

DETERMINANTS OF CHINESE GOVERNMENT SIZE: AN EXTREME BOUNDS ANALYSIS

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From 1982 onwards, the Chinese State Council and the National People's Congress have had a standing policy of reducing the size of the public sector of the Chinese economy. The aim of this policy is to increase the share of Chinese economic activity that is conducted in the market sector. The reasoning behind this policy is that resources that are controlled by the public sector are used relatively inefficiently, impeding Chinese economic growth. Several attempts have been made to reduce the Chinese public sector since 1982. Most regard these previous efforts as having been unsuccessful. This suggests that general economic and social factors may be determining the size of the Chinese public sector. A better understanding of these factors could enable the Chinese government to implement policies that have a greater chance of success. Accordingly, this paper will study the factors associated with the size of the public sector at the level of Chinese provinces. We will use Leamer's Extreme Bounds Analysis (Leamer, 1985, 2008) to identify robust correlates with public sector size. Explanatory variables include provincial income, share of the population that is working, urbanisation, and ethnic diversity. Policy variables of particular interest include fiscal decentralisation, the "flypaper effect" (i.e., the importance of central government fiscal transfers to provinces), and the previously unexplored factor of the degree of corruption across provinces. Significance of the latter variable would give added support to the Chinese government for its current policy of reducing corruption by government officials.