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Can you please provide information on risks of corruption for foreign businesses in China?

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SUMMARY

Corruption has particular characteristics in China. Chinese leaders consider corruption to be a threat to the political system and, therefore, a matter of great concern. In fact, since 2013, when Xi Jinping was appointed president, the Chinese government has been implementing an aggressive anti-corruption campaign.

Increased corruption has not prevented the development of the Chinese economy, becoming the second largest economy in the world after the United States. China presents the paradox of being in a process of opening to the wider world to achieve their ambitious economic plans and respond to new social demands, while having a political regime that is not willing to lose control and uses authoritative means to keep it.

Author(s):

Nieves Zúñiga, Transparency International,
thelpdesk@transparency.org

Reviewer(s):

Robert Martinez Kukutschka, Transparency International,
thelpdesk@transparency.org

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1. OVERVIEW OF CORRUPTION IN CHINA

Background

Corruption in China has special characteristics. It is not just a general concern, it is also seen by Chinese political leaders as a threat to the political system. In words of Xi Jinping, president of the People’s Republic of China since 2013, corruption could lead to the collapse of the Chinese Communist Party and the downfall of the state. The seriousness of the problem in the last decades and the fear of political collapse motivated Jinping’s war against corruption, initiated five years ago. Corruption is especially worrying for Chinese political leaders because the legitimacy of the party, and of the political system in general, is not based on elections, as in democracy, but on a political meritocracy that selects and promotes leaders with superior ability and virtue (Bell no date). Hence, in China, the level of corruption is indicative of the level of meritocracy, and therefore of legitimacy, of the political class.

Another reason that makes corruption in China different is that, contrary to arguments that correlate lower levels of corruption with higher economic growth, in China corruption and economic development have grown simultaneously. The post-Mao economic reform undertaken at the end of the 1970s transformed the economy from a command economy – controlled by the government to attain its social goals – into a market economy that empowered other players, such as private businessmen and entrepreneurs. As a result of that transformation, from 1979 to 2010, China’s average gross domestic product (GDP) growth was 9.91 per cent, reaching its highest point of 15.2 per cent in 1984. At present, China is the world’s second largest economy after the United States.

Nonetheless, the economic transformation also opened opportunities to different forms of corruption. In mid 1980s, petty corruption flourished with private businessmen seeking to establish their companies. In addition, a price reform based on a hybrid system – according to which commodity prices were fixed by the state based on whether they were sold in the state-planned economy or in emerging market – also facilitated corrupt exchanges. Considering that market prices were higher, officials found that diverting goods into the market was an opportunity to increase profits (Wedeman 2012). In the 1990s, corruption intensified and affected senior-level officials who auctioned off control rights for enterprises and real estate (Wedeman 2012). The rapid growth of the economy also implied a higher demand for capital and, due to the lack of a developed capital market in China, the government became an important source of investment loans, which created opportunities for private gain.

According to the economist Jaddish Bhagwati, what makes corruption in China different is that it involves “profit-sharing”, in contrast to other countries like India where corruption is defined as “rent-seeking”. In India, in his words, “people jostle to grab a cut of existing wealth” whereas “the Communist Party [in China] puts a straw into the milkshake so they have an interest in having the milkshake grow larger” (Pilling 2014). An example, might be the transformation of local governments in entrepreneurial “local development states”, which create partnerships with businesses and receive ad hoc taxes and other forms of illicit profit-sharing (Wedeman 2012). At the origin of this collective character in corruption could be the “guanxi social circle network”, an informal social institution whose maintenance of a circle of benefits is an objective for those involved in corruption.

In recent years, China’s growth has evolved towards a more sustainable and inclusive development, and towards an economic model that is consumption-led rather than investment-driven (World Economic Forum 2018). China is also changing from being a low-cost manufacturer into a value-added developer of cutting-edge products and services (World Economic Forum 2018). New goals for the Asian country included in their “One belt one road” and “Made in China 2025” plans are improving manufacturing and services industries to promote Chinese companies abroad and revamp infrastructure and industry. This ambitious economic plan is bringing important social transformations, such as the emerging of a middle class and a significant migration to the cities. In turn, this new Chinese demographics has increased social demands and financial needs, and created challenges such as a significant problem of pollution and environmental damage. Thus, the government is adapting public institutions to support the economic dynamism, responding to new social demands, addressing inequalities and facing challenges.
**Extent of corruption**

Data on corruption in China show different results depending on what the indexes capture and whose perceptions they are. According to Transparency International’s 2017 Global Corruption Barometer (GCB), which reflects general public perceptions on corruption, 73 per cent of the respondents in China believed that the level of corruption had increased. This perception positions China at the top of the countries in the Asia-Pacific region captured in the 2017 GCB. Transparency International’s Corruption Perception Index (CPI), which collects data on how corrupt the public sector of a country is seen to be by business people and country experts, shows that perceptions of corruption in China have improved in the last years, moving from a CPI score of 36 in 2014 to 41 in 2017. It situates the country below the middle point, between being considered highly corrupt or very clean. In 2017’s CPI, China scored 41 (0 being highly corrupt and 100 very clean) and was ranked 77 out of 180 countries. Comparing different countries and territories in the region, China is perceived to be considerably more corrupt than Singapore (score 84), Hong Kong (score 77), Japan (score 73), Taiwan (score 63) and South Korea (score 54).

The World Bank’s control of corruption indicator, which besides petty and grand corruption in the public sector considers the capture of the state by elites and the private sector, indicates a progressive improvement since 2012. In the last five years, China moved from a score of -0.44 – on a scale from -2.5 (weak) to 2.5 (strong governance performance) – to a score of -0.25 in 2016.

The data on China offered by the Index of Public Integrity, a composite index aiming to provide an objective and comprehensive picture of the state of control of corruption measuring six components – judicial independence, administrative burden, trade openness, budget transparency, e-citizenship and freedom of the press – also showed an improvement. Data from 2015 and 2017 indicated a slight improvement in all components except in budget transparency, which, on a scale between 1 and 10 with a higher value representing better performance, remains considerably low (1.21). The score for trade openness had also decreased slightly (6.78). After budget transparency, the lowest indicator in 2017 was freedom of the press (1.23) and the highest score was for administrative burden, which also represents the biggest improvement between 2015 (7.61) and 2017 (8.25).

**Forms of corruption**

Bribery and giving gifts are the most common forms of corruption in China. According to data provided by Transparency International’s 2017 GCB, 26 per cent of the respondents paid a bribe when accessing basic services. The services most affected by bribery are public education; public hospitals; ID, voter’s card and permits; the police; and the courts. Between 16-30 per cent of the respondents paid a bribe in each of those services. In China, as in Taiwan, Cambodia or Myanmar but contrary to Thailand or India, the richest people pay more bribes (31 per cent) than the poorest people (24 per cent).

Other forms of corruption in China are diversion of public funds, favouritism in decisions of government officials, and other irregular payments. According to data provided by the Global Competitiveness Index 2017-2018, on a scale of 1 to 7, with 7 the most desirable outcome, diversion of public funds achieved the value of 4.1, irregular payments and bribes 4.5, and favouritism in decisions of government officials 4.5. The trend for the diversion of public funds seems to be steady, whereas irregular payments and favouritism appears to be increasing slightly.

**Corruption in business**

Private sector firms and foreign investors in China face several challenges. Among those challenges are: discriminatory practices, selective regulatory enforcement, licensing barriers, the lack of an independent judiciary, poor intellectual property rights enforcement, forced technology transfer and the lack of the rule of law (US Department of State 2017). The demand to make payments or give gifts to officials to overcome some of those challenges and do business is frequent.

According to a survey conducted by Charney Research in 2015, 35 per cent of companies in China confirmed that they had to pay bribes or give gifts to officials to operate. Respondents to the Executive Opinion Survey 2017 (World Economic Forum 2017) situate corruption as the fourth most problematic factor for doing business in China after access to financing,
inefficient government bureaucracy, inflation and policy instability. Following data from the Global Enabling Trade Report 2016, corruption at the border in China is one of the most problematic factors for importers, and corruption at foreign borders is the least among the most problematic factor for exporters.

The expectation to pay bribes or give gifts appears to be more frequent in some stages of economic activity than in others. Enterprise Survey data on China (World Bank 2012), shows that 42.2 per cent of firms were expected to give gifts to secure government contracts. Of them, 19.2 per cent were expected to give gifts to get an import licence and 18.8 per cent to get a construction permit. Gifts in meetings with tax officials were expected by 10.9 per cent of the firms, and 10.8 per cent of them were expected to give gifts to public officials to get things done. According to the Executive Opinion Survey 2015, up to 7.1 per cent of the respondents reported that corruption at the border is among the most problematic factors for importers. Corruption at foreign borders is reported as one of the most problematic factors for exporters by 3 per cent of respondents.

Following data provided by Charney Research (2015), several aspects, such as geographical location, company size and ownership, and the sector, are important aspects to consider when it comes to identifying where the risks of corruption are higher. For example, not all regions in China have the same responses when it comes to bribery. According to Charney’s data, the areas in which bribery was most commonly reported are Beijing region (43 per cent), where there is a high concentration of bureaucracy, and the most developed and dynamic regions (Guangdong 39 per cent, Chongquing 38 per cent and Shanghai 34 per cent). The west of the country (19 per cent), the north-east (27 per cent) and the south-west (27 per cent) seem to be areas with less demand for bribery.

According to Charney Research, company size, ownership and the sectors also makes a difference when it comes to the risks of corruption. State-owned micro and small firms, and those with few resources, are more vulnerable (50 per cent paid officials) than privately-owned firms (30 per cent paid officials). In addition, corrupt payments are more frequent among foreign and Hong Kong based companies than among mainland firms.

The sectors most vulnerable to corruption are real estate and construction (41 per cent of respondents paid bribes) followed by manufacturing (36 per cent), services (35 per cent), retail (34 per cent) and transport (32 per cent). Farming is the sector least affected by bribery (23 per cent). Within these sectors, some areas present more risks for corruption than others. For example, in real estate and construction, residential realty (44 per cent) and transportation construction (42 per cent) present higher incidences of corruption. In manufacturing, metal producers pay most bribes (46 per cent) followed by capital goods (39 per cent), food (36 per cent), information technology (IT) (34 per cent), automotive (33 per cent), chemicals (33 per cent) and textiles (32 per cent). In services, the media, chain restaurants and Telecom/IT firms present the same frequency in the payment of bribes (38 per cent). Private healthcare is reported as the service with less incidence of bribery (25 per cent). In retail, luxury goods (38 per cent) and apparel (37 per cent) are the most affected areas for bribery and payments of gifts, followed by food (34 per cent), furniture and appliances (32 per cent). Car dealers were the least exposed to bribery or gifts giving (28 per cent). In transportation, shippers are considerably more vulnerable to corrupt payments (37 per cent) than travel agents (28 per cent).

In addition to bribery, companies in China are likely to experience political interference or facilitation of payments when acquiring public services or in the judicial system (Business Anti-Corruption Portal 2016).

2. SECTORS AFFECTED BY CORRUPTION

The judiciary

The judicial system in China presents some characteristics that increase the corruption risks for business. In China, there is not an independent judiciary and judges are often under the control of the Chinese Communist Party (CCP). Courts at the local level are particularly vulnerable to corruption since the judges are appointed and paid by local governments. This increases the risks of biased or poorly enforced decisions (Business Anti-Corruption Portal 2016).

Companies have questioned the capacity of the legal system to efficiently settle disputes and challenge regulations, though they also report that the
enforcement of contracts is faster and less expensive than the regional average (Business Anti-Corruption Portal 2016).

The police

The police constitutes another sector with risks for firms working in China. Companies have reported that police services are unreliable in protecting them from crime and enforcing the law (Business Anti-Corruption Portal 2016), and abuses of power by the police are rarely prosecuted. According to data provided by Enterprise Survey (World Bank 2012), 66 per cent of the firms interviewed paid for security. Road police influencing the circulation of goods were cited as frequent takers of bribes by 11 per cent of the firms interviewed by the Charney Research (2015). According to the 2017 GCB, around 16-30 per cent of service users paid a bribe to the police, which is not higher than bribery indexes in other sectors such as courts, public schools or public hospitals.

Public services

Companies consider government regulations to be burdensome and sometimes inefficient, and they have reported a spread of the irregular payments and bribes. Another challenge faced by foreign companies is arbitrary regulatory obstacles are susceptible to being overcome through irregular means, particularly in a market with restricted foreign access (Business Anti-Corruption Portal 2016).

Nonetheless, China has made starting a business less costly by reducing the business registration fee (World Bank 2017).

Regulations and tax administration

Tax collectors have been reported to be the second most-frequent takers of bribes and gifts (56 per cent), after local-level officials (79 per cent) (Charney Research 2015). The requirement to meet with tax officers is higher in China (59.4 per cent) than the average in the East Asia and Pacific region (53.8 per cent) (World Bank 2012).

According to Doing Business 2017, paying taxes in China takes longer (263 hours per year) than the average in the region. The exchange of bribes with tax officials is also reported as frequent by the Global Competitiveness Report 2015-2016. However, China has made the process of paying taxes easier by enhancing electronic systems and by unifying the criteria and accounting methods for tax deductions (Doing Business 2015). In a more positive tone, only 6.3 per cent of the firms consider tax rates a major constraint and 3.5 per cent identify tax administration a major constraint (World Bank 2012).

The number of days to obtain an operating licence (27.5) is higher than the average in the region (19.5), and to obtain a construction related permit (29.7) slightly lower than in the region (30.4).

Customs

Customs presents a moderate to high corruption risk for companies working in China (Business Anti-Corruption Portal 2016). The number of days to obtain an import licence is higher in China (26.3) than the average in the East Asia and Pacific region (20.6) (World Bank 2012).

Even if the costs to export and import are lower in China than in the region (World Bank 2017), the burden of paperwork makes clearing customs an area vulnerable to bribery. Irregular payments are reported as pervasive when importing and exporting (Global Competitiveness Report 2015-2016). Transparency levels at the border are moderate.

Public procurement

Public procurement presents high corruption risks. The process of obtaining contracts and licences are marked by pervasive bribery (Global Competitiveness Report 2015-2016). Well connected companies and individuals are favoured by government officials, and public funds are often diverted. Regarding procurement, it is important to consider the sectors in the Chinese economy in which the government encourages foreign investment while restricting or prohibiting it in others.

3. LEGAL AND INSTITUTIONAL FRAMEWORK

Overview

The Chinese government, led by President Xi Jinping, undertook in 2012 an intensive anti-corruption
campaign involving investigations into all sectors of government, the economy and the military. The anti-corruption campaign also involved judicial, administrative and party discipline reforms with a preventive character. As expressed by H E Huan Shuxian, Minister of Supervision at the Anti-Corruption Summit in London (2016), government efforts to curb corruption have focused on: improving the party’s style by tackling formalism, bureaucratisation, hedonism and extravagance; zero tolerance and tough punishment of corruption; strengthening the supervision of officials through cross-party inspections; and building stronger institutions. As a result of the anti-corruption campaign, there have been many arrests for corruption in China in the last year. In 2016, the government declared that one million Chinese officials were punished by corruption (BBC 2016).

The official war against corruption has been questioned in terms of its efficiency and its methods. The lack of an independent press and the lack of independence of the judiciary, guided by the party, hamper the transparent and consistent application of anti-corruption efforts (US Department 2017). Likewise, it has also been questioned how prosecution for corruption represents a threat to human rights. In fact, since 2016, the death penalty is applicable in cases of embezzlement or for accepting bribes equal or superior to US$463,000 (Beech 2016).

International conventions


At the 2016 Anti-Corruption Summit in London, China expressed its commitment to enhance international anti-corruption cooperation through actions like denying a safe haven to those engaged in corruption through extradition, strengthening information sharing with international communities concerning cross-border movements of corrupt officials, and signing bilateral treaties on extradition and mutual legal assistance in criminal matters, among others.

Domestic legal framework

China provides a comprehensive legal framework in the public and the private sector to criminalise corrupt actions such as facilitation of payments, money laundering, active and passive bribery, and gifts (Business Anti-corruption Portal 2016). Nevertheless, anti-corruption laws are said to be enforced in a selective manner.

Two main laws apply to cases of corruption: the Anti-Unfair Competition Law and the Criminal Law (Business Anti-corruption Portal 2016). In the first case, commercial bribery is punishable by economic and administrative sanctions. Criminal investigation might apply to serious offences. Prohibited acts of commercial bribery are giving bribes in order to sell or purchase goods, and receiving bribes in the course of selling or purchasing. The illicit income is confiscated and fines range from RMB100,000 (around US$15,800) to RMB200,000 (around US$31,600).

The prohibitions in the Criminal Law include giving and receiving money or property (including cash, items and proprietary interests that include housing renovation, the release of debt, membership services or travel) to obtain undue benefit. The law distinguishes between official bribery, which refers to personnel working for the state, and non-official bribery, which involves personnel not engaged in public services or working in private companies. Penalties for bribery include a range from fines and the confiscation of property to imprisonment and the death penalty. Commercial bribery is prosecuted if the bribes exceed RMB 60,000 (around US$9,500) and can result in a minimum of three years’ imprisonment. Bribes superior to RMB 2 million (around US$316,000) can mean prison from three to ten years. Life imprisonment and the death penalty can be applied in “specially serious cases”.

In 2015, China’s Criminal Law was amended regarding corrupt acts. For example, bribing civil servants’ relatives or other close relationships is considered a crime that imposes monitory fines to both
the giver and the taker of bribes. In minor cases, bribe-givers who aid authorities can be given more merciful punishments.

Based on information collected by Vandepol, Hui and Wu, companies that offer bribes to public officials or people related to public officials, including those directly responsible for such an offence and the person in charge of the companies, are subject to:

- a criminal fine levied on the company
- up to five years imprisonment and a criminal fine for the person responsible for offering bribes to public officials
- up to three years imprisonment and a criminal fine for the person responsible for offering bribes to former public officials or persons related to public officials

The Criminal Code does not establish limitations on hospitality expenses. Nevertheless, there is a threshold amount for the prosecution of official bribery, among other limitations (Vandepol, Hui and Wu): RMB30,000 (around US$4,800) for individual bribe-givers; RMB 200,000 (around US$31,600) for corporate bribe-givers; and RMB 30,000 (around US$9,600) for bribe recipients.

Institutional framework

China has several institutions with mandates to address different aspects and levels of corruption. Institutions with the mandate to investigate criminal violations of laws related to anti-corruption are the Supreme People’s Procuratorate (SPP) and the Ministry of Public Security. A more preventive approach to corruption is implemented by the Ministry of Supervision (MOS) and the Discipline Inspection Commission (CCDI), which are in charge of enforcing ethics guidelines and party discipline. The National Audit Office inspects the accounts of state-owned enterprises and government entities.

The National Bureau of Corruption Prevention (NBCP) is responsible for improving transparency in the government and coordinating anti-corruption efforts among different institutions. In 2017, President Xi Jinping announced the creation of a newly consolidated anti-corruption watchdog called the National Supervision Commission (NSC), to be formally established at the annual National People’s Congress plenary session in 2018. The NSC will take over the functions of the Ministry of Supervision, anti-corruption units of the SPP and the NBCP, and pass a corresponding National Supervision Law.

The creation of the NSC has also raised concerns (BBC 2018). This new agency will oversee all public servants exercising public power, not only party members. This implies that around three times as many people will be supervised as the previous watchdog institutions in China. NSC will be in charge of supervision and investigation. This power and the weakness in the enforcement of human rights in China has raised concerns from organisations like Amnesty International about the potential threat this represents to human rights (BBC 2018).

The institutional reform of the CCP Discipline Inspection Commission (DIC) and Supervision Agency has been the focus of the anti-corruption campaign after the 18th CCP National Congress in 2012 with two main pillars: administrative reform and disciplinary regulation. In particular, efforts have been devoted to optimising the organisational structure, which has led to an increase of the number of DIC and supervision divisions from 8 to 12, and the proportion of officials engaged in corruption investigations has increased by more than 50 per cent. Another aspect of the reform has been to focus on core responsibilities to prevent the distraction resulting from the participation of the DIC and Supervision Agency in other groups and committees within the government structure. In this sense, the core responsibilities of DIC and the Supervision Agency have been redefined as supervision, implementation of CCP’s discipline and accountability. Other reform measures have been strengthening management on accredited agencies, promoting the reform of the state supervision institutions, improving legal and CCP regulation systems, and enhancing supervision on the DIC and Supervision Agency.

Other stakeholders

Media

China is one of the most restrictive societies for the media and civil society organisations. Even if the constitution states that citizens enjoy freedom of speech, of the press and of association, authorities do not respect these freedoms when they conflict with the party’s interest. Imprisonment of critical journalists or
human rights activists are not rare in China. In 2015, for example, 49 journalists went to prison (Business Anti-Corruption Portal 2016).

Since Xi assumed the leadership of the CCP, there has been a trend of ideological tightening. In 2015, the government revoked the permit of the newspaper Moneyweek and shut down the website of the 21st Century Business Herald for reporting on corruption (Freedom of the Press 2016). In 2016, the government adopted new laws and regulations increasing internet censorship that further decreased the space for investigative journalism (Freedom of the Press 2017). The CCP maintain authority over published, online and broadcast content, and only state-run media outlets have government approval to cover CCP issues or sensitive topics (US Department State 2016).

Civil society
Civil society participation in policy formulation is very regulated and controlled in China, and sometimes officials use methods of harassment and intimidation against civil society advocates (Business Anti-corruption Portal 2016). Only NGO’s with non-political agendas are better respected by the government. In this context, the role played by the media and civil society organisations to curb corruption is considerably reduced and challenging.

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