt behaviour by officials.

Chinese-style anti-corruption campaigns between the 80's and 90's did not have the means, nor the intention to deter corruption as a whole (Wedeman 113, 2005). While cases of petty corruption, or quantitative corruption seem to have lowered between the 80's and 90's, qualitative corruption seems to have intensified. One reason could be the fact that

⁹ Wedeman, Andrew. “Anticorruption Campaigns and the Intensification of Corruption in China” *Journal of Contemporary China*, 14:72, 93-116.

anti-corruption campaigns happened once every four years approximately during the 1980's and 1990's (Wedeman 114, 2005). As such, the fear and the net cost of getting caught for petty corruption during an anti-corruption campaign are higher for officials should they get caught, in relation to officials who accept larger bribes. The latter's net costs of getting caught outweigh the net income of accepting higher bribes, especially when detection rates are low and the monitoring capability of the principal is limited in its capacity.

From the principal-agent-client perspective, officials who act in a corrupt collusive manner could possibly adhere the risk of crackdowns or getting caught by working together to minimize the overall risk and net costs of getting caught. That being said, it seems that campaign-style enforcement seems to be based on the assumption that officials act independently from each other in corrupt behavior, as was mainly the case between 1978 and 1992. However, with deepening market reforms and decentralization, officials found other, more collusive ways to conduct corrupt behavior, while the institutions that were in place to monitor and curb corruption were largely based on low level petty corruption, instead of more intense, collusive corruption.

However, after the 16th Congress in 2002, the CCP has made many efforts to speed up its institution building and to work towards clean government building (Zhu 85). The State Council made a significant number of regulations on to punish graft and embezzlement of Party members, officials and bureaucrats. Furthermore, changes were made in terms of regulations on administrative supervision on the local level. Local governments and cadres all had their own regulations and monitoring bodies aimed at curbing corruption (Zhu 85). Secondly, the Administrative Procedural Law of the People's Republic of China was implemented to further improve the monitoring of government agencies towards stronger institution building, not only by giving local cadres the opportunity to work towards clean government, but also uphold monitoring from above through the Administrative Procedural Law¹⁰ (Zhu 85).

From all the regulations and documents that were either published or came into effect, the most important one is the "Implementation Outline for Establishing a Corruption Prevention System Based on Education, Institutional Building, and Supervision" (Zhu 86). The document consists of three parts which are focused on expanding anti-corruption education within the Party and cadres, efforts to speed up institution building in regard to monitoring

¹⁰ Administrative Procedure Law of the People's Republic of China. "http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content_1383912.htm"

anti-corruption behavior, and to establish supervision on large investment projects, made in state firms or private firms which are under the supervision of local administrations (Zhu 86-87). This shift from a more campaign-style enforcement towards institution-oriented anti-corruption efforts show that the CCP realized it could not uphold the same style of anti-corruption campaign if market reforms and decentralization deepened.

Although the CCP's reoriented towards a more institutionalized form of anti-corruption, it seems that despite these efforts corruption is difficult to contain and has intensified even more (Zhu 87). As mentioned earlier, this intensification can be traced back to the sums of money involved. Corrupt officials used their administrative power to obtain extraordinary sums of money by unlawfully giving credit, the improper leasing of land, or by engaging in smuggling activities such as the Xiamen smuggling case (Zhu 87). In 2003, there were 178 corruption cases which involved corruption where the sum of money was between 1 million yuan and 10 million yuan (Zhu 88). Secondly, there has been a surge in high-ranking officials who engage in corrupt behavior, with an average of 195 crime related corruption cases at the bureau level (Zhu 88). This can be interpreted in the following manner: Although it is difficult to assess how many high-ranking officials conduct corrupt behavior and in what time period, the fact that under new institution-oriented anti-corruption campaigns these cases come to light, can have two implications. First, the fact that there are relatively many corruption cases involving high-ranking officials shows that in a principal-agent-client triangle, the principal (high-ranking official) can also be part of the corruption scheme. From a decentralization perspective, a local high-ranking official as principal has the task to monitor and regulate the agent. However, should the principal be part of the corruption scheme, regulation on corrupt behavior is almost completely eliminated, since there is little to no supervision on the principal, since central authority has been weakened with the expansion of local power in the process of marketization.

Anti-corruption Efforts Under Xi Jinping

Between the 1980's and the 00's, the Chinese government has made serious efforts to change its anti-corruption campaigns from campaign-style enforcement, towards a more institutionalized form of anti-corruption campaigns. While this new form of anti-corruption cases had relatively success in exposing more corrupt cases involving high-ranking officials, it also showed that detecting corruption could be seen as more difficult through market reforms and further decentralization, which gave local cadres more responsibility in monitoring and regulating their administrative officials on corrupt behavior. However, should

the principal be involved in the corruption scheme, such a checks and balances on the local level are almost made completely insignificant. President Xi Jinping seems to take another approach in curbing corruption, by recentralizing power to certain central institutions and by specifically aiming to arrest high-ranking officials, in an attempt to eliminate corruption schemes from the top-down to more local levels (Keliher, Wu 8).

Under the direction of Xi Jinping and Wang Wishan, the Party has started a comprehensive and uncompromising anti-corruption campaign, focused mainly on high officials (Keliher, Wu 8). As a result, some of the most powerful civil and military officials in China are either being investigated or already imprisoned, such as former security chief Zhou Yongkang, who was sentenced to life imprisonment in 2015 for abuse of power and accepting bribes, and his associates are gradually being sentenced, showing that Xi's approach of attacking the "big tigers" in order to expose a corruption scheme involving multiple agents and clients seems to work (Keliher, Wu 9-10). However, not only high level officials are targeted, but so are mid and lower level official for petty crime, with nearly 300,00 officials being punished, from which 200,000 received 'light punishment', 82,000 'severe punishment' such as demotion within the bureaucracy¹¹. With the anti-corruption campaign intensifying, reports from all over China show growing fear of prosecution among government officials, as well as a cutback in department spending (Keliher, Wu 10). Gift-giving, extraordinary banquets are things from the past, since such behavior would now result in investigation, something officials are keen to avoid. In other words, the net costs for heads and cadres in conducting collusive corrupt behavior seem to outweigh the net income of doing so, effectively halting corruption out of fear of getting caught.

A key aspect in this rather successful anti-corruption campaign has been the recentralization of power back into the hands of central institutions (Hualing 138). Xi and Wang are re-developing the central-local relationship by transferring the power to monitor and regulate corrupt behavior from provinces and ministries to the Central Commission for Discipline Inspection (CCDI), effectively reinforcing central power over regions within the overall Party structure, a stark contrast with the decentralization process introduced in 1992 (Hualing 139).

Central control is established through two independent mechanisms. The first mechanisms seeks to further centralize monitoring and regulating power in the hands of the CCDI, while the second mechanism seeks to revitalize the central inspection system, which as an

¹¹ "China says 300,00 punished for corruption"

<https://www.cbsnews.com/news/china-300000-punished-for-corruption-in-last-year>. March 6, 2016

institution has been in place for almost ten years, however has never been effectively used (Hualing 139). Disciplinary inspection has failed to effectively curb corruption, mainly due to the lack of independence from local powerful cadres, with local disciplinary officers unwilling to investigate local corruption because of local politics or social ties, questioning the possible role they play in any collusive schemes within the specific cadre they ought to investigate.

According to Fu Hualing, the disciplinary system's most essential part operates in a hierarchically and horizontally manner across three different types of institutions: The CCDI, The Provincial Party Committee (PPC) and the provincial level disciplinary inspection committee (CDI) (139). Horizontally and as part of the PPC, the CDI is in charge of anti-corruption measures on the provincial level and reports to the PPC. However, hierarchically, a CDI is also accountable to the CCDI directly, with results in overlap and unclarity in terms of monitoring and regulating power, since in essence the CCDI exercises effective central control and could potentially surpass the PPC, questioning the use of a Provincial Party Committee (Hualing 140). To make the disciplinary system more effective, the CCDI and CDI have the authority to dispatch a disciplinary officer to be positioned in a specific government department or either central or local level. However, a following problem that arises is that the respective disciplinary officer may be accountable to the CCDI, however such an officer eventually will be co-opted by the government office he or she needs to supervise, resulting in self-regulatory supervision of the respective government office, paralyzing the disciplinary system at the operational level (Hualing 140).

Despite certain irregularities in terms of discretionary power among these agencies, an important factor that differentiates Xi Jinping's anti-corruption campaign from its predecessors is his large focus on punishing high-ranking officials caught in corrupt behavior (Hualing 150). This shows that Xi's anti-corruption campaign is focused on breaking up a collusion network by taking down the most significant principal or high ranking agent. Argumentation behind the focus on punishing high ranking officials is that by cutting of the person responsible for coordinating subordinate agents, as well as direct dealings with external clients, will break up the collusion network in its totality (Hualing 151).

Thus, in what way can Xi Jinping's anti-corruption campaign be best conceptualized? First, the heavy handed top-down approach of arresting senior officials has as main goal to create a short-term deterrence of corrupt behavior within China's bureaucracy (Hualing 152). However, while this may result in a short period of deterrence on corruption, such measures

do not adequately tackle the root problems of stopping further spreading and deepening of corruption. To overcome the problem of stopping the spread of corruption, it seems that Xi Jinping is first attempting to create a shockwave by arresting senior officials and by doing so roll up any schemes of collusive corruption. Such should a wave of anti-corruption measures be fruitful, it is argued that Xi's government will turn its attention towards creating more effective anti-corruption institutions, by recentralizing power back to the CCDI. This in turn will shift the balance of power, strengthening the role of principal at the central at the cost of provincial and lower levels. However, aside from recentralizing power back to the CCDI, further development of more permanent anti-corruption institutions still need to be conceptualized more extensively.

VI. Conclusion

Market reforms introduced in 1978 created a rather successful path towards economic development in China. It can be argued that the dual-track price system created new incentives for officials to conduct in corrupt behavior. However, such corrupt behavior was largely done by individual state officials and were thus relatively easy to detect central state authorities. From a principal-agent perspective, the first reform period saw central state institutions as the principal, responsible for monitoring and regulating state officials, as agents, in overseeing that state-fixed output requirements were met. The dual-track price system enabled agents to sell of state assets at market prices, should state-fixed output requirements be met. However, when state officials realized more money could be made by selling of state assets above market prices to the highest bidder when state-fixed output requirements were not met, detection of corrupt behavior by agents was relatively easy for the principal.

However, the 90's saw the introduction of deepening market reforms, which enabled private businesses to compete in markets first dominated by state-owned enterprises. Furthermore, administrative decentralization shifted the principal-agent dynamic in two ways. First, since private businesses could compete in markets, a third entity entered the principal-agent framework in the form of a client. Secondly, administrative decentralization shifted bureaucratic power from the state level, towards local administrative levels. Flexibility in policy implementation further strengthened the authority of local governments in reaching economic development goals. However, such decentralization and flexibility in policy implementation created new opportunities for agents in conducting corrupt behavior. Senior state officials had increased administrative authority within the bureaucratic framework of their subordinate government agencies, which in turn all had a specific role, such as for example the distribution of business licenses to private businessmen, or the sale of land rights. This increase in administrative authority for local governments paved the way to a new form of corruption in the form of collusion networks among different agents and clients. Collusion could either come in the form of a vertical, horizontal, or outsider-insider collusion framework, depending on the role of the agents involved as well as the desired outcome by clients when approaching officials. The Xiamen Smuggling case provides a well example of how severe collusive corruption can be, and how extensive collusion networks can be, including a wide variety of government agencies as well as officials and Party members responsible for custom formalities, combatting smuggling operations and fighting back against corruption.

Anti-corruption measures seem to have been effective in curbing corruption on the short term, without an attempt to combat the root cause of corruption to prevent it from happening in the future. While Xi Jinping's anti-corruption campaign is mainly focused on the detection of senior officials and their collusion networks, there are already gradual steps taken in recentralizing power back to the principal at the central level. Flexibility in policy implementation in terms of checks and balances to detect corruption within Chinese bureaucracies to a central authority in the form of the CCDI and their respective agencies. However, time will tell if Xi Jinping will be able to create permanent anti-corruption institutions focused on eliminating corruption measures at its roots.

An answer to why corruption has intensified despite economic and bureaucratic reforms can thus be found in analyzing the complex and changing role of government agencies and bureaucracies in policy implementation for economic development as well as in combatting

corruption. The principal-agent-client framework provides a interesting perspective on how economic and administrative reforms shifted relations between the principal, agents and clients as well as how such reforms created incentives and new opportunities for collusive corruption within China's political economy. The full effect of reforms under Xi Jinping is still underway and therefore provides new opportunities to examine corruption from a principal-agent-client perspective in future research papers.

VII. Bibliography

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