Political factors in China's growth model: A theoretical model of local officials' incentives

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Local officials' incentives to extract fiscal revenue and to be promoted are commonly seen as important factors in determining China's economic growth during the past three decades. In this paper, we incorporate both fiscal and promotion incentives in a two-sector dynamic general equilibrium model to analyse how politicians' fiscal and promotion concerns change the political economy equilibrium. The results show that, under plausible assumptions, the promotion incentive has a positive effect on public goods provision and thus on economic growth. But the magnitude of the effect is limited. Only when the promotion incentive is relatively large, a promotion concerned politician can significantly outperform a selfish politician. This is because a fully rent-seeking "stationary bandit" will also deliver desirable public goods and show good economic performance if that person faces no uncertainty of political tenure. Our finding implies that the current controversy in empirical studies about the relationship between economic growth and political turnover in China can partly be explained from their failure to address the (positive) effect of fiscal extraction on economic growth.

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