

Leniency, Asymmetric Punishment and Corruption: Evidence from China

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Since coming into office two years ago, Chinese President Xi Jinping has carried out a sweeping, highly publicized anticorruption campaign. Skeptics are debating whether the campaign is biased towards Mr. Xi's rivals, and even possibly related to the current economic slowdown. What is less debated is the next stage of Mr. Xi's anti-corruption strategy, which is going to alter the legal statutes. Amendment IX, proposed in October 2014, includes heavier penalties, but two important tools in the fight of corruption – one-sided leniency and asymmetric punishment – became more limited and discretionary. We argue that studying a 1997 reform and its effects can shed some light onto why the Chinese leadership seems dissatisfied with the current legislation and the likely effects of the proposed changes.

What We Know about Leniency

In our context, leniency can be defined as the concession of reduced sanctions (or full immunity) to wrongdoers that cooperate by self-reporting and providing information against former partners in crime. Formal and informal exchanges of leniency against information and collaboration are normal features of law enforcement in most countries. Policies of this kind have been extensively and quite successfully used to fight the Italian and American mafias, drug dealing and other organized crimes, and have become the main instrument to fight collusion in antitrust since the US reform in 1993 (see Spagnolo, 2008).

For crimes in which multiple offenders cooperate, one-sided leniency conditional on being the first to self-report can be a very powerful tool of law enforcement: by playing the partners in crime against each other, it may elicit information, greatly facilitate prosecution and generate deterrence at a very low cost. A conspicuous scientific literature

with theoretical, experimental and empirical contributions shows the great potential of these policies, when properly designed and administered, for deterring collusive crimes (Miller 2009; Spagnolo 2008; Bigoni et al. 2012, 2015). On the other hand, Buccirossi and Spagnolo (2006) show specifically for the case of corruption that, when poorly designed or administered, these same policies may become ineffective or even counterproductive.

Asymmetric Punishment

A related way of using leniency towards one party (to play it against the other) in the fight against corruption has been at the center of a recent intense policy debate after the popular note “*Why, for a Class of Bribes, the Act of Giving a Bribe Should Be Treated as Legal*”, by Kaushik Basu (2011). Then chief economist of the Indian government and now of the World Bank, Basu advocated asymmetric depenalization of bribe giving, which can be thought of as a form of unconditional, one-sided leniency. More

precisely, the note proposed to legalize bribe giving in the form of *harassment* bribes (also called extortionary, or discharge-of-duty bribes) paid to obtain something one is entitled to, while strengthening sanctions against bribe taking. As with other forms of leniency, the idea is to create a conflict of interests between the partners in crime by increasing the temptation for one party to betray and report the illegal act, leading to a severe punishment of the other.

In the debate sparked by this note many different arguments have been put forward, both against it and in favor of it. Dufwenberg and Spagnolo (2015) discuss formally some of the issues raised by critics of the proposal, while Abbink et al. (2014) provide (mixed) experimental evidence on its effectiveness. Later, a blogpost by a Chinese law scholar, Li (2012), attracted our attention to the case of China, where asymmetric punishment (bribe-giver impunity) has been in place since 1997. She argued, probably reflecting the political debate in the country rather than based on factual evidence, that the system had not been successful. We felt this claim granted a deeper investigation into the details of the Chinese legal reform and the changes it introduced, and of course a careful inspection of the data to back it.

A Study in Red

In a new working paper, Perrotta Berlin and Spagnolo (2015), we set out to understand the evolution of the anti-corruption legislation in China over the last decades, and then to evaluate the effects of the policy changes occurring in 1997. Two new elements were given the strongest legal status in 1997: leniency for wrongdoers that self-reported and cooperated with investigators, and asymmetric punishment (no charge for bribe givers) for bribes paid to obtain something one was entitled to. Concurrently, penalties were decreased, in particular for bribe-takers.

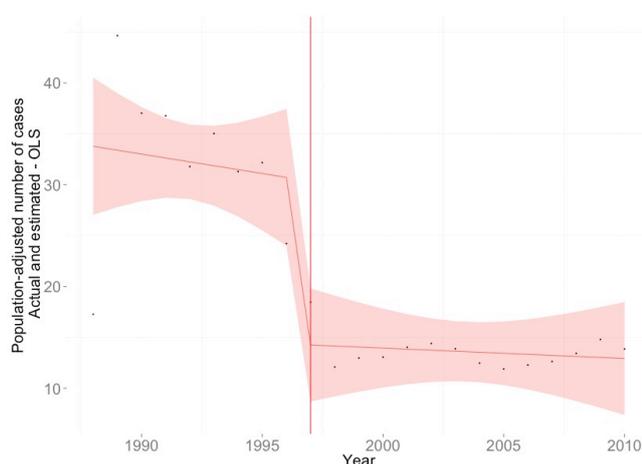
To understand the likely effects of this policy change we would ideally look at correspondent changes in corrupt transactions. Data on the prevalence of bribery, however, are notoriously hard to come by because of the secretive nature of this activity. Instead, we use several data sources which capture on the one hand actual corruption cases tried in courts, and on the other hand surveys of corruption perceptions. In particular, we have collected the number of arrests and public prosecutions on the counts of corruption and bribery from the Procuratorates' Yearly Reports for each Chinese province since 1986.

It is not straightforward to infer changes in total corruption, which is unobserved, from changes in discovered cases tried in court. The data on prosecutions mix together corruption and anticorruption activities, as they fail to distinguish occurrence of the criminal activity from detection. A policy that deters crimes but at the same time increases the fraction of those that are successfully prosecuted will have an ambiguous effect on the number of prosecutions. We adapt for this purpose the testable predictions developed by Miller (2009): he models the occurrence of criminal activity (cartel formation, in this case) and derives predictions for how changes in the rate of occurrence and the rate of detection affect the time series of detection.

The preliminary evidence we have so far points to a substantial and stable reduction in the number of major corruption cases around the 1997 reform, a result consistent with a positive deterrence effect of the 1997 reform. The evidence is suggestive, and some alternative interpretations of the patterns in the data, shown in the plot below, cannot be excluded at the moment. While a peak-and-slump pattern as in Miller (2009) would have been much stronger evidence supporting the success of the reform at deterring corruption, we cannot exclude that the drop in prosecutions is simply due to a general worsening in detection. Although we deem this unlikely in the light of the general political climate of the time, we need more and better

data to support our interpretation. Still, claims that the reform did not have an effect appear not supported by the data.

Figure 1. Change in Corruption Prosecutions before and after law reform in 1997



Source: Perrotta-Berlin and Spagnolo (2015).

More to be done

A case study analysis is under way to corroborate and help the interpretation of these preliminary findings. We will analyze in depth a stratified random sample of prosecution case files between 1980 and 2010. Given that we sample a given number of cases, in this part of the analysis we cannot gain any insight about the incidence of bribery in general. We can instead observe the impact of the legislative reform on specific details of the corrupt behavior, and the mechanisms through which this behavior occurs or is deterred. In particular, we will be able to distinguish between cases of extortionary (harassment) bribes and bribes paid to obtain illegitimate benefits. Moreover, this will allow us to shed light on whether and how leniency and asymmetric punishment were applied in practice. The details of the case files might even allow us to gain insight into how the bribe-size and the value of corrupt deals evolved through the reform and even the selection into bureaucracy.

Conclusion

One-sided leniency, conditional on reporting an act first, or unconditional, as when bribe giving is depenalized, may be powerful corruption deterrence instruments if well designed and implemented in the right environment, but may also have negative effects. It has been argued that these instruments have been ineffective in China, after they were reformed in 1997, however, without data supporting the claim. Part of the reason lies in the difficulty to obtain good data on corruption. Another obstacle is the subtlety of interpreting them when they relate only to detected and convicted cases, rather than to the whole population of corruption cases.

We cannot solve completely the issue of data quality, as we also need to rely on official reports of counts of corruption cases. However limited, the exercise performed on aggregated data clearly shows that the 1997 Criminal Law reform did have an effect, consistent with increased corruption deterrence. To further support this finding we will collect and analyze micro-data from a randomized sample of these cases. This will allow us to isolate at a higher level of detail the changes in criminal behavior, reporting behavior and prosecution activity, and link them to the details of the legal reform to highlight the mechanisms at work.

China is home to a sixth of humanity, and currently undergoing a massive crackdown on corruption. Whatever we can learn about the effectiveness of their past and present anti-corruption policies is likely to have considerable welfare effects. Moreover, the 1997 reform was the object of a policy debate, and comments on its effectiveness came without data to support them. We believe our effort to use data to shed light on what this reform actually changed will be a valuable input to further research and policy discussion on this important topic.

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