



Do land revenue windfalls create a political resource curse? Evidence from China[☆]



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ABSTRACT

By analyzing a panel on the political turnovers of 4390 county leaders in China during 1999–2008, we find that the revenue windfalls accrued to these officials from land sales have undermined the effectiveness of the promotion system for government officials. Instead of rewarding efforts made to boost GDP growth, promotion is positively correlated with signaling efforts, and with corruption. The robust positive relationship between land revenue windfalls and political turnover, or specifically promotion, suggests that those who are politically connected to their superiors and those beyond the prime age for promotion are the primary beneficiaries. The case for corruption is substantiated by the evidence inferred from anti-corruption crackdowns, which reveals that the additional effect of land revenue on political turnover and size of bureaucracy (a proxy for corruption) decreases significantly in crackdowns but that land revenue has no effect on city construction expenditure (a proxy for signaling).

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1. Introduction

A consensus is slowly emerging that revenue windfalls—be they the result of natural resource abundance or government transfers—do not always benefit society (Ades and Di Tella, 1999; Brollo et al., 2014; Caselli and Michaels, 2013; Mehlum et al., 2006; Robinson, et al., 2006; Ross, 1999, 2012; Svensson, 2000; Vicente, 2010).¹ In particular, the one channel that has been identified

recently pertains to the political process. Based on a political agency model with career concerns and endogenous entry of political candidates, Brollo et al. (2014) find that a larger budget, in their case government transfers in Brazil, is associated with both more corruption and a pool of individuals of a lower quality entering politics.

As with natural resource abundance or government transfers elsewhere, we show that the windfall revenues that sub-provincial—specifically county—governments in China obtain from selling land for nonfarm development purposes and over which they have monopoly rights are also a political resource curse. We consider land revenue windfall in China a “curse” because it has been significantly undermining the alleged effectiveness of a mechanism of rewarding the subnational officials’ effort (or ability that is otherwise unobserved) in boosting GDP growth for as long as three decades,² and produces the kinds of effects that Brollo et al. (2014) alluded to, even where voting is a closed option to the selection of political elites.

Touted as an “institutional foundation” of China’s sustained economic growth, the country’s meritocratic political selection system—one which provides high-powered promotion incentives to China’s subnational leaders—is predominantly viewed as the

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¹ Many authors pose what essentially is the same rhetorical question in regard to the welfare effects of natural resource abundance and/or revenue windfalls. For instance, Brollo et al. (2014: 1759) ask: “Suppose new oil is discovered in a country, or more funds are transferred to a locality from a higher level of government. Are these windfalls of resources unambiguously beneficial to society?”

² Since reforming its economic system in the late 1970s, China has sustained a near double-digit growth rate for well over three decades.

reason behind the miraculous success of its economic reform. Specifically, under a decentralized competitive setting—presumably necessitated by the sheer scale of the national economy, those who are able to grow their local economies the fastest will be rewarded with promotion to higher levels within the Communist hierarchy (also known as “jurisdictional yardstick competition”, Maskin et al., 2000; Xu, 2011). Empirical evidence has indeed shown a strong association between GDP growth and promotion (Chen et al., 2005; Edin, 2003; Jia et al., 2014; Landry, 2008; Li and Zhou, 2005; Persson and Zhuravskaya, 2015; Yao and Zhang, 2015; Whiting, 2000).³

While this institutional arrangement has likely remained intact at the provincial level (thanks to the absence of land revenue windfalls), the same cannot be said for the lower levels. Since 1998, sub-provincial officials (consisting of, in the decreasing order of hierarchy the prefecture and the county) have been assigned exclusive statutory rights to sell land, resulting in some of them reaping huge windfalls of such revenue (known in Chinese as land conveyance fee or *tudi churangjin*). Classified as “extra-budgetary revenue”, it is a category that does not obligate them to share it with upper-level authorities.⁴ For instance, while accounting for less than 10% of the county’s extra-budgetary revenue before 1998, this land revenue grew to constitute nearly 80% of the county coffers in 2008 (Fig. 1 Panel A).⁵ This resulted both in an extraordinary rise in extra-budgetary revenue as well as in its share of total revenue (Fig. 1 Panel B), to the extent that China’s local officials have been criticized for having become overly dependent upon land sales in fueling investment growth (*The Wall Street Journal*, March 1st, 2013). In addition, there is also convincing evidence linking land revenue with corruption.

By constructing a unique data set that matches the biographical data of county party secretaries with the fiscal and socioeconomic data of 1753 counties in 24 Chinese provinces over a 10-year period (1999–2008), we seek to analyze the effect of this revenue windfall on the political selection of China’s local (county) leaders and corruption. In the case of selection, we find that, while GDP growth continues to have a significant and positive effect on political turnover—specifically promotion, so does land revenue. But most importantly we find that land revenue *reduces* the significance of GDP growth in determining promotion. Furthermore, land revenue is found to have an additionally significant effect for those connected to their superiors in terms of sharing the same birthplace or having previously worked in the prefectural government, as well as those who have already passed the prime age of promotion—due presumably to their lack of competitiveness. To the extent that GDP growth is a good proxy for the unobserved ability of the county leaders, these lines of evidence lend credence to the claim that land revenue has an adverse effect in the

selection of county leaders.

There are two possible channels through which land revenue may have “substituted” GDP growth to some extent in determining the promotion of county officials. The first plausible channel is *signaling*. By analyzing the patterns of county budget expenditures for the 1999–2007 period, we find that county officials have directed the land revenue windfalls disproportionately to projects that serve to signal their “achievements”—notably ostentatious public projects, e.g. city construction projects, known in Chinese as “image” or “political achievement” projects, and to have strategically timed them in such manners as to prevent their signaling efforts from going to waste.⁶

A second, possible channel is outright *corruption*. By using an inferential or “forensic economics” approach, and by assuming that some county leaders may use land revenue directly to bribe their way to promotion, or collude with prefectural officials in selling land, we find supportive evidence that, in the event of a crackdown on the corruption of higher-level (prefectural and provincial) officials in the same province in which the county officials serve, the additional effect of land revenue decreases significantly in the year in which such crackdown occurs. While having the same positive and significant effect on the size of bureaucracy—a proxy for corruption, such crackdowns do not have similar effects on city construction expenditure—a proxy for signaling. In addition, we find strong evidence that expenditures involving cash and other allowances paid to government staff (administrative expenditure) and the beefing up of the government bureaucracy are much greater than the other expenditure categories such as social welfare spending and research subsidies provided to private enterprises—a finding that reinforces the evidence of a rent-seeking or simply corrupt local government.

To rule out the possibility that our estimations may be biased by the endogenous land revenue variable, we instrument land revenue with an interaction term that takes into account the amount of land in a county *unsuitable* for commercial and real estate development (as determined by terrain), on the one hand, and the exogenous (and time-varying) demand shock, on the other. We proxy for this demand shock using trends in the national interest rate, under the assumption that land revenue is essentially a product of the demand for, and supply of, land. To ensure that our instrument is robust, we replace the national interest rate with the provincial capital cities’ house prices as our second instrument. Regardless of the instrument used, the result remains significant, relieving us of the concerns of both omitted variable bias and reverse causality. Additionally, we find that the two components of our instrument are insignificantly correlated with a county official’s connections and/or factional ties, and that their significance has not increased over time (especially after 2002) in response to the growing land revenues. Together, these findings alleviate the concern that well-connected officials might be able to duly influence the locational choice of their appointment.

By analyzing the effect of land revenue windfalls on the economic-cum-political behavior of China’s county officials, our paper contributes to the emerging literature on the political resource curse, as well as to the literature pertaining to the political selection of China’s subnational leaders and its link to economic growth. Specifically, we find that, while the Chinese bureaucrats are immune to the reelection pressure that their counterparts in

³ A slight exception is Jia et al. (2014), who find that promotion at the provincial level is simultaneously contingent upon performance and connections. In the case of Persson and Zhuravskaya (2015), they find that the career concerns of native provincial party secretaries are significantly weaker than those who were transferred from other provinces.

⁴ The allocation of rights by the central government to regional authorities over this “extra-budgetary” revenue is not something new. In order to invigorate the local leaders’ incentives to spur economic growth, the central government had since 1984 already devolved to regional governments the rights over the profits and taxes of the enterprises under their jurisdictions (Blanchard and Shleifer, 2000; Montinola et al., 1995; Oi, 1992, 1999; Qian and Xu, 1993; Qian and Weingast, 1997).

⁵ The privatization of the previously state-owned housing units that began in the 1990s and soon after the promotion of land auctioning practices since 2002, are believed to have inadvertently spurred the growth in land revenues. But the effect of land revenue on local coffers, while dramatic for the county, is much smaller for the province; for example, in 2008 land revenue accounted for only 9.2% of the extra-budgetary revenue at the province level but a hefty 79% at the county level. The county is important because it is the level where resources required for mobilizing development reside.

⁶ The tendencies for public officials to engage in unproductive signaling behavior is by no means limited to only authoritarian regimes. For instance, empirical studies have consistently found that reelection incentives for politicians under democracy have frequently led to signaling efforts in the respects of war making (Hess and Orphanides, 1995), public goods provision (Caselli and Michaels, 2013; De Janvry et al., 2012) and more generally economic performance (Besley et al., 2010).

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