Corruption and Human Capital: Evidence from China
Justin Jihao Hong
Boston University (ASSA 2023)

Abstract

Motivation
- Theories: corruption disincentivizes productive activities and distorts talent allocation (Baumol, 1967; 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., Oliner, 2006; Femia 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; Ferman et al., 2018)

Anti-corruption Visits (2013-)
- Apart from consolidating power, a sharp attempt to reduce corruption (Francois et al., 2020; Lorenzten 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

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 externabilities (Krueger, 1974)
- Chinese Economy: the state sector dominates
- Key traits: ability + public service motivations/integrity (Becker and Stigler, 1974; Dal Bo et al., 2017, Beley 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
  - SOE applicants: honesty score from the personality test (automatically by the system, using psychological techniques to indirectly measure)

Data: child-parent panel

<table>
<thead>
<tr>
<th>Occupation</th>
<th>Dep. var.</th>
<th>ability</th>
<th>integrity</th>
</tr>
</thead>
<tbody>
<tr>
<td>public sector jobs</td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Obs.</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Mean of dep. var</td>
<td>0.352</td>
<td>0.352</td>
<td>0.352</td>
</tr>
<tr>
<td>Mean of ability</td>
<td>0.014</td>
<td>0.014</td>
<td>0.014</td>
</tr>
<tr>
<td>Mean of integrity</td>
<td>(0.019)</td>
<td>(0.019)</td>
<td>(0.019)</td>
</tr>
<tr>
<td>Robustness: Correlation</td>
<td>0.343</td>
<td>0.343</td>
<td>0.343</td>
</tr>
</tbody>
</table>


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-sector 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

Contact
Justin Jihao Hong
Boston University
Email: hjihao@bu.edu
Website: www.hjihao.org/research

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).