

Evaluation of Local Leaders in China

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Properly evaluating a local leader is important not only to make sure he is the right person for a particular job, but to give him the right incentives to perform that job well. This note makes suggestions for re-designing the system of evaluation of local leaders in China.

We will begin in section 1 by describing local government's main achievements in China and also their biggest failures. In section 2, we outline the existing evaluation system for local leaders. We then turn in section 3 to some general principles for redesigning the evaluation system. Finally, in section 4, we make suggestions for specific features to include in the new evaluation system.

1. Successes and Failures of Local Government

Local governments have played a critical role in China's economic development. China is a large and diverse country, and local government has enabled national policies to adapt to local conditions, making them much more effective. Indeed, local initiatives and local experimentation have been important for the very formulation of national policy. Cross-regional policy variations have given enterprises the opportunity to find the environment that best fits their needs. Finally, encouraging competition between local governments has helped promote economic efficiency. Without these critical contributions of local government, the Chinese economy would not be what it is today.

However, there are also some serious problems associated with local government.

Local governments are eager to promote local investment and to protect the local tax basis. This fosters economic growth but implies that local firms get land and credit too cheaply. It also means that they face soft budget constraints (they are too difficult to shut down

when they fail) and that they are unduly protected from outside competition. These effects have led to productive over-capacity in some sectors, especially in steel, aluminum, cement, construction glass, and solar panels.

Local governments do not make sufficient effort to improve the general business environment. The bureaucratic red tape for getting business licenses and getting business projects approved remains burdensome for many enterprises. Private property owners are often subject to infringement of their property rights. Some businesses face arbitrary levies by the government. Enterprises are treated highly unequally by local governments, and many worry that they will not get a fair judgment or enforcement of that judgment in disputes with other parties. The 2014 World Bank Doing Business Report ranks China only 96th out of 189 countries in the quality of its business environment.

Local governments tend to be biased against consumer interests in favor of businesses. In particular, they often do a poor job of protecting the environment and ensuring food safety.

Local government spending is often allocated unwisely. There is a good deal of waste, especially in carrying out showcase projects. There is also a severe corruption problem.

All these phenomena have their origin in the existing incentive system for local leaders.

2. The Existing Incentive System for Local Leaders

According to a leading hypothesis, local leaders in China are incentivized by participating in a GDP “tournament”: a leader is promoted only if his region performs well economically relative to others.¹ This theory explains some of the salient features of the Chinese economy mentioned in section 1, including strong economic growth, pollution,² over-investment in industry and local

¹ An early theoretical analysis is offered by Maskin, Qian and Xu, “Incentives, Information, and Organizational Form,” *Review of Economic Studies*, 2000.

² Jia, “Pollution for Promotion”. UCSD Working Paper, 2014.

protectionism,³ over- investment in housing,⁴ and high levies.⁵ There is also substantial empirical work supporting it.⁶ However, the theory cannot explain all the failures described in section 1. In particular, it does not predict that local government will treat enterprises unequally or that some government officials will act corruptly. Moreover, it is somewhat at odds with recent empirical studies that suggest that a local leader's political connections may be more important for promotion than his region's economic performance,⁷ or, at least, that economic performance matters a great deal only when a local official is politically well-connected.⁸

Accordingly, a complementary theory---based on less formal incentives---has recently been developed to supplement the GDP tournament model.⁹ In this new theory, a local official will give certain enterprises special treatment (in particular, helping them to secure cheap land or credit) when (i) the businesses of those enterprises fit his personal taste well, or (ii) those enterprises are run by local elites or politically powerful individuals outside the region, or (iii) it is especially easy for him to siphon off resources from them for his pet projects or personal gain. Some of the evidence for this complementary theory includes findings that state-owned enterprises get cheaper credit; that private firms with better political connections get bank loans more easily than others;¹⁰ that local protectionism is more severe in sectors where SOEs enjoy a bigger share;¹¹ and that only state-owned auto makers enjoy a home advantage in market share.

³ Zhou, "Incentives and Collaboration in Promotion Games and a Discussion on Local Protectionism and Repetitive Investment", *Economic Research*, 2004.

⁴ Gao, Long, and Xu, "Collective Leadership, Career Concern, and the Housing Market in China: The Role of Standing Committees", *World Bank Working Paper*. 2014.

⁵ Lu and Landry, "Show Me the Money: Interjurisdiction Political Competition and Fiscal Extraction in China", *American Political Science Review*, 2014.

⁶ For example, Li and Zhou, "Political turnover and economic performance: the incentive role of personnel control in China," *Journal of Public Economics*, 2005.

⁷ For example, Shih, Adolph, and Liu, "Getting ahead in the communist party: explaining the advancement of central committee members in China," *American Political Science Review* 2012.

⁸ Jia, Kudamatsu, and Seim, "Political Selection in China: the Complementary Roles of Connections and Performance," *Journal of European Economic Association*, 2014.

⁹ Bai, Hsieh, and Song, "Special Treatment: An Institutional Foundation of China's Economic Growth," Working Paper, University of Chicago and Tsinghua University, 2015.

¹⁰ Bai, Lu, and Tao, "Property Rights Protection and Access to Bank Loans: Evidence from Private Enterprises in China," *Economics of Transition*, 2006.

¹¹ Bai, Du, Tao, and Tong, "Local Protectionism and Regional Specialization: Evidence from China's Industries," *Journal of International Economics*, 2004.

Together, the two models of incentives account for all the successes and failures of local government depicted in section 1. They also suggest that to eliminate the failures, one must change the way that local leaders are evaluated.

3. Principles for Re-designing the Evaluation System

First, it is important that the powers and responsibilities of local leaders be clearly delineated. Such a delineation is a prerequisite for any reform of the evaluation system. It requires careful consideration of the boundaries between government and the market, between government and society, between different levels of government, and between different branches of government. A detailed discussion of the delineation, however, is beyond the scope of this note. It is heartening to note that efforts are made to publish the list of power and responsibilities of different branches of the government.

Second, the performance evaluation should be as comprehensive as possible, including aspects such as the extent to which power has been abused and the extent to which responsibilities have been fulfilled. Moreover, because no list of aspects can ever be complete (and even if it were complete, the proper weighting for different aspects would remain ambiguous), there should also be an evaluation of overall performance (which strikes a balance between short-term and long-term considerations).

Third, both subjective and objective evaluations are necessary. Subjective evaluation is required because objective measures of some aspects of performance are not readily available, and---as already mentioned--- the right emphasis to give different aspects is unclear.

Fourth, getting a range of informed people involved in making the subjective evaluations is important. In principle, different aspects of evaluation can be handled by different groups of people, but this may be administratively too complicated. It would probably be useful to experiment to see whether creating a single group for all aspects of evaluation or different groups for different aspects is more effective. Regardless of

which approach is taken, the group of evaluators should be inclusive enough to be broadly representative of the population and big enough so that the group's collective opinion cannot be easily manipulated. The group should also be independent of the leaders who are evaluated. In making this reform, one might start by giving the People's Congress and the People's Political Consultative Conference the power to evaluate performance of local leaders. The results of such evaluations could be used together with existing subjective evaluations.

Fifth, subjective evaluators need better information about local leaders' performance. They should also be allowed and encouraged to discuss such information among themselves. A first step in this direction would be to improve the transparency of the government budget. Another step would be to make the results of all objective evaluations known to the subjective evaluators. Again, this could start with the People's Congress and the People's Political Consultative Conference.

Sixth, benchmarking across regions and across time and should be considered. To understand why, note that there may be common factors affecting all regions simultaneously. These common factors are not the result of any local leader's choices, and so no leader should be held accountable for them. Regional benchmarking is a way to ensure this, just as time benchmarking is a way to avoid making leaders responsible for time-persistent factors out of their control.

Finally, one should pay particular attention to informal or hidden incentives that may limit the effectiveness of formal performance evaluation. If, for example, higher level officials interfere in local affairs, then holding local leaders accountable for outcomes is not likely to improve their performance. Similarly, allowing higher-level officials to reward or punish local leaders outside the explicit evaluation system will tend to make that system less effective.

4. Suggestions for Specific Features of Performance Evaluation

(1) Objective measures:

a) Economic performance

- i. Economic growth rate (Gross Regional Product and Gross Regional Income) ii.

Unemployment rate

- iii. Total employment
- iv. Fiscal deficit as a share of GRP
- v. Balance of debt to GRP ratio

b) Environment

- i. Energy consumption per unit of GDP
- ii. Fulfillment of emission reduction target
- iii. Air quality iv. Water quality
- v. Soil quality
- vi. Forest coverage
- vii. Urban green area

c) Resident welfare

- i. Household income growth
- ii. Poverty rate
- iii. Education expenditure as a share of local fiscal expenditure
- iv. Public health expenditure as a share of local fiscal expenditure
- v. Infant mortality rate
- vi. Public expenditure on housing as a share of local fiscal expenditure
- vii. Ratio of rental rates to per capita income
- viii. Social insurance coverage rate ix. Social insurance fee collection rate (2)

Subjective evaluation:

- a) Overall performance of the local leader
- b) Ability of the local leader
- c) Character of the local leader

- d) Diligence of the local leader
- e) State of the local economy
- f) Long term health of the local economy
- g) Quality of the local business environment (it is important to get the opinion of the business community on this)
- h) State of local ecological environment
- i) Overall level of residents' welfare
- j) Quality of education
- k) Quality of health services
- l) Quality of public transportation
- m) Quality of other public services
- n) Overall quality of regulations that safe-guard consumer benefits
- o) State of food safety
- p) Overall state of local cultural development
- q) Overall level of social harmony
- r) Overall quality of local governance
- s) Responsiveness by leadership to residents' demands