



Promotion Incentive: Corruption and Its Implications on Local Fiscal Cycles in China

Liutang Gong¹, Jie Xiao², and Qinghua Zhang³

Guanghua School of Management, Peking University, 100871, China

College of Economics, Shenzhen University, 518060, China

Guanghua School of Management, Peking University, 100871, China

Abstract

In addition to economic performance, this paper explores another incentive factor of local political leaders in China--being clean (or staying away from corruption). Our data suggests that both factors are crucial to provincial leaders' promotion. Given these incentives, this paper establishes a model to describe the decision-making process of political leaders regarding fiscal expenditures, and conducts an empirical test of political budget cycles using Chinese provincial-level data from 1990 to 2006. The findings show that promotion incentives drive cyclical fluctuations in various types of local fiscal expenditures that are synchronized with the timing of the National Congress of the Communist Party (NCCP). Specifically, the growth rate of infrastructure expenditure significantly reduces, while that of administration expenditure increases during the years in which the NCCP takes place. This paper also tests another possible channel of political budget cycles; that is, the time inconsistency effect caused by the turnover of provincial leaders. This effect turns out to be insignificant for all types of expenditures.

Keywords: Corruption; Incentive Role; Political Budget Cycles; Fiscal Expenditure; Time Inconsistency

JEL Classification: H72; D90; H30

¹ *Guanghua School of Management, Peking University, China, E-mail address: ltgong@gsm.pku.edu.cn*

² *College of Economics, Shenzhen University, China, E-mail address: jie_xiao@szu.edu.cn*

³ *Guanghua School of Management, Peking University, China, E-mail address: zhangq@gsm.pku.edu.cn*

1. Introduction

Over the past three decades, China has experienced rapid economic growth, to which local governments contribute greatly. With the fiscal decentralization introduced as part of the economic reforms since 1979, local governments have been playing an important role in supporting new firms and city construction (Qian and Weingast, 1997; Bai, Tao and Tong, 2008). At the same time, many researchers point out that political centralization is another crucial ingredient in China's economic development (Blanchard and Shleifer, 2000). The central government has been in a strong position to either reward or punish local leaders through promotion. (Huang, 1998). This paper studies how this political control from the central government affects fiscal decisions of local governments. Specifically, we analyze the role of corruption in promotion of provincial leaders in China and explore its implications on local fiscal cycles. In China's M-structure political system, the central government controls the promotion or renewal of the tenure of local government leaders. The evaluation criteria used by the central government thus greatly influence the decision-making processes of local government leaders. Since the reform, economic performance has been the dominating factor in the evaluation of provincial leaders (Li and Zhou, 2005; Maskin, Qian, and Xu 2000; Blanchard and Schleifer, 2000; Qian, Weingast and Montinola, 1995). However, accompanying the country's rapid economic growth, corruption has become an increasingly serious problem that is causing wide social discontent and eroding the ruling power of the Chinese Communist Party (CCP). With the increasing concern over corruption, central government has carried out sharp measures to corruption activities in recent years. The nationwide anti-corruption event is a sign that the veto power of corruption scandals is gaining more weight in the central government's personnel control over provincial leaders. A provincial leader who becomes involved in a corruption scandal will find her chance of promotion to be greatly reduced, even if she neither committed the corruption herself nor was directly responsible for the incident. Moreover, such officials may be removed from office and may even face legal investigation and indictment.

Using data on the turnover of provincial secretaries between 1990 and 2010, we first examine the role of various incentive factors in determining provincial leaders' turnovers. We find that in addition to the positive effect of economic performance, which is well-documented in the literature, corruption scandals significantly lower the probability of getting promotion. Another interesting finding is that increased

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