The administrative monopoly in China’s economic transition

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Abstract

Corruption in transition economies has become the very focus of many recent discussions on politics and economics. However, the existing research has not taken full account of the experience of the gradual transition countries, especially China, and the incentives for rent creation in the transition process. Based on existing studies in this field, this paper addresses a new category of corruption in transition economies. In the context of the rent seeking theory, the authors examine what they regard as a unique type of corruption in China—administrative monopoly (AM), and outline its essence, causes, forms, features, the scale of the rent created, and the dissipation of the rent.

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Keywords: Administrative monopoly; Corruption; China; Economic transition; Gradual transition

Introduction

Corruption is one of the manifestations of institution failure. In the course of economic transition, while old institutions are undergoing transformation, new mechanism has not yet taken shape. Consequently, there are ample opportunities and temptations for breeding corruption. Corruption not only siphons off huge economic benefits and causes severe social pollution, but also brings the legitimacy of some governments into serious question. From an international perspective, many academics have suggested that corruption in transition economies tends to be more rampant and endemic, compared with that in more developed economies.

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It is not difficult to understand why governments and scholars all over the world have called corruption in transition economies a serious concern.

The purpose of this paper is to address a new category of corruption in transition economies not having been fully explored by current studies on corruption. In the context of the rent seeking theory, we examine what we think of as a unique type of corruption in China—administrative monopoly (AM), and try to outline its causes, forms, features, the scale of the rent created, and the dissipation of the rent. We find that AM is one of the most endemic types of corruption in China in that it has brought about huge social welfare loss and is arousing extensive public resentment.

Changes have to come about if the government really means to fight corruption. The most important option should be the re-orientation of the roles played by the governments in the economy, and the regulation of the domestic market in accordance with norms and rules of the World Trade Organization (WTO). The government of China has to scrap the current doctrine of omnipotent government and to make a paradigm shift to good governance characterized by openness, transparency, efficiency and integrity.

This paper consists of six parts. Part II is a summary of the existing approaches on corruption in transition economies and their limitations when applied to China. On this basis, part III offers a Chinese corruption scenario illustrating the fact that AM is a unique phenomena pertaining to China’s current policy of gradual transition. Part IV concentrates on the essence, causes, forms and features of AM in China at present. Part V estimates social welfare loss caused by AM in China, and analyzes the dissipation of the rent. Part VI is a concluding remark.

Summary of current studies on corruption in transition economies

Since the 1990s, the world has witnessed a remarkable phenomenon in global economic development, that is, the development of transition economies in many different countries. Accompanying such development, there has been an emergence of a series of political, economic and social problems, among which the rapid spread of corruption remains the most distinct one. The endemic penetration of corruption not only erodes economic achievements in different countries, but also severely endangers the social stability and development over the long term.

Over the past decade, some institutes, especially the World Bank Institute, have produced a proliferation of literature on corruption in transition economies, among which were those by Daniel Kaufmann and Joel S. Hellman, who conducted systematic and comprehensive studies on grand corruption (Hellman et al., 2000b), underground economies (Kaufmann and Kaliberda, 1996), state capture (Hellman et al., 2000a), barter (Marin et al., 2000) and privatization (Kaufmann and Siegelbaum, 1996) in the East European countries and the former Soviet Union.

Susan Rose-Ackerman also contributed to corruption research in this field with her calculation of the rent in African transition economies (Coolidge and Ackerman, 1997). In China, in the context of the rent seeking theory, scholars like Wu...
(1999) and He (1999) analyzed rents in various forms in China and the opportunities which caused corruption. Heli Hu, Anpei Wan (Wu, 1999: pp. 29–97) and Hu (2000, 2002) conducted pioneering research on the scale of rent in different stages of the economic reform of China. Other scholars carried out in-depth research on institution failures, which have soared during the period of economic reform. Such a Herculean proliferation of literature has contributed much to the fight against corruption in various countries.

Over the past three years, some leading experts, especially those from the World Bank Institute and the International Monetary Fund (IMF) have conducted some inspiring empirical research. Based on the finding of a survey on enterprise performance by the World Bank in 1998 in the East European countries, that is, the 1999 Business Environment and Enterprise Performance Survey (BEEPS), those experts and scholars tried to summarize and categorize corruption in transition economies, focusing on its magnitude, especially on its impact on enterprise performance and development. They have drawn some important conclusions. However, given the fact that this survey was conducted among enterprises in the East European countries, such study bears little resemblance to China’s experience in transition. It is our intention to address the specific phenomenon of corruption in China in the hope to fill in the gap between those existing findings and what has happened in China.

According to Abed and Davoodi (2000), there are two kinds of corruption in transition economies—the state capture and the administrative corruption (Table 1). State capture is defined as a situation in which public sectors or people, group, or enterprises from private sectors try to influence the formulation of legislation, norms, ordinances or other public policies in the political process by offering illicit and secret payment or interests to the public officials (Abed and Davoodi, 2000: p. xv). It is one of the important manifestations of grand corruption. On the other hand, there is administrative corruption, which is generally understood as petty corruption. It is defined as a situation in which people offer illicit payment or interests in kind to the public officials to obstruct the enforcement of law or policies in order to ensure favorable treatment for their own interests (Abed and Davoodi, 2000: p. xvii).

Based on the same survey, Hellman et al. (2000b: p. 6) took a further step by identifying another kind of corruption in transition economies, which they described as influence, in addition to state capture and administrative corruption. According to their definition, influence refers to a situation in which the enterprises try to shape the public policy outcomes by exerting strong influence in the process of formulation of law or policies without offering necessary illicit and secret payment to the public officials (Hellman et al., 2000b: p. 6). The most distinct difference between influence and state capture is that in the case of influence, the enterprise concerned does not try to carve out niche markets or to obstruct competition by offering bribes to government officials. To achieve its goals, it would rely on its own superiority in terms of its market share, production magnitude, property rights, privileged access to resources and its connections with officials at different levels of the government.
Compared with Aded’s research, Hellman’s categorization of corruption in transition economies goes a step further. However, both of their observations share some constraints. First, their findings are built upon the survey of enterprises, and their categorization of corruption is consequently based on the enterprises’ role in the transition stage, without taking account of the governments’ initiatives in the rent creating process, especially government’s active rent creation. Second, their observations are drawn from those transition economies where a “shock” treatment was adopted, such as the former Soviet Union and the East European countries. Accordingly, their findings bear no reference to China, a typical gradual transition economy. Then a gap is created between the existing studies and the actual situation.

AM—one of the most characteristic types of corruption in China’s economic transition

According to the rent seeking theory, corruption is a rent seeking in kind. As defined by Gorden Tullock, rent seeking refers to the activities using scarce resources to capture an artificially created transfer from the political process, which is in excess of those a competitive marketplace would allow, but less than the damage that it brings to the others (Tullock, 1999: p. 27). This phrase comes up in the theory of applied economics in the 1970s. It refers to activities of seeking directly

<table>
<thead>
<tr>
<th>Types of corruption</th>
<th>Offering direct and illegal payment</th>
<th>Not necessarily offering direct illegal payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exerting influence in the process of regulatory policy formulation</td>
<td>State capture</td>
<td>Influence</td>
</tr>
<tr>
<td>Administrative monopoly</td>
<td>Administrative corruption</td>
<td>Relationship (Guan Xi)</td>
</tr>
</tbody>
</table>

* We would like to emphasize that here we regard “relationship (Guan Xi)” as one of the important forms of corruption in the transition economies, in that it is common in China. Relationship means that people try to influence the implementation of policies without offering a direct and illegal payment. To what extent “relationship” can work has also a lot to do with the social customs. One of most commonly recognized practices of relationship is that public officials abuse their entrusted power for gains to their family members or friends. We need to bear in mind that there is hardly any pure relationship, which does not involve with an exchange of interests. Therefore, we treat relationship as one type of corruption, at least as potential corruption. According to Fan and Grossman, a key factor which played an important role in China’s central and planned economy was “relationship”, and it is still continuing to play such an important role during the dual-track economy. It is “personal relationship” between government officers and managers of enterprises that controls the distribution of resources. Under the “relationship”, managers have to keep very good relationship with relevant government officers and managers of other enterprises, in order to get necessary resources of production (such as electric power, water) and to duly deliver materials and semi finished product needed. This shows that “relationship” plays certain active role when the system is not flexible.
unproductive profits. Here, we should pay attention to the fact that the government is not only an object for “being captured” during the course of rent seeking, but also a subject with strong incentives to create rent.

According to Wei He, rent creating can be divided into three categories based on the roles that the government plays: the government’s unintentional rent creation, the government’s passive rent creation and the government’s active rent creation (He, 1999: pp. 206–238).

Unintentional rent creation is mainly an outcome of interference with and regulation of the economy by the government, with good intention and without awareness of its consequential negative impact. In the early stage of the economic reform in China, the government’s decisions to relax the control on commodity prices and to adopt a “dual-track” interest rate and exchange rate were typical examples of unintentional rent creation. With the development of market economy and the reduction of government’s direct interference, unintentional rent creation has been decreasing.

Passive rent creation refers to situations where the government, under the lobbying and persuasion by certain interest groups, uses its power to provide comparative advantages to a particular sector or enterprise. Rent seeking occurs, in part, because interest groups can receive special benefits through government actions. According to the academic categorization of corruption in transition economies, both state capture and influence can be regarded as government’s passive rent creation. Interest groups seek regulatory policies that will carve out niche markets or obstruct competition, by offering illegal payment or exerting influence to induce or compel government to promulgate regulatory standards in their favor. It is in such a process that a rent is created.

Active rent creation means that with actual knowledge of possible benefits from rent seeking activities, different departments of government try their best to design regulations with the intention to create rents, in order to increase the benefits of their own industrial sectors or local enterprises affiliated with them. As a return, the latter must provide them with profits, which are gained from the rent created by the government specifically for them.

According to the research by Kaufmann and Hellman, in the East European countries and the former Soviet Union, the government’s passive rent creation behaviors—such as state capture and influence—are prevalent. But the experience of these countries is in sharp contrast to that of China in terms of the pace of transition. While all these countries adopted a “shock treatment”, China has chosen a gradual transition route. This difference in the speed of transformation has serious implication on the types of corruption.

In the former Soviet Union and the East European transition economies, the shock treatment has broken the pre-existing links between the government and the enterprises overnight. As most of the enterprises were undergoing privatization, the relationship between the state-owned enterprises (SOEs) and the government was becoming loose, and the government’s capability to regulate the economy has been greatly reduced. Such a situation also reduced the room for interest groups to maneuver. As Hellman has demonstrated, only those enterprises that are large in
scale, magnitude and powerful in its close relationship with the bureaucracies and with more resources at their disposal, could exert strong "influence" in the process of public policy making, while those new or emerging entrepreneurs can only use pay-off to influence regulatory policies or decisions. This is what they refer to as state capture.

In other gradual transition countries, especially in China, active rent seeking by government is common because of the intermingling of its functions of governing and enterprise managing. Before the streamlining of state administration structure in 1998, there was too much interference by too many ministries or commissions of the central government with the economy. Since the umbilical cord between some governmental departments and their affiliated enterprises was not cut off, the former often sought to ensure a favorable treatment for interests of their own or of their affiliated enterprises, by regulatory policies such as restriction on market access, tariffs and licensing.

AM is an important feature of the planned economy, but it is not true that AM in all Leninist countries can be regarded as corruption. It is just one of the main instruments of its governance. After transition, such mechanism as AM does not meet the need of the market economy any longer. It restricts competition and market entry, therefore causing huge economic loss. The purpose of AM was rent seeking, which brought plenty of advantage to some related interest groups. In fact, it became a kind of active rent creation activity by government. Some local governments and departments of central government try to protect self-owned enterprises making use of AM, and thus get additional income. The aims of them are not consistent in that of the state. AM is fit for the traditional planned economy in China, but not so for the market economy after the 1980s.

In China’s transition period, AM, which was inherited from the planned economy, became an excuse for unnecessary monopoly, so it is not only a source of administrative corruption but also a type of corruption itself. In the East European countries and the former USSR AM, unlike in China, is not so rampant. Since the SOEs in these countries have been separated from the governments, the former only try to capture the latter to influence the policy making process. So the main kind of corruption in these transition countries is "state capture", while in China it is AM that becomes the main type of corruption. So we argue that AM is a unique kind of corruption in China's transition period, although all Leninist, planned economies have AM.

In fact, we find that administrative corruption, state capture or influence emerge not exclusively in those transition economies adopting "shock treatment". In other words, these forms of corruption are also common scenarios in all other market economies. The only reason why they are more pronounced in the transition economies is simply that in those countries, institutional failure is more evident. Olson’s analysis of labor unions, sector groups, farmer associations, and cartels projected a clear picture of these two types of grand corruption in the well-developed market economy such as the US (Olson, 1995).

In China, this situation is different from what was referred to by Hellman and Kaufmann as an "influence" or "state capture", which are both actions
undertaken by enterprises themselves. Although in China, the close link between the state and SOEs is being relaxed step by step, in many sectors, the interests of state monopolies are well safeguarded. The protection of the state-owned and monopolistic enterprises by China’s government, defined as AM by us, is a deliberate act of the government. It is active rent creating by the government in order to protect interests of some or all SOEs.

By a widely accepted definition, corruption refers to abusing public power for private gains. Although public officials in AM sectors do not get profit directly for themselves, they do abuse public trust so that the government sectors, they work for, benefit much from AM. In the following part, we will illustrate the inherent mechanism for it. Based on the above-mentioned studies, we suggest a new classification of corruption in transition economies for which we use the following: (a) whether an illegal payment is offered directly; and (b) whether influence is exerted in the process of policy making or policy implementation.

Our division of corruption in transition economies challenges the widely accepted opinion that the main subject of corruption is always an individual, such as public official. Our study shows that in China, the subjects of corruption, whether in the case of state capture, AM or influence, are almost all SOEs. Furthermore, we found that the economic loss caused by corruption mainly took place in those areas where group corruption or sector corruption prevails. It is a typical systematic corruption. Accordingly, one of the important manifestations of grand corruption in today’s China is the AM, arising out of active rent creating practice of the government. In the following section, we outline the essence, causes, various forms and features of AM in China, and highlight social welfare cost associated with it.

The causes, forms and features of administrative monopoly

In our study, we define AM as a type of monopoly maintained by administrative power, to which various government departments resort so as to ensure a monopolistic status for interests of their own or of a particular sector or local enterprises affiliated with them. Because AM is realized by law generally, administrative rules or regulations, it is often referred to as statutory monopoly or legal monopoly.

Difference between AM and other types of monopoly

Before discussing AM in detail, we should distinguish it from other types of monopoly. According to Gregory Mankiw, monopoly can be classified into three categories: market monopoly, natural monopoly and administrative monopoly (Mankiw, 1999: pp. 314–343).

Market monopoly comes into being through market competition. During the process of competition, a few enterprises established their monopoly status by their superiority in capital, technology, marketing or advanced management. Market monopoly is a kind of “structural monopoly”; market share is established via fair competition. Such a market monopoly plays an active role in promoting an efficient allocation of resources. Only when those who have dominated the market
try to restrict market competition by illegal means, such as price manipulation and discrimination, market carving-out, conspired blockage and illegal mergers, would the consumers’ interests be infringed. This is called “behavior monopoly”.

Natural monopoly means that the total cost for one individual enterprise to produce many different products is less than the total cost for many different enterprises to produce each of these products. Natural monopoly usually happens in the public service sectors, for example, water, electric power or heating supply.

Distinct from market monopoly and natural monopoly, AM is established by the government through regulatory policies. It is aimed to guarantee interests of the government and their affiliated enterprises. It is common in China during its gradual transition process.

By the widely accepted definition of corruption, we would like to emphasize the word “private”. It cannot be understood narrowly as only referring to public officials themselves or/and their families; we must take into account interest groups that they are acting for or belong to. In a gradual transition economy such as China, some government departments try to block market competition via AM to ensure their own interests or those of the locally affiliated enterprises. This is also a typical instance of corruption.

Causes of administrative monopoly

AM takes place during China’s transition process from planned and centralized economy towards market economy. It is a problem created by the old system. Before the economic reform and the open-door strategy, China had adopted a planned and centralized economy system characterized by AM. Government’s controls penetrated through virtually all sectors and almost every perspective—from market access to supply of raw materials, from price setting to sales of products; all were under direct control of the government. Since 1979, the government has reduced its control in most of the sectors, with competition permitted and the market economy taking shape. However, in some sectors, the government’s monopoly is still in place, and the government often engages in anti-competition activities by regulatory policies and administrative means, with the excuse of or in the pretext of sector management and market order maintenance. The government is not only the maker of the rules of the game, but also the sportsman competing in the game and the referee for the game at the same time (Sachs et al., 1999). Therefore, it is impossible to launch any meaningful campaign to fight against monopoly. This would lead to the so-called “government failure”.

One of the hardest issues in China’s economic system reform is the “separation of the administration from the enterprise”, which means that the government should pull out from all those places where the market works better, and only focus on providing public goods and services. It should be noted that after 20 years of reform, great progress has been made in this regard. The administration has given up its direct interference with many competitive sectors, and through institution reform, it has diminished many administrative institutions which used to control the sectors. At the same time, it has transferred a lot of its power of
coordination to the macro-management departments. The SOEs in those sectors have been gradually separated from the administration, and become fully independent bodies competing in the market.

However, in those sectors traditionally not opened to market competition and characterized by network, such as electric power, telecom, railways or civil aviation, the relevant supervising ministries still act on behalf of the interests of the sector and refuse to open to market competition claiming that these sectors belong to natural monopolies. The underlying reason is that most of those monopolistic sectors are owned by the state who is either a solo owner or a majority shareholder, with the administration controlling the management and the personnel. Those sectors not only pay taxes, but also turn in profits which are an important source of revenue for the government. Accordingly, the ministries in the central administration act more on behalf of the interests of such affiliated enterprises, rather than the public interests in general, sometimes promulgating policies inconsistent with the developmental strategies of the central government.

Since the very beginning of the economic reform, China has been undergoing fiscal decentralization and administrative decentralization. Administrative power of the local government has been expanded. Whether enterprises operate well has a direct impact on the revenue of the local government. When the local-owned or the sector-owned enterprises become inefficient and their profits go down, their direct superiors would usually resort to administrative power to terminate or restrict market access by other enterprises not from the same region or not within the same sector, rather than attempt to promote competition capability of those non-profitable enterprises. The incentives to pursue local or sector interests constitute a strong motivation for AM, especially for regional monopoly (Pei, 2002).

**Main forms of AM: sector monopoly and regional monopoly**

Generally speaking, AM has two main forms: sector monopoly and regional monopoly. Sector monopoly is the outcome of the policies implemented by the central administration or specific sector-governing departments to exclude or restrict market access by other sector players and to prevent competition so as to ensure interests of their own sectors.

Regional monopoly refers to action of local governments to set up market barriers by its administrative power. It works in two ways: (1) restricting market access of goods from the outside; and (2) limiting out-flow of local goods, raw materials and technologies. Regional monopoly is harmful in many ways. First, it

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1 Here is an example from the Civil Aviation: China’s Bureau of Civil Aviation plays two roles. It is a sector regulator, and a majority shareholder of many aviation companies at the same time. On the average, it owns more than 85% of shares in 10 aviation companies, which have been consolidated into three companies in August 2002. It mandates that all aviation companies buy air fuel from its joint venture subsidiary—Chinese Air Fuel Supply Company, which sells air fuel at a price about 60% higher.

2 The prohibition on price discount in civil aviation sector by the Bureau of Civil Aviation in 2000 is apparently inconsistent with China’s overall policy—expanding internal demands.
frustrates the emergence of a single national market and blocks development towards a single and open market system. Second, it directly disturbs market competition and allocation of resources. It produces rent seeking opportunities and incentives for local government officials. Although proponents of regional monopoly argue that regional monopoly can protect development of local enterprises, actually such a “development” is at the expense of the loss of welfare of all consumers in the whole region. Regional monopoly transfers the cost of inefficiency to the consumers.

We should bear in mind that AM has taken place in many sectors, besides sector monopoly and regional monopoly. AM in some monopolistic sectors—such as electric power, telecommunication, civil aviation and railway sector—is surely remarkable. But AM is also thriving in many other sectors including higher education, medical care and sanitation, sports, culture, entertainment, publication, and tourism. These markets should be opened and competition should also be promoted.

Features of administrative monopoly

According to Yu (2001), the main features of AM are:

- It generally occurs in enterprises either owned or absolutely controlled by the state. In both cases, these enterprises are directly run by the government and subject to control of the government in personnel, distribution and operation;
- The legitimacy of such a monopoly comes from the administrative status of the enterprises as being run by the government and consequently from their compliance with law or regulatory policies; monopoly status is ensured by the government by favorable rules or administrative regulations.
- Monopoly enterprises not only pay taxes but also turn in profits to the state treasury;
- AM blocks market competition and leads to inefficiency of monopolistic enterprises and poor resources allocation.

AM is against competition for following reasons:

- It applies discriminatory treatment to the private enterprises and enterprises not affiliated with the government and restricts market access of those sectors not belonging to natural monopoly;
- The administration acts on behalf of their enterprises to set up a cartel price;
- A monopoly of public resources is established, hence only a few enterprises can have exclusive access to them;
- It establishes regional barriers by administrative means.

For those monopoly enterprises, it is common that their demand curve is equivalent to that of the whole society. Therefore, if those enterprises reduce the supply of their products or services, the price will be pushed up, but their profits will not
necessarily decrease. Instead, it will lead to unsatisfied demand on the part of the public, and reduce the general welfare of the whole society.

Assessment of economic loss caused by administrative monopoly

Tremendous economic loss caused by AM

According to the rent seeking theory, monopoly distorts efficient allocation of resources and causes two types of loss. One is the loss of net social welfare, which is generally referred to as Harberger Triangle (see Fig. 1; Tullock, 1999: p. 2). The other is the loss suffered by consumers, that is the surplus transferred from consumers to producers. This is called Tullock Quadrangle (see Fig. 1; Tullock, 1999: p. 13). Superficially, the transfer of consumer’s residual is only a transfer of fortune, not a loss of the net social welfare. However, Tullock’s research indicates that due to a huge cost created by the rent seeking and rent-protection processes, the rent will finally dissipate and this will eventually lead to a loss of net social welfare.

The research by Harberger and Harvey Leibenstein shows that loss of the net social welfare caused by monopoly is actually very small. Therefore, we will concentrate on loss of the consumers.

In China, the rent accumulated by the sector monopoly can be divided into two parts. One is the loss of social welfare reflected in the monopoly price (i.e. Tullock Quadrangle). The other includes various illegal fees collected by monopolistic sectors under various pretexts, upon which they transfer the costs of mismanagement and the investments for future development to the consumers. Hu (2000) calculated China’s loss of social welfare in the late 1990s caused by monopoly price in some monopoly sectors (Table 2). In 2002, based on China’s official statistics, he estimated the various illegal fees collected by the monopolistic sectors from 1998 to 2001 (Table 3).

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**Fig. 1. Economic analyze of rent seeking activities.** Note: $P_m$: price in monopolistic market; $P_c$: price in competitive market; $Q_m$: quantity in monopolistic market; $Q_c$: quantity in competitive market.
Hu’s calculation shows that sector monopoly has created a huge economic loss to China, and has become one of the most important sources of the economic loss caused by corruption, far more than those caused by petty corruption such as accepting briberies by government officials. It is one of most severe types of corruption in present China. Sector monopoly directly infringes on the consumers’ interests. Therefore, it has been brought into the focus of the whole society.

In contrast to people’s concern about sector monopoly, there has been little study of the economic loss caused by regional monopoly in China up to now. In this regard, the research done by Sandra Poncet, an economist from the Center for International Research and Development in Paris, is quite inspiring (Gilley, 2001). According to one of her latest study, the trade tariff between different provinces in

Table 2

<table>
<thead>
<tr>
<th>Monopoly sectors</th>
<th>Amount of rent (billion RMB/year)</th>
<th>Proportion to GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric power</td>
<td>56–112</td>
<td>0.75–1.50</td>
</tr>
<tr>
<td>Transportation and post</td>
<td>74–90</td>
<td>1.0–1.2</td>
</tr>
<tr>
<td>–Post and telecom</td>
<td>21.5–32.5</td>
<td>0.29–0.43</td>
</tr>
<tr>
<td>–Civil aviation</td>
<td>7.5–10</td>
<td>0.1–0.13</td>
</tr>
<tr>
<td>Medical care</td>
<td>7.5–10</td>
<td>0.1–0.13</td>
</tr>
<tr>
<td>Total</td>
<td>130–202</td>
<td>1.7–2.7</td>
</tr>
</tbody>
</table>

Note: Calculated at present price; GDP is calculated as 7500 billion RMB. Source: Hu (2001: p. 61).

Table 3
Estimation of illegal fees collected by the monopoly sectors

<table>
<thead>
<tr>
<th>Monopoly sectors</th>
<th>Year</th>
<th>Illegal income (billion RMB)</th>
<th>Proportion to GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illegal fees from power sector</td>
<td>1998–1999</td>
<td>2.74</td>
<td></td>
</tr>
<tr>
<td>Financial burdens on peasants by disunited living electricity price</td>
<td>2001</td>
<td>35</td>
<td>0.37</td>
</tr>
<tr>
<td>Illegal charges of telecom</td>
<td>1998–1999</td>
<td>2.17</td>
<td></td>
</tr>
<tr>
<td>Financial burdens of patients by rectifying medicaments purchase and sale</td>
<td>2001</td>
<td>10.1</td>
<td>0.11</td>
</tr>
<tr>
<td>Other illegal charging cases</td>
<td>2001</td>
<td>3.15</td>
<td>0.03</td>
</tr>
<tr>
<td>Total</td>
<td>2001</td>
<td>53</td>
<td>0.60</td>
</tr>
</tbody>
</table>


According to Qingze Cao, Deputy Secretary of the Central Discipline Supervision Committee of Chinese Communist Party, the amount of economic loss caused by 1.33 million cases from October 1992 to June 2001—which mostly belong to petty corruption—is 40 billion RMB, about 0.45% of the GDP of the same term.
China in 1997 was around 46%, while it was 35% a decade ago. The regional trade barriers within China are as much as those between European Union (EU) countries, or between Canada and the US. What is even worse is that, with the decrease of import tariff the inter-province trade barriers have been in a steady rise since the 1980s. Poncet finds that in 1997, Chinese consumers bought 21 times more goods produced in their local provinces than those from other provinces, whereas in 1987, this figure was only 11 times. Chinese provinces’ integration into the international market has accompanied the domestic market disintegration. Poncet’s study shows that China’s regional monopoly is severe and getting worse and worse with China’s integration into the global economy. It is not difficult to predict that “domestic market segmentation” will remain one of the most important manifestations of AM for a quite long period from now on.

**Dissipation of rent from the sector monopoly**

Rent sought by AM is spent mainly for the following purposes:

- Bailing out the excessive operation costs caused by mismanagement in monopoly sector enterprises;
- Constituting an important source for employees’ welfare in monopoly sectors, such as health fees and pension;
- Creating an important source of informal expenditures for the relevant supervisory governmental department;
- Creating profits and channeling them from the SOEs to the state.

Monopoly rent makes it possible for poorly managed enterprises in the monopoly sectors to survive. In China, the efficiency of the enterprises in monopoly sectors is generally poor. According to Shujie Liu’s study (Liu, 1999: p. 7), from 1985 to 1996, the increase in the rate of labor productivity in monopoly sectors is far below China’s average rate. In contrast, the average salary of employees in monopoly sectors is much higher than that of all other employees in China. From 1995 to 1999, each employee in the power sector earns 14,294 RMB more than those in other sectors, that is, an additional 2859 RMB per year. The power sector had to pay 7910 million RMB in addition each year for salaries of the employees alone. Numerous rents sought by monopoly sectors provide abundant capital to maintain inefficient operation and high salaries. Table 4 illustrates how the rent was spent on high salaries in the monopoly sectors.4

Tullock’s research shows that rent will eventually be dissipated and converted into net loss of social welfare. At the first glance, however, it seems that there is a gap between the theory and the Chinese reality. China’s experience indicates that part of the rent is submitted to the state as profits, not all for dissipation. But a further analysis proves that Tullock’s conclusion is correct. According to Shujie

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4 This does not include other forms of income besides salaries for employees in AM sectors, such as high awards, kinds of subsidies, and non-monetary benefits.
Liu, for example, in 1996 when prices in monopoly sectors increased drastically in comparison with those of 1985 and the increase was much larger than the inflation rate of the same period, the profit rate of the power sector was only 7.33%, and it went down by 54.58% in comparison with that of 1985. At the same time, the deficit of the railway transportation was 1.38 billion RMB, a decrease of 120% in comparison with its surplus of 6.4 billion RMB in 1985. Also, the local telephone had a deficit of 3.56 billion RMB; and the post office lost 7 billion RMB (Liu, 1999: p. 4). These statistics prove that profits in monopoly sectors are continuously declining, and it supports Tullock’s observation on rent dissipation.

It is worth noting that the profits turned over to the state by monopoly sectors should include a return of the government’s prior capital investment in those monopoly sectors. Also, over the past years, SOEs received from the government many subsidies, return of income tax, and tax reduction as well. Enterprises in monopoly sectors have not only dissipated tremendous rent, but also absorbed huge financial incomes which should have been collected by the state. The above analysis has shown that much of the rents have been submitted to relevant supervising governmental ministries and have become an important source of off-budget revenue for those ministries, such as extra expenditures, employees’ welfare, construction fees for governments’ hotels, guest houses or training centers, domestic and international travel fees of government officials and so on. It accounts for the incentives for rent creation by the government departments.

Table 4
Rent dissipated by salaries of employees in AM sectors (2000)

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Average salary of employees (RMB)</th>
<th>Average salary of the whole country (RMB)</th>
<th>Amount above national average (RMB)</th>
<th>Number of employees (10,000)</th>
<th>Rent dissipated (billion RMB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power, gas and water supply</td>
<td>12,830</td>
<td>3459</td>
<td>281.8</td>
<td>9.75</td>
<td></td>
</tr>
<tr>
<td>Post and telecom</td>
<td>16,359</td>
<td>6988</td>
<td>113.2</td>
<td>7.91</td>
<td></td>
</tr>
<tr>
<td>Civil aviation</td>
<td>23,454</td>
<td>14,083</td>
<td>11.7</td>
<td>1.65</td>
<td></td>
</tr>
<tr>
<td>Railway transportation</td>
<td>13,920</td>
<td>4549</td>
<td>187.1</td>
<td>8.51</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>27.82</td>
</tr>
</tbody>
</table>

Source: Statistic Ye.

Conclusion

Based on the latest international studies on corruption in transition economies, this paper attempts to incorporate China’s experience into the proliferating literature on this subject by identifying a more sophisticated and important corruption phenomena in the context of economic transition in China: the AM.

By examining its essence, causes, forms, features, as well as the economic losses it caused, this paper shows that the AM is one of the most severe types of corruption in China at the country’s current stage of the reform process. It is a kind of active rent-seeking activity which is an outcome of the long standing mixture of the
functions of the government with its interference in enterprises’ management. AM not only causes huge economic loss, but does so at the direct expense of the consumer’s welfare.

AM is a special form of corruption, emerging in the process of economic transition. With a further development of China’s reform of the economic and political systems, and with China’s accession to the WTO, administrative power of the government would be restricted, the rents caused by AM will surely be in decline, and AM itself will be gradually reduced with the conclusion of transition.

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