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Just put it on my tab

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11

For a long time, one of my colleagues was curious why, in mainland China, many luxury goods stores were located inside hotels. Then one day, while waiting to check out from a hotel, he overheard a few words between another guest and a member of the hotel staff.

Employee: "Sir, how would you like to handle the bills for the handbags, shoes, ties, etc?"

Guest: "Just include them in the room bill."

Not surprisingly, entertainment and travel spending is a standard category of expenses in Chinese accounting. More surprising is the magnitude of this expenditure. The World Bank surveyed such spending at 3,470 mainland businesses - in 15 cities in Liaoning province and 18 in the rest of the country. It found average entertainment and travel expenditure amounted to 20 per cent of total wages, or 2.6 per cent of sales.

Entertainment and travel can be legitimate business expenses. Big deals are struck over long lunches at fancy restaurants. Business executives do travel to scout new opportunities and meet potential clients.

But why do mainland businesses spend so much on entertainment and travel? Could businesses be using these expenses to bribe government officials?

At one time, Beijing decreed that any meal provided to government officials could not exceed four dishes. The result: record-breaking plate sizes.

Three economists - Cai Hongbin of Peking University, Fang Hanming of Yale University and Colin Xu Lixin of the World Bank - analysed the findings of the World Bank survey. They found interesting comparisons between two cities: Shenzhen; and Guiyang, capital of Guizhou province, in the relatively backward southwest.

According to the World Bank survey, average entertainment and travel expenses amounted to 1.2 per cent of sales for businesses in Shenzhen, and 5 per cent of sales for those in Guiyang. The challenge for the three economists was distinguishing the reasons for entertainment and travel spending.

The survey asked businesses in each city to report the percentage of officials they perceived to be helpful. This information was the basis for an index of official helpfulness.

The theory underlying the index is that in cities where government officials are inherently more helpful, there is less need to bribe them for protection or assistance. On the index of official helpfulness, Shenzhen was rated at 36.7 per cent, Guiyang at 22.6 per cent.

The World Bank survey also considered the taxes that businesses paid. Taxation in China is notoriously arbitrary. Even within a single city, the local government may impose different tax rates. As a percentage of sales, the average tax was lowest in Shenzhen, at 3.8 per cent, and almost three times higher in Guiyang, at 11.2 per cent. The higher the average tax, the greater the incentive for businesses to bribe officials for lower taxes.

The economists concluded that slightly over half the difference in entertainment and travel spending between Shenzhen and Guiyang was due to the latter's poorer government services and higher tax rates. They believed that 38 per cent of such spending by Guiyang businesses was directed at paying off government officials, presumably in the form of entertainment and travel expenses. It may be no wonder, then, that sharks are becoming an endangered species and China's airlines are booming.

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