

Regulation and Corruption in China

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Abstract

It is widely accepted in the growth literature that bad institutions and corruption are both bad for growth. However, in many Southeast Asia countries include China, their legal and financial systems are not well developed, their corruption levels are high, yet they are of the fastest growing economies. This forms a puzzle.

This paper looks at the interaction between corruption and regulations, reveals a mechanism that sometimes corruption can actually keep those bad policies from being fully implemented and thus support growth. That is, corruption is a way to escape bad regulations; it enables people to break the status quo at the time when institutions are bad. This kind of corruption is not as any hindrance to the economy, but as convenient device for overcoming regulatory hurdles that distort incentives and opportunities. Although China has many bad laws and regulations, which are bad for growth, China also has high level of corruption, which has offset the bad effects of these laws and regulations and made those bad laws less harmful for growth. In this sense, there is good corruption that actually supports growth. This solves the puzzle.

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