The politics of China's anti-corruption campaign

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CHINESE President Xi Jinping's anti-corruption campaign has highlighted the seriousness of China's official malfeasance. The outcome of Xi's campaign will shape a new era of China's politics, economy and foreign policy.

'Corruption' covers quite disparate phenomena with different consequences. It may mean graft, which is taking a tip—even a multi-million dollar one—for doing your job, or it may mean corruption in the stricter sense, taking money in return for undermining national policy or the national interest. When a Chinese official gets a large illegal kickback for building a good road, that is graft.

Chinese 'corruption' is overwhelmingly graft, whereas, for instance, in the Philippines under former president Ferdinand Marcos and in India, corruption in the narrow sense predominates. How can we tell? We can do case studies. In the Philippines, for instance, many important projects were designed to fail. A hotelier would borrow US$100 million with a government guarantee, then steal US$40 million for personal use and let the hotel go bankrupt during an economic downturn, leaving the government with the debt. That is corruption.

Beyond case studies is the Biblical saying: 'By their fruits ye shall know them'. In China, good roads and ports get built, consistently. In India they don't. Likewise with primary education, and with games like the Olympics and the Asian Games. In China graft predominates, while in India corruption predominates.

There is also what the Japanese term 'structural corruption'. In Japan, virtually all government officials and senior executives are personally honest: no bribes, much hard work. But five major interest groups—agriculture, retail, construction, property and banking—dominate the legislature to the extent that they can pervert national policy to their benefit. The construction lobby provides the template. For a long period, Japanese infrastructure spending (for a country the size of California) exceeded US infrastructure spending. There are world-class bridges used largely by deer and rabbits, and bullet trains to small towns.

So powerful was the grip of the construction lobby on the nuclear regulators that the operators of the Fukushima nuclear plant were allowed to build in an inappropriate location, to inappropriate standards, ignoring even crucial safety rules like the one requiring a fire station inside the plant. And all the while public discussion was smothered by propaganda about safety.

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The scale of graft in China has become a potentially fatal problem for the Chinese regime. The economic costs of Indian corruption are far greater. The economic costs of Japan's structural corruption dwarf both.

These varieties of corruption overlap. But the overall patterns are quite distinctive and predictive.

Probably the single greatest consensus in the literature about corruption in China is that the authoritarian system inevitably causes extreme corruption and that China would be much cleaner if it became more democratic. As the examples of the Philippines, Thailand and India show, this is an ideological conceit. Democracies in poor countries typically have much more crippling corruption than China, and it is rooted in the processes of democracy. In very poor countries, there are few or no political contributions other than bribes or candidate self-funding; peasants can't donate. In very poor democracies, the complexity of democratic judicial systems makes it very difficult to convict criminals and therefore empowers wealthy criminality. In Taiwan, a reforming Leninist government under Chiang Ching-kuo cleaned up world-beating corruption, but the advent of

PICTURE: KYODO / AAP

Sensational front pages on 30 July 2014 report the decision to pursue a case for alleged graft against former security chief Zhou Yongkang.

democracy under Lee Teng-hui and Chen Shui-bian partially revived it.

In China, as in all emerging economies, most officials supplement their salaries with irregular income. But the forms and intensity vary. One characteristic of the Asian miracle economies is that the values of the top leaders have generally given priority to national service; they focus on how they will be seen by future historians. In the Marcos Philippines and in much of Latin America and Africa, the motivation to become president is that the president can become richer quicker. While some of their family members did well, nobody has accused Park Chung Hee, Chiang Ching Kuo, Lee Kwan Yew or Deng Xiaoping of being in it for the money. They were obsessed with saving their countries through economic growth.

The core reason why graft rather than policy-defeating corruption prevails in China is that the growth-focused system demands performance at all levels. China is run like a business. Every village head, city mayor, provincial governor and party secretary has performance requirements—economic growth, domestic and foreign investment, building key roads and bridges, and improvements in children's education—that must be met to gain promotion and avoid punishment.

And Chinese officials are held to high standards. Even in poor provinces like Anhui, Chinese roads are generally better than their US counterparts. China's railroad minister became obscenely rich but built extraordinary railroads. To get a promotion the mayor must not just fulfil his targets but also outperform ambitious colleagues. Although politicians everywhere orate about fostering growth, most countries do not hold political leaders at any level to performance standards.

Jiang Zemin and Zhu Rongji oversaw an economy characterised by pervasive graft but they knew how to keep it under control by using structural reforms. They sought to cut the top levels of government in half, while quadrupling salaries, to ensure that officials could live on their incomes. They gave every government and party bureau a quota

of regulations to cut, to reduce the number of opportunities for squeeze. They drastically reduced the number of state-owned enterprises (SOEs) and put the remaining ones on more of a market basis. They forced the military to give up over two-thirds of its non-military businesses. And they promoted competition and demanded increased transparency of various kinds. So corruption, while still pervasive, remained within limits.

Hu Jintao and Wen Jiabao reversed many of the Jiang–Zhu reforms. They took office at a time when the population was weary of market-oriented reforms, having seen 50 million state enterprise jobs and 25 million manufacturing jobs evaporate. Hu and Wen embodied the reaction against such stresses. Market reforms ceased and in some cases receded.

They also had to cope with the global financial crisis and, like leaders everywhere, they poured money into the only institutions that could create rapid increases in production: the big companies. The government and party bureaucracies nearly doubled, from 40 million officials to 70 million. The SOEs revived their pre-eminence and the 1990s campaign to increase competition dissipated. Senior military officers reverted to managing numerous and often huge side businesses and driving Mercedes 500s. Some top leaders and their families began making hundreds of millions or even billions.

Graft opportunities rose much faster than economic growth. As property development reached a huge scale, and as asset inflation magnified the fortunes available from property, official control over property allocations became the basis for great fortunes. Private equity Chinese-style became a particular specialty of many princelings. In the West, private equity means buying a company, reorganising it, and selling it profitably based on arguably improved value. In China, it often means persuading the local party secretary to allow you to buy into a good SOE just before stock market listing—with stock market prices at three times the level of Western market prices for much of the Hu–Wen era. The scale of graft became astronomic.

Graft became such a high proportion of local officials' income that their behaviour began to shift in the direction of the Philippines' Marcos-era officials. Many became reluctant to approve smaller projects because small projects provided so little squeeze. This turned out to be corrupt in the narrow sense.

Most importantly, whereas the central tendency of the Jiang–Zhu era had been the successful centralisation of power—bringing the localities, the money supply, the SOEs and the military under firmer central control—the Hu–Wen era saw the cession of power to enormously influential interest groups: the SOEs, the big banks, the party and government bureaucracies, local governments and the military.

By the end of Hu–Wen's first term, leading thinkers at China's great universities were expressing openly their concerns that one day the centre might lose its ability to govern effectively. Zhou Yongkang's Petroleum Faction, built around controlled energy prices and oligopolies, provided the archetype of the emergent interest group—an economic empire larger than many national economies, with Zhou both managing the empire and serving as China's security chief. Leading corporate executives openly ridiculed the prime minister's key policies and ministers sometimes defied him. Rising interest group power entailed emergent structural corruption.

> A generalised sense of unfairness spread, potentially threatening the legitimacy of the regime

Along with these economic ramifications came crucial political developments. The Deng and Jiang eras, 1979–2003, were characterised by a sense of mobility and universal opportunity. In the Hu–Wen era, this sense of opportunity declined. Instead, the core social image was of a congealing party-government-SOE-military elite that controlled most of the opportunities.

In this context, inequalities of income and wealth became more politically salient despite the leadership's successful efforts to narrow the gap between the wealthy coast and the relatively impoverished interior. Resentment of a judicial system biased toward the elite became intense; viral stories spread about elite children who ran people over in their expensive cars and arrogantly defied the families of the victims to seek recourse. A generalised sense of unfairness spread, potentially threatening the legitimacy of the regime.

All of this came to a head at a decisive moment. China's successful economic strategies had reached diminishing returns. To continue rapid development, and to maintain political legitimacy, China had to shift its growth model in ways that would severely damage the interests of the

PICTURE: MANDEL NGAN /AFP PHOTO / AAP

Wang Qishan, centre, 'China's most savvy economic leader and governmental operator', who has been chosen to head the anti-corruption drive, pictured at the 2011 US-China Strategic Economic Dialogue in Washington DC with Chinese State Councillor Dai Bingguo and the then US Secretary of State, Hillary Clinton.

preeminent interest groups.

Rapid growth had been based on net exports and infrastructure investments implemented by the SOEs. New growth would have to come from domestic not foreign markets, from consumption not investment, from small and medium enterprises (SMEs) not SOEs, and from services not manufacturing. An environmental crisis and a debt squeeze also required a strong centre that could impose new rules on resistant localities. This was the worst possible time for the emergence of powerful interest groups determined to defend and squeeze the status quo.

The shift to a new economic order requires interest rate liberalisation (which threatens the SOEs and local governments), exchange rate liberalisation (which threatens export interests), more transparent and predictable regulation (threatening officials' power) and taking away the unfair advantages of the SOEs in finance, housing, access to land, and ability to gain approvals. An assertive foreign policy further requires military leaders who are not focused on making their next hundred million. In short, needed reforms fundamentally threatened the interests of every major component of the old order at a time when those components seemed on the verge of becoming the dominant forces in the polity. If the trends of the Hu–Wen era were to continue, not only would it jeopardise the ability of the central government to reform environmental and financial practices, but incipient structural corruption would potentially cripple the system.

One of the virtues of the Chinese system is that its planners and political leaders face the future with clear eyes. Well before the end of the Hu–Wen administration Chinese planners were working with the World Bank to write China 2030, a vision of an economy transformed to meet the new challenges. They distilled the requirements into what became the radical reformist, market-oriented proposals of the third and fourth plenums under Xi Jinping.

Realising the magnitude of opposition they would face, they achieved a working consensus to restructure China's top political

leadership to confront and defeat recalcitrant interest groups. They streamlined the Politburo Standing Committee from nine to seven and stripped away the extreme factions from the top leadership. Old guard interference was reduced by arranging for Hu to leave the Central Military Commission in return for Jiang Zemin being less active. They chose a charismatic leader, Xi Jinping, and put him in charge of a set of coordinating 'small leading groups' that control the important aspects of Chinese governance.

This newly decisive leadership then announced economic plans that radically infringe the interests of every one of the newly powerful interest groups. Having taken on all the most powerful interests in China, they deployed their most powerful weapon: the anti-corruption campaign. To wield that weapon they chose China's most savvy economic leader and governmental operator, Wang Qishan. They struck immediately at the archetype of reactionary interest group power: Zhou Yongkang and his Petroleum Faction, followed quickly by top military leaders.

This is one of the most audacious gambits in modern history: taking on all the most powerful groups at the same time, betting on leadership unity, a technocratic economic strategy, an anti-corruption campaign as the core political weapon, and a huge wave of popular political support mobilised by the anti-corruption campaign.

Political leaderships facing comparable challenges in India, Brazil or the US take the political leadership structure as given and try to squeeze through whatever limited reforms the interest group coalitions will bear. A more audacious approach like Mustafa Ataturk's classic Turkish reform creates one coalition to ram through a limited reform, then re-groups another coalition to ram through another until the job is done. The Chinese team has bet the farm on a campaign against every important group simultaneously.

So what are the prospects?

The history of anti-corruption campaigns suggests that structural reforms are crucial and sending in the cops is necessary but insufficient. Under Xi there are glimmerings of structural reform, particularly in the judicial system. Centralisation of judicial appointments, for instance, could radically reduce conflicts of interest in the courts. Marketisation and competition, somewhat compromised by efforts to consolidate national champions, promise to reduce the margins available for corruption.

Starting with the fourth plenum, the leadership has shown determination to reduce the costs of opaque, unpredictable, politicised governance. The most promising strategy is a determination to delineate property rights clearly, in both agriculture and industry, which should reduce theft of state assets and sequestration of private assets. But these are just initial plans that have not yet been implemented.

Continued popular support depends on delivering economic reforms and limiting an economic downturn, while coping with a financial squeeze

Implementing economic reform has a paradoxical relationship to the anti-corruption campaign. The corruption campaign is vital to nullify interest group opposition, but it also frightens and immobilises the officials who should implement reforms. Any reform hurts someone and the offended person may respond with an accusation of corruption—which is very frightening because almost everyone has some vulnerability. So until the intensity of the anti-corruption campaign diminishes, economic reform will be limited. And that could take a while.

Fortunately, financial reform is politically easier than judicial, regulatory or SOE reform. Liberalisation of interest rates, stock market listings and the currency, and opening of stock markets, are accelerating and will be transformative. A campaign to internationalise the currency is being used the way Zhu Rongji used the WTO: to force the pace of domestic reform.

The outcome is uncertain. Xi's experienced, able leadership team has the initiative. They have a brilliant economic strategy. And, for now, they have overwhelming public support. But bureaucratic resistance may gradually coalesce. Continued popular support depends on delivering economic reforms and limiting an economic downturn, while coping with a financial squeeze. To do this President Xi must resolve the paradox that the anti-corruption campaign is prerequisite to economic reform, but at the same time inhibits immediate reform. EAFQ

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