

# **From Profit-Sharing to Residual-Chasing: A Study of Grand Theft in an Era of Economic Slowdown**

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# Corruption and Economy

- ▶ Many scholars have examined how corruption affects economic performance. A large body of literature documents the negative effects of corruption on economic growth ([Gould and Amaro-Reyes 1983](#); [Klitgaard 1988](#); [Shleifer and Vishny 1993](#); [Mauro 1995](#); [Laporta 1999](#); [Mo 2001](#)).
- ▶ However, there is another stream of literature arguing in favor of corruption. These authors contend corruption can serve as grease for the wheels of economic growth ([Leff 1964](#); [Huntington 1968](#); [Acemoglu and Verdier 1998](#); [Ahmad et al. 2012](#); [Huang 2015](#)).
- ▶ Recently, comparativists started to decompose corruption and examine the effects of different types of corruption. [Ang's \(2020\)](#) Unbundled Corruption Index (UCI) serves as a novel example in this regard.
  - ▶ Whether corruption involves elites or non-elites
  - ▶ Whether corruption involves theft or exchange

# A Typology of Corruption Proposed by Ang (2020)

|                   | Non-elites  | Elites  |
|-------------------|---|---|
| Involves theft    | <b>Petty theft</b> THA<br>Street-level bureaucrats privately pocket illegal fees; extort street vendors for protection money; agencies coerce companies to pay for their services; take group vacations on public funds                                       | <b>Grand theft</b> NGA<br>Top officials illegally siphon public funds into private accounts; create ghost payroll for family members; illegally keep state-subsidized properties for themselves; executives in SOEs collude to embezzle funds; misuse of public funds   |
| Involves exchange | <b>Speed money</b> BGD, RUS, IND<br>Citizens pay police bribes to avoid penalties; tips to receive basic medical services; private payments to expedite medical services; small bribes to speed up licensing process; excessive regulations to extract bribes | <b>Access money</b> USA, JPN, KOR<br>Businesses directly pay massive bribes for deals; pay for politician's family expenses for deals; allocate corporate positions to family members of politicians; politicians build clientelist network for indirect bribe-taking; lobbying for favorable regulations; revolving door; loose oversight and bailouts with impunity |

# Gaps in the Literature

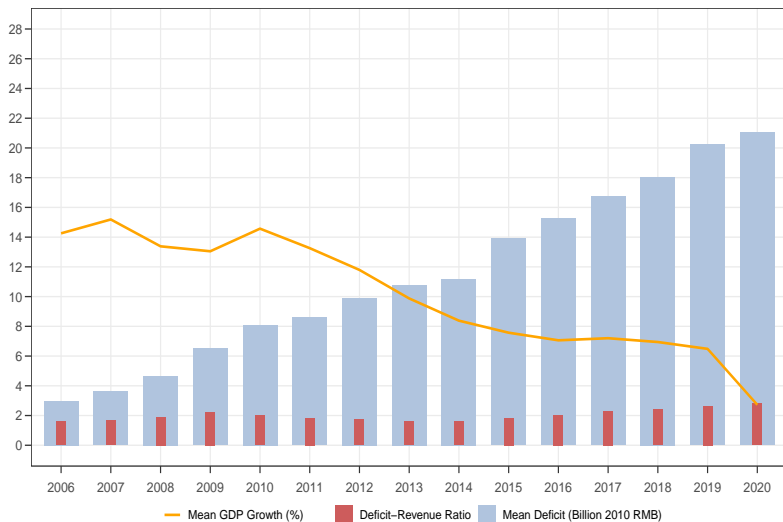
- ▶ Most studies revolve around how corruption affects economic growth, with little attention paid to the possibility that economic environment can shape government behavior including corruption
- ▶ The newly developed framework by Yuen Yuen Ang (2020) is restricted to an analysis of 15 countries based on expert opinions. More objective measures of the different forms of corruption are needed.
- ▶ A monetary measure of grand theft with broader meanings
  - ▶ Siphoning public funds into private accounts
  - ▶ Using public money for group interests
    - ▶ Free or low-cost housing for insiders
    - ▶ Oversized housing provident funds and housing allowances
    - ▶ Private use of government-owned vehicles
    - ▶ Reimbursement for unreasonable travels
  - ▶ Mismanagement/misuse of public funds
    - ▶ Lending public money to private companies

# Looming Fiscal Crisis in China



- ▶ China has been experiencing an economic slowdown in the past decade, with the pandemic making the matter even worse.
- ▶ Consequently, the finance of local governments deteriorated substantially.
- ▶ In some regions, the government had difficulty paying the salary of civil servants.
- ▶ In other cases, the government delayed the salary payment to peripheral employees such as those working in the transit system, public schools and hospitals.

# A Temporal Perspective of China's Fiscal Deficit



# Solutions to Fiscal Pressure

## 1. Intergovernmental transfers

- ▶ Financial strength of the upper-level government is also weakened as a result of economic slowdown

## 2. Land conveyance revenues

- ▶ The peak of the housing price growth occurred in 2009
- ▶ Multiple rounds of regulations to contain housing prices
  - ▶ 2010–2014, overall tightening
  - ▶ 2015–2016, overall loosening
  - ▶ 2017–present, overall tightening
  - ▶ “Houses are to be resided in rather than to be speculated on.”

## 3. Loans and bonds

- ▶ Strictly regulated by the central government after 2013
- ▶ The new Budget Law of 2014

## 4. Fiscal audit

- ▶ Virtually the only viable method for the local government at times of economic downturn without slashing budgets

# Government Audit in China

- ▶ Government audit is conducted by the executive branch as opposed to the legislature
  - ▶ Falls under the direct administration of city mayors (secondary to Party Secretaries only)
- ▶ Audit agencies reveal the amount of public funds used in a questionable manner (referred to as “fiscal misuse” in this paper)
  - ▶ Violations of government regulations
  - ▶ Losses and squandering
  - ▶ Mismanagement
- ▶ Consequences of government audit
  - ▶ Rectifying financial misconducts
  - ▶ Subjecting the questionable portion to its original purpose
  - ▶ Reducing or suspending the appropriations
  - ▶ Withdrawing the remaining funds, in part or in whole
  - ▶ Prosecuting the concerned party if dereliction of duty, economic crime or corruption is uncovered



# Theoretical Expectations

- H1: Fiscal pressure compels city governments to audit fiscal misconduct more rigorously, resulting in a greater size of the misused amount reported by the audit department.
- H2: The effect of fiscal pressure is moderated by the economic environment.
  - H2a: During high-growth periods, fiscal pressure may not have a significant effect on the misused amount of government spending.
  - H2b: At times of economic austerity, fiscal pressure can induce the government to discover a greater size of the misused amount.

# Economic Slowdown and Fiscal Audit: Suggestive Evidence

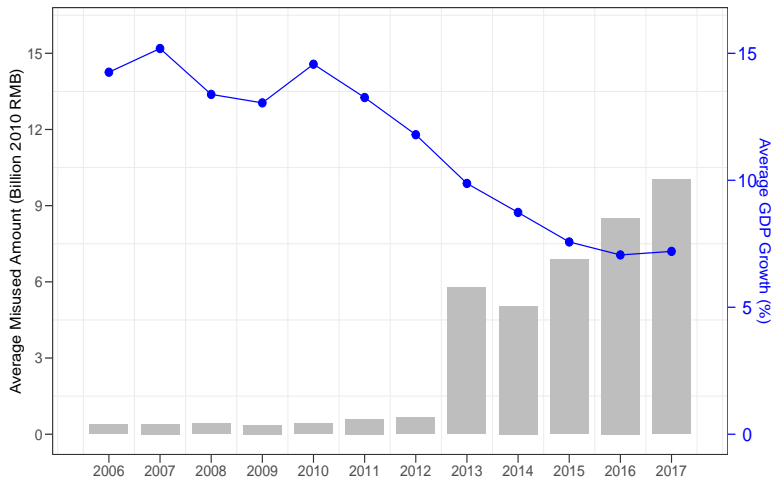


Figure 1: Economic slowdown and fiscal audit in China (2006–2017)

## 1. Data

- ▶ Various statistical yearbooks and government reports
- ▶ City-level panel data on 293 Chinese prefectural cities spanning from 2006 to 2017

## 2. Variables

- ▶ Fiscal audit of misused public funds: measured in billion 2010 RMB
- ▶ Fiscal deficit (and lagged term): measured in billion 2010 RMB
- ▶ GDP growth rate: percentage point
- ▶ Log population: the log of city population in million residents
- ▶ Log GDP per capita: the log of GDP per capita in 2010 RMB
- ▶ Inflation rate: percentage point
- ▶ Mayor characteristics: gender, age, education, tenure

## 3. Models

- ▶ Fixed effects models controlling for city heterogeneity
- ▶ Interactive terms to account for conditional effects

# Empirical Analysis at Chinese City Level

**Table 1:** Regression analysis based on fixed effects models

|                             | <i>Dependent Variable: Misused Amount (in Billion 2010 RMB)</i> |                      |                      |                      |                      |
|-----------------------------|---|----------------------|----------------------|----------------------|----------------------|
|                             | (1)   | (2)                  | (3)                  | (4)                  | (5)                  |
| Fiscal deficit              | 0.300***<br>(0.029)   | 0.236***<br>(0.030)  | 0.170***<br>(0.031)  | 0.053**<br>(0.025)   | 0.353***<br>(0.070)  |
| Lagged fiscal deficit       | 0.237***<br>(0.031)   | 0.173***<br>(0.031)  | 0.106***<br>(0.033)  | -0.011<br>(0.026)    | -0.030<br>(0.026)    |
| GDP growth                  |   | -0.400***<br>(0.045) | -0.299***<br>(0.048) | -0.271***<br>(0.039) | -0.072<br>(0.058)    |
| Log population              |   |                      | 14.704***<br>(3.727) | 10.397***<br>(3.509) | 11.103***<br>(3.496) |
| Log GDP per capita          |   |                      | 2.662***<br>(0.614)  | 3.437***<br>(0.570)  | 3.563***<br>(0.568)  |
| Inflation rate              |   |                      | -0.199**<br>(0.097)  | -0.165**<br>(0.067)  | -0.164**<br>(0.067)  |
| Fiscal deficit × GDP growth |   |                      |                      |                      | -0.025***<br>(0.006) |
| Mayor controls              |   |                      |                      | ✓                    | ✓                    |
| City fixed effects          | ✓   | ✓                    | ✓                    | ✓                    | ✓                    |
| Observations                | 3,062   | 3,052                | 3,044                | 2,484                | 2,484                |
| R <sup>2</sup>              | 0.104   | 0.130                | 0.144                | 0.137                | 0.146                |
| Adjusted R <sup>2</sup>     | 0.012   | 0.039                | 0.054                | 0.023                | 0.032                |

Note: \* $p < 0.1$ ; \*\* $p < 0.05$ ; \*\*\* $p < 0.01$

# Interactive Effects

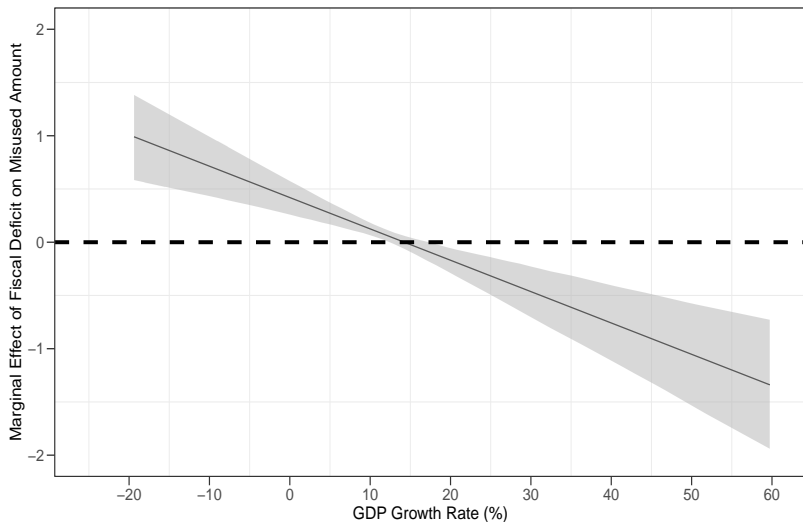


Figure 2: The marginal effects of fiscal deficit conditional on economy

# Evaluating Alternative Explanation

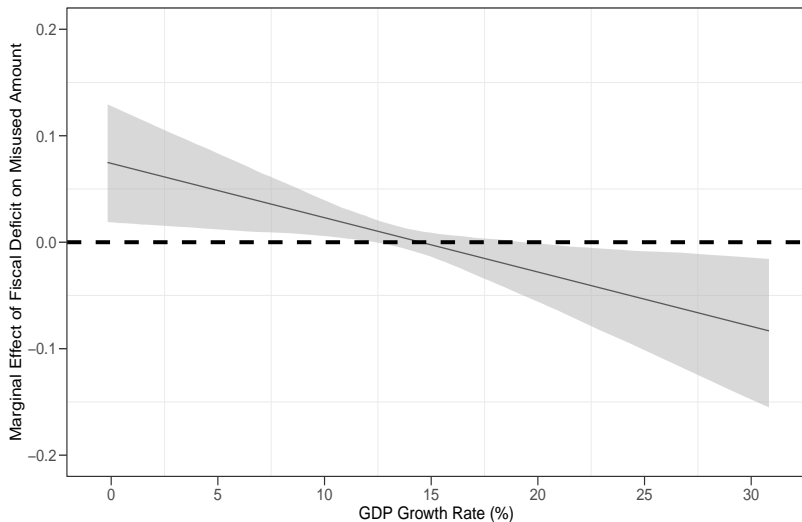


Figure 3: The updated marginal effects based on the period 2006–2012

# Conclusion

- ▶ This paper demonstrates that government corruption is shaped by economy, which stands in stark contrast to the voluminous literature on whether and how corruption affects growth.
- ▶ Fiscal strain compels the government to scrutinize financial activities more rigorously. This phenomenon is especially pronounced when the economy slows down or stagnates.
- ▶ In the context of the pandemic, China's average economic growth from 2020 to 2024 dropped to an unprecedentedly low level of 4.88%. China's local governments may enter a new era from profit-sharing to residual-chasing.

Thanks for your attention!  
All comments are appreciated!  
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