

Pick a card, any card: Cloaked corruption in China

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In late 2014, the Shanghai office of the China Banking Regulatory Commission fined seven commercial banks for breaking credit card rules, including not doing due diligence in assessing credit cardholders' ability to repay loans.

Since the first credit card of global standard was issued in China in 1985, the total number of credit cardholders has climbed to 100 million, with 343 million credit cards issued worth a total credit line of 3.66 trillion yuan (\$\$799 billion).

In 2013, credit card usage in China accounted for over 50 per cent of its total retail consumption. Credit card debt outstanding for six months or more jumped by more than 70 per cent to more than 25 billion yuan, indicative of a culture of credit card slavery.

Part of the reason for the easily available credit is the lack of proper supervision in China's credit card system.

For banks, getting support from local governments is critical for their operation and growth. Local governments are an important source of deposits.

Yet, offering explicit bribes to government officials can be rather costly to bank managers, especially with the Chinese government embarking on a campaign to eliminate corruption.

Banks are, therefore, on the lookout for creative means to engage in disguised corruption without getting caught.

The lack of transparency and governance in China's credit card system makes credit cards a potentially important and viable vehicle for corruption.

It can potentially be used as an implicit bribe to government officials, with banks extending overly generous credit lines and delinquency terms to them.

To assess if indeed banks use credit cards to disguise corruption,

we studied a representative, random sample of a bank's customer accounts, covering all provinces in mainland China. It contained consumer credit card data of close to one million individuals.

We found that even with similar income and comparable demographics such as education and age, banks issued bureaucrats with credit lines that are 14 per cent higher than those they issued to non-bureaucrats.

Furthermore, this bureaucrat credit premium is almost 18 per cent greater among higher-ranked bureaucrats, showing that banks favour bureaucrats who have more power to engage in a quid pro quo ("something for something" in Latin) to help them in their operations.

Do bureaucrats justify these higher credit lines because they are more creditworthy?

Sometimes, banks have "soft" information on which they decide on a higher credit line.

We studied the subsequent credit card performance of these bureaucrats.

Rather than bureaucrat credit accounts being less risky, as would be needed to justify a credit premium, we found that these accounts are 15 per cent more likely to become delinquent. At all levels of the credit line or income, bureaucrats exhibited a higher delinquency rate than

non-bureaucrats. Hence, they are not more creditworthy.

If bureaucrats are delinquent, do they get treated differently? Following the disguised corruption argument, if banks are willing to offer extended credit lines to bureaucrats, then they may likewise offer preferential treatment by being willing to "forgive" the bad debt arising from their delinquent credit cards and reinstating the cards to active status relative to those of regular non-bureaucrat customers.

Indeed so.

Delinquent accounts of bureaucrats experienced a higher probability of gaining reinstatement than those of non-bureaucrats.

But what is interesting is that regular customers with delinquent credit cards paid off their debt quickly to avoid high interest expenses and be reinstated.

But those of bureaucrats took a longer time to be reinstated, suggesting that they most likely achieved account reinstatement by the bank writing off their credit debt.

We also observed that the more senior a bureaucrat is, the higher the reinstatement rate and the longer the reinstatement time.

Disguised corruption is not prevalent throughout China. Bureaucrats in regions which have high amounts spent on business expenses for travel and

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entertainment – expenses that are necessary to grease the machinery – received some 14 to 30 per cent more in credit line, and experienced a higher delinquency rate, higher reinstatement likelihood as well as longer time till reinstatement.

In addition, there is evidence that branches within a bank that grant more credit lines to bureaucrats are associated with higher government deposits, compared to branches within the same bank located in areas associated with lower bureaucrat credit line premium.

This is consistent with banks receiving benefits in the form of government deposits in

return for the implicit bribes they extend to bureaucrats.

Are there any losers? The regular non-bureaucrat customers appear to suffer from credit under-provision – those living in areas with a high bureaucrat credit line premium are associated with significantly lower credit lines, relative to non-bureaucrat customers in similar development areas but with a lower bureaucrat credit line premium.

Did the corruption crackdown work? It appears so.

There was less favouritism shown towards bureaucrats.

We found that bureaucrats' credit card accounts that originated during the first year post-crackdown period have smaller credit line premium over non-bureaucrats than those whose accounts were started before the crackdown. Moreover, the delinquency rate and reinstatement likelihood for existing and new bureaucrats' credit card accounts fell during the first year after the crackdown, making them no different from non-bureaucrat customers.

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