

Corruption and Human Capital: Evidence from China

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Abstract

Motivation

- ▶ **Theories:** corruption disincentivizes productive activities and distorts talent allocation (Baumol, 1900; Murphy et al., 1991; Acemoglu, 1995)
- ▶ **Existing empirical work:** indirect channel in which corruption distorts public good delivery and thus affects human capital (e.g., Olken, 2006; Ferraz et al., 2012)
- ▶ **This paper:** How do rent-seeking opportunities shape occupational preferences and talent accumulation?

This Paper

- ▶ Exploits China's **staggered** anti-corruption inspections that dampen **perceived returns to rent-seeking** sharply at the city-time level.
- ▶ Data: representative child-parent panel & unique personnel data from a state-owned enterprise (SOE), with measures of individual ability and integrity

Preview of Results

- ▶ **Reducing corruption** → **positive selection for integrity into the state sector**
 - ▶ Remains present even when conditioning on ability and family background
 - ▶ True for both occupational preferences and realized labor outcomes.
 - ▶ Implications: shifts in reward structures reshape political selection
- ▶ **Further evidence on talent accumulation**
 - ▶ Suggestive of greater investment in children's human capital
 - ▶ Implications: allocation and accumulation margins reinforce each other

Background & Empirical Strategy

Rent-Seeking and Human Capital in China

- ▶ Long-tradition of *Guanxi* (favor-exchange) norms
- ▶ Rent-seeking play important roles in shaping economic activities
 - ▶ State sector jobs attract talents, but also rent-seekers (Manion, 2004; Bai et al., 2021)
 - ▶ Even if unwilling, citizens are still incentivized to allocate some talent and resources toward rent-seeking (Acemoglu, 1995; Fisman et al., 2018)

Anti-corruption Visits (2013-)

- ▶ Apart from consolidating power, a sharp attempt to reduce corruption (Francois et al., 2020; Lorentzen and Lu, 2018)
- ▶ Rich variation: province-to-city inspection visits (PCDI)
 - ▶ Dispatching inspection teams to local cities – intensive audits and spot-checks for 1-3 months
 - ▶ List of regions confidential before notified (10-14 days before the visit)
 - ▶ A heightened awareness of potential corruption risks

Empirical Strategy: Staggered Inspection Timing

- ▶ **Stacked-by-event diff-in-diffs:** only not-yet-treated units as clean controls
- ▶ To examine talent allocation: further interacting with individual traits

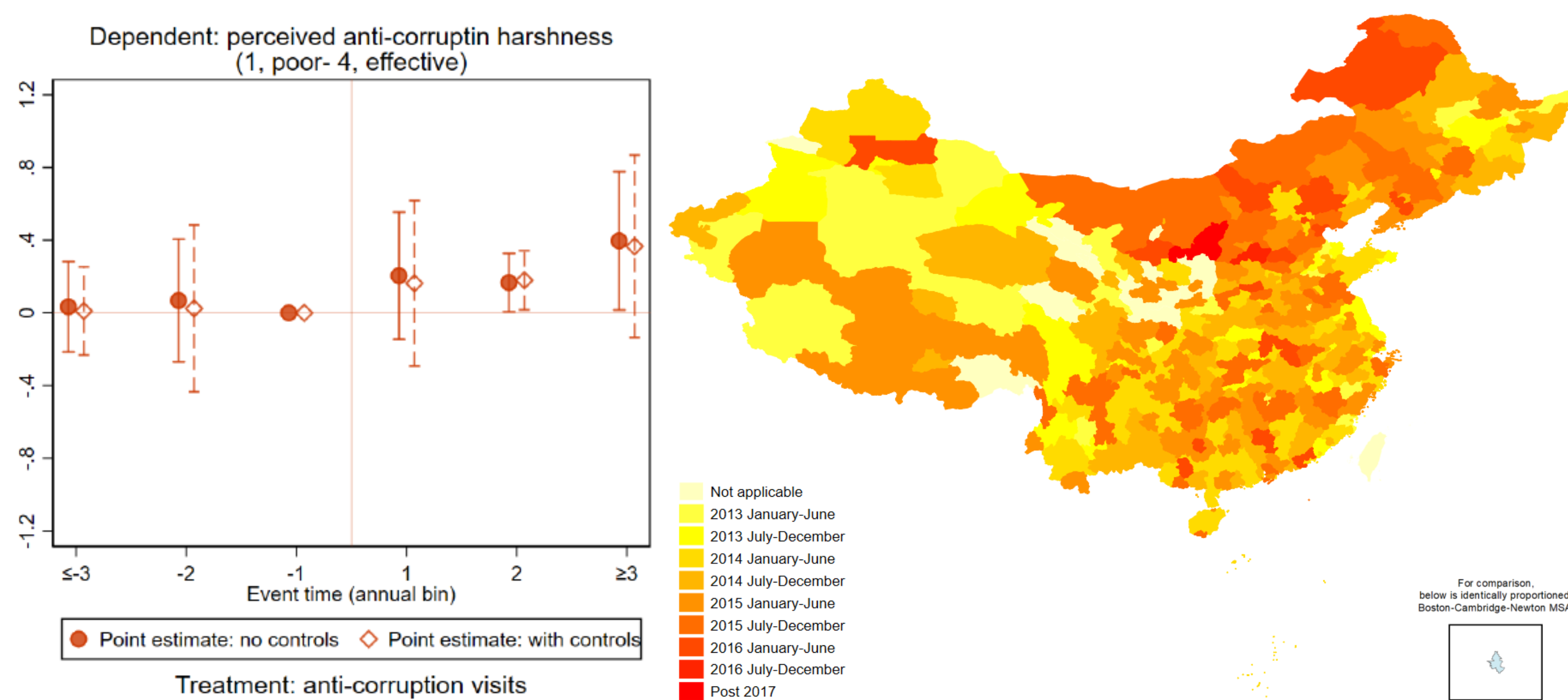


Figure 1 and 2. The left panel shows the reality check -- anti-corruption visits induce greater perceived costs of corruption. The right panel visualizes the timing of the first province-to-city inspection visits in mainland China. Data sources: manually collected from official websites and newspapers + Chinese Social Survey (2011-2017)

Talent Allocation: Selection into Public Jobs

Why is selection into the state sector important?

- ▶ The first-order outcome in this setting: anti-corruption + public jobs bear plentiful rent-seeking opportunities and salient externalities (Krueger, 1974)
- ▶ Chinese Economy: the state sector dominates
- ▶ Key traits: **ability + public service motivations/integrity** (Becker and Stigler, 1974; Dal Bo et al., 2017; Besley et al., 2021)

Key Challenges: Measuring Traits

- ▶ **Measuring ability**
 - ▶ Household panel: cognitive scores and academic performance of children
 - ▶ SOE employees: work effectiveness assessment
- ▶ **Measuring integrity**
 - ▶ Household panel: **inconsistency of separate responses from parents and children + public-mindedness index** evaluated by parents
[⇒ internal validation: correlation=0.343, P-value<0.001]
 - ▶ SOE applicants: **honesty score from the personality test** (automatically by the system, using psychological techniques to indirectly measure)

Data: child-parent panel	Occupational preferences: public sector jobs			Occupational preferences: government officials		
	(1)	(2)	(3)	(4)	(5)	(6)
Mean of dep. var	0.352	0.352	0.352	0.061	0.061	0.061
Inspected	0.014 (0.019)	0.014 (0.019)	0.012 (0.019)	-0.005 (0.008)	-0.002 (0.008)	-0.002 (0.009)
× Integrity index (standardized, time-invariant)		0.034*** (0.011)	0.035*** (0.010)		0.013** (0.006)	0.011* (0.007)
× Ability index (standardized, time-invariant)			0.004 (0.011)			0.003 (0.006)
Household × City × Cohort FEs	Y	Y	Y	Y	Y	Y
Time (semester) × Cohort FEs	Y	Y	Y	Y	Y	Y
Lower order interactions	Y	Y	Y	Y	Y	Y
Observations	37,078	37,078	36,211	37,078	37,078	36,211

Table 1. Unit of obs.: child(-parent)-year. Dep. var.: a binary = 1 if both the child and their parents prefer the corresponding occupation. Inspected: a binary that is 1 if the city of residence has been inspected by the anti-corruption team. Standard errors are clustered at the city-cohort level. * p < 0.10, ** p < 0.05, *** p < 0.01. Data source: China Education Panel Survey (2013 – 2015).

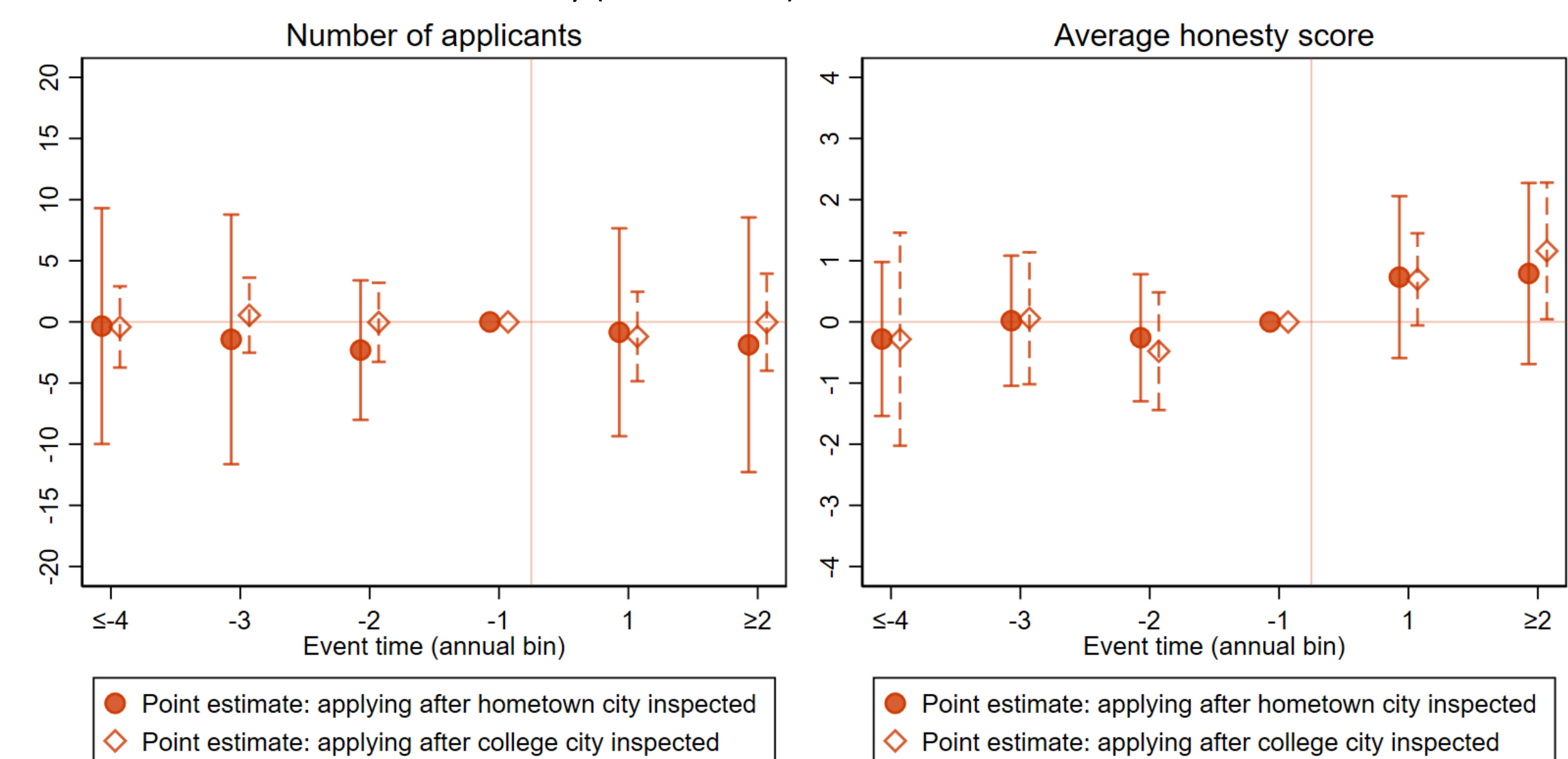


Figure 3. Unit of obs.: city-year cell. "Average honesty score" is elicited from the personality test result (automatically assessed by the system using several psychological techniques). The identification holds constant the year of entry and the hometown/college city FEs to absorb any demand side changes. Data source: Applicants to administrative positions of a provincial-level SOE in Southern China (2011 – 2020).

Reducing corruption → Positive selection on integrity into public jobs + no differential selection on ability

- ▶ Screening on ability may not alter the problem of negative selection of incentives into the state sector (Hanna and Wang, 2017)
- ▶ Instead, **shifts in reward structures** (e.g., reducing rent-seeking opportunities) may in part improve political selection -- and not necessarily depreciate the average quality of the applicant pool

Further Results on Talent Accumulation

- ▶ The previous analyses take the talent stock as static
- ▶ **Nevertheless:** Reducing corruption incentivizes human capital (Ehrlich and Lui, 1999)
- ▶ Household panel: anti-corruption is associated with
 - ▶ Increased desired educational attainment of households
 - ▶ Increased investment in children's human capital (both pecuniary and non-pecuniary)
 - ▶ Not purely driven by changes in public education over the short term

Concluding Remarks

- ▶ **Rent-seeking → Talent allocation into the state sector**
 - ▶ Reducing corruption induces positive selection on integrity, even if conditioning on selection on ability and family background
 - ▶ First causal evidence: *within-society* variation in reward structures
- ▶ **Broader implications**
 - ▶ Potential trade-off: even if deterring "capable" individuals in the short run – **improved selection of incentives may help alleviate the rent-seeking equilibrium trap**
 - ▶ Moreover, the allocation and accumulation margins may reinforce each other: not-yet-realized productivity of children → long-term human capital gains in all sectors

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Robustness

- ▶ Career uncertainty: opposite predictions
- ▶ Socio-economic changes: strong balances in pre-treatment characteristics + robust to the inclusion of a host of controls and selection by family background
- ▶ Limited spillover/anticipatory effects
- ▶ Not driven by significant changes in honesty of overall population (Ajzenman, 2021)