

**Features, Problems and Reform of County and Township
Fiscal Administration System in China**

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Abstract

That China's counties and townships are in fiscal predicament is an acknowledged fact. This problem is largely attributed to the current multi-tier fiscal system, the county and township fiscal administration system in particular. So far, we still lack overall analytic research on the county and township fiscal administration system and the relationship between functions and powers and fiscal powers at county and township levels in the context of multi-tier fiscal system and its structure despite a sound normative framework for county and township fiscal system depends on such research. By analyzing the multi-tier fiscal system and its structure, this paper discusses the status, features, problems and causes of the county and township fiscal administration system, sorts out distribution and operation of functions and powers, expenditure responsibilities and fiscal powers across levels of government, and, from the angle of standard, puts forward some thoughts for resolving these problems. The research finds that the fiscal administration system of "supervising the lower level" and the functions and powers "mandated by higher levels" not only conflict with the internationally accepted principle of fiscal federalism, but are free from the restriction of local democratic fiscal rules and procedures, both unfavorable to the efficient operation of county and township fiscal administration system. This is why further reforms are necessary.

Keywords: People's Republic of China, Local Government, Public Policy, Public Finance, County and Township Fiscal Administration System, Tax Sharing Fiscal Administration System, Multi-Tier Fiscal System, Fiscal Federalism

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Features, Problems and Reform of County and Township Fiscal Administration System in China

1. Introduction

As is known to all, there exist big problems in China's county and township fiscal administration system. While a large number of documents to date focus on analyzing fiscal difficulties facing counties and townships,¹ interpreting relevant government policies (e.g. the rural tax and fee reform) and consequences,² and studying problems and countermeasures concerning specific operations of county and township fiscal administration system,³ there is less overall research on the system and its operation from the perspective of multi-tier fiscal system. Further less empirical analyses has been done on functions and powers, fiscal powers and expenditure responsibilities,⁴ although a sound normative framework depends on this type of research. The county and township fiscal administration system is in direct connection with a series of issues,

¹ E.g. *Overcoming Difficulties in Public Finance at County & Township Level and Innovation in Fiscal System*, by Jia Kang, Bai Jingming, *Economic Research Journal*, Issue 2, 2002; *Analysis on Rural Taxation, Government Regulation and Fiscal Reform*, by Tao Ran, Liu Mingxing, Zhang Qi, *Economic Research Journal*, Issue 4, 2003; *Rural Public Finance Issues*, by Zhejiang Rural Finance Research Associates, Zhejiang University Press in Hangzhou, 2006.

² E.g. *Rural Tax Reformation in China*, by He Kaiyin, Sun Li, China Zhi Gong Press in Beijing, 2000; *The Public Finance System in China: Theory, Policy and Empirical research*, by Chen Xiwen, China Development Press in Beijing, 2005.

³ E.g. *County and Township Level Fiscal Expenditure System: Reform and Countermeasures*, by Zhou Yean, published on *Management World (Monthly)*, Issue 5, 2000. *A Preliminary Exploration on Township Finance and Reform—Investigation on Hong Town*, by Wu Licai and Li Zhilan, published on *China Rural Survey*, Issue 4, 2003.

⁴ The multi-level fiscal system viewpoint mainly focused on the central and provincial government, incidentally took into account the municipal government's financial administration system, and neglected deep analysis of county and township fiscal issues in the multi-level fiscal framework. Such as *Deployment of Public Services Administrative and Financial Power in All Levels of Government*, by Song Li, Liu Shujie, China Planning Press in Beijing, 2005. Many comments and perceptions of the county and township fiscal system and its operational issues included the multi-level fiscal system viewpoint, but these comments and perceptions do not constitute research literature. A few financial research literature focused on multi-level financial system analysis, such as *China's rural financial theory and practice*, by Zhu Gang, Jia Kang, etc., Shanxi Economic Press in Taiyuan, 2006, and *2007 China's Financial Development Report—Reformation and Prospects of China's Fiscal Level-management System*, by the Finance and Public Policy Research Center of Shanghai University of Finance and Economics, Shanghai University of Finance and Economics Press in Shanghai, 2007. Zhu Gang and his team's research has made good comparative analysis for the county and township financial system cases, but its focus are not on the division of functions and powers, revenue powers and expenditure responsibilities in multi-level government. As an important conclusion, the book emphasizes that establishment of rural public choice mechanisms and the rural grass-roots democracy is very important for strengthening financial constraints to counties and townships. In addition, many data in the book are as of 2002, but there have been many changes in China's county and township fiscal system since then. For the research report made by Finance and Public Policy Research Center of Shanghai University of Finance and Economics, it almost did not involve problems related to county and township fiscal management system, while focused on the multi-level fiscal system.

including higher-level administration of county and township finance, county-level administration of township finance, respective fiscal administration systems of counties and townships, fiscal revenue and expenditure of counties and townships, transfer payment from higher levels to the township, allocation of functions and powers, expenditure responsibilities and revenues powers across levels of government. Starting from analysis of multi-tier fiscal system and intergovernmental relations, this paper discusses problems existing in the county and township fiscal administration system. First, it examines the status, features, problems and causes of higher-level administration of the county and township fiscal system, and dissects the allocation and operation of functions and powers, expenditure responsibilities and right to revenue across levels of government; then, from the angle of standard, it puts forward some thoughts for resolving the problems existing in the county and township fiscal administration system.

2. Features, Problems and Causes of the County Fiscal System in China

The higher-level administration system of county finance in China mainly involves a hierarchy of administration, distribution of revenue, division of functions and powers regarding expenditure responsibilities, and the fiscal transfer payment system. The tax sharing system, either central-provincial or provincial/prefectural-county, emerges in the form of decentralization on the premise of a centralized administrative system.

As a whole, China is a unitary state that pursues the fiscal administration system of “supervising the lower level.” There are two levels of government that administer county finance—the provincial level and the prefectural/municipal level. The model in which the provincial-level government directly administers county finance is called the system of “province supervising county” (or “province directly supervising county”), and the model in which the prefectural/municipal-level government administers county finance is called the system of “city supervising county.”

In sum, the basic features of China’s county fiscal administration system include the following points: a) The allocation of budgetary revenue is carried out by means of the administration instead of legislation. b) Higher-level and county governments are playing games in terms of revenue assignment. While higher levels dominate the allocation of budgetary revenue, counties take strategic countermeasures by taking advantage of the autonomy they have to a certain extent to pursue other revenues (extra-budgetary revenue, land transfer income, etc), or by highlighting fiscal difficulty to acquire general or special transfers from higher levels and to create favorable conditions for next-round bargaining of revenue assignment. c) Following the beaten path, division of expenditure responsibilities at all levels is unclear, making higher levels arbitrary in changing and shifting expenditure responsibilities. d) The design of the current tax sharing

system for administration of county finance does not effectively consider, and thus fails to meet, the preferences and requirements of county governments and residents.

2.1 The Fiscal Administration System Reform Featuring “Province supervising county” and “County Strengthening and Power Expansion”

The 1994 reform of tax sharing fiscal administration system, implemented in light of the Decision of the State Council on Implementing the Tax Sharing Administration System (No. 85 [1993], promulgated by the State Council, hereinafter referred to as “Decision”) defined central-provincial fiscal relations. Without specific provisions on sub-provincial fiscal administration systems, the Decision provided in general terms that provinces should formulate systems for fiscal administration of cities and counties within their jurisdictions in accordance with the Decision.⁵ In response to it, provinces have carried out reform of sub-provincial fiscal administration systems since 1994. At the outset of reform and opening up, most provinces adopted the principle of “supervising the lower level” and established a vertical fiscal administration system, following the hierarchy from “province supervising city” to “city supervising county,” except that Zhejiang province stuck to the old system of “province supervising county.” Thus in specific operations after 1994, which level administered county finance differentiated two major county fiscal administration systems: one was direct provincial oversight of county finance, called the “province supervising county” system; the other was municipal oversight of county finance, called the “city supervising county” system. With the promulgation of the No. 1 Document by the central government in 2009, many counties and cities pushed forward the fiscal system reform of “province directly supervising county (city)” and the similar pilot reform of “county strengthening and power expansion.”⁶

⁵ The “provincial power,” despite a division of power under the centralized system, is conducive to local diversity of fiscal administration system. The existence of “provincial power” makes some scholars regard China’s fiscal system as “quasi-fiscal federalism” or “quasi-federalism.” See Krug, B., Zhu, Z. and Hendrichske, H. (2004). China S Emerging Tax Regime: Devolution, Fiscal Federalism, or Tax Farming? ERIM Report Series Reference No. ERS-2004-113-ORG, and Zheng, Y. (2007). De facto federalism in China: Reforms and dynamics of central-local relations. Series on contemporary China. Vol. 7. Hackensack, N.J.: World Scientific.

⁶ See *Yiwu’s Power Expansion: Exploring New Road for “Province Governing County,”* by Hu Zuohua and Fu Piyi, published on *Economic Information Daily*, 21/12/2006. As introduced by Zhuo Yongliang, Zhejiang applies the fiscal system of province directly supervising county; as of organizational structure, it conducts direct supervision on county and city principals. Zhejiang’s “province supervising county” fiscal system can date back to 1953 when it generally established city and county level fiscal system under the center’s decision of cancelling prefectural-level finance and establishing county (city) level finance. While some provinces changed original “province supervising county” into “prefecture (city) supervising county” fiscal system, Zhejiang province, based on its own needs of development, persisted in “province supervising county” except in late period of Cultural Revolution. In 1982, the center decided to carry out the administrative system of “city supervising county” in an all-around way; Zhejiang consequently engaged in the work of “abolishing prefectural-level and establishing municipal-level governments.” By taking into comprehensive consideration the strong voice from cities for administering county finances, the active implementation of “city supervising county” fiscal system in other provinces, and worries from counties that “city leading county” may turn into “city exploiting county,” the provincial government decided to persist in the original “province supervising county” system, and optimized it several times. See Zhuo Yongliang, *The Zhejiang Case of “Province Supervising County” Reform*, published on

The “province supervising county” system involves direct provincial allocation to counties of fiscal revenue and expenditure and budgetary funds, direct arrangement of yearend settlement, and direct linkage between county finance and provincial finance, which is similar to the municipal-provincial fiscal linkage. The “city supervising county” system, in contrast, requires putting counties (cities) within the same economic district under the administration, including fiscal administration, of a central city which is therefore turned into a first-class local authority under direct provincial leadership. The fiscal system of “province supervising county” has remained in effect since the founding of new China until the implementation of tax sharing system in 1994; since then, this model was replaced with the system of “province supervising city, city supervising county,” with the exception of Zhejiang province, which stuck to the old “province supervising county” model.

The fiscal administration system of “province supervising city, city supervising county” was gradually put into place at each level from 1994, with a view to breaking administrative barriers and urban-rural disconnection, making central cities economic engines to drive the development of surrounding counties. Accordingly, the merit of “city supervising county” system was that some economically strong prefectural cities as a higher level of administration could drive the economic growth of surrounding counties to a certain degree by, for example, providing transfer payment that may exceed the share of fiscal revenue to be turned over by surrounding counties. Nonetheless, the “city supervising county” model added a tier to the intergovernmental fiscal hierarchy. The more levels, the more institutional constraints county and township governments suffered. In many areas, the proceeding of “city supervising county” system was not in smooth waters: a) administrative efficiency fell off due to increased government levels. b) The “city supervising county” system allowed most prefectural cities to share county fiscal revenue, and centralize a portion of county fiscal resources (i.e. “city exploiting county”). c) A number of prefectural cities did not provide reciprocal fiscal and administrative supports; indeed, the administrative intervention or non-action of prefectural governments became an obstacle to continuous county development and fair competition between counties and cities (“city coercing county”); the experiences of county-level cities under the jurisdiction of Suzhou city was a case.⁷ d) A number of prefectural governments tended to “decentralize duties and responsibilities while centralizing control over revenue,” leading to fluctuation of service of lowest-level

21 Century Business Herald, 7/8/2007. In all, Zhejiang’s long-established “province supervising county” model is related to some accidental factors, then local leaders’ sight in particular, so that the province kept away from the “city supervising county” model more than once. Zhejiang’s model suits its local conditions—comparatively small geographical area, a small number of counties within jurisdiction and rapid private economic growth and massive economic development. See Gao Peiyong edited *China’s Finance and Tax Reform during Twelfth Five-Year Plan Period*, Beijing, China Financial and Economic Publishing House, 2010, P211

⁷ E.g. A county-level city under the jurisdiction of Suzhou city, Jiangsu province, once sought the status of “deputy-prefectural level city” in order to combat prefectural Suzhou’s restriction on its development. Wujin district of Jiangsu Changzhou city used to change from “county” to “county-level city;” Changzhou city, for convenience of control, got approval in 2002 to change Wujin to “district.”

governments.⁸ e) Cities with a smaller scale of economy and less strength could hardly drive the development of surrounding counties (calves pulling large carts).⁹

Strong points of “province supervising county” fiscal administration system included: a) weakening of prefectural/municipal-level fiscal functions and avoidance of reduction in administrative efficiency by removing the intermediate link of municipality; b) convenience for provinces to observe the fiscal conditions of various counties and thereby increase supports to those in fiscal straits and speed up provincial transfer payment;¹⁰ c) provision of room for county economic growth by avoiding “the big coercing the small,” a situation likely to take place in city vs. county competition.¹¹ Examples include the “province supervising county” fiscal administration system implemented in Zhejiang, which covered direct provincial allocation of fiscal revenue and expenditure, earmarked transfers and budgetary funds, and directed arrangement of yearend settlement to 63 counties (including county-level cities) and cities (excluding municipalities with independent planning status); while the county/city finance was directly linked with provincial finance, they had no settlement relations under the system.¹² The weakness of “province supervising county” system involved aggravation of information asymmetries caused by limited government manpower and difficulty putting into action provincial administration of county finance; in provinces with an expansive territory and a large number of counties and cities, it was hard for the governments to conduct effective supervision of counties’ fiscal behavior.

Comparison of respective strengths and weaknesses of the two fiscal systems, “city supervising county” and “province supervising county,” brought about “province supervising county” or “county strengthening and power expansion” reformation, carried out by the central government in recent years. While most counties across China applauded the reform, some counties in the practice of “city supervising county” system held the opposite view, for they acquired from the prefectural/municipal level fiscal and administrative supports at an amount larger than the compliance cost they had to pay (including the portion of fiscal revenue to be turned over). In an investigation conducted by the author, some poor counties under the jurisdiction of Nanning city, Guangxi province, acquired substantial transfer payments from the city each year; Liyang city of Jiangsu province, with a quite booming economy, still received considerable fiscal support from

⁸ Jiang Haibo, ditto.

⁹ *Gu Shengzu: Four Disadvantages of “City Supervising County” and Five Problems of “Power Expansion and County Strengthening,”* by Chen Yejun. *People Net Theory Channel*, 04/03/2009

¹⁰ For this point, see Notice of Anhui Provincial People’s Government Regarding the Implementation of “Province Directly Supervising County” Fiscal System Reform, No. 8 [2004] issued by Anhui provincial People’s Government.

¹¹ “*Province Supervising County: a New Local Reform Tide*,” by Lin Nan, Hu Zuohua, published on *China Comment*, 28/01/2006

¹² Lin Nan, Hu Zuohua, ditto.

prefectural Changzhou city due to old revolutionary base areas under its jurisdiction. Either in poor county of Nanning city or in the booming Liyang city, some officials were opposed to carrying out the fiscal system reform of “province supervising county.”

Anhui and Hubei provinces launched the fiscal pilot reform of “province supervising county” in 2002. Up to June 2007, eighteen provinces across China adopted the “province supervising county” administration system, with the fiscal system as a component,¹³ added by four municipalities directly under the central government, which were already in practice (due to the absence of prefectural/municipal level in their administrative hierarchy), a total of 22 provinces, municipalities and autonomous regions put into effect the “province supervising county” system.

In the center’s 2009 Document No.1, the fiscal system of “province directly supervising county” was promoted with suggestions to incorporate major producers of grain, oil plants, cotton and live pigs into the reform, make steady progress in the pilot reform of “county strengthening and power expansion,” encourage qualified provinces to take the lead in streamlining government, and accomplish these goals in accordance with the law. So far, an increasing number of provinces have implemented the pilot reform of “province supervising county” fiscal administration system.

Over the past few years, China has implemented the aforementioned trial reform of “county strengthening and power expansion,”¹⁴ mainly involving delegation of fiscal powers to the lower level, that is, provinces directly administer county finance under the two-level fiscal system while prefectural/municipal-level leadership of administration over counties remained. In essence, it was a form of preceding “province supervising county” model, supplemented with a certain degree of decentralization in economy, investment and administration.¹⁵ In 2007, for example, Sichuan province chose Anyue county (under the jurisdiction of prefectural city Ziyang) as a pilot to implement the reform of “county strengthening and power expansion,” which included contents of “province supervising county” fiscal system. The pilot reform was also carried out in provinces which were already practicing the “province supervising county” system.¹⁶ By direct administration of a unified tax sharing system, effective in Anyue county

¹³ *Twenty-two Regions Throughout China Have Carried out the System of “Province Directly Supervising County,”* published on *China Economic Weekly*. 14/06/2007

¹⁴ Compared to other provinces, Zhejiang province carried out “county strengthening and power expansion” respectively in 1992, 1997 and 2002. See *Strengthening County and Expanding Power: a Difficult Road of Sixteen Years*, by Jiang Haibo, *China Business Journal*. 16/02/2009.

¹⁵ *25 Years for Implementing “City Supervising County” System across China: County Strengthening and Power Expansion in Deep Waters*, by Zhang Zhanbin, published on *Decision Making*, 29/01/2008

¹⁶ E.g. Zhejiang province started the 4th-round pilot reform of “county strengthening and power expansion” in 2006, with Yiwu city as only pilot for this trial: 131 administrative powers that used to belong to Jinhua city and 472 provincial powers for economic and social management were decentralized to Yiyu city in various forms, for a time, Yiwu was called by media “the most powerful county in China.” By the end of 2007, transfer of authority related to 603 events was completed, with 572 events and powers in place. See “*Province Directly Supervising County” Still*

and Ziyang city, Sichuan provincial government aimed at securing its interests and realizing incremental regulation. As of 1 January 2007, Ziyang city no longer participated in sharing of Anyue's fiscal revenue, while the central and provincial governments continued doing so under the fiscal system.¹⁷

The system of “county strengthening and power expansion” had the following advantages in specific operations: a) It helped to streamline government, simplify administrative procedures, as well as reduce or even eliminate prefectural control and intervention, and centralization of county fiscal resources. b) It promoted autonomy in power-expanded counties. c) It highlighted the importance of economic districts in promoting regional economic integration, instead of the consolidating or even coercing effect of prefectural cities as an administrative division. On the other hand, the system had a series of problems:¹⁸ a) Supports from prefectural cities to power-expanded counties were reduced. While prefectural cities centralized a portion of county fiscal resources, they also provided financial support to some backward counties under their jurisdictions. With “county strengthening and power expansion,” prefectural cities reduced financial support to power-expanded counties. The issue of matching funds is an example: while provincial subsidies were delivered for approved projects, the required matching funds from prefectural cities were not available, and provincial governments had no relevant policies of direct subsidization leaving backward counties (cities) in a funding bottleneck. b) Land, finance, industry and commerce, taxation and other vertical administrative departments under direct provincial control were self-contained and reluctant to shift powers down to counties. With a decisive impact on local economic growth, these departments had their own respective vertical administrative systems, making the power-expanding policy impotent before the centralized structure. c) The reality that power-expanded counties were unlikely to separate totally from prefectural cities to which they belonged (e.g. personnel administration of county governments may remain under the control of prefectural governments) drove prefectural-county contradictions when county governments had to deal with two bosses—the provincial government and the prefectural government—at the same time. d) With “county strengthening and power expansion,” provincial governments had to deal with a great number of counties, making it necessary to enhance supervision and administration by, for example, establishing “regional administrative offices” at the prefectural level as government agencies dispatched by provinces. Besides, the expansion of county powers stopped at the level of government and left local democracy unchanged, weakening the counterbalance to local governments.

Both the “province supervising county” model or the “city supervising county” model and the reform of “county strengthening and power expansion” involved two deep-seated structural

in the Trial; Whether Prefectural Cities Relinquish Powers Is the Key, published on *China News Week*, 07/08/2008

¹⁷ Sichuan Provincial People's Government, *Implementation Opinions of Pilot Development of Expanding Power and Strengthening Counties* (No. 58 [2007] issued by Sichuan government)

¹⁸ Partly refer to Zhang Zhanbin, ditto.

problems: 1) With the old thinking of “supervising the lower level,” reformations of the vertical government system were unlikely to eradicate problems related to the vertical fiscal and administration systems, wherein the most serious problem was information asymmetry between higher and lower levels. To address the problem, a sound democratic system at grassroots level needed to be established. 2) While all reforms proceeded within the administrative framework, division of functions and powers and allocation of revenues and expenditures ought to have been determined by NPC legislation. The Budget Law of China stipulates that the State Council shall promulgate separate regulations on allocation of revenue and expenditure. The Regulation for Enforcement of Budget Law promulgated by the State Council further stipulates that the State Council shall issue separate regulations on the intergovernmental tax sharing system; both only need to be submitted to the NPC for the record. In light of international practice, the adjustment of central-local fiscal relations, as part of intergovernmental redistribution of powers, should be determined by legislation rather than administration. Both of the administration-oriented regulations need to be rectified, for they violate basic legal principles and the spirit of law, and are inconsistent with procedures of democratic finance. The existence of deep-seated structural problems makes it hard for local governments to achieve good governance.

2.2 Allocation of Revenues

In China, county-level governments have very limited fiscal powers, especially with regard to levying taxes: a) Governments at provincial and lower levels have no authority to formulate tax laws; fee collection events are decided by the center, provinces or major municipalities, and are finally controlled by the center. County-level governments have no power to collect fees in the locality for own needs without the approval of higher levels. b) While rigid restrictions are imposed on county government borrowing, they still manage to borrow by using subordinate enterprises or projects. As stipulated in the 2004 Budget Law, local budgets across levels shall be prepared under the principle of “making ends meet,” list no deficits and prohibit local government debt issuance, except as otherwise provided by laws or State Council regulations. Restrictions, however, do not include enterprise borrowing or borrowing for projects, and fail to prevent provision of invisible guarantees by local governments for enterprise or project loans. 3) Higher level governments are in the driver’s seat in administration of county tax sharing systems and allocation of county revenue, but such dominant control is affected by the bargaining power and countermeasures of county governments.

In their administration of county fiscal systems, provincial or municipal governments take the following procedures in allocating revenues:

- a) Under the tax-sharing administration system, the central government cuts off a large share of revenues (the center’s regular revenue and the central portion of shared revenue) from the province (including counties). The provincial government then cuts off a share of revenues from municipalities and counties under its jurisdiction (the provincial

government's regular revenue and the provincial portion of shared revenues with municipalities and counties).

- b) Many central cities practicing the “city supervising county” fiscal system or the system of “county strengthening and power expansion” cut off a share of revenues from counties and cities under their jurisdictions, usually in the name of “centralizing a portion of revenue.”
- c) Governments from central to prefectural levels keep control over lower-level governments through redistribution and centralization of revenue, and transfer payment of disposable revenue.

In the process of revenue allocation, governments at different levels pay attention to maintaining their respective vested interests. The higher level tends to centralize revenue from the lower level with a view to increasing future revenue, thus forming a multi-tier model of revenue allocation featuring “the below following the behavior of the above” and “supervising the lower level.” The centralization of county/city fiscal resources by higher-level governments is not infinite but restricted by local bargaining power, and the strength of rent-seeking and countermeasures like “leaving wealth with the people.”

The 1993 State Council Decision ruled that provinces have decision-making power on sub-provincial level fiscal administration systems, so the county fiscal systems effective after 1994 showed systematic diversity. While all provinces called their fiscal systems below the provincial level part of the “tax sharing system,” a standard sub-provincial tax sharing system does not exist: practices of the “fiscal contracting system” and the “base method” remain effective in many places, and “tax sharing” is achieved by applying the bases of actual county and township revenues before 1994, with a focus on revenue allocation. Common practices, as seen in various regions, include maintaining the original hierarchy for sharing except for the types being transferred to higher or lower levels, and adjusting the allocation of business taxes in a few places. 75% of the value added tax (VAT) is allocated to the center and the remaining 25%, it is left to cities and counties for sharing in most areas. It is shared by provinces, cities and counties in a small number of areas. In most areas, the types to be allocated from the central to local level and newly collected tax items are shared by provinces, cities and counties.¹⁹ As stated above, some localities implement the fiscal administration system of “city supervising county,” under which prefectural governments participate in sharing of county revenues; some other localities implement “province supervising county” system, under which prefectural governments do not participate in sharing of county revenues.

¹⁹ *The Tax sharing Fiscal Administration System in China*, edited by Local Affairs Department of Ministry of Finance. Beijing, China Financial and Economic Publishing House, 1998, P14

Table 1: Revenue Assignments Breakdown at All Levels of Government 2006

	Amount (100 million)						Percentage (%)				
	national total	central level	provincial level	prefectural level	county level	township level	central	provincial	prefecture	county	township
total general budget revenue	3876	2045.7	467.4	598.6	535.9	228.4	52.8	12.1	15.4	13.8	5.9
fund revenue	725.3	170.7	215.8	192.5	142.4	3.9	23.5	29.8	26.5	19.6	0.5
extra-budgetary revenue	640.8	46.7	195.1	195.6	181.3	22.1	7.3	30.4	30.5	28.3	3.4
total	5242.1	2263.1	878.3	986.7	859.6	254.4	43.2	16.8	18.8	16.4	4.9

Source: China Finance Yearbook 2007 and other data provided by the Ministry of Finance.

The 1994 fiscal reform brought a significant increase in the ratio of fiscal revenue to GDP and a high degree of centralization of revenue toward the central government. According to statistics, the ratio of fiscal revenue to GDP in 1993 was 12.3%, rising to 20.8% in 2007. The central revenue made up only 22% of fiscal revenue in 1993, but rose to 54.1% in 2007. Table 1 shows the revenue assignment breakdown at all levels of government in 2006, including general budget revenue, fund revenue and extra-budgetary revenue. In the same year, the central government accounted for 52.8% of total general budget revenue, while county-level and township-level governments accounted for 13.6% and 6.2% respectively; and the center accounted for 43.2% of the aggregation of general budget revenue, fund revenue and extra-budgetary revenue, while counties and townships shared 16.4% and 4.9% respectively. In addition, debt revenue played an important role in supporting the “payroll finance” and “construction finance” of local governments, including counties and townships. As estimated by the Research Institute of Fiscal Science, Ministry of Finance, the overall balance of local government debt would exceed 4,000 billion yuan by the end of 2008.²⁰

Taking the case of Anyue county, Sichuan province, we may analyze China’s county tax sharing fiscal system. Table 2 reflects provincial and low-level government administration of Anyue’s fiscal sharing system. The county is under the jurisdiction of prefectural city Ziyang. With a total population of 1.54 million and an agricultural population of 1.4 million in 2006, Anyue is populous, and a major county of hill-type agriculture. In 2005, it produced a GDP of 6.33 billion yuan, despite a general budget revenue of only 88.05 million yuan. From 2003 to 2006, the allocation of Anyue’s revenue to the central, provincial, municipal and county governments was as follows:

²⁰ *Focusing on “Debt Risk” of Local Governments*, by Han Jie, Wen Xuan, published on *China Comment*. 08/04/2009

VAT: 75% went to the center and 25% to the local; for the local portion, 8.75% went to the province and 16.25% kept by the county (allocated based on the administrative division to which it belongs). Consumption tax: 100% was allocated to the center. Business tax (excluding business tax for banking and insurance industries): 35% taken as tax base for provincial-level allocation of revenue; 65% kept by the county. Vehicle purchase tax: all acquired by the center. Local enterprise income tax: 60% went to the center; the remaining 40% went to the province in the form of provincial enterprise income tax, or was kept by the county in the form of county enterprise income tax. Personal income tax: the center shared 60%, the province, 14%, and the county, 26%. Business tax: railway business tax and business tax for central banking and insurance industries was allocated to the center; business tax for local banking and insurance industries was allocated to the province; for general business tax, 35% went to the province and 65% to the city. Resource tax: offshore oil resource taxes all belonged to the center; for others, the province shared 35%, and the county shared 65%. House property tax, urban land use tax, stamp tax, and deed tax: 35% went to the province and 65% was kept by the county. Urban maintenance and construction tax, land value increment tax, vehicle and vessel usage plate tax, and farmland occupation tax: 100% was allocated to the county. It can be seen from the table that the central and Sichuan provincial governments acquired a large part of Anyue county's revenue while Ziyang city only shared 15% of sewage charges.

The general budget revenue of Sichuan Anyue county in 2005 only amounted to 88.04 million yuan, compared with the total local general budget revenue of 164.36 million yuan (Table 3); the gap between the two was the portion shared by central, provincial and prefectural levels, making up 46.4% of total local general budget revenue. Besides, central and provincial subsidies (including all sorts of tax refunds) came to 598.96 million yuan, 6.8 times as local general budget revenue. County-level fund revenue was 19.9 million yuan, 22.6% of local general budget revenue. The extra-budgetary revenue was large, totaling 74.42 million yuan, 84.5% of local general budget revenue. The fiscal dependence rate of Anyue county can be computed by using the formula as below:

Table 2: Breakdown of Tax Revenues Shared by Higher-Level Governments and Anyue County (2003–2006)

Types of Revenue		Coverage and Percentage of Sharing by Province, Municipality, County and Township
1. Taxes and Fees		
	VAT	Central 75%, Provincial 8.75%, County 16.25%
Revenues	Consumption Tax	Central 100%
	Business Tax	
	Business Tax for Banking and Insurance Industries	Provincial 100%
	General Business Tax	Provincial 35%, County 65%
	Enterprise Income Tax	County Enterprise: Central 60%, County 40%
	Personal Income Tax	Central 60%, Provincial 14%, County 26%
	Resource Tax	Provincial 35%, County 65%
	Urban Maintenance and Construction Tax	County 100%
	House Property Tax	Provincial 35%, County 65%
	Stamp Tax	Provincial 35%, County 65%
	Urban Land Use Tax	Provincial 35%, Provincial 65%
	Land Value Increment Tax	County 100%
	Vehicle and Vessel Usage Plate Tax	County 100%
	Slaughter Tax	Cancelled
	Agricultural Specialty Tax	Cancelled
	Deed Tax	Provincial 35%, County 65%
Other Revenues	Operating Income of State-Owned Assets	County 100%
	Subsidy for State-Owned Enterprise Losses	
	Administrative Charge	County 100%
	Fine And Confiscatory Revenue	County 100%

	Special Revenue	Sewage Central 30%, Provincial 15%, Municipal 15%, County 40%, Education Surtax, County 100%
	Others	County 100%
2. Tax Increment Refund	VAT Refund	-
	Consumption Tax Refund	-
	Enterprise Income Tax Refund	-
	Personal Income Tax Refund	-
3. The Portion of Revenue in Excess of Base		County 100%
4. Other Sharing		-

Data source: Feng Xingyuan, Research Report on County and Township Fiscal Problems of Anyue County, Sichuan Province, Sub-report for Research on County and Township Fiscal Problems, joint project by NDRC and Australian Government, 28/10/2006.

Fiscal dependence rate = (central, provincial and municipal subsidies - refunds of consumption tax and VAT - income tax base refund) / total county disposable financial resources * 100%

The fiscal dependence rate of Anyue county in 2005 is computed as 73.6%. Accordingly, the county's fiscal self-sufficiency rate under the current tax sharing fiscal administration system can be defined as:

Fiscal self-sufficiency rate = 100% - fiscal dependence

By computation, the fiscal self-sufficiency rate of Anyue county in 2005 was 26.4%. It is noteworthy that the revenue list and computation did not include debt revenue and social security funds. Outstanding debts of the county and its townships came to 1.44 billion yuan by the end of 2005, 16.4 times the local general budget revenue. In addition, village-level debts amounted to 89.59 million yuan, or on average, one hundred thousand yuan per village. The total amount of village-level debts was 1.02 times as county-level general budget revenue.

Anyue's agriculture tax revenue in 2003 reached 51.91 million yuan, or 47.5% of the local general budget revenue of the same year. With the rural tax and fee reform, the agriculture tax revenue dropped to 26.68 million yuan in 2004, or 27.6% of the local general budget revenue of the same year. By 2005, the agriculture tax revenue fell to zero. It is thus clear that for Anyue, a county with a large agricultural population base, agriculture tax revenue was once the primary source of revenue. After the cancellation of agriculture tax, however, the business tax became the single primary source of revenue. A great quantity of expenditure was filled in by central and provincial transfers.

Table 3: Sichuan Anyue County Final Accounts of General Budget Revenue in Fiscal Year 2005 — Unit: 10 Thousand Yuan

Item	Amount	Item	Amount
I. Total local general budget revenue	164,360	II. Central and provincial subsidies	598,960
(i) local general budget revenue (I)	88,040	1. refunds of consumption tax and VAT	22,460
1, total fiscal revenues	52,910	2. income tax base refund	1,240
wherein: VAT	8,370	3. special subsidies	129,820
business tax	19,030	4. general purpose transfer payment	153,870
enterprise income tax	1,540	5. transfer payment subsidy for salary adjustment	90,450
personal income tax	5,660	6. transfer payment subsidy for rural tax and fee reform	84,690
resource tax	370	wherein: transfer payment subsidy for primary and secondary school teacher salaries	27,660
urban maintenance and construction tax	7,680	7. transfer payment subsidy for cancellation of agricultural specialty tax and reduction in agriculture tax rate	65,050
house property tax	2,140	8. transfer payment subsidy for alleviation of county and township fiscal difficulties	8,600
stamp tax	230	9. subsidy for further issuance of national debt	34,780
urban land use tax	270	10. settlement subsidy	5,780
slaughter tax		11. subsidies for agriculture tax deduction or exemption caused by disasters,	

		subsidy for enterprise and public institution budget	
agriculture tax		transfer payment subsidy for enterprise and public institution budget	
agricultural specialty tax		III. county fund revenue	19,900
land value increment tax	2,530	wherein: paid land use revenue	18,790
vehicle and vessel usage plate tax	920	IV. county extra-budgetary revenue	74,420
farmland occupation tax	730	wherein: administrative fee	74,420
deed tax	3,440	V. county disposable financial resources	781,320
2, operating income of state-owned assets	5,890		
3, administrative fee	20,330		
4, fine and confiscatory revenue	5,930		
5, special revenue	2,720		
6, others	260		
(ii) central revenue	49,910		
VAT	38,610		
consumption tax	210		
others	11,090		
(iii) provincial revenue	26,270		
(iv) prefectural revenue	140		

Note: Provincial subsidies include subsidies and refunds from the central and provincial governments.

Data source: Feng Xingyuan, Research Report on Fiscal Problems of Anyue County, Sichuan Province, Sub-report for Research on County and Township Fiscal Problems, joint project by NDRC and Australian Government, 28/10/2006.

Table 4: Higher-Level Administration of Anyue County Tax Sharing Fiscal System since 2007 Pilot Reform of “County Strengthening and Power Expansion”

Types of revenue	Allocation of fiscal revenue to Sichuan province, Ziyang city and Anyue county
Tax revenue	<p>Provincial-county allocation of tax revenue: For 8 types of taxes, including the 25% local portion of VAT, and business tax, the province and pilot counties share at a ratio of 35:65; minority county pilots do not currently share. Enterprise income tax is shared by the center and local government, the 40% local portion going to the province if paid by provincial enterprises, and to the county if paid by county enterprises. 92.5% of export refunds are provided by the center; for the 7.5% local portion, the province and pilot counties shared at a ratio of 35:65, and minority county pilots follow the preceding rules to bear 100%.</p> <p>Municipal-county allocation of tax revenue: Pilot counties and cities do not participate in tax sharing. The center and the province participate in sharing of pilot county revenue, but cities do not.</p>
Other revenue	<p>Administrative fee, special revenue, governmental fund and other non-tax revenues of pilot counties should be paid to central, provincial, pilot county treasuries or special fiscal accounts, pursuant to relevant provisions.</p> <p>The municipality to which the pilot county belongs to does not participate in sharing of county non-tax revenues.</p> <p>According to principles concerning the allocation of economic responsibilities and functions and powers, non-tax revenues and corresponding expenditures do not partake in base transfer.</p>
Revenue base and refund	<p>The province determines the revenue base and expenditure base and allocates them directly to pilot counties (cities). With 2006 as the base year, the province separates the share of tax refund, income tax base, export refund base, other base subsidy (to be turned over) and special base subsidy (including matching fund payment to pilot counties as arranged in 2007 municipal budget) that should belong to pilot counties from municipal finance, reduces (increases) the base of provincial subsidy to cities and pilot counties, and delivers payments to pilot counties according relevant settlement approaches. In 2007, the province delivers the whole share of 2007 county real revenue increment that should go to the municipality if computed under the original system to the municipality as a subsidy by means of yearend settlement. From 2008 to 2010, the province delivers 50% of the share of that very year’s county real revenue increment that should go to the municipality if computed under the original system to the municipality as a subsidy by means of yearend settlement, and includes it into the base.</p>

enterprise affiliation and revenue base	For municipal enterprises and public institutions located within pilot counties, the provincial fiscal department shall conduct procedures to transfer their relationship of administrative subordination, revenue base and expenditure base on consensus between the city and the county involved.
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Source: Sichuan province Opinions on the Fiscal Administration System Reform in Power-Expanding Pilot Counties, 10/7/2007

As from 1 January 2007, Sichuan province made Anyue county a pilot for “county strengthening and power expansion,” implementing the “province supervising county” fiscal administration system. As prescribed in Opinions on the Fiscal Administration System Reform in Power Expanding Pilot Counties²¹ issued by Sichuan provincial government, a basic principle of reform was the safeguard of interest and increment regulation, that is, to properly regulate revenue increment of future years on the premise of maintaining vested interest of counties (cities). Table 4 provides details of what higher-level governments did in fiscal administration of Anyue’s tax sharing system since the 2007 reform of “county strengthening and power expansion.”

The administration-based revenue distribution system at provincial and below levels in China, including higher-level administration of county tax sharing system, offered flexibility in provincial budgeting and contributed to intergovernmental equality in revenue within the province.²² Cost had to be paid though: a) Municipal and county governments sacrificed autonomy; a lot of backward cities and counties depended highly on central and provincial transfers, with a weakened sense of responsibility. b) Lack of a stable, formal system of distribution with general budgets led to reduced predictability of local revenue and shrinking budgetary organization and appropriation. 3) Lack of such a system generated counter incentives for revenue mobilization as local governments were driven to shift fiscal resources off-budget, or²³ even hide them in extra-systemic revenues.

2.3 Division of Functions and Powers and Expenditure Responsibilities

In the national administration of the provincial fiscal system, the central government overemphasized redistribution of revenues but neglected adjustment of functions and powers, leaving the latter, to a certain extent, undefined, ambiguous, and highly decentralized.²⁴ Such problems similarly exist in the sub-provincial fiscal administration system.

²¹ Appendix to *Implementation Opinions on Pilot Development of Expanding Powers and Strengthening Counties*, issued by Sichuan provincial people’s government, 10/07/2007

²² Centre for Public Policy Studies, Shanghai University of Finance and Economics, ditto, p186

²³ Centre for Public Policy Studies, Shanghai University of Finance and Economics, ditto, p186

²⁴ Centre for Public Policy Studies, Shanghai University of Finance and Economics, ditto, p178

The 1994 tax sharing system reform was designed to improve the ratio of fiscal revenue to GDP and fiscal centralization. As stipulated in the 1993 Decision of the State Council on the Tax Sharing Fiscal Administration System (No.85 [1993] issued by State Council), central and provincial governments negotiated a rational range of fiscal expenditure across levels based on the central-local assignment of functions and powers, and unified taxes into the categories of central tax, local tax and shared tax under the principle of “corresponding revenues to responsibilities.” By naming their fiscal administration “tax sharing system,” sub-provincial level governments across China all adhered to (at least nominally) the model of responsibility-based assignment of revenue.

The principle of corresponding revenue to responsibilities is in line with international practice in form, but differs greatly in terms of specific operations. Internationally, the principle of correspondence implies preconditions and mature practices. Implicit preconditions include division of functions between government and market and division of functions and powers at all levels of government. Mature practices involve determining needs and expenditures in light of government duties and responsibilities, wherefrom determining revenues and allocation. Reflected here is the principle of “expenditure determining revenue,” which follows another—“functions determining expenditures.” The tax sharing system in China is in absence of the foregoing preconditions. Higher-level governments, in their administration of lower-level fiscal systems, focus on distribution favorable to themselves, for which they allow or wink at lower-level governments to dig for a large quantity of off-budget revenue. The more that is earned, the more that is typically spending—a reflection of “revenue determining expenditure,” and a manifestation of “unlimited government,” which is an obvious feature of government hierarchy in China.

County and township division of functions and powers and expenditure responsibilities have the following characteristics: a) The Constitution of China and the Local Government Organization Act set out local government functions and powers (authority); documents regarding the tax sharing system promulgated by administrative departments do not stipulate government functions and powers (authority). b) Government hierarchy makes it impossible to realize rational assignment of functions and powers (authority) at all levels by legislation. Provisions on local government functions and powers (authority) touch upon extent of authority at each level, but, with a high degree of overlapping, do not made explicit which level of government bears responsibility for what functions. c) Government functions and powers (authority), as provided by existing laws, require lower-level governments to carry out mandates, decisions and commissions made by higher levels, thus leaving room for higher-level governments to shift responsibilities onto lower-level governments and exacerbating the problems of fiscal administration and expenditure responsibilities at county and township levels. d) Legislation does not stipulate government expenditure responsibilities. Some localities follow provisions provided in tax-sharing-system documents issued by administrative departments; others determine expenditure responsibilities by applying previous expenditure base. Provisions on

expenditure responsibilities provided in tax-sharing-system documents envelop all local affairs to be addressed by local governments at the same level, virtually overlapping that of the higher level, which allow higher-level governments to shift their own-level expenditure responsibilities onto lower-level governments.

Specifically, Article 107 of the Constitution of China defines extent of authority of local governments, according to which, county and above level local governments administer economy, education, science, culture, health, sports undertakings, urban and rural construction, finance, civil affairs, public security, nationalities affairs, judicial administration, supervision, family planning and other administrative affairs, promulgate decisions and orders, appoint and dismiss, train, examine, reward and punish administrative staff within their respective administrative divisions. Township people's governments enforce resolutions passed by township-level people's congress and decisions and orders promulgated by higher-level government departments, and manage administrative work within their respective administrative divisions.

The functions and powers, or authority, of provincial, prefectural/municipal, county/city and township governments are specified in Articles 60 and 61 of the Organic Law of Local People's Congresses and Local People's Governments of the People's Republic of China. Core contents are as follows:

1. To enforce resolutions of the same level people's congress (governments above the county level also enforce decisions of the standing committee of the same level people's congress), decisions and orders of higher-level government administrative departments, to promulgate decisions and orders. Governments above the county level can develop administrative measures.
2. Local governments above the county level shall lead the work of subordinate departments and lower-level people's governments, change or abolish improper orders and instructions of subordinate departments and improper decisions or orders of lower-level people's governments.
3. Local governments above the county shall appoint and dismiss, train, examine, reward and punish government administrative staff as prescribed by laws.
4. To implement national economic and social development plans and budgets, to administer all matters related to economy, education, science, culture, health, athletics, environmental and resource protection, urban and rural construction, finance, civil affairs, public security, minority affairs, judicial administration, supervision, family planning and other administrative affairs within their respective administrative regions.

5. To protect property owned by the whole people and collective property owned by the working people, protect citizens' lawful private property, maintain social orders, safeguard citizens' rights of the person, democratic rights and other rights, and protect the lawful rights and interests of economic organizations.
6. To protect the rights of ethnic minorities and respect their customs. Local governments above the county level shall provide aid for areas inhabited by ethnic minorities to practice regional autonomy pursuant to the constitution and law, and help them to develop politics, economy and culture.
7. To safeguard women's equality, equal pay for equal work, freedom of marriage and other rights endowed by the constitution and law.
8. Governments above the county level shall carry out other tasks mandated by higher-level administrative departments. Township-level governments shall engage in other issues mandated by higher-level governments.

The foregoing 4th point is rather ambiguous: while it states that local governments at each level assume similar functions within their own jurisdictions, they are not assigned functions and powers corresponding to the public goods and services they provide. The 1st and 8th points provide that lower-level governments shall carry out decisions and orders made by higher-level administrative departments and other tasks mandated by higher-level administrative departments or people's governments; this would, from the legal point of view, inevitably result in a low degree of autonomy at the lower levels, with their administrative responsibilities and expenditure responsibilities easily influenced by higher-level governments.

From the angles of democratic finance and fiscal federalism, public goods and services to be provided by governments across levels are determined democratically by public procedures within respective jurisdictions. That is, governments are accountable to citizens by providing public goods and services autonomously within the extent of authority defined by law. Here, government functions and powers shall be decentralized to the lowest possible level. In other words, the principle of subsidiarity shall be followed. According to the principles of fiscal federalism and subsidiarity, if public goods and services provided at the local level have externalities, or spillover effects, local governments should consider internalization by means of self-organizing protocol or higher-level government participation (e.g. transfer payment or co-provision) and takeover (turning them into their own functions and powers). Compared to the requirements of democratic finance and fiscal federalism, China's current fiscal administration system is still far behind.

It can be said that under the five-level government system in China, formal division of government functions and powers and expenditure responsibilities is absent. While the

constitution stipulates the extent to which the central government exercises authority over local governments in principle, it does not make a distinction between different levels. Except for the central government's exclusive authority over foreign affairs and national defense, the government's functions and powers at the local level are virtually a replica of the center's (Table 5).²⁵ The Budget Law ensures local budget autonomy, but in reality, budget autonomy is nonexistent. Regarding the central-local division of expenditure, it does not make explicit how to assign expenditures among governments at sub-provincial levels. The common practice is the approach of "supervising the lower level," that is, a higher-level government exerts control over the expenditures of the government one level below within its jurisdiction. Provincial (under the "province supervising county" system) or prefectural (under the "city supervising county" system) governments determine expenditure assignments of county governments while county governments determine expenditure assignments of township governments. This way, division of functions and powers can be different in various provinces and prefectures.²⁶ Despite that, higher-level governments are not free to unilaterally determine expenditure responsibilities of the lower levels because in practice, it is county and township governments rather than higher-level governments that provide the vast majority of public goods and services. County and township governments, however, have to shoulder the heavy burden of spending as a result of lacking revenue autonomy and primary revenue. The downward shift of expenditure responsibilities by higher-level governments was a significant trend by 2003,²⁷ which then began to reverse after the central government substantially increased investment in agriculture, rural areas and farmers. Even so, county and township governments still need to shoulder the main burden of providing basic public services.

²⁵ Center for Public Policy Studies, Shanghai University of Finance and Economics, 2007, p178-179

²⁶ World Bank. "China National Development and Sub-national finance: A Review of Provincial Expenditures," Report No. 22951-CHA, April 9, 2002.

²⁷ In 2001, China began to implement a fiscal system with county-level government as the investment subject so that the subject of united government and public investment in rural compulsory education upgraded from township to county. Expenditure responsibilities remained at county and township levels, and were not turned over to higher levels.

Table 5: Overview on Government Expenditure Responsibilities across Levels

Level	Classification		Nature of Government	Primary Expenditure Responsibilities
national	the central government		national	central government operation, national security and foreign affairs, investment subsidy to enterprises directly under the center, national key construction, macro-control, higher education of universities directly under ministries, social security of key state-owned enterprises, cultural undertakings of the center
provincial	province (autonomous region)		local	provincial government operation, investment subsidy to provincial enterprises, major provincial infrastructure
	municipality directly under the central government		municipal and local	municipal government operation, investment subsidy to municipal enterprises, urban construction
prefectural	prefecture		local	prefectural government operation, investment subsidy to prefectural enterprises, major prefectural infrastructure
	prefecture-level city	governing counties	municipal and local	municipal government operation, urban education, investment subsidy to municipal enterprises, urban construction, local infrastructure, unemployment and pension insurance and relief

		not governing counties	city government	city government operation, urban education, investment subsidy to city enterprises, urban construction, unemployment and pension insurance and relief
county-level	county		local government	county government operation, education, medical care and public health, spending on rural support, county infrastructure and urban construction, family planning
	county-level city		municipal and local	city government operation, education, medical care and public health, spending on rural support, urban construction and local construction, family planning, unemployment and pension insurance and relief
township-level	township		rural government	township government operation, rural education, family planning

Source: relevant contents of World Bank (2002), by Tian Fa, Zhou Chenying (2004), Yin Haibo (2002).

Table 6: Intergovernmental Assignment of General Budget Expenditure (Part) in 2006

budget accounts	Amount (100 Million Yuan)						Percentage (%)				
	national total	central level	provincial level	prefectural level	county level	township level	central level	provincial level	prefectural level	county level	township level
capital construction expenditure	439	148.4	101.7	109.8	71.1	8.1	3.4	2.32	2.5	1.62	0.18
enterprise innovation fund	96.5	1.3	18.2	37.7	24.7	14.6	0.14	1.89	3.91	2.56	1.51
expenditure on agriculture, forestry, water conservation and meteorology	216.1	109.3	18	18.6	49.9	20.3	5.06	0.84	0.86	2.31	0.94
operating expense on industry, transportation and circulation departments	58.1	13.5	15	11.4	16.7	15.5	2.33	2.58	1.96	2.87	0.27
operating expense on recreation and sports and broadcasting	84.2	8.4	17	17.6	28.9	12.4	0.99	2.02	2.09	3.43	1.47
educational outlay	478	29.5	71.5	81.8	242.8	52.5	0.62	1.5	1.71	5.08	1.1
expenditure on medical care and public health	132	2.4	26.9	36.2	605.3	5.9	0.18	2.04	2.75	4.59	0.45
operating expense for other departments	146.2	11.1	42.4	37.4	47.3	7.9	0.76	2.9	2.56	3.24	0.54
pension and social relief	90.8	0.6	7.4	21.6	50.7	10.5	0.06	0.82	2.38	5.59	1.16

expenditure on retirees of administrative institutions	133	10.9	25.1	24.9	58.1	14	0.82	1.88	1.87	4.37	1.05
expenditure on social security	212.4	24.1	76.4	68.3	41.4	2.3	1.14	3.6	3.22	1.95	0.11
administrative expense	335.6	46.1	36.1	76.3	120.9	56.2	1.37	1.08	2.28	3.6	1.67
expenditure on public security organs	217.4	9.9	50.4	75.4	78.3	3.5	0.45	2.32	3.47	3.6	0.16
urban maintenance cost	153.7	0	9.5	65.6	65.5	13.1	0.0	0.62	4.27	4.26	0.85
annual total expenditure	4,042.3	1,089	709.9	845.9	1,127.7	269.7	2.69	1.76	2.09	2.79	0.67

Source: calculated according to China Finance Yearbook 2007 and other data provided by the Ministry of Finance. Expenditure here refers to the expenditure of respective levels.

Because a great quantity of public goods and services that fall into the local category entail local provision, management, payment or payment on others' behalf, the local proportion of expenditure in form is neither low nor high. In 2006, the local general budget expenditure accounted for 73.1% of total general budget expenditure, in which the county and township portion made up 27.9% and 6.7% respectively (Table 6);²⁸ if adding general budget expenditure, fund expenditure and extra-budgetary expenditure, the local portion constituted 75.6% of the total, of which counties and townships shared 27.2% and 5.6% respectively (Table 7). Statistics showed that in 2010, local general budgetary revenue accounted for 48.9% of total general budgetary revenue, and local general budget expenditures covered 82.2% of total general budgetary expenditure. The international index for fiscal decentralization refers to the ratio of local fiscal expenditure. Measured by ratio, China seems to have a high degree of fiscal decentralization, but it is problematic to measure the degree of fiscal decentralization by using a single expenditure ratio. Taking into consideration the distribution of revenues and expenditures, and the division of powers and responsibilities, our fiscal administration system is actually rather centralized. The ratio of local expenditure as an index of fiscal decentralization works on the premise of a centralized fiscal system in China, and this premise cannot be challenged or overturned.

²⁸ Fiscal expenditure here does not include national repayments of debt principal, added sinking fund and balance of fiscal revenue and expenditure in 2004.

Table 7: Breakdown of Government Expenditure at All Levels in 2006

	Amount (100 Million Yuan)				Percentage (%)						
	national total	central level	provincial level	prefectural level	county level	township level	central level	provincial level	prefectural level	county level	township level
total general budget expenditure	4042.3	1089	709.9	845.9	1,127.7	269.7	2.69	1.76	2.09	2.79	0.67
fund expenditure	699.3	170.7	175.1	192.8	153.6	7.1	2.44	2.5	2.76	2.2	0.1
extra-budgetary expenditure	586.7	37.8	1,801. ¹	1,807. ¹	1,672. ¹	20.8	0.64	3.07 ¹	3.08 ¹	2.85 ¹	0.35
total	5328.3	1297.5	10,652. ¹	12,194. ¹	14,485. ¹	297.6	2.44	2.00 ¹	2.29 ¹	2.72 ¹	0.56

Note: 1. estimated data. Estimate proportions of provincial, prefectural and county level extra-budgetary expenditures by applying proportions of extra-budgetary revenues, then compute amounts of extra-budgetary revenues at three levels and other summed data accordingly.

Source: China Finance Yearbook 2007 and other data provided by the Ministry of Finance.

2.4 Transfer Payment

Many types of transfer payment systems have been established in China since 1994. Common international practice classifies transfer payment into general purpose transfer payments and special transfer payments: the former includes tax refunds and transfer payments for fiscal equalization (general transfer payment subsidy) and the latter includes transfer payments for salary adjustment, transfer payment subsidies for rural tax and fee reform, transfer payment for minority areas, original system subsidy, special transfer payment subsidy, and so on.²⁹

²⁹ Contents about classification and analysis of fiscal transfer payment derive from Qiao Baoyun, Feng Xingyuan and Zhu Hengpeng's *On the Influence of China's Fiscal Transfer Payment Scale and Means on Local Government Scale*, internal manuscript, 2008. Transfer payment in China usually includes three types: fiscal resources transfer payments, tax refunds and original system subsidies, and special transfers. Amongst this final category, fiscal resource transfer payments include general purpose transfer payments, transfer payments for minority areas, transfer payments for salary adjustment, transfer payments for rural tax and fee reform, and fiscal resource transfer payments for yearend settlement. Such classification tends to confuse general purpose transfer payments belonging to fiscal resource transfer payments with non-general transfer payment, or even cause them to appear identical. This is why I follow the internationally accepted method of classification in this paper. For the usual method of classification in China, refer to Center for Public Policy Studies, Shanghai University of Finance and Economics, ditto, p213-214

Central-to-Local Transfer Payment

General Purpose Transfer Payment

Tax refund. The 1994 tax sharing fiscal system reform incorporated VAT and consumption tax into the category of central tax, and simultaneously set up the VAT refund accounting subject and the consumption tax fund accounting subject to ensure provincial revenue from the two types of tax at 1993's level. The refund amount of VAT/consumption tax at that time was equivalent to the refunded amount of the previous year plus 30% of the VAT/consumption tax of the same year. As in 2002, personal income tax and enterprise income tax³⁰ also fell into the category of shared tax. The two taxes then were shared by the central and provincial governments at a ratio of 50:50, but from 2003, the central share rose to 60%. Considering stability of provincial fiscal revenue, the central government set up corresponding income tax refund accounting subjects to ensure provincial revenue from income taxes would not fall lower than the 2001 level. In 2008, the refunds from VAT and consumption taxes amounted to 337.2 billion yuan, and the refund to the income tax base amounted to 91.019 billion yuan, totaling 428.219 billion yuan (Table 8).³¹

Transfer payment for fiscal equalization (general transfer payment subsidy). Transfer payment for fiscal equalization belongs to formula-based general transfer payment; here we call it general transfer payment subsidy. In order to reduce regional financial inequality, the central government initiated a formula-based payment mode—the fiscal equalization transfer payment in 1995 (called “transitional transfer payment” before 2001). The amount of this payment is decided by three factors—the relevant province's standard fiscal revenue, standard fiscal expenditure and standard fiscal gap in proportion to the national revenue-expenditure gap. The scale of this item is controlled by the central government flexibly, depending on each year's disposable fiscal resources, and incremental growth of fiscal resources in particular. Although growing rapidly from 2.07 billion yuan in 1995 to 351.052 billion yuan in 2008, the formula-based general transfer made up only 15.3%, a rather low proportion of total central-to-local transfer payment.

The net amount of general purpose transfer payment from the center to the localities is equal to the foregoing tax refund plus the fiscal equalization transfer (general transfer payment subsidy) minus the revenue turned over by localities. The amount of turnover in 2008 was 93.993 billion

³⁰ Income tax coming from the following enterprises shall belong to the central government and not be shared: railway transportation, national postal service, Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, China Development Bank, Agricultural Development Bank of China, Export-Import Bank of China, offshore oil and gas companies, China National Petroleum Corporation, China National Petroleum & Chemical Corporation.

³¹ *Table: the center's expenditure for tax refund and transfer payment to localities in 2008*, Xinhua News Agency 06/03/2009, quoted from http://www.gov.cn/2009lh/content_1252791.htm

yuan,³² so the same year's net amount of general purpose transfer payment was computed to be 685.278 billion yuan.

Special Transfer Payment

According to international standard of classification, China's special transfer payment in 2008 came to 1,515.29 billion yuan, constituting 66% of total central-to-local transfer payment.³³

- *Transfer payment for salary adjustment.* The central government increased civil servant salaries several times since 1998. This item is designed to fill the fiscal gap caused by the center's salary raise policy and ensure smooth implementation in various regions, especially the central and western regions. Besides these, provinces having difficulty paying rural elementary and secondary school teacher salaries are compensated from the salary adjustment transfer, which amounted to 239.23 billion yuan in 2008.
- *Transfer payment subsidy for rural tax and fee reform.* This item was initiated in 2000 for promoting implementation of national policies. More specifically, it promoted abolishing "fees paid by farmers for overall township planning and village reserve" and phasing out the agriculture tax.³⁴ It was designed to fill county, township and village fiscal gaps caused by the rural tax and fee reform. From 2001 to 2007, the central government arranged a total of 327.7 billion yuan as the transfer payment subsidy for rural tax and fee reform; the figure was 76.254 billion yuan in 2008.
- *Transfer payment for minority areas.* Transfer payment was launched in 2002 with an eye to supporting the development of ethnic minority areas, which generally suffer underdeveloped economies. In 2002, the total amount of this payment was one billion yuan. From this baseline, the amount has been increased proportionally every year. In 2008, the transfer payment of the central government for minority areas reached 27.579 billion yuan.

³² Ministry of Finance. *Report on Central and Local Budget Performance in 2008 and Central and Local Drafted Budget in 2009 (summary)*, delivered on 2nd session of 11th NPC, 05/03/ 2009.

³³ Computed according to data from the Ministry of Finance *Report on Central and Local Budget Performance in 2007 and Central and Local Drafted Budget in 2008* and the *Report on Central and Local Budget Performance in 2008 and Central and Local Drafted Budget in 2009*, the two figures should be 718.81 billion yuan and 996.693 billion yuan separately. Here data in Report is replaced by data in *China's Financial Reform for Thirty Years*, edited by Xie Xuren, and the computing result is 689.8 billion yuan. See P91 of this book.

³⁴ Among the rural taxes and fees that have been abolished were three types of village levies (for public reserve funds, public welfare funds, and management fees) and five types of township pooling funds (for rural education, family planning, militia training, rural road construction, and subsidies to entitled groups such as disabled veterans).

- *Original system subsidy (a form of transfer payment for offsetting the decrease of local revenue caused by the 1994 tax sharing reform).* The original system subsidy was a form of fixed quota transfer payment under the fiscal contracting system effective from 1988 to 1993. The payments amounted to 12.6 billion yuan both in 2003 and 2004. Starting from 1994, local governments, according to the central-local fiscal contracts that were enforced starting in 1994 and were still effective then turned a share of revenue over to the central government or received subsidies from the center. The amount of transfers roughly equaled the fiscal deficit estimated in the first year (the gap between fiscal revenue and fiscal expenditure). So far, 16 provinces, including Inner Mongolia, Jilin, Fujian, Jiangxi, Shandong, Guangxi, Hainan, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang, still receive this form of transfer from the center. The original system subsidy amounted to 13.614 billion yuan in 2008.

Table 8: Transfer Payment from Central to Local Governments in 2008
Unit: 100 Million Yuan

Item of Transfer Payment	Amount
I. central-to-local general purpose transfer payment	779. 271
general transfer payment subsidy	351. 052
refunds of VAT and consumption tax	337.2
income tax base refund	91. 019
II. special transfer payment	1515. 29
transfer payment for minority areas	27. 579
reward and compensation fund for county and township basic fiscal resources safeguard mechanism	43. 818
salary adjustment transfer payment	239. 23
transfer payment subsidy for rural tax and fee reform	76. 254
compulsory education transfer payment	26. 936
subsidy for rural compulsory education debt solution	15
fiscal resources transfer payment for resource-exhausted cities	2.5
quota subsidy (original system subsidy)	13. 614
subsidy for enterprise and public institution transformation	33.5
fiscal resources subsidy for settlement	35. 466
transfer payment to administrations of industry and commerce in compensation for the fees they used to collect from sole proprietors and fair trade markets	4.7
special transfer payment subsidy	996. 693
education	68. 763

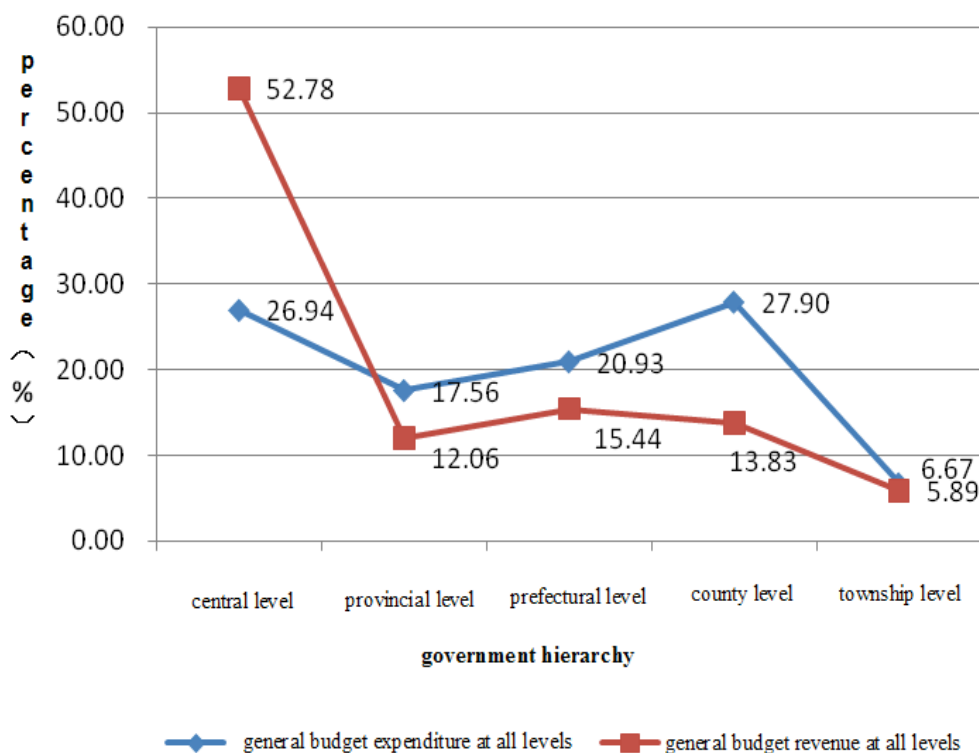
science and technology	8. 588
social security and employment	239. 931
medical care and public health	78. 002
environmental protection	97. 409
rural water resources	151. 313
other special transfer payment	352. 687
total central-to-local transfer payment	2294. 561

Source: Xinhua News Agency, 06/03/2009

- *Special transfer payment subsidy*. Usually called “special transfer payment” by the Ministry of Finance, there were 174 special transfer payment subsidy projects at the beginning of 2008. This type of subsidy is project-based, with a special clearly-defined purpose, e.g. supporting agricultural development, subsidizing infrastructure construction, aiding backward areas, or providing emergency funds for natural disasters. In 2008, this form of transfer payment rose to 996.693 billion yuan or 43.4% of total transfer payment from the center to localities.
- Other types include rewards and compensation funds for county and township basic fiscal resources, safeguard mechanisms, compulsory education transfer payments, subsidies for rural compulsory education, debt relief, fiscal resource transfer payments for resource-exhausted cities, fiscal resource subsidies for settlement, subsidies for enterprise and public institution transformation, and transfer payments to industry and commerce institutions in compensation for the fees they used to collect from sole proprietors and fair trade markets. Payments totaled 161.92 billion yuan in 2008.

While the center’s fiscal expenditure for the central level was 1,337.431 billion yuan in 2008, central-to-local transfer payments, including tax refunds, came to 2,294.561 billion yuan, 1.7 times the former, and 63.2% of total fiscal expenditure of the central government. The local-level revenue of the same year was 2,356.504 billion yuan, plus the central transfer payment of 2,294.561 billion yuan, local fiscal revenue came to 5,065.06 billion yuan. The central transfer payment shared 46.8% of funding for local fiscal expenditure, which was 4,905.272 billion yuan.

Chart 1: 2006 General Budget Gap of Government at All Levels



Source: China Finance Yearbook 2007 and other data provided by the Ministry of Finance

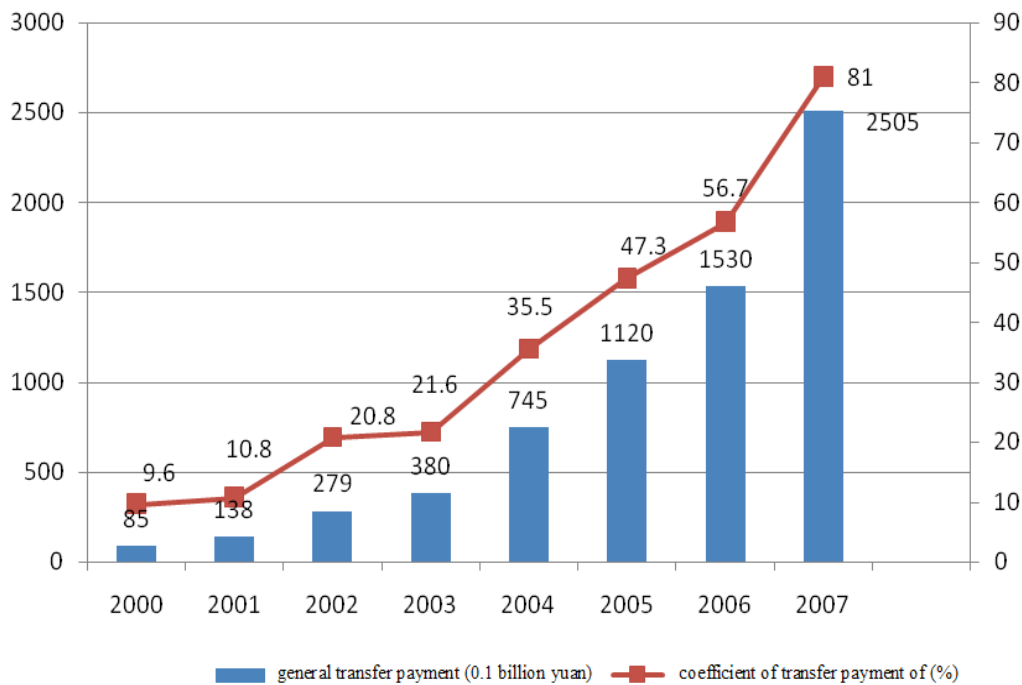
A large part of the foregoing central-to-provincial transfer payment goes to central and western regions as well as counties, townships and villages. In central and western areas, for example, 54.4% of local fiscal expenditures on average derive from the center’s transfer payments. Hierarchic centralization of county and township general budget revenues by higher-level governments produces heavy dependence of county and township finances on higher-level transfer payments. Chart 1 shows general budgetary gaps of governments at all levels in 2006. On the whole, governments across sub-national levels depend on transfer payments, from the central government in particular, to fill in their revenue-expenditure gaps. This is reflected by the vertical gaps between revenue and expenditure of governments at the same level.

The high ratio of local expenditure can be largely attributed to the center’s return en masse of centralized revenue to local governments by means of transfer payment, the majority of which is special transfer payment, rather than transfer payment for fiscal resources equalization (general transfer payment subsidies). Among the central-to-local transfers in 2007, transfer payment for fiscal equalization reached 250.5 billion yuan,³⁵ only 13.8% of the national total, but accounting

³⁵ *General Transfer Payment Shifts from For “People” to For “Things,”* by Li Zheng, published on China Taxation News, 07/07/2008

for 81% of the local standard fiscal gap, compared to 9.6% in 2000 (Chart 2).³⁶ This clearly shows that it played a crucial role in lower-level fiscal equalization in various provinces. Different from fiscal equalization transfers, special transfer payments are required to reflect the center’s policy direction, directives and centralized control. In reality, it is often a means for government departments, or a number of officials, to control resources and reap financial benefits.

Chart 2: General Purpose Transfer Subsidy and Coefficient (2000–2007)



Note: coefficient of transfer payment refers to fiscal equalization transfer in proportion to local standard fiscal gap.

Source: edited by Xie Xuren, *Review on China’s Fiscal Reform for Thirty Years*, China Financial and Economic Publishing House, 2008

Transfer Payment from Provinces and Prefectural Cities to Lower-level Governments

It should be noted that besides central-to-local transfer payment, provinces and prefectural cities also provide transfer payment to a number of counties. Sources of funding involve central-to-local transfers and funds allocated by local governments themselves.³⁷ Such transfer payments include general purpose transfers and special transfers (Table 9).

³⁶ *China’s Fiscal Reform for Thirty Years*, by Xie Xuren (Editor-in-chief), China Financial and Economic Publishing House, 2008

³⁷ Edited by Xie Xuren (Editor-in-chief), ditto, p104

Table 9: Types of Transfers from Provinces to Lower-Level Governments in China

Type	Sub-Type	Example
general purpose transfer payment	tax refund	Heilongjiang: in 2007, revenue base to be turned over and refund of consumption tax, VAT, enterprise income tax, personal income tax and business tax allocated directly to counties (determination and allocation of business tax base to be turned over excluding counties subordinate to Harbin municipality) Anhui province:
	Subsidy for system adjustment	Shanxi province: starting in 2007, began to regulate provincial and low-level government fiscal systems, and implement the “province directly supervising county” model in 35 national-level key counties for poverty alleviation and development. New bases determined for pilots: taking 2006 as a base year this plan transferred upward or downward according to new regulations to ensure the vested interest of all levels. Municipalities determined the range of revenue, subsidies for system adjustment (or revenue to be turned over) and quota subsidies for fiscal resources according to united provincial rules. Schemes for implementing system adjustment and county and township bases are reported to provincial government for approval.
	general transfer payment subsidy	Shaanxi province: provided general transfer subsidies to poor cities and counties in 2008, totaling 12.16 billion yuan (computation as shown in Theme 1)
special transfer payment	matching funds for county and township projects provided by the center	Guizhou province: in 2009, planned investment in 88 rural drinking water safety projects in process totaled 50.375 million yuan, including budgetary investment increases of 40.3 million yuan, provincial matching funds of 5,038 thousand yuan, and prefectural matching funds of 5,037 thousand yuan Xiuning county of Anhui province: in 2009, NRCMS-participating farmers each volunteered to pay 20 yuan per year, added to by national, provincial and county-level subsidies of 80 yuan for each farmer each year (central: 40 yuan, provincial: 30 yuan, county: 10 yuan), totaling 100 yuan per person per year

	provincial special transfer payment subsidy	Anhui province: in 2009, 2.5 billion yuan of special transfer payments were arranged for establishing SME credit guarantee funds and loan risk compensation Jiangyan city of Jiangsu province: in 2008, NRCMS funding criteria was set at 100 yuan/person, therein individuals paid 20 yuan/person, with provincial subsidies of 40 yuan/person, and city and township (district) matched funds of 40 yuan/person
	Provincial incentive transfer payment to cities and counties	Hubei province: in 2008, the province rewarded governments of municipalities, prefectures, cities directly under provincial jurisdiction, forest districts, counties (cities, districts—hereinafter referred to as cities and counties) for supporting industrial cluster development, 90% of incentive funds used to support key growth in industrial clusters, 10% for other growth industrial cluster development.

Source: documents from relevant provincial and municipal governments.

General purpose transfer payments include tax refunds, subsidies for system adjustment and general transfer payment subsidies. Special transfers include provincial and municipal matching funds for centrally-financed county projects (e.g. NRCMS matching funds), funds for province and municipal-financed county projects, and incentive transfers such as “rewards in place of subsidy,” “rewards for deficit reduction” and “rewards for step-up of fiscal revenue.” Provincial transfer payments to lower levels are set at a single, uniform size. In many provinces, the announced scale of transfer payments actually included the central portion transferred downward via province, as shown in the Anhui case: in 2007, the Anhui provincial government arranged 56.27 billion yuan for transfer downward, which included 26.78 billion yuan of fiscal resources transfer payment. Only a few provinces have established the formula-based downward general transfer subsidy system; most provinces simply deliver central-to-city/county transfers to destinations,³⁸ and provide, in a passive way, matching funds as required by the center. Shaanxi province, for example, allocated 12.16 billion yuan as general transfer payment subsidies to cities and counties facing financial troubles in 2008 (computation as referred to in Theme 1).³⁹ In 2006, the Hubei provincial government paid to 102 counties (cities, districts) 34.3 billion yuan of fiscal resources transfers, accounting for 67% of county (city, district) general budget

³⁸ *Reform Improves Fiscal Transfer Payment System*, by Wang Yuan, published on *China Investment*. 27/12/2008.

³⁹ *Provincial Announcement to Cities and Counties on the Method of General Transfer Payment In 2008*, issued by Shaanxi Provincial People’s Government General Office, (2008) No. 86, 06/08/2008.

expenditure.⁴⁰ Zhejiang province arranged 600 million yuan of transfer payments for ecology and environmental protection.⁴¹

Poor counties have a high degree of dependence on central, provincial and prefectural transfer. An example is Anyue county of Sichuan province which, as shown in Table 2, is highly dependent on central and provincial transfers. Transfer payment provided by provinces and prefectural cities to lower-level governments mainly serves the following purpose: 1) General purpose transfer payment: including tax refund and general transfer payment subsidy; the latter is designed to safeguard basic fiscal resources of counties facing fiscal difficulties and to achieve a certain extent of fiscal equality at provincial and municipal levels. 2) Special transfer payments: referring to special provincial and prefectural expenditure on counties and townships, including special transfer subsidies provided by provinces and prefectures themselves, matching funds for centrally financed county and township projects, and incentive transfer payment, by which it means some provinces and prefectural cities develop reward and punishment standards and provide transfer payment accordingly as an incentive by taking into consideration the growth of county fiscal revenue, excess over the required standard, financial balance, loan repayment to higher-level governments, control of the number of civil servants on the government payroll, and so forth.⁴² Some other provinces arranged transfer payment to exceptionally poor townships, such as Anhui province.

⁴⁰ *Insisting on Scientific Financial Management and Developing County Economy*, by Wang Qiyang, published on *Review of Economic Research*. Issue 41, 2007

⁴¹ Zhejiang Provincial Department of Finance, *Zhejiang Province's Overall Implementation of Ecological Finance Transfer Payment System*, issued on *Huangyan Financial Information Net*. 03/06/2008

⁴² Edited by Xie Xuren (Editor-in-chief), ditto, p104-105

Theme 1: Methods Shaanxi Province Applied for General Transfer to Cities and Counties in 2008

Formula for computing general purpose transfer payment to a county:

County general purpose transfer payment = minimum fiscal resources safeguard subsidy + general transfer payment subsidy

Formula for computing general transfer payment subsidy to a county:

County general transfer payment subsidy = (its standard expenditure – its total fiscal resources) x proportion of provincial share x general transfer coefficient

Formula for computing county general transfer coefficient:

General transfer coefficient = (provincial-to-county general transfer increment – minimum fiscal resources safeguard subsidy) ÷ \sum (its standard fiscal gap x proportion of provincial share)

Computation of minimum fiscal resources safeguard subsidy:

To establish basic fiscal resources safeguard mechanism based on Shaanxi county-level standards of personal expenditure and daily public expenditure in 2007 (26,000 yuan per capita per year), that is, for counties and districts with annual per capita fiscal resources lower than 26,000 yuan (computed by applying a standard number of civil servants on the government payroll), to determine the minimum standard of expenditure by applying the standard number of civil servants on county government payroll and the standard per capita expenditure of 26,000 yuan; and to make up the deficiency in full of total fiscal resources below the standard expenditure.

Source: General Office of Shaanxi Provincial People's Government, Notice on Methods of Provincial Transfer Payment to Cities and Counties 2008, issued by Shaanxi Government General Office No. 86 [2008], 0 6/08/2008.

2.5 Problems and Causes of County Fiscal Administration System

So far, there exist a lot of problems in county fiscal administration systems, the most overarching of which are summarized below:

- The existing county fiscal administration system protects vested interest by focusing on fiscal revenue regulation and avoiding crucial problems in fiscal and tax system reform, such as lack of clear definition in functions and powers, and expenditure responsibilities. The intergovernmental fiscal system is under an administrative framework rather than a legislative one, left with residues of precious fiscal contracting system and base method.

Original system subsidy, tax refund and some other practices make the system more complicated and less transparent.⁴³

- Under the current county fiscal administration system, intergovernmental division of functions and powers and expenditure responsibilities are ambiguous. Powers of higher-level governments, endowed by law to decide, change, reverse, transfer and adjust functions and powers of the lower levels drive indefinitiveness and instability, leaving higher levels with extensive room to shift expenditure responsibilities downward.
- Intergovernmental distribution of both fiscal resources and expenditure responsibilities lies under the control of the central and higher-level governments. While revenue allocation is centralized, responsibilities are shifted down tier by tier. Serious mismatches between revenue and expenditure assignments drives lower-level governments to adopt countermeasures (including extra-budgetary and extra-system levies) to combat this system.
- While the legislative power of taxation belongs solely to the central government, the legislative power of fee collection is under the firm control of the center, provinces and major cities. Local mobilization of revenue sources is not encouraged, nor are local governments empowered to adjust tax rates.
- A sound system of local taxation is not in place. Sub-provincial governments have neither a formal system of revenue distribution nor primary taxes, and can easily be deprived of original primary taxes by higher-level governments (e.g. by putting some taxes into the category of shared tax). Therefore, local revenue depends highly on extra-budgetary funds, extra-systemic funds and debt financing.
- The current intergovernmental fiscal administration system is designed to safeguard vested interests of government across levels by consolidating incremental revenue. Despite the rapid growth of general transfer payment subsidies in recent years, its aggregate amount is limited and inadequate to safeguard basic fiscal resources for provision of nationally determined basic public services.

⁴³ Transparency of finance and budget is affected both by the complexity of budget system itself and the extent of fiscal information disclosure by all level governments. According to a study made by Center for Public Policy Studies, Shanghai University of Finance and Economics, if total fiscal transparency is assumed to be 100 score, the province with a highest level of transparency in 2009 is Fujian, scoring 62.66, the scores of all other provinces were lower than 33.96, and Gansu province scored the lowest, 14.79. See *Report on China Financial Transparency in 2009—Evaluation of Financial Information Disclosure at Provincial Level*, by Center for Public Policy Studies, Shanghai University of Finance and Economics, Shanghai: Shanghai Cai Jing Chu Ban She (www.shcjcb.com), 2009.

- The tax sharing reform has resulted in centralization of revenue allocation and decentralization of expenditure responsibility. The rural tax and fee reform realized tax reduction or exemption, abolition of “fees paid by farmers for overall township planning and village reserve,” and reduction or cancellation of rural labor accumulation and volunteer work. The broadening fiscal gap makes poverty-stricken counties highly dependent on transfer payment.
- Relatedly, many county and township governments fall into debt, willingly or not, by undertaking their own functions and responsibilities or in implementing mandated services. Heavy debt burdens, including contingent liability, exacerbate the fiscal predicament of many counties and townships.
- The excessively high proportion of transfer payments to local disposable fiscal resources in poorer areas indicates a neglect of formal revenue allocation to increase local fiscal revenue. Besides this, general purpose transfer payment as compensation for fiscal resources has an excessively small share in transfer payments while special transfer payment has an excessively large one. The former is determined formulaically for computing basic fiscal gaps; the latter is subject to government discretion and lacks of transparency

There are also some specific problems in county fiscal administration system:

- The proportion of refunds of over-base VAT or consumption tax falls off year by year, showing intensified centralization of local finance.⁴⁴
- The growing number of special funds controlled by government departments and poor transparency of management makes these departments interest groups and targets of non-governmental interest groups for rent seeking. This accounts for the large number of special fund projects of low efficiency.
- Intergovernmental responsibilities are ambiguous in terms of project management and division of labor. Which level of government bears responsibilities for a specific project is unclear, and intrinsic to this system is a certain degree of arbitrariness—the higher levels have excessively broad discretionary authority. The center can require localities to

⁴⁴ *Intergovernmental Fiscal Relations in China*, compiled by Budget Department of Ministry of Finance. Beijing: China Financial and Economic Publishing House, 2003, p132 and other pages. According to 1993 tax sharing methods, the central-to-local refund amount is by applying last year’s refund base and growth rate of turnover VAT and consumption tax multiplied by coefficient of 0.3%, instead of the proportion of absolute amount of the two taxes to be turned over. Consistent with the development trends in other provinces, from 2000 to 2005, the refund increment of two taxes showed a falling tendency in proportion to the increment of two taxes to be turned over in Inner Mongolia, from 22% to 11.8%. See *Establishing Fiscal Development Outlook of Leaving Wealth with the People*, by Zhu Xiaojun and Zhang Yongjun, published on *Survey Research Report*. 10th issue, 2008

pay for centrally financed projects and determine the size of local matching funds. Examples include grain risk fund, the food self-sufficiency project, comprehensive agricultural development, prison/reeducation-through-labor infrastructure loan interest subsidies and other projects, which all require local governments to provide matching funds, bringing a heavy burden to poverty-stricken counties.⁴⁵

- The structure of fiscal expenditure is irrational; general budgets are virtually equal to “payroll finance.” In most counties of China (especially in central and western regions), the vast majority of fiscal expenditure is administrative expenditure, 80–90% used for guarantee of payroll payment and maintenance of public services and facilities.⁴⁶
- There is an overlarge number of statutory expenditure or higher-level mandated expenditure, combined with serious intervention. All sorts of intervention from central authorities bring obstacles for localities to arrange financial, human and material resources. Statutory and higher-level requirements relate to every aspect. For example, a lot of regulations and policies set requirements for spending on such key undertakings as agriculture, science and technology, education, public health, family planning and cultural propaganda, some requiring a growth rate higher than that of recurring revenue, others requiring a certain proportion to GDP. Such practices impair fiscal autonomy of local governments, create inflexible spending and rigid fiscal structure, and so add to local burden of expenditure.⁴⁷

Causes of above problems involve the following aspects:

- In China, government at all levels is still amidst a transition of functions from an unlimited government to a service-oriented one; in this course, governmental fiscal power is not effectively constrained, division of functions between government and market is not clearly defined, and the “serviceability” governments present lacks an orientation toward civil demands.

⁴⁵ Compiled by Budget Department of Ministry of Finance, ditto, p175

⁴⁶ *Brief Analysis of Countermeasures Helping County Finance Get Through Difficult Situation*, by Guo Shijiang, Li Changzheng and Chen Lin, issued on *Website of Research Institute for Fiscal Science of Ministry of Finance*. 21/12/2005

⁴⁷ Compiled by Budget Department of Ministry of Finance, 2003, ditto, p175. Zhang Ji: *Comparison of Intergovernmental Gap of Financial Expenditure*, published on www.chinaacc.com, 24/02/2009. E.g. according to the Agriculture Law of P.R.C, the state shall gradually increase total spending on agriculture, the growth rate of annual national investment in agriculture shall be higher than that of regular revenue of national finance; according to the Education Law of P.R.C, the growth rate of budgetary funding for education shall be higher than that of regular fiscal revenue of national finance; according to the Law of Family Planning of PRC, the growth rate of annual operating expense for family planning shall be higher than that of regular fiscal revenue; according to the State Council Pilot Programme for Improving Urban Social Security System (issued by State Council [2002] No. 42), expenditure on social security shall grow to 15%-20% in proportion to fiscal expenditure.

- Promotion of local government officials partly depends on individual performance achieved within their administrative divisions. Such performance is often linked with GDP growth rate, construction and project initiation, in other words, it is linked to fiscal input, thus representing a strong incentive for local governments as a whole to inflate fiscal revenue and expenditure.⁴⁸
- The local fiscal system at each level is centralized with a of division of power dominated by the higher levels. This allows higher-level governments to change allocation revenue, centralize receipts or arbitrarily adjust and shift responsibilities and expenditures down to lower levels.
- Government functions and powers and expenditure responsibilities at all levels are not clearly defined. For systemic reasons, a large part of local functions and expenditures are related to implementing higher-level policies and regulations, which creates favorable conditions for higher-level governments to adjust and shift down responsibilities and expenditures.
- Tax sharing is controlled by higher-level administrative departments (empowered inappropriately by the Budget Law passed by the legislature) rather than legislative procedures, thus creating favorable conditions for higher-level governments to adjust allocation and centralize local revenue.
- Established on the basis of old fiscal contracting systems and methods, the administration-dominated tax sharing system is not geared toward responsibility requirements and expenditure needs of government at county and other local levels, nor does it follow the established international practice that division of functions and responsibilities takes precedence over distribution of revenues. The result is a mismatch between revenue assignments and expenditure needs, with a broad fiscal gap arising at county and township levels.
- The rural tax and fee reform deprived counties and townships of revenues from agriculture tax and agricultural specialty tax; townships and villages lost fees paid by farmers for overall township planning and village reserve, and other income sources. The further broadening fiscal gap leads to a high degree of dependence of counties, townships and villages on transfer payment from central and other higher-level governments.

⁴⁸ According to CBRC statistics, by the end of 2009, local government loan balance was 7.38 trillion yuan, a y-o-y growth of 70.4%. See *Local Government Is in Debt as much as 7.38 Trillion; Experts from Chinese Academy of Social Sciences Claim It Is Still in Control*, by Lu Xiaoping, Zhang Dukang, issued on People Net, 21/05/2010

3. Features, Problems and Causes of the Township Fiscal Administration System

The township fiscal system in China was generally established in the late 1980s.⁴⁹ county governments carry out administration of township fiscal system under the principle of “supervising the lower level.” Since 1994, numerous counties in various regions have adjusted their township fiscal systems, showing diversity of structure. Apart from that, the rural tax and fee reform, the comprehensive rural reform pilot and other related reforms have had a great influence on county administration of the township system.

3.1 Overview on Township Fiscal Administration System

China’s county and township fiscal administration system takes on the following forms: a) a tax-sharing fiscal administrative system, b) a combined system of tax sharing and fiscal contracting, c) a fiscal contracting system, d) the “county supervising township finance” system, and e) other forms. Similar to the super-township fiscal administration system, a truly normative township tax-sharing fiscal administrative system is nonexistent in China. All forms of township fiscal systems, including township tax sharing systems, are dominated by higher-level government and are therefore flexible.

The Tax-Sharing Fiscal Administrative System

This model, characterized by normative sharing of taxes, features unified leadership, hierarchic management, allocation of revenue and determination of a revenue and expenditure base. In the case of Dianjiang county, Chongqing municipality, the first-class townships of Xinmin and Taiping are in the practice of “determining revenue, expenditure, base, quota of subsidy (or turnover), and sharing revenues.” These measures fall into the category of tax-sharing (Table 8), through which provincial, prefectural and county governments no longer centralize revenues from townships after determination of expenditure, revenue, base and quota of subsidy (turnover). As a form of tax sharing in general, it retains residues of fiscal contracting and base method: for example, in Dianjiang county, Xinmin town and Taiping town governments must individually determine the factors that increase expenditure and reduce revenue while township bases remain unchanged. Both of these are typical in the fiscal contracting system; meanwhile, quota subsidy (or turnover) base and revenue sharing proportion are vestiges of the contracting system.

Combined System of Tax-Sharing and Fiscal Contracting

This model includes forms, such as “dividing taxes, determining revenue and expenditure, contracting for progressive increase, retaining all excess, contracting for 3–5 years,” “dividing

⁴⁹ Zhao Shukai, *Township Governance and Government Institutionalization*, Beijing, The Commercial Press, 2010

taxes, determining revenue and expenditure, sharing above-base revenue in proportion or sharing excess,” “dividing taxes, determining revenue and expenditure, contracting for progressive increase in above-base revenue,” “determining and linking up revenue and expenditure, turning over progressive increment (subsidies progressive deficiency), retaining all excess, self-bearing excess expenditure or deficiency of revenue.” Combining the parallel process of tax-sharing and contracting, the hybrid form is a “mainstream model” of the township fiscal system.⁵⁰ For example, Donggang city of Liaoning province started in 2005 to implement the model of “determining and linking up revenue and expenditure, turning over progressive increment (or subsidizing progressive deficiency), retaining all excess, self bearing excess expenditure or deficiency of revenue” (Table 10): the portion of revenue exceeding expenditure is turned over (the larger the excess, the larger the proportion to be turned over). The formula for computing turnover proportion is as follows: $(1 - \text{fiscal expenditure base} \div \text{fiscal revenue base}) \times 100\%$. System subsidies are implemented in the opposite situation. The city then centralizes 10% of its share of actual township excess revenue to establish the “township fiscal development regulation fund.” The formula for computing excess sharing is: $\text{amount of excess sharing} = \text{actual fiscal revenue} - \text{planned fiscal expenditure} - \text{system and other turnovers} + \text{system subsidy}$.

Fiscal Contracting System

There are two models in practice: 1) Counties (cities) determine township revenue and expenditure bases; townships turn over the excess portion of revenue over expenditure, and retain all remaining revenue. Conversely, the excess portion of expenditure over revenue is subsidized in quota, and any deficiency of revenue is borne by townships themselves or is deducted from expenditure. 2) Counties (cities) determine the amount of revenue to be turned over (or the amount of expenditure for subsidy) and the proportionate increase in revenue (or proportion of progressive increase in subsidy), but do not intervene in spending and allocation. Instead, they manage township revenue targets by rewarding for surpluses and punishing for deficiencies.⁵¹ For example, in 2008, Jianyang city of Fujian province put into force the model of “determining bases, contracting for revenue and expenditure, rewarding for excess, reducing expenditure for deficiency, contracting for one year.” Here taxes are not divided, but only revenue and expenditure bases determined and contracting implemented.

“County Supervising Township Finance” System.

As a component of comprehensive rural reform, the “county supervising township finance” system was first implemented in Anhui province in 2003. It is in fact more a model of “united control over revenue and expenditure” system. As provided in the Notice of the Ministry of

⁵⁰ *Humble Opinions of Township Fiscal System under System of Tax Distribution*, published on *Public Finance Research*. By Huang Daofen, Xu Zhaozhu and Zhou Pin. Issue 10, 1997, p.62-63

⁵¹ Huang Daofen, Xu Zhaozhu and Zhou Pin, ditto.

Finance on Further Promoting the Work of County Supervising Township Finance, issued on 28 July 2006, the “county supervising township finance” shall be implemented in principle, except in townships with a large size of revenue and expenditure and a considerable level of management. The work of “county supervising township finance” mainly involves joint preparation of budget, unified setup of accounts, centralized collection and payment, unified procurement, unified bill management, and county-township networking. Therein, the “united setup of accounts” requires cancelling township finance budgetary accounting; county financial departments shall be in charge of township finance, general accounting and check computation of accounts. Correspondingly, all township accounts in various financial institutions shall be cancelled and substituted with accounts opened uniformly by county fiscal departments in various township financial institutions; relevant subsidiary accounts of settlement shall be set up in light of the actual situation. In terms of the “centralized collection and payment,” all township budgetary and extra-budgetary revenues shall be incorporated into county fiscal systems. Township budgetary revenue shall be turned over in full to the county and township extra-budgetary revenue be paid in full to county extra-budgetary revenue special account. County fiscal departments shall check all computation of accounts according to the categories and subjects of county revenue. County expenditure is based on annual township budget. Under the related principle of “key events preceding general events,” the priority is to guarantee salary payment and gradually realize unified payment of salaries. The official expense imprest system is established to facilitate timely fund use by townships.

Table 10: County Administration of Township Fiscal System and Features

Region	Type of System	Application Period	System Feature	Description
Dianjiang county, Chongqing municipality	tax sharing system (to a number of first-class townships)	2008–2011	<ul style="list-style-type: none"> • Implement “determining revenue, expenditure, base, quota of subsidy (or turnover), and sharing revenues” in first-class towns Xinmin and Taiping. • Towns by themselves digest factors that increase expenditure and reduce revenue, and township bases remain unchanged, 	<ul style="list-style-type: none"> • Self-digestion of factors that increase expenditure and reduce revenue, and non-adjustment of township bases contain the contents of tax sharing system and base method, and traces of fiscal contracting system.
Donggang city of Liaoning	tax sharing system + fiscal	2005	<ul style="list-style-type: none"> • “Determine and link up revenue and expenditure, turn over progressive 	The part of revenue base in excess of expenditure base is

province	contracting system		<p>increment (subsidies progressive deficiency), retain all excess, self-bear excess expenditure or deficiency of revenue”</p> <p>Then gather 10% of its share of township actual excess revenue to establish the “township fiscal development regulation fund.” Formula for computing excess sharing: amount of excess sharing = actual fiscal revenue - planned fiscal expenditure - system and other turnovers + system subsidy.</p>	<p>turned over (the larger the excess, the larger the proportion to be turned over). Formula for computing turnover proportion: $(1 - \text{fiscal expenditure base} \div \text{fiscal revenue base}) \times 100\%$. System subsidy is implemented for the opposite situation. Contain contents of tax sharing system, base method and fiscal contracting system</p>
Jianyang city of Fujian province	fiscal contracting system	The whole year of 2008	Determine bases, contract for revenue and expenditure, reward for excess, reduce expenditure for deficiency, contract one year	<p>For township actual revenue in yearend (except tobacco tax), reward at amount of 70% of excess revenue above base, or reduce expenditure base at amount of 70% of deficiency below base</p> <ul style="list-style-type: none"> Taxes are not shared. Include contents of fiscal contracting system and base method.
Yanbian county of Sichuan province	county supervising township finance	starting from 2007	Maintain townships’ power of budget management unchanged, capital ownership and right of use unchanged, power of financial examination and approval unchanged, status of independent accounting	Yanbian County Center for Township Fiscal Administration (hereinafter referred to as Township Administration Center) established as a deputy-section-chief

			entity unchanged, debtor-creditor relationship unchanged cancel original township banking accounts, funds under unified examination and approval, payment and accounting	public institution subordinate to County Bureau of Finance (personnel treatment in light of national public servant treatment)
Anyue county of Sichuan province	county supervising county finance	2005	Revenue-based subsidy, minimum security, use by contracting <ul style="list-style-type: none"> • Cancel township-level revenue and treasury, incorporate original township revenue into county finance. County re-determine the amount of subsidy for revenue to be turned over. • On that basis, and considering actual fiscal situation, the county worked to safeguard minimum per capita fiscal resources, and allocate fiscal resources determined in light of “revenue-based subsidy and minimum security” for township use by contracting. 	Include contents of fiscal contracting system.

Source: documents about relevant counties’ township fiscal administration system.

The pilot reform of “county supervising township finance” was initiated after 2002 in Anhui, Hubei, Hebei, Henan, Heilongjiang, Jilin and Inner Mongolia, and then spread in other areas. At the beginning of 2005, Jiangxi province launched the experiment in “county supervising township finance” pilots within the framework of comprehensive rural reform. By May 2008, the system had been successfully implemented in 1,420 townships, making up 96% of the total number of townships in the province. Yanbian county of Sichuan province issued the Interim Measures for Implementing “County Supervising Township Finance” Fiscal Administration System in Yanbian County (Table 10). As prescribed therein, all township fiscal funds, including

budgetary funds, extra-budgetary funds, higher-level transfers, governmental funds, special funds (excluding special funds for which county-level accounting is required by policies) and other funds, shall be collected and paid uniformly via the account of Township Administration Center. Original township accounts in financial institutions shall be cancelled, substituted by “basic settlement account” and “basic expenditure account,” both opened by the County Center for Township Administration. Townships shall open only three accounts: “imprest account,” “special fund account” and “village-level fund account.” In 2005,⁵² Sichuan Anyue county began to adjust its township fiscal administration system by implementing the “county supervising township finance” model.⁵³ Given the original practices of “fixed revenue and expenditure, contracting for revenue and expenditure, and quota turnover (subsidy),” contents of adjustment included “revenue-based subsidy, minimum security and use by contracting,” that is, the county cancelled township-level revenue and treasury, incorporated all township revenue into county finance and re-determined the amount of subsidy for revenue to be turned over to safeguard minimum per capita fiscal resources in light of county fiscal conditions. It also incorporated fiscal resources, determined in light of “revenue-based subsidy and minimum security,” for township use by contracting. Details were as follows: 1) Township-level treasures were abolished. Township Offices of Finance uniformly opened “budgetary basic deposit accounts,” “extra-budgetary fund special accounts” and “civil affairs fund special accounts” in local financial institutions. 2) The county determined the township-level amount of subsidy for revenue to be turned over. The 2005 subsidy was 10% the amount of the township business tax and deed tax actually completed in 2004. 3) The county determined the amount of subsidy for township per capita minimum security by using foregoing method to adjust township per capita fiscal resources and make up the deficiency in case of per capita fiscal resources lower than 17,500 yuan. Anyue county centralized education expenditure responsibilities (excluding liabilities) and special subsidy for township interest expense, took actions to safeguard basic township institution operation, and introduced township fiscal incentives and restraint mechanisms to conduct “rewards in place of subsidy” on the basis of performance assessment. As shown in Table 11, Anyue county had disposable financial resources totaling 184.34 million yuan in 2005. Following the practice of “county supervising township finance,” the township budget was cancelled, and relevant revenue subjects were turned into subsidy revenue (not general budget revenue) and turnover revenue.

⁵² *All Townships in Jiangxi Will Carry out “County Supervising Township Finance” Comprehensively by the End of This Year.* By Li Meijuan, issued on *Xihua Net*. 17/06/2008

⁵³ See *Announcement of Anyue County People’s Government on Adjusting Township Fiscal System.* Issued by Anyue County People’s Government, (2005) No.93, 14/12/ 2005.

Table 11: Sichuan Anyue County Total Disposable Fiscal Resources in 2005
Unit: 10 Thousand Yuan

Subject	Amount
subsidy revenue (county to township)	184.34
therein: general transfer payment	36.22
salary adjustment subsidy	3.59
transfer payment subsidy for rural tax and fee reform (excluding transfer payment subsidy for primary and secondary school teacher salaries)	57.03
transfer payment subsidy for cancellation of agricultural specialty tax and reduction in agriculture tax rate	65.05
revenue to be turned over (township to county)	34.28

Source: Bureau of Finance of Anyue County

In sum, the system of “county supervising township finance” played the following roles for townships short of money:⁵⁴ 1) Reducing township spending to relieve fiscal difficulty, stopping up loopholes of arbitrary charging, spending, recruiting and borrowing to ensure the rational assignment of township expenditure in sequence of “salaries, operation and key projects;” 2) Consolidating and deepening rural tax and fee reform—while the reform restricted township revenue scale, the “county supervising township finance” system controlled township expenditure; 3) County finance played a large part of township expenditure functions, thus creating conditions for county-township administration system.

Other Township Fiscal Administration Systems

Here included is the system of united control over revenue and expenditure. In 2006, for example, Hebei province started to implement two township fiscal systems: the comparatively normative tax sharing system, and the system of united control over revenue and expenditure combined with incentives.⁵⁵ Details were: townships with rapid economic growth, a higher level of non-agricultural industry cluster and a larger scale of fiscal revenue implemented the normative tax sharing system, featuring “hierarchic administration, responsibility-based expenditure, revenue sharing, unity of power and responsibility.” Townships with slower economic growth, a lower level of non-agricultural industry cluster, weaker tax base, a smaller

⁵⁴ *Anhui Province Carries Out Systems of “County Supervising Township Finance” and “Province Directly Supervising County,”* published on *Zhong Guo Jing Ji Wang* (<http://www.ce.cn/>). 23/06/2006.

⁵⁵ *Hebei Province Tries Out Two Fiscal Systems of the County to the Township,* published on *Economic Daily*. 20/12/2006.

scale of fiscal revenue, and which was unlikely to grow into a regional economic center in the short term, implemented the system featuring “united management of revenue and expenditure, determination of revenue and expenditure, reward for excess and savings for own use,” that is, the system of “united control over revenue and expenditure.”

3.2 Problems and Causes

The above-mentioned problems and causes of the county fiscal system are also applicable to the township fiscal system. Besides, rural tax and fee reform has a relatively large influence on township fiscal administration systems. Serious problems also exist in the “county supervising township finance” system of which comprehensive rural reform is related.

According to Feng Xingyuan’s survey of 37 villages in 7 provinces nationwide, problems caused by rural tax and fee reform include:

Following tax and fee reform, township governments are affected the most in terms of decreasing revenue because of losing the functions of levying agriculture tax and collecting fees paid by farmers for overall township planning and other taxes and administrative charges, while governments at the county level are facing increasing expense pressure.

After the rural tax and fee reform, in some areas the gap in county and town governments between revenue and expenditure is increasing, and the debt pressure on these governments is rising correspondingly.

In some villages, the collective economy has a weak income basis and fewer income sources, which diminishes the supply of public products and service for village organizations.

In some villages, the economy is in deficit, sometimes heavily so, which also has an impact on fund-raising and supply of public goods to village organizations.

After the tax and fee reform, it is hard to carry out the system of “one case one meeting;” villages’ ability to provide public goods is greatly weakened; in some villages, governance has no concrete content and the interior driving force for self-government among villagers is not fully activated.

After the abolition of agriculture tax, farmers do not directly shoulder taxes so their consciousness of taxes has gradually weakened, and they may begin to prefer rights to obligations. After rescinding the agriculture tax, township and village leaders do not have to spend large amount of labor, material and money to collect taxes and charges, therefore, they have less communication with villagers, and the relationship between them becomes gradually indifferent.

Many local peasants receive some biased information from policy publicity and public opinion and are misled to think that they do not have to pay any taxes and fees, which will influence the collection of normal charges (such as, electric charge and irrigation fee). Besides, as villagers do not need to pay taxes and fees, compared with before, the villagers are more easily made to be mere figureheads in terms of representation right and policy-making right within the framework of villagers' self-government.

The main reasons behind these problems are related to the rural tax and fee reform:

- The tax and fee reform reduces the amount of charges and finally cancels agriculture tax and agricultural specialty tax (tobacco is not included). Thus, county and township governments lost an important source of income; but, such \ income in terms of its scale is less important to the central and other higher-level governments;
- “Fees paid by farmers for overall township planning and village reserve” is cancelled, removing an important source of income for villages and townships;
- With the abolition of the agriculture tax, villages and towns cannot collect illicit charges appended to the agriculture tax before;
- Many villages and townships lost their source of income for paying debt;
- Many villages even lost their source of income for paying cadres' salaries and office expenses;
- Villages even lost source of income for infrastructure and basic public services.

Although the system of “county supervising township finance” involved in comprehensive rural reform has its advantages, it also brings some problems:

- Such a system is by nature the same as the fiscal administration system of “united control over revenue and expenditure.” It cancels the initiatives of township governments in budget and conflicts with current budget law to some extent. Therefore, this system is a interim one, requiring further reform of township administrative and fiscal systems;

- Such a system tends to drain township enthusiasm in promoting local economy development,⁵⁶ especially in those towns with more developed economies;
- It leads to high costs in time and efficiency in transferring funds, complicated formalities for reimbursement and difficult circulation practice for bills;
- Township governments cannot grasp the overall situation of their revenue and expenditure, have no clear understanding of its revenue, expenditure, balance, exchanged money and so on, and cannot make inquiries easily;
- It is easy to cause severe information asymmetries between township management centers in county and township governments, and provides possibility for corruption.

In all, this system reflects that the reform of whole government system lags behind. To solve all the problems in township administrative and fiscal systems by centralized powers of government of higher levels does not fully activate and utilize the potential of democratic policy-making, administration and supervision at the basic level.

4. Some Thoughts for Solving the Problems in County and Township Fiscal Administration System in China

To solve current problems in county and township fiscal administration system, it should truly clarify the functions and powers as well as fiscal responsibilities and powers at all levels and implement a real tax sharing system. The following suggestions may be feasible policy prescriptions:

4.1 Distribution of Functions and Powers (authority):

The authority of governments at all levels should be divided in the form of law. Five kinds of local government authority should be clearly distinguished, that is, existing authority for local governments, new established authority for local governments, authority entrusted by higher-level governments, authority shared by local governments and higher-level governments, and undefined authority. If undefined authority is related to the authority for local governments which is not defined in law, without special stipulations it will come under the governments of

⁵⁶ E.g. in Yingshang County, except the financial revenue collected by national tax and local tax departments, in 2005 financial revenue of six townships is zero; in 2007 financial revenue of four townships is zero. These township governments collect no revenue but still have money to support their operation, because all is supplied by the county finance. See Li Wa: "Problems and Suggestions of 'County Supervising Township Finance' in My County." Yingshang Finance Network. (<http://www.yscz.gov.cn>) 28/10/2008.

lowest possible level. The basis of authority distribution is principle of subsidiarity, which means that authority of governments does not include those general affairs that can be undertaken by individuals, society and market, and means to distribute the authority to the governments at the lowest level which are capable to shoulder corresponding government affairs. Only when the lower-level governments could not shoulder the corresponding government affairs, higher-level governments will consider to support that of lower levels in an more economic and subsidiary way. This means that general affairs that can be assumed by individuals, society and market should be first excluded from existing authority for local governments.

Division of Expenditure Responsibilities

Being consistent with four kinds of authority for local governments and the undefined authority, five kinds of expenditure responsibilities can be distinguished: assuming expenditure responsibility for existing authority for local governments, new established authority for local governments, authority entrusted by governments of higher levels, authority shared by local governments and governments of higher levels and undefined authority. If afore-mentioned existing authority for local governments is adjusted, the corresponding expenditure responsibility should be adjusted too.

Distribution of Revenue Powers

Being consistent with five kinds of authority and expenditure responsibility of local governments, in order to fulfill these authority and responsibility, local governments should clarify and obtain corresponding revenue powers. Governments at county and township levels could realize revenue rights through various means:

- Fulfilling functions and powers entrusted by higher-level governments and corresponding expenditure responsibilities, governments at county and township levels should get equivalent transfer payment from the higher levels.
- Besides, other revenue powers of governments at county and township levels are first realized through dividing the revenue between counties and higher-level governments; county revenue issue can be solved by flexible ways (the county can put the tax sharing system and other fiscal systems into practice in some townships) and then by transfer payment according to principle of subsidiarity.
- Currently, a large amount of functions and powers and expenditure responsibilities flock in county and township-level governments. The problem that the central, provincial and some prefectural/municipal governments over-centralize revenue could be solved by canceling prefectural power in centralizing county revenue and by reducing central and provincial centralization over county revenue according to “province supervising county”

fiscal administration system. In fact, since the implementation of fiscal reform in 1994, the fiscal revenue brought by economic growth has contributed a lot to the sharp rise of central and provincial finance, so it is not necessary any more to centralize county revenue.

- To implement the tax sharing system in the real sense, the practice of distributing revenue according to enterprise subordinate relations should be broken, and revenue should be distributed in the light of dependent territory principle uniformly. Generally, through revenue redistribution, measures should be taken to cancel residues of original base method and contracting system used as the transitional forms of 1994 fiscal reform, to simplify revenue distribution among governments, to promote fiscal transparency and institutionalize the revenue distribution at the level of law not administration. Definition of revenue allocation among governments should be done through legislation not administrative means. Budget Law should be adjusted correspondingly. The power that defines fiscal administration system among governments should be taken over by legislative branch, but not shifted to executive branch simply through legislative delegation.
- Through redistribution, governments at county level should obtain its major tax categories, such as redistributing the proportion of local share of VAT which can be higher than 25%, at the same time, canceling tax revenue refund and original system subsidy, simplifying revenue distribution. Provincial governments do not centralize revenue from local share of VAT.
- Steps should be taken to build a relatively stable and independent local tax system, and endow provinces with legislative power to some local taxes, especially the legislative power for revenues from local resources.
- When setting the range of tax rate of some tax categories (such as business income tax), local governments could decide the actual ad valorem rate by themselves in the light of actual requirement within the stipulated range, thus to some extent leading to rule-oriented tax competition.

Transfer Payment

There are still many problems about intergovernmental transfer payment, and the following improvements are required:

- Transfer payment of higher-level governments should permit the existence of fiscal gap among areas and no absolutely equal fiscal resources. Key measures can be made to

guarantee that all areas at least could reach the lower or lowest basic public service level in uniform requirements.

- Efforts should be made to increase the proportion of general transfer payment, to compute general transfer payment in accordance with the gap of various regions between the lowest basic standard expenditure requirements and standard fiscal resources. In this way, the lowest general transfer payment could be worked out and provided.
- As is mentioned in the above, lower-level governments should be provided with corresponding transfer payment fund to compensate their expenditure if they are entrusted with authority and expenditure responsibility. Up to now, the ordinary practice is that higher-level governments only provide support from the level of policy, but provide no or less fund.
- Although local governments should undertake the part of shared authority and expenditure responsibility that comes under lower-level governments, governments of higher levels should provide corresponding special transfer payment subsidy or additional revenue power stipulated in legislation, if governments of higher levels define governments of lower levels to assume more shared authority and expenditure responsibility in policy.
- In general, the local governments should be empowered to have primary tax, levy local tax and expand the local share of shared revenue. Correspondingly, transfer payment should be reduced to promote financial expenditure efficiency.
- Special funds types which are too many should be reduced and general transfer payment should be added to promote financial expenditure efficiency and transparency.
- With the increasing proportion of general transfer payment to special transfer payment, requirements on provision of matching funds by county and township governments should be cut off, because excessive requirements for matching fund will drive county and township governments to incur debt and cook the book.

Tax Collection and Administration

On the basis of redistributing revenue with strict follow of the tax sharing system, tax collection and administration should annul the practice of separating domestic enterprise, foreign invested enterprise and foreign enterprise taxes. Except tariff, all the revenue will be administrated with the principle of dependent territory, be first handed into the national treasury and then transferred to local fiscal accounts so as to lower collection cost and the compliant costs of paying taxes.

In addition, our country currently carries out the system of five-tier government, under which it is hard to distinguish authority, expenditure responsibilities and revenue powers, to prevent authority shuffle and ambiguity in responsibility among governments. Too many levels of governments also lead to heavy burden of taxpayers and lower governance efficiency due to the overlong decision-making chain and a high degree of information asymmetry. To better carry out the afore-mentioned county fiscal administration system reform, efforts are still needed in cutting off government hierarchy and conducting reform of administrative division. Specific suggestions are as follows:

1. Efforts should be made to constantly pursue fiscal administration system reform of “province supervising county” or “county strengthening and power expansion” and annul the system of “city supervising county.” In principle, with the gradual building and improvement of market economy system and gradual transformation of government functions, the advantages of “province supervising county” or “county strengthening and power expansion” system become more prominent, such as reducing one administrative level, lowering fiscal withholding and cutting off administrative costs. Besides, such kind of reform could contribute to the administrative and fiscal systems reform at provincial, city and county levels. At present, “province supervising county” or “county strengthening and power expansion” reform encounter obstacle in some administrative fields, which exactly reflects the lag of government administrative system reform and the necessity of further strengthening “province supervising county” fiscal administration system reform and the whole “province supervising county” reform (including administrative, fiscal, economic, social and other fields). Some people believe some prefectural cities can continue to have “city supervising county” fiscal administration system, for these places provide part net transfer payment for the counties under their administration. In fact, it could achieve better results through increasing central and provincial general transfer payment based on standard form. Moreover, in the perspective of economic development, economic region and market will come into play. That prefectural governments play the role of administrative region through the system of “city supervising county” will easily restrain county development instead. In short term, however, some municipal governments could keep the “city supervising county” fiscal administration system, which provide part net transfer payment for counties under their administration.
2. As “province supervising county” fiscal administration system requires a province to administrate multitudinous cities and counties, considerations must be taken to reduce some provinces’ jurisdiction area by division reform or reintroduce area administrative office in some places. If some provinces’ jurisdiction area must be reduced, then it must be noted that some of our provinces and counties follow the natural border line of ancient times and around these places subculture areas have taken shape. Artificial reduction of some provinces’ jurisdiction area will cause destruction to our country’s cultural

tradition. Therefore, giving consideration to cultural tradition factor, we only reduce the area of the prefectural city within its jurisdiction and of the provinces with too many cities and counties or wide range of territory.

3. In short term, townships can be managed in accordance with “county supervising township finance” or by retaining township’s status that “government of each level makes its own budget;” in medium term, townships can be managed by adopting systems of village office or township government; in long term, with functions transformation of government across levels, system of village office can be taken into consideration. With the reform of rural taxes and administrative charges and comprehensive rural reform, many townships lose one revenue source, that is, tax and charges, and the function of township government shrinks dramatically. Under such circumstances, these townships could rely on the transitional method—“county supervising township finance”—to become accustomed to the new environment. In medium term, in these areas township government and budget level should be annulled and village offices should be set in accordance with new legislation. In long term, with the transformation of government functions, township governments will be all replaced by village offices. Regarding to the more developed townships with dense population, they can share the equal status with the county in reference to America’s and Germany’s practice treating cities and townships equally (all are local self-governing bodies.)

Finally, if China’s fiscal administration system is to meet the demand of residents within the prefecture and provide them with public goods and services, local democracy is required to help the residents participate the policy-making, governance and supervision of local public affairs.

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