The Robber Barons of Beijing

Can China Survive Its Gilded Age?

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It seemed like a typical story of Chinese corruption. Stuffing suitcases full of company shares, the businessman lavished bribes on influential officials in exchange for cheap loans to subsidize his railroad projects. The target of his largess, those in charge of public infrastructure and budgets, were his friends and business associates. Their family members ran firms in the steel industry, which stood to benefit from the construction of new track. Over time, as the ties between the officials and the businessman grew closer, the officials doubled their financial support for his ventures, indulging his inflated costs and ignoring the risk of losses. Slowly but surely, however, a financial crisis brewed.

Stories like this are endemic to China: business leaders colluding with officials to exploit development projects for personal enrichment, graft infecting all levels of government, and politicians encouraging capitalists to take on outsize risks. No wonder some observers have insisted since the 1990s that the Chinese economy will soon collapse under the weight of its own excesses, and bring down the regime with it. But here's the twist: the businessman is not Chinese but American, and the tale took place in the United States, not China. It describes Leland Stanford, a nineteenth-century railroad tycoon who helped catapult the United States' modernization but whose path to immense fortune was paved with corrupt deals.

The Gilded Age, which began in the 1870s, was an era of crony capitalism as well as extraordinary growth and transformation. Following the devastation of the Civil War, the United States rebuilt and boomed. Millions of farmers moved from fields to factories, infrastructure opened up long-distance commerce, new technology spawned new industries, and unregulated capital flowed freely. In the process, swashbuckling entrepreneurs who seized on the right opportunities at the right time—Stanford, J. P. Morgan, John D. Rockefeller—amassed titanic levels of wealth, while a new working class earned only a pittance in wages. Politicians colluded with tycoons, and speculators manipulated markets. Yet instead of leading to disintegration, the corruption of the Gilded Age ushered in a wave of economic, social, and political reforms—the Progressive era. This, along with imperial acquisitions, paved the way for the United States to rise and become the superpower of the twentieth century.

China is now in the midst of its own Gilded Age. Private entrepreneurs are growing fabulously wealthy from special access to government privileges, as are the officials who illicitly grant them. Recognizing the dangers of crony capitalism, Chinese President Xi Jinping is attempting to summon China's own Progressive era—an age of less corrup-

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tion and more equality—through brute force. The problem, however, is that this is not the way to ensure that real reform takes hold. Xi is suppressing the bottom-up energy that holds the key to solving China's current woes—and in so doing, he may end up making them even worse.

CATEGORY ERROR

For students of corruption, China poses a baffling puzzle. Normally, corrupt countries are poor and stay that way. Study after study has shown a strong statistical relationship between corruption and poverty. But China has managed to sustain four decades of economic growth despite levels of corruption that even Xi has described as "grave" and "shocking." Why does it seem to have bucked the trend?

The answer lies in the type of corruption that prevails in China. Conventional metrics of corruption ignore the different varieties it comes in. The most popular metric, the Corruption Perceptions Index, released by Transparency International every year, measures corruption as a one-dimensional problem that ranges on a universal scale from zero to 100. In 2020, China scored 42, ranking it as more corrupt than Cuba, Namibia, and South Africa. Conversely, high-income democracies consistently rank among the cleanest countries in the world, reinforcing the popular belief that corruption is a malaise that is exclusive to poor countries.

Although appealing in its simplicity, this conception of corruption is misleading. In reality, corruption comes in distinct flavors, each exerting different social and economic harms. The public is familiar with three main types. The first is petty theft: police officers shaking down people on the street, for example. The second is grand theft: national elites siphoning off massive sums from public treasuries into private accounts overseas. The third is speed money: petty bribes paid to regular officials to bypass red tape and delays and grease the wheels of bureaucracy. All three types are illegal, vociferously condemned, and rampant in poor countries.

But corruption comes in another, more elusive variety: access money. In this kind of transaction, capitalists offer high-stakes rewards to powerful officials in exchange not just for speed but also for access to exclusive, lucrative privileges, including cheap credit, land grants, monopoly rights, procurement contracts, tax breaks, and the like. Access money can manifest in illegal forms, such as massive bribes and kickbacks, but it also exists in perfectly legal forms. Take lobbying, which is a legitimate means of political representation in the United States and other democracies. In exchange for influence over laws and policy, powerful groups fund political campaigns and promise politicians plush positions after they leave office.

Different types of corruption harm countries in different ways. Petty theft and grand theft are like toxic drugs; they directly and unambiguously hurt the economy by draining public and private wealth while delivering no benefits in return. Speed money is akin to painkillers; it may relieve a headache but doesn't improve one's strength. Access money, on the other hand, is like steroids. It spurs muscle growth and allows one to perform superhuman feats, but it comes with serious side effects, including the possibility of a complete meltdown.

Once one unbundles corruption, the Chinese paradox ceases to look so baffling. Over the past four decades, corruption in China has undergone a structural evolution, moving away from thuggery and theft and toward access money. By rewarding politicians who serve capitalist interests and enriching capitalists who pay for privileges, this now dominant form of corruption has stimulated commerce, construction, and investment, all of which contribute to GDP growth. But it has also exacerbated inequality and bred systemic risks. Bank loans, for example, go disproportionately to politically connected companies, forcing cash-strapped entrepreneurs to borrow from shadow banks at usurious rates. Connected companies, flush with excess credit, can then afford to spend irresponsibly and speculate in real estate. Furthermore, because politicians personally benefit from the investments they bring into their jurisdictions, they are driven to borrow and build feverishly, regardless of whether the projects are sustainable. As a result, the Chinese economy is not just a high-growth economy but also a high-risk and out-of-balance economy.

THE EVOLUTION OF CORRUPTION

This dramatic evolution of corruption and capitalism began with Deng Xiaoping, who steered China in a new direction after three decades of disaster under Mao Zedong. Without explicitly saying so, Deng introduced a new religion: pragmatism. He recognized that simultaneous political and economic liberalization would be too destabilizing for China. For a nation shaken by chaos, he said in a historic 1978 speech, "stability and unity are of prime importance."

Thus, Deng chose the path of partial economic liberalization. Instead of leaping straight into capitalism, he introduced market reforms on the margins of the planned economy and delegated authority to local governments. In doing so, he laid the ground rules for profit sharing within the bureaucracy: that is, apparatchiks would personally benefit from capitalism as long as they stayed loyal to the Chinese Communist Party. No wonder officials at all levels enthusiastically embraced market reforms. As the reforms got underway, many officials doubled as surrogate entrepreneurs—operating collective enterprises, recruiting investors through personal networks, and running businesses on the side.

But as markets opened up beginning in the 1980s, corruption flourished. It came in forms that were particular to a still backward country with a mixed economy and a government with little capacity to monitor millions of bureaucrats. Local governments, for example, held what were called "small treasuries," slush funds filled with the unauthorized fees, fines, and levies extracted from residents and businesses. Because central regulators exerted scant oversight over local budgets, embezzlement proliferated. So did petty bribery, as the emerging class of private entrepreneurs was forced to pay local bureaucrats to overcome red tape. Even giant multinational corporations such as McDonald's were not spared; at one point, local agencies slapped its restaurants in Beijing with 31 fees, most of them illegal. In the countryside, such corruption led to widespread complaints about the burdens shouldered by farmers, sparking protests across rural China.

Then came the Tiananmen Square crackdown of 1989, which struck a devastating blow to the reform movement. At that point, China could have easily reverted to Maoism. Instead, Deng rekindled the flames of capitalism through his famous "southern tour" in 1992, before passing the baton to his successor, Jiang Zemin. The new leadership took Deng's partial market reforms in the 1980s to the next level. Beijing's pledge to establish "a socialist market economy" may have rung hollow to many Western ears, but it soon unleashed an institutional revolution.

In some ways, this post-Deng period can be likened to the United States' Progressive era. Beijing dismantled key elements of central planning (for example, price controls and production quotas) and drastically reduced state ownership in the economy. From 1998 to 2004, about 60 percent of workers in state-owned enterprises were laid off. Simultaneously, the central government pursued bold reforms in banking, public administration, public finance, and regulation. These efforts laid the foundation for an accelerated phase of growth—but without formal political liberalization.

At the helm of this progressive campaign was Zhu Rongji, China's premier from 1998 to 2003. Famous for giving fiery speeches in which he berated local officials for their ineptitude, Zhu rolled out a wide range of administrative reforms. Beijing consolidated public bank accounts in order to eliminate illegal slush funds and keep a closer watch over financial transactions. It divested government agencies of their side businesses to prevent them from abusing their regulatory powers. And it replaced cash payments of fees and fines with electronic payments to prevent bureaucrats from extorting citizens or stealing from public coffers.

The reforms worked. Beginning in 2000, the number of corruption cases involving embezzlement and the misuse of public funds fell steadily. Media mentions of "arbitrary fees" and "bureaucratic extortion," an indicator of the public's concern about these issues, also declined. It was no surprise, then, that by 2011, when Transparency International asked Chinese respondents whether they had paid a bribe to access public services in the past year, only nine percent said they had, compared with 54 percent of Indians and 84 percent of Cambodians. In China, at least in the more developed coastal areas, the growth-impeding forms of corruption had finally come under control.

PAY TO PLAY

Access money, however, exploded. After 2000, the number of bribery cases soared, and they involved ever-larger sums of money and officials of ever more seniority. Newspapers ran front-page stories on corruption scandals, replete with lurid details of decadence and greed. A former minister of railways was charged with taking \$140 million in bribes, not including the more than 350 apartments he had been given. The head of one state-owned lender allegedly kept a harem with over 100 mistresses and was arrested with three tons of cash hidden in his home. A police chief in Chongqing amassed a private museum collection that included precious works of art and fossilized dinosaur eggs.

Why did access money explode? Because the reforms China took did not diminish the government's power over the economy so much as change it. Whereas in the 1980s, the primary role of public officials was to plan and command, in the globalized capitalist economy of the 1990s, they acquired new functions—attracting high-stakes investment projects, borrowing and lending capital, leasing land, demolishing and building at a frenzied pace. All these activities gave officials new sources of power that were previously unthinkable in a socialist system.

The change can be traced to a seemingly obscure problem: a fiscal imbalance between the central government and local governments. In 1994, as part of their modernizing drive, Jiang and Zhu recentralized tax revenue, keeping the lion's share in Beijing and drastically reducing the fraction kept by localities. The local governments were left financially strapped even as they faced continued pressure to promote growth and deliver public services. So an alternative source of income was found: land. All land in China belongs to the state and thus cannot be sold, but the right to use it can be leased. Beijing allowed local governments to lease those rights to corporate entities in order to raise revenue.

From that point onward, China's army of local officials marched away from industrialization and toward urbanization. Instead of relying on manufacturing as the primary engine of growth, local governments turned their attention to leasing agricultural land to real estate developers for residential and commercial use. In the two decades after 1999, the amount of revenue raised through the leasing of land rights grew more than 120-fold. Developers profited handsomely from this arrangement, collecting exorbitant rents after leasing farmland at bargain prices and turning it into glitzy real estate projects. In one instance related to me by a bureaucrat, the value of a piece of land increased by a multiple of 35 simply through being converted from rural to urban use.

The local officials who controlled land rights also did well for themselves, accepting hefty kickbacks for aiding their cronies in securing prized parcels. They helped developers rig auctions to buy land plots cheaply, and they deployed the power of the state to artificially speed up the process of urbanization. Local functionaries packed farmers into suburban apartments to free up rural land, and they invested heavily in urban infrastructure, such as electric grids, public utilities, parks, and transportation, to increase the value of new developments.

All this new infrastructure was funded not only through the sale of land rights but also through loans. The law prohibited local governments from running budget deficits, but officials got around that rule by setting up subsidiary companies known as "government financing vehicles." These entities took out loans to raise money, which the officials then used to finance their pet infrastructure and construction projects.

It was this twin source of credit—leasing land and borrowing money—that financed China's massive infrastructure boom. Between 2007 and 2017, the country more than doubled the length of its highways, from 34,000 miles to 81,000 miles—"enough to go around the world more than three times," a government website boasted. The construction of subways was just as frenzied. China now boasts eight of the world's 12 longest subway systems.

Although it turbocharged China's urbanization, the infrastructure boom generated new risks. Local governments and their financing vehicles accumulated mounting debts. Even central regulators did not know the scale of these liabilities until 2011, when they conducted their first audit, which found that local governments had borrowed about $1.7 trillion. Despite repeated edicts from Beijing against borrowing, local debts continued to rise, reaching $4 trillion in 2020, nearly equivalent to the total income local governments earned that year. This is the bubble that so many fear could burst.

To understand the marriage of growth and corruption, consider the case of an official named Ji Jianye. In 2004, Ji became the party secretary of Yangzhou. Repositioning the city as a historic tourist site, he launched a massive demolition and construction campaign that earned him the nickname "Bulldozer Ji." These efforts paid off: the media hailed Ji for reviving the city, the United Nations recognized his city with an award, tourism flourished, and the price of luxury real estate skyrocketed. In 2010, Ji was transferred to a more prominent post: mayor of Nanjing, a provincial capital.

But as investigators would later discover, Ji was sharing directly in the profits of his ambitious urban redevelopment schemes. Like other Chinese bureaucrats, his official salary was very low; his real compensation came from corporate contributions. In a city undergoing a massive reconstruction, Ji directed nearly all the government contracts to a private construction company named Gold Mantis, owned by his longtime friends, which repaid him in the form of kickbacks. During Ji's tenure in Yangzhou, the company's profits grew 15-fold in just six years, and when the company subsequently went public, Ji received a percentage of the shares.

Stories such as Ji's suggest that portrayals of the Chinese state as predatory or rapacious miss the true nature of its crony capitalism. Ji lined his own pockets, but he also successfully transformed Yangzhou. In recent decades, there have been many officials like him, leaders who are corrupt yet also deliver commerce, infrastructure, and public services. Unlike politicians in other countries who simply steal from the public or put obstacles in the way of entrepreneurs, these officials collect bribes by making it easier, not harder, for capitalists to do business.

None of this is to say that access money is good for the economy. To the contrary, like steroids, it causes unbalanced, artificial growth. Owing to Chinese officials' power over land, collusion between businesses and the state has funneled excessive investment into one particular sector—real estate, which offers unmatched windfalls for the politically connected. As a result, Chinese businesses face perverse incentives to shift their efforts away from productive activities, especially manufacturing, and toward speculative investment. Some state-owned railway companies and defense contractors, for example, now find their real estate investment activities to be more profitable than their core businesses. Beijing recognizes the threat such a shift poses: in 2017, it issued a warning against "abandoning productive for speculative activities."

Access money also exacerbates inequality. Within the business world, politically connected capitalists can easily secure government contracts, cheap loans, and discounted land, giving them an enormous edge over their competitors. In society at large, the superrich snap up luxury apartments as investment properties, while urban housing remains out of reach for many ordinary Chinese. The result is a perverse situation in which the minority of Chinese people who own homes often do not live in them and the majority who need homes cannot afford them.

ENTER XI

In 2012, Xi took on the mantle of leadership under ominous circumstances. The party was facing its biggest political scandal in a generation: Bo Xilai, a Politburo member once seen as a contender for the top position, had been dismissed from his posts and would soon be arrested on charges of graft and abuse of power. This wasn't just any corruption scandal. Bo, the son of a prominent Chinese Communist Party leader, was also implicated in the murder of a British businessman, and he was rumored to have been plotting a coup against Xi.

This dramatic episode surely helped form Xi's worldview, imprinting in him a deep sense of insecurity not only about the party's future but also about his own survival. For Xi, Bo's brazenness revealed that access money in a supersized economy had created elite factions far more powerful than those any previous leader had had to contend with. And for the Chinese public, Bo's downfall offered a rare peek into the world of state-business collusion and the lavish lifestyles of the political elite.

It was now clear that China was rife with corruption, inequality, moral decay, and financial risk. Since Deng's reforms began, the party had successfully lifted an estimated 850 million people out of poverty by dint of sustained economic growth, but a small minority had benefited disproportionately, particularly those lucky enough to control property. In 2012, China's Gini coefficient (a measure of income inequality, with zero representing perfect equality and one representing perfect inequality) reached 0.55, exceeding the United States' figure of 0.45. This was an especially jarring distinction for a nominally communist country. A businessman in Shanghai described the whiplash to me this way: "When I was growing up, textbooks tried to convince us about the decadence of capitalism by showing a picture of rich Americans' pets enjoying air conditioning, a luxury that few Chinese dreamed of having in those days. Today, my neighbor's dog will only drink Evian."

No wonder Xi has chosen to define his legacy by fighting two key battles: one against corruption and the other against poverty. At his maiden speech to the Politburo, Xi did not mince words about the threat that Bo's saga represented. "Corruption will doom the party and the state," he declared. Since then, he has launched the longest and widest-ranging anticorruption drive in the party's history. By 2018, a staggering 1.5 million officials had been disciplined. Unlike previous anticorruption campaigns, this one is purging not just low-level officials but also high-level ones—"flies" and "tigers," in Xi's words.

Is Xi's crackdown merely a pretext to purge his enemies or a genuine effort at reducing corruption? The answer is both. It would not be surprising if Xi has used the campaign to root out those who pose personal threats, including officials who were allegedly linked to a plot to overthrow his rule. But he has also set out to strengthen bureaucratic ethics—

for example, issuing a list of eight regulations prohibiting "extravagance and undesirable work practices," such as drinking on the job. His campaign has also been remarkably thorough, extending beyond public offices into state-owned companies, universities, and even official media outlets. An abrupt drop in the sale of luxury goods after the campaign began suggests a temporary restraint in bribery and conspicuous consumption. But Chinese citizens' perceptions have been mixed. While many are impressed by the forceful crackdown, others are disillusioned by the grotesque details of greed that the corruption investigations have revealed. Moreover, the campaign may not be doing much about inequality. According to Chinese government statistics, although the country's Gini coefficient fell continuously from the year Xi took office to 2015, it has since picked up again.

It is too soon to say whether Xi's campaign has substantially reduced the prevalence of access money. But two things are clear. First, Xi's forceful campaign has placed officials on high alert. My analysis of a cohort of 331 city party bosses found that 16 percent of them were removed for corruption between 2012 and 2017, a high rate of turnover that should give local leaders good reason to put their corruption on hold. Second, the only significant predictor of whether officials survived the crackdown was whether their patron—the official who oversaw their appointment—also survived. Performance didn't matter, suggesting that under Xi, the political system has become more personalist than rules-based. In short, Xi's campaign has had a mixed record. It has successfully struck fear into corrupt officials, but it has not removed the root causes of graft—namely, the enormous power of the government over the economy and the patronage system in the bureaucracy.

THE ROAD NOT TAKEN

China does not exist in a vacuum, of course. Across the Pacific, its chief rival is also experiencing a repeat of the Gilded Age. This time, the new technology the United States is grappling with is not steam power but algorithms, digital platforms, and financial innovations. Like China, the United States is beset by sharp inequality. Its government, too, fears the populist backlash from the losers of globalization, and the country is similarly struggling to reconcile the tensions between capitalism and its political system. In that sense, the world is witnessing a curious form of great-power competition today: not a clash of civilizations but a clash of two Gilded Ages. Both China and the United States are struggling to end the excesses of crony capitalism.

But the two countries are pursuing this goal very differently. Transparency mandates, muckraking journalists, and crusading prosecutors were central ingredients in the United States' battle against graft during the Progressive era; today, President Joe Biden's progressive agenda rests on restoring the integrity of democracy. Xi, on the other hand, has opted to stamp out inequality and corruption by tightening political control.

Xi's pledge to eradicate rural poverty, for instance, has been carried out in the manner of a national campaign. Central planners have imposed hard targets on local officials, and the entire bureaucracy, even the entire society, has been mobilized to meet them, regardless of what it takes. Although the cause is noble, the methods are extreme. Edicts from the top pressure local officials to eliminate poverty by fiat—by relocating millions of residents from remote areas to suburbs, for example, regardless of whether they want to move. Some of the uprooted now have neither farmland nor jobs.

The crusade against corruption is similarly top-down. In addition to arresting large numbers of corrupt bureaucrats, Xi has exhorted officials to demonstrate loyalty and adhere to party ideology. These measures have resulted in bureaucratic inaction and paralysis—"lazy governance," as the Chinese say—with nervous officials opting to do nothing, so as to avoid blame, instead of introducing potentially controversial initiatives. Xi's insistence on political correctness also extinguishes honest feedback within the bureaucracy. Officials' fear of reporting bad news, for instance, may have contributed to the delay in China's early response to the COVID-19 outbreak.

It didn't have to be this way. China could have taken a different path in its quest to control corruption. Before Xi, in fact, the country was making steady progress toward open governance. Some local governments were increasing transparency and starting to solicit public input on policies. Despite the constraints of censorship, investigative newspapers such as *Caixin* and *Southern Weekend* regularly uncovered scandals that prompted reforms. Several localities experimented with reporting the assets and income of government officials, a move supported by legal activists; in 2012, central regulators considered turning these experiments into national law. As soon as Xi's anticorruption campaign began, however, these bottom-up efforts were snuffed out, and the government tightened its control over civil society.

In many ways, Xi's centralization of personal power has put him in an exceptional position to challenge vested interests and advance difficult reforms. He could reduce monopoly control of state-owned enterprises and empower private companies, which, as of 2017, accounted for more than 90 percent of new jobs created. A strong private sector would accelerate the type of broad-based growth that reduces inequality. Or Xi could correct the fiscal imbalance between the central government and local governments, so that the latter are not forced to lease land and borrow money to raise revenue. He could also streamline the ballooning demands imposed by central planners on local governments, a move that would both reduce their need to exercise regulatory power and relieve their budgetary pressures.

Yet Xi has shown little interest in such reforms. Instead, in his bid to end crony capitalism, he is reviving the command system, the very approach that failed miserably under Mao. After successfully controlling the COVID-19 outbreak, he appears more convinced than ever that national mobilization and top-down orders under his strongman leadership are the only path forward. But by rejecting a bottom-up approach, Xi is stifling China's adaptability and entrepreneurship—the very qualities that helped the country navigate its way through so many obstacles over the years. "It's like riding a bike," an official once told me. "The tighter you grip the handles, the harder it is to balance."