Corruption by monopoly: Bribery in Chinese enterprise licensing as a repeated bargaining game

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Abstract

This article presents a structural analysis of corruption in Chinese enterprise licensing using a repeated bargaining model. I demonstrate that once relative bargaining powers are correctly accounted for, certain institutional features of the Chinese licensing system do lead to bribery as a robust outcome. Exercises in comparative statics then reveal that certain conventional anticorruption measures may have counterintuitive effects. Furthermore, the robustness of bribery is a direct result of licensing officials' monopolistic powers. If overlapping jurisdictions are introduced, the resulting bureaucratic competition would completely eliminate bribery in some cases and greatly reduce the size of the bribes in other cases.
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1. Introduction

A great deal of progress has been made in the positive analysis of corruption since Rose-Ackerman published her landmark study in 1978. A rich body of literature analyzing the welfare effects of corruption has emerged, while a related vein of inquiry has focused on the institutional context of the phenomenon. A number of models have been developed to explain the structural factors affecting the level and incidence of corruption (e.g., see Andvig, 1991; Andvig & Moene, 1990; Cadot, 1987; Mookherjee & Png, 1995; Shleifer & Vishny, 1993; Tirole, 1996). However, most of the models presented thus far have been

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generic models designed to yield generalizable results, whereas attempts to model the institutional framework of corruption in any specific setting have been exceedingly rare. While the insights derived from generic models can be valuable in any regional context, at a country-specific level, our inquiry is likely to be more fruitful if we attempt to model the institutional setting of our subject explicitly. Efforts along this line can not only tell us more about particular countries, but they may also serve to illustrate, in a more concrete setting, the complex interaction between various mechanisms often studied in isolation in generic models, and highlight the relative importance of various factors.

In this article, I shall analyze one such model of a particular type of bureaucratic corruption in contemporary China, based on a model of bribery in Chinese enterprise licensing presented by Manion in 1996. In China during the past two decades, the prevalence of official corruption has become as much a feature of the country's economic landscape as the coastal boomtowns and double-digit growth rates (e.g., Kwong, 1997).[1] Corruption was a major source of discontent, contributing to the protests of 1989 (Ostergaard & Petersen, 1991), and it continues to top numerous opinion polls as one of the most serious problems facing the country today. Of the various forms of corruption, petty bureaucratic corruption has perhaps the most direct impact on the general population. A routine example of corruption of this type occurs in the system of enterprise licensing, which Manion (1996) described and modeled as a bargaining game between the applicant and the licensing official.

All commercial enterprises in China require government authorization in the form of operating licenses. These licenses are usually obtained from local bureaus of the State Administration of Industry and Commerce. Corrupt officials in these offices may extort payment from applicants who are legally entitled to receive licenses, or they may issue licenses to ineligible applicants in exchange for payment. In particular, Manion identified four features of the current system that make corruption pandemic "by design." These include: (a) information asymmetry due to extreme opacity of formal regulations and heavy reliance on ad hoc operative standards; (b) high relative costs of delay for the applicant; (c) low expected costs of sanctions for both the applicant and the official (in particular, under the Chinese legal code, *paying* a bribe for an eligible application does not constitute an offence for the applicant); and (d) low expectation on the part of the applicant of encountering a clean official.

Manion modeled the structures and expectations identified above as institutional features in an asymmetric information game. Based on her solution to the game and comparative statics analysis, she argues that bribery is a robust outcome and "to move away entirely from the corrupt equilibrium... requires very substantial changes in institutional design." However, as Yavas (1998) demonstrated, Manion's original solution was incorrect, and an equilibrium of no bribery can be achieved much more readily. Herein lies the paradox: As Manion (1998) pointed out in her response, "evidence of various sorts indicates that bribery in Chinese enterprise licensing is an empirical regularity. The model is a formalization of the description... If the model fairly easily yields a no-bribery

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[1] In 1995, the year Transparency International began its first annual corruption perception index (CPI) survey, China received a dismal CPI score of 2.16 (out of 10) and ranked 40th out of 41. Six years later, its CPI score has improved somewhat (to 3.5), but still lags behind countries such as Colombia and Bulgaria (Source: Transparency International; www.transparency.org).