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FISCAL DECENTRALIZATION IN CHINA

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CHAPTER 1

INTRODUCTION

Decentralization, or centralization, this is the question which has been

puzzling the Chinese government since the middle of 1950's. In recent years, some ministries of the central government argued strongly that it was necessary to stop the trend of decentralization which had led to many troubles in the national economy; whereas most local governments thought only by further decentralization could they fulfill their responsibilities. The Chinese and foreign economists issued a lot of suggestions with different ideas. A general argument is that issuing some centralized policies, the Chinese government changed the direction of the economic system reform.

Is it true?

What happened in China is not so simple that it is very easy to draw a reasonable conclusion. Fiscal system is one of the main economic systems. This paper will discuss such a complicated topic by analyzing the prevailing fiscal system. In recent economic system reform, there were a lot of papers published inside and outside China. Many international institutions and foreign economists visited China and wrote official and non-official reports. These reports are excellent and helpful for both Chinese governments and the world. Because Chinese economic system is much more different from that of other countries, it is rather difficult to make it clear in a short time. In order to go further, I intend to

discuss deeply something which has been noted and discussed already. I hope that this paper will be useful and helpful for everyone interested in the Chinese economic system reform.

In its economic system reform, undoubtedly, it is worth studying for all the economists interested in China.

In recent years, Chinese and foreign economists have developed a series of research projects in various economic fields and produced good results. These achievements enriched, to a large extent, economic theory. The Chinese government gained a great deal from such fruitful researches.

The fiscal relationship between the central and the local governments is one of the most important elements in every economic system. In the last 10 years, the Ministry of Finance

has

been

changing a great deal and the main trend is toward decentralization. In the process of the economic system reform, introducing the commodity principle into the public ownership has led to considerable decentralization in every economic field. The fiscal

administration has been becoming more and more complicated. Some special features emerged within the fiscal relationship between the centrality and the locality. This paper will discuss both the advantages and disadvantages of these features and compare them with those of other countries.

In order to make clear the background for discussion, it is necessary to draw a rough picture of the Chinese fiscal system. A World Bank mission visited China in 1988 and issued an excellent report named "China: Revenue Mobilization and Tax Policy Issues and Options". This is the most detailed and comprehensive picture of the Chinese tax system up to now. Therefore it is one of the essential books for every economist interested in the Chinese tax system. This paper will discuss the fiscal relationship between levels of governments further. The topic of this paper is so comprehensive that I can't concentrate my efforts on a narrow area only. I have to discuss several aspects of fiscal decentralization in China. Before doing so, I will draw a rough picture of the Chinese fiscal system. Parts of it can be recognized in detail in the World Bank mission's report; others are the essential elements of the fiscal system without them no one can understand precisely the real story.

## 1. THE BASIC REVENUE RAISING SYSTEM IN CHINA

## (1) THE CATEGORY OF REVENUE

### A. budget revenue

#### a. tax revenue

(a) industrial and commercial taxes

(b) fuel oil special tax

(c) salt tax

(d) tariff

(e) agriculture and animal husbandry taxes

(f) construction tax

#### b. enterprises revenue

#### c. debt revenue

#### d. energy and transportation fund revenue

#### e. other revenue

#### f. subsidy for loss of enterprises (negative revenue)

### B. extrabudget revenue

a. extrabudget revenue of the local governments

b. extrabudget revenue of the administrations and the institutions

c. extrabudget revenue of the state-owned enterprises and the department responsible for them

## (2) THE CHANNELS OF REVENUE RAISING

In China, the state-ownership is divided into 4 levels. This means that each state-owned enterprise may be owned by centrality, province, municipality, or country.

The collectively-ownership is divided into 5 levels: no central collectively-owned enterprise exists; there are provincially-owned, municipally-owned, county-owned, township-owned, village-owned enterprises. Because the township-run enterprises were collectively-owned enterprises in the past, no state-owned enterprise is at the township governments now, though some township enterprises get their capital from the township governments. There is no village governments but village administration committee. So, some small enterprises located in the villages are named village collectively-owned enterprises. In fact, when people say "township enterprises", it means all the enterprises at and under township level.

As regard the private enterprises, there should not have been levels of jurisdiction, but in order to administer conveniently, the governments divide them into 3 level: county, township, village. Only a few special private enterprises are seen at municipal level.

There is another characteristic of the Chinese enterprises which should not be ignored. The state-owned enterprises at the central, provincial, and municipal levels are divided into 2 groups:

The first group includes those whose branches or sub-companies

have no obligation to pay tax to the governments directly. All their branches or sub-companies, no mas belong to this group as well.

The second group includes those whose branches or sub-companies (if any) have individual obligations to pay their tax to the governments who administer the areas where the branches or subcompanies located. Most enterprises are included in this group.

Having made clear the characteristics, We can introduce the main channels for raising budget revenue:

Total revenue is collected by levels of the governments.

The enterprises in the first group submit their tax due by their headquarters to the levels of the governments by whom the headquarters are owned. For example, the People's Bank of China, the Ministry of Railway, etc. submit their revenue by their headquarters to the central government directly. Same channels for the provincial and municipal enterprises in the first group.

The revenue collected by the local governments is divided into 3 parts: "fixed central revenue", "fixed local revenue", and "shared revenue between the centrality and the localities". As part of the total "fixed central revenue", the "fixed central revenue" collected by the local governments is sent to the central treasury directly. The "fixed local revenue" and the "shared revenue" are collected by the local governments and sent to the local treasuries. The local treasuries transfer part of the



"shared revenue" to the central treasury which is calculated according to the sharing rule. The energy and transportation fund is in fact a method for transferring part (15%) of the extrabudget revenue to budget revenue. There is a special rule for sharing the energy and transportation fund. But the Channel of raising it is the same as that of the other kinds of the "shared revenue".

We should note that same channels is used for the levels of the local governments. For example, the provincially-owned enterprises in the first group submit their tax due as "fixed provincial revenue" to the provincial governments directly by sending their money to the provincial treasuries. The municipal and county governments collect the tax due from other provincially-owned enterprises in the second group. All the revenue from these enterprises is divided into 3 parts as well. The first one is "fixed provincial revenue" which is sent to the provincial treasuries directly. The others are "fixed municipal revenue" or "fixed county revenue" and "shared revenue between province and municipal" or "shared revenue between province and county". (In some provinces, e.g. Jiangsu province, no direct fiscal revenue sharing relationship exists between the provincial and the county governments. In others e.g. Anhui province, there is.) The municipal or county treasuries transfer part of the "shared revenue" to provincial treasuries according to the sharing rule made by the provincial governments and retain part of "shared revenue"

and "fixed revenue" as their budget revenue. This is true as well for the municipally-owned enterprises.

There is neither treasuries nor tax authorities at the township level. Only some township governments have their own independent budgets. Therefore, in general all the revenue from the enterprises at and under township level is collected by the branches of the tax authorities and finance bureaus of the county governments. \_

It is crucial to make clear the channels for raising extrabudget revenue. According to the definition, there are 3 types of extrabudget revenue.

The retained profits and the depreciation funds of the state-owned enterprises are the first type of the extrabudget revenue.

The institutions e.g. universities, get their regular grants from the governments for their day to day operations. But, they can also undertake projects supported by enterprises. They can use part of the money provided by these enterprises to fulfill the projects and retain the surplus as their extrabudget revenue. Many governments' agencies collect some kinds of charge for particular purposes, for example, the Highway Bureaus collect a road maintenance fee from vehicle owners. After necessary spending for keeping road in good condition they may have a surplus. The retained surplus money (if any) of such agencies and institutions is the second type of the extrabudget revenue.

The local surcharge on taxes or fees collected by the local governments is the third type of extrabudget revenue. The difference between the local fixed revenue and the governments' extrabudget revenue is that the former is based on the decision made by the central government and the latter by local governments themselves.

It is worth noting that only the second and the third types of extrabudget revenue are within the field of our discussion. Generally speaking, the revenue and expenditure of the state-owned enterprises are included in the governments' finance. We will, however, exclude them from the governments' finance because the revenue and the expenditure of the state-owned enterprises in China, which is a socialist country, are too much to discuss here or we will have to discuss the total economy.

We can see that the second type of extrabudget revenue is not placed in the governments' accounts. there is a special account of it. Although third type of extrabudget revenue and expenditure are part of the governments' revenue and expenditure, they are not placed in the general accounts of the governments. Making these clear will be very useful for us in the discussion below.\*

### (3) THE ORGANIZATIONS OF REVENUE RAISING

There are several organizations in charge of revenue raising:

A. the debt department and the comprehensive plan department of the Ministry of Finance are in charge of foreign and domestic debt

revenue respectively.

B. the Custom Head Office is in charge of Tariff Duty and VAT and product tax on import and export goods.

C. the levels of tax authorities are in charge of industrial and commercial taxes, fuel oil special tax, salt tax, construction tax and energy and transportation fund revenue of all enterprises.

D. the levels of finance bureaus are in charge of enterprise revenue, subsidy for loss of all enterprises and agriculture and animal husbandry tax.

E. the types of the extrabudget revenue show clearly which organizations are in charge of collecting them.

#### (4) THE REVENUE SHARING SYSTEM

There are 3 elements of the Chinese revenue sharing system:

##### A. REVENUE SHARING BASE

The Revenue Sharing Base is the first element of the existing revenue sharing system. As stated above, total fiscal revenue is divided into 3 parts: "fixed central revenue", "fixed local revenue" and "shared revenue". The prevailing revenue sharing base was issued by the central government in 1985. There have been some adjustments since then.

The first principle for setting the revenue sharing base is that every level of the governments can use its discretion to decide the revenue sharing base on which the lower level of government share the revenue

collected by themselves. This means that the revenue sharing base between provincial and the municipal governments could be different from that between the central and the provincial governments. Similarly the revenue sharing base between the municipal and the county governments could be different from the former two.

The second principle for setting the revenue sharing base is the ownership of the enterprises. The "ownership" here means not only nature of the ownership but also the level of the ownership. Generally speaking, the revenue from collective-owned and private enterprises is always "shared revenue". Regarded as the state-owned enterprises, it is more complicated. Every level of governments has power to decide which kind of revenue from its own state-owned enterprises would be the "fixed revenue" of its own or the "shared revenue" with the lower level of governments. Therefore, when a state-owned enterprise's ownership changes from an upper government to a lower one or vice versa, the revenue sharing base must be adjusted.

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## B. REVENUE SHARING FORMULA

The Revenue Sharing Formula is the second element of the existing revenue sharing system. The basic formula is:

$$\text{RATIO} = \text{E}(\text{BASE YEAR}) / \text{R}(\text{BASE YEAR})$$

where

RATIO is the proportion of the "shared revenue" to be retained by the lower government for the following years

$E(\text{BASE YEAR})$  is actual amount of local government expenditure permitted by the upper government in the base year

$R(\text{BASE YEAR})$  is "shared revenue" collected by the lower government in the base year

There are some important factors which should be stated as below.

As regards  $E(\text{BASE YEAR})$ : At the beginning of every year, a local government must submit its final fiscal account statement to the upper government. The upper government examines and decides which item of the expenditure should not be included in the budget expenditure. After getting rid of such unreasonable items, the upper government approves the budget expenditure of the lower one. Only such permitted budget expenditure can be used as the base for calculating the ratio.

As regards  $R(\text{BASE YEAR})$ : The actual "shared revenue" is not the same as that listed in the document published by the State Council. In 1985, according the document of the State Council, many kinds of taxes were listed as "fixed local revenue". But, for calculating the ratio of 1985, most items of "fixed local revenue" were included in the "shared revenue" base figure. From 1989, the revenue of some items of taxes were moved from "shared revenue" into actual "fixed local revenue".

As regards RATIO: Generally speaking, in 1985, the ratio was fixed

for 5 years. Actually, slight changes happened every year in the period from 1986 to 1989. Many factors would affect the ratio: the change of the jurisdiction of the state-owned enterprises would affect the R(BASE YEAR) and the E(BASE YEAR); additional demand of expenditure would raise the ratio; the change of responsibility would affect the E(BASE YEAR); etc.

More important, not all the actual "shared revenue" and the permitted "budget expenditure" are used as the base to calculate the ratio. Some items of "shared revenue" and "budget expenditure" have their special formula and ratio. For example, the ratio of the revenue from "land occupation tax" is fixed as 50%. All the revenue from this tax is used for special expenditure (i.e. investment for land improvement) excluded in the general budget expenditure as the sharing base.

## 2. THE BASIC BUDGET EXPENDITURE SYSTEM IN CHINA

### (1) THE CATEGORY OF EXPENDITURE

#### A. budget expenditure

##### a. capital construction expenditure

##### b. circulating capital expenditure

##### c. research and development expenditure

##### d. geological prospecting expenditure

##### e. operation expenses on industry, transportation, commercial \_ sectors. \_

##### f. aid and operation expenses on agriculture sector

##### g. operation expenses on culture, education, science, health \_ sectors

- h. social relief and welfare expenditure
- i. defence expenditure
- j. administration expenditure \_
- k. expenditure on national debt
- l. expenditure on price subsidies
- B. extrabudget expenditure
  - a. fixed asset investment
    - (a) development and transformation expenditure
    - (b) capital construction expenditure
  - b. overhaul expenditure
  - c. simple building expenses
  - d. welfare expenditure
  - e. bonus expenditure
  - f. road maintenance expenditure
  - g. city maintenance expenditure
  - h. three kinds of expenses on science and technique
  - i. extra-circulating capital expenditure
  - j. operation expenses \_
  - k. administration expenses
  - l. energy and transportation fund transferred to budget revenue
  - m. other expenditure

## (2) THE RESPONSIBILITIES OF LEVELS OF THE LOCAL GOVERNMENTS

In China, the distinction between the responsibilities of the central and the local governments depends mainly on "ownership". Every level of government is in charge of the expenditures of all the institutions and enterprises owned by itself. Only under some conditions, can a level of government apply for special extra grant from the upper one or ask the lower ones to submit more. This is the basic principle of the responsibilities of the levels of the governments. This is similar to the principle of the distinction of revenue.

Generally speaking, the items of local expenditure show explicitly



the responsibilities of local governments. Actually, apart from defence expenditure, national debt expenditure, geological prospecting expenditure, circulating capital expenditure, the other types of local expenditure are all the same as those of central ones. In fact, there is local geological prospecting expenditure, but it is too little to be listed as an independent item of local budget expenditure. As regards circulating capital capital, in recent years, only a few state-owned enterprises have been able to obtain free circulating capital from government finance. Most of them can get theirs (not free) from the banks only. The circulating capital expenditure has been becoming less and less. It is therefore unnecessary to list it as an individual item. In terms of national debt expenditure currently, only the central government has power to borrow abroad, therefore, no such expenditure item is in the local budget expenditure above. With regard to defence expenditure, as in every country, the Chinese central government is in charge of it. In the strict sense, only defence and national debt expenditure are specifically central expenditure. If the central government allows the local governments borrow abroad, all the local expenditures are the same as the central ones but defence expenditure.

— In view of the local extrabudget expenditure, what we discuss here are only the extrabudget expenditures of the local institutions and the local governments agencies. But, because the items of the extrabudget

expenditure of some institutions or governments' agencies are similar to those of the state-owned enterprises, there are no specially different items between them. The main items of the local extrabudget expenditure are as follows:

- a. development and transformation expenditure
- b. overhaul expenditure
- c. capital construction expenditure
- d. road maintenance expenditure
- e. administration expenditure

If we compare them with the general items of the extrabudget expenditure, there is no real difference between the central extrabudget expenditure and the local one.

### (3) THE ORGANIZATIONS OF EXPENDITURE

Generally speaking, the organization of expenditure is very clear. All the budget expenditure is managed by the Ministry of Finance (of the central government) and finance bureaus (of various levels of the local governments). As regards the extrabudget expenditure, the principle is that those units who collect it spend it.

### (4) SPECIAL ISSUES

"Theory is pale and the tree of life is ever green." Reality is always much more complicated than theory. This is true for China as well. There are many special issues in practice, especially in the recent economic

system reform. Some of those can't be ignored in this paper.

In the last 10 years, various levels of local government have levied many kinds of "taxes" in order to achieve certain targets. Such "taxes" are neither listed in the budget account nor the extrabudget account. They comprised a series of special accounts of the local governments. Only part of them are recognized by the central government. The following are some examples of the main items.

#### A. local development funds

In the last 3 or 4 years, some provinces have levied a kind of grain development fund in order to balance the development of industries and agriculture, especially of grain. For example, Zhejiang province transferred its surplus rice to other provinces before 1986. Because the development of the township enterprises absorbed a great deal of the labour force in rural areas and occupied a lot of cultivated land, and income from agriculture is so less that farmers are unwilling to invest any more in agriculture. As a result, the grain production became less and less, so that Zhejiang province had to buy rice from others. The same problems occurred in each province, so no province could easily buy grain from others. Zhejiang province decided to levied a so-called "grain development fund". This means that every local enterprise (excluding centrally-owned ones!) had to pay 0.1% of its turnover value to the provincial government as a special aid for the development of agriculture,

especially for that of grain production. The revenue of this "local tax" is used as subsidy to reduce the prices of agricultural production means or to increase the prices of agricultural products, especially that of rice. Similarly, a kind of vegetable development fund etc. appeared in many provinces and cities.

#### B. "contribution" of township enterprises

Before the abandonment of the "people's commune", at and under the level of township, there was a so-called "combination of government and commune" system. This meant that the people's communes, as "economic bodies", were simultaneously governments at the township level. Meanwhile, the nature of both the ownership of the commune-run and the brigade-run enterprises was collective-ownership. In that time, the leaders of the communes and brigades ordered the commune-run and the brigade-run enterprises to submit part of their after-tax profits in order to support agricultural production, to provide collective welfare, or to distribute to the members of their own communes and brigades as personal income. Some policies on this matter were issued by upper levels of governments, even by the Ministry of Agriculture or the State Council.

In the last 10 years, there have been 3 main changes in the township enterprises: the first is the abandonment of the commune. Only the township governments were administration leaders at the township level.

They were no longer owners of the township enterprises. The second is that the previous commune-run and brigade-run enterprises, as independent, collective-owned, township enterprises have no direct financial relationship with farmers who have their own responsible land as their main production means. The third is that a lot of new private township enterprises have been being established. Such private enterprises have no more financial relationship with farmers at all. Because of such changes, the using of the after-tax profit of the township enterprises as the personal income of the farmers has reduced sharply. However, some previous policies on the using of the after-tax profit of the commune-run and brigade-run enterprises are still valid. For example, if a township enterprises uses its profit to support agricultural production (as subsidy for reducing the prices of the agricultural production means, etc.), such profit can be, under a certain threshold, dedu\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*collective welfare.

In fact, such "contribution" composes a special kind of "local tax" excluded in "budget revenue" and "extrabudget revenue". The spending of such "contribution" is a special kind of "local expenditure" excluded in

current "budget expenditure" and "extrabudget expenditure".

### C. specially raised funds

In recent years, the pressure on the local governments to improve the living conditions of the residents in their own areas has become more and more heavy. Every local government is eager to provide better water supply, electricity power, houses, roads, garbage disposal, communication, etc. But, the lack of "budget revenue" and "extrabudget revenue" has forced them to find out new ways of raising special funds to support such projects. Many local governments ask all the related units to submit certain amounts of money to pay for the costs of such projects. Some local governments use "the benefit principle" similar to that of taxation as the standard to collect money from the related units. Such projects are essentially temporary items. The governments establish special institutions whose responsibilities are to carry out the projects. They collect money according to the decisions made by the local governments. When the projects are finished, they will be dismissed. The financing of such projects is much more complicated than that of others. There are many resources for the money. No one knows in detail how the related units (state-owned, collective-owned, private enterprises; institutions; governments' agencies; even army; citizens; etc.) deal with the money in their accounts. There must be some enterprises placing the money into their

production cost accounts ---- this would reduce their tax due. The tax revenue of the governments would decrease. If there are sharing ratios between the local governments and the central government or between the levels of the local governments, the central and the upper local governments would lose a certain amount of their due revenue. The finance relationship between levels of the governments would be damaged by such specially raised funds and no matter how many arguments there are about them they make confusions in governments' finance system (including both revenue and expenditure systems).

## **CHAPTER 2\_**

### **\_THE FEATURES OF THE FISCAL SYSTEM IN CHINA**

We have got a rough picture of the Chinese fiscal system. It is not enough for us to analyse the fiscal decentralization in China. Besides the rough picture, some features of the Chinese fiscal system should be discussed here in order to understand the fiscal system deeply. The following are the essential features of the Chinese fiscal system.

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#### **1. THE HISTORY OF THE FISCAL SYSTEM IN CHINA**

Why is the Chinese fiscal system so complicated that it takes a very

long time for foreign economists to make clear how the system works. The basic reason is its varied history. Only by recognising the development of its history, can we understand why such complicated phenomena happen today. China has a long history and the history imposes a very strong effect on the present. This is true for the fiscal system as well. A brief but plain history of the fiscal system is an essential part of the present fiscal system.

The main feature of the Chinese economic system in the early of 1950's was the "highly centralized planned economy". The basic principle of the fiscal system was "unified revenue and expenditure". Such a basic principle was reflected in the following two aspects:

(1) The relationship between the state-owned enterprises and the governments. \_

According to the fiscal rule, all the profits earned and depreciation funds drawn by the state-owned enterprises had to be submitted to the governments; all the losses would be subsidised by the governments' grants; all the capital for investment was appropriated by the governments; all the fixed and circling assets were used by the enterprises freely; all the bonus and welfare funds of the workers were drawn based on the total wages and placed into the production cost accounts. No relationship between the funds spent and the revenue earned by the state-owned enterprises existed at all! (see THE EDUCATION DEPARTMENT OF



THE MINISTRY OF FINANCE 1986, P93-94, P116-118.)

(2) The relationship between the central and the local governments.

In 1950, the central government issued the first document on the fiscal relationship between the central and the local governments. The main contents were as follows: all the powers of fiscal administration were concentrated to the central government; all the grain tax, various taxes, all the profits earned and the depreciation funds drawn by the state-owned enterprises had to be submitted to the central treasury; all the fiscal expenditures were appropriated by the central government; no relationship between the local revenue and the local expenditure; all the revenue and expenditure were brought into the national budget. The local governments could levy a little surcharge only. (see YINONG TIAN, HUAICHENG XIANG, FULIN ZHU 1988, P20-22.)

Such is the start point of the Chinese fiscal system. It lasted until 1956. Mao Zedong was such an politician that he believed China must step forward along the way which was chosen by the Chinese people. After a deep discussion with tens ministers, he made a famous speech: "ON TEN IMPORTANT RELATIONSHIP". One of the ten is "the relationship between the centrality and the locality", in which he pointed out that power of the administration should be distributed to the locality.

In fact, since then, the fiscal decentralization has been being in process, although along a tortuous way. It is not necessary to list all the

documents here showing the changes of fiscal system in the last 40 years. It is useful for everyone to recognize the start-point of the Chinese fiscal system for their analysis. Although it was the situation 40 years ago, the effect of it is still too strong to be ignored. \_

## 2. THE PLURALIZATION OF THE BENEFIT SUBJECT

We have made clear what the start-point is, and now we look at the present situation of the fiscal system.

What is the main result of the economic system reform? What is the primary achievement of the combination of the public ownership with the commodity principle?

All in all, it is "the pluralization of the benefit subject".

Before the economic system reform, no independent benefit of any state-owned unit existed. Although every state-owned unit had its individual account and was ordered to increase its income and decrease its expenditure as much as possible, it had accountability in name only. No matter which kind of unit it is, a level of government, a government's agency, a state-owned institution, or a state-owned enterprise, its benefit was granted from the upper governments step by step.

Since the beginning of the economic system reform, this condition has been changed thoroughly. Every state-owned unit has its independent benefit now. The state-owned enterprises need not submit all their profits to the governments. They can keep part of the profits as their self-owned

funds and spend it in the way they like, although there are still some regulations of the spending of their self-owned funds. The institutions can keep their extrabudget revenue and spend it in the same way as the state-owned enterprises'. The local governments have more and more power to deal with the fiscal affairs happening in their administration areas. No matter whether or not these are correct, there are indeed independent benefits existing among the state-owned units. \_

There is a crucial mark which shows what meaning the "pluralization of the benefit subject" has.

Several years ago, in the "capital resource" of the account of a unit, only 3 items existed: state-owned; collectively-owned; private. Generally speaking, one unit has only one item filled. This means that the state-owned enterprises have the state-owned capital only, and the collectively-owned and the private ones have theirs own separately.

But now, there are two important changes in the account.

Firstly, many enterprises have several capital resources. Many enterprises have got their capital from some state-owned, collectively-owned and/or private units. There are 3 ways for an enterprise to get its capital from several ownerships: the first way is that some state-owned, collectively-owned, and/or private enterprises invest to establish a new enterprise. If the state-owned (or collectively-owned, or private) enterprises take main part of the total capital, the ownership of this new

enterprise will be state-owned (or collectively-owned, or private) with parts of its capital from other ownership resources. So, in the account of the new enterprise, all the 3 items of "capital resource" are filled. The second way is that when a state-owned (or collectively-owned, or private) enterprise makes a great deal of loss and is unable to go further, another enterprise with different ownership agrees to annex it. So, the annexing enterprise has its total capital from different ownership. The third one is that two enterprises with different ownership agree to merge into a single one, the merged enterprise has its capital from different ownership. \_

Secondly, more important, many state-owned enterprises have their capital from several state-owned units, but all these units would be listed in the account. Specially, parts of its capital comes from itself. So, there are 3 types of the state-owned capital: The first one is the "original state-owned capital". This is the capital invested before by the governments. It is impossible to distribute it to its original resources. The second one is the "self-owned capital". This is the capital invested by the enterprise using its after-tax profit and/or its depreciation funds. The third one is the capital from other state-owned units. All these units would appear on the list of the resource of its capital. There are many subitems of the "state-owned capital" in the account of a state-owned enterprise. When the state-owned enterprise makes loss, every capital owner will lose their benefits, though all of them are state-owned units. When the

enterprise gets profit, every capital owner will share with each other.

Until the end of 1989, there were 6966 enterprises annexed by 6626 enterprises. In 1989, 2559 by 2315. In 1988, the percentage of the state-owned enterprises annexing the collectively-owned ones was 88.22% and in 1989, 84.16%. In 1988, the percentage of latter annexing the former was 9% and in 1989, 11.11%. The percentage of the annexing between different ownership was 25.32% in 1989, and that within the same ownership was 74.68%. (see PEOPLE'S DAILY NEWS, 1990)

Same happens in the account of institutions.

It is more complicated for the local governments. Every local government has its budget account and extrabudget account. Meanwhile, they have some special accounts as well. It is more interesting that some kinds of revenue and expenditure don't appear in the budget and the extrabudget accounts at all, e.g. some specially raised funds.

We have not judged whether these are correct or not, but the phenomena show indeed "the pluralization of the benefit subject" clearly.

"The pluralization of the benefit subject" does provide the base for the combination of the public ownership with the commodity principle. If there is no independent benefit and no accountability existing among the state-owned units, how can we introduce the commodity principle into the public ownership? \_

We can say that "state-ownership" now is entirely different from that in the past, though the name is the same as before, though it is not the same as "the collective-ownership" and "private-ownership" as well. (It needs much more pages to discuss "the ownership reform in China", but the brief introduction above is enough for our paper.)

### 3. THE RELATIONSHIP BETWEEN THE ENTERPRISES AND THE GOVERNMENTS

We have made clear both the original and prevailing situations of the fiscal system. Based on such a background, we can see that the relationship between the enterprises and the governments in China is quite different from that of other countries. We can use the following to describe it.

Both the independent and the dependent relationship exist between the enterprises and the governments. \_

First, "the unified revenue and expenditure" principle has been abolished. If the enterprises get more profits, they have right to retained more to spend for the development of their own and for the welfare of their workers, especially for the latter, even though sometimes they don't get more profits by their own efforts. Whereas if they get less profits, they have to spend less for both development of the enterprises and for welfare of the workers.

Second, there is no absolutely independent relationship existing. If

the enterprises get much more profits not because of their own efforts, the governments, sometimes, would ask the enterprises to submit more profits. Similarly, if the enterprises get loss, no matter why they do it, they can apply for government grants. Generally speaking, the governments would use many measures to keep such enterprises going.

It is said that "getting benefit from the extra profits whereas not bearing the extra loss" is the new principle of the relationship between the enterprises and the governments. This means no strict accountability of the enterprises exists. In recent years, in order to introduce the commodity principle into the public ownership further, some local governments allow some enterprises who get much more loss and seem impossible to recover to go bankrupt and let other enterprises annex them or let them merge with others. This can be seen as a further step of introducing of commodity principle. It will make the state-owned enterprises more independent than before and provide a much better base for the further introduction of the commodity principle. But now, the principle "getting benefit from the extra profits whereas not bearing the extra loss" is still working. Such a principle becomes a table for negotiations between the enterprises and the governments. Of course, the main topic on the table is how much the governments would grant for the enterprises' loss.

In terms of the collectively-owned enterprises, the relationship

between them and the governments is not quite the same as that between the state-owned enterprises and the governments. Generally speaking, the governments give no grant to them for their development. They have absolutely independent benefits. But in the last 40 years, the ownership of most "large-scale collectively-owned enterprises" became ambiguous. It looked like almost the same as that of the state-owned enterprises. No concrete people are the owners of such collectively-owned enterprises. They pay their taxes to the tax authorities and submit part of their profits as the administration fees to a certain department of the governments (e.g. collectively-owned enterprises administration, not the finance bureaux). If they get loss, the department would grant at least part of their loss to keep them going. In a very long time, if they get much more profits, no one but the enterprises themselves can get benefit from the extra profit. This was true for many township enterprises before 1978. Especially, many county (mainly) governments invested in such "large-scale collectively-owned enterprises" and no repayment needed. There was another name for them, i.e. "half state-owned enterprises" or "second state-owned enterprises". Although there is a decisive change of the state-ownership in the economic system reform, the ownership of such "large scale collectively-owned enterprises" has not changed a lot. In fact, they have more independent benefit and accountability, but the difference between them and the state-owned ones is not significant at all.



The ownership of the private enterprises is much more complicated than that of the state-owned and the collectively-owned ones. In the period from 1978 to now, there were indeed a lot of people who invested to establish private companies or enterprises. Because of many political and economic reasons, many of the private enterprises registered as "collectively-owned" ones. Sometimes, such enterprises may be treated as collectively-owned enterprises, sometimes not. It is very difficult to make clear the ownership of a "collectively-owned enterprise", especially that of those who were established as "collectively-owned enterprises" in recent years.

Although there is much confusion of the ownership of the enterprises, the most important feature of the relationship between the enterprises and the governments has not changed yet. There are five levels of governments: the central, province, municipal, county, township.(see Table 1.) The most important feature is that as an enterprise, no matter which kind its ownership is, its must be either centrally-run, or provincially-run, or municipally-run, or county-run, or township-run. And so it should submit part of its profit to its "own" government apart from that to the upper ones. Generally speaking, a level of government has its power to order all the enterprises "owned" by the lower levels of governments to contribute their profits as its revenue. But, the lower levels of governments who are in charge of administering them can, to a

certain extent, protect "their" enterprises from the heavy burden issued by the upper governments. When we discuss the fiscal decentralization, the level of the ownership is much more important than the nature of the ownership. In order to protect its "own" enterprises, a level of government does not care what damage will be brought to the related enterprises "owned" by other levels of governments, even though its enterprises are private and others are "state-owned".

Both the nature and, more important, the level of the ownership are special features of the fiscal system in China.

#### THE RESPONSIBILITY FOR PROMPTING ECONOMIC DEVELOPMENT \_

In general, the items of the expenditure of the governments are related to the responsibilities of the governments directly. In China, the principle for determining the responsibilities of the governments is similar to that for determining the relationship between the enterprises and the governments. This means that every level of governments is in charge of administering all the units and people at and under its level. Not only enterprises but also other units, e.g. schools, universities, hospitals, scientific institutions, social security, etc. are administered according to their "level"s. \_

From 1953, the central government determined the basic principle

for expenditure (in fact, it is the basic principle for the responsibilities of various levels of governments) which has been lasting since then. This principle is that the distinction of expenditure depends on the jurisdiction. This means that all the expenditures of those units, including enterprises, institutions, administrations, who are under the jurisdiction of a level of government, are listed as the budget expenditure of that level of government. This can be named the "jurisdiction level principle".

It is very interesting to compare the items of the central budget expenditure with those of the local one. We can see, that with the exception of defence expenditure, the items of the central budget expenditure are all the same as those of the local one. It shows us that, basically speaking, no distinction of functions exists between the central and the local governments.

If we compare the items of the expenditure of the local governments in China with those in other countries, we can see that a significant difference is that Chinese local governments have the responsibilities for prompting the development of the economy. The share of "economic expenditure" is too high to be ignored. In many countries, the local governments are responsible for providing public services only. They spend nothing for investing in factories, companies, etc. They do nothing for the economic development in their areas directly. If they get more money, they would improve the public services, including education,

health, transportation, etc. In China, if a level of government does nothing for the economic development in its area, they would face terrible troubles, e. g. no new revenue resources, lower employment rate, lower income of the people living in its area, no improvement of the public services, etc. In China, the budget expenditure of various levels of local governments is not decided by a formula which is calculated based on same level of public services. Only by investing in profitable enterprises, can the local governments get more and more revenue to support itself to improve the public services and the level of its residence's life. This is the main mechanism of the responsibilities of the local governments.

Why do the local governments in China have such a special responsibility? Why should the local governments improve their public services and the level of the their residence's life by direct investments? 3 reasons for this: that the main ownership is state-ownership; the pluralization of the benefit subject; the "jurisdiction level principle" of the responsibilities of the governments.

## CHAPTER 3

### MEASURING THE FISCAL DECENTRALIZATION

#### IN CHINA

Before we measure the fiscal decentralization, we should make clear

the government system in China. The following is the main structure of the Chinese government system.

STATE COUNCIL				
MUNICIPALITY	PROVINCE	AUTONOMOUS REGION		
URBAN DISTRICT AND SUBURB		CITY	PREFECTURE	
BLOCK OFFICE	COUNTY	URBAN DISTRICT AND SUBURB	COUNTY	CITY
TOWNSHIP	TOWNSHIP	BLOCK OFFICE	BLOCK OFFICE	TOWNSHIP

In the structure of the government system, the first tier is State Council, the second municipality, province and autonomous region. The third tier are "urban district and suburb" of MUNICIPALITY i.e. BEIJING, TIANJIN, and SHANGHAI, and "city". It is worth noting that "prefecture" is not a level of local government but the agency of the provincial government. The fourth tier are county, "block office" of MUNICIPALITY, "urban district" equivalent to county level, and "city" equivalent to county level. The fifth are township and "block office" equivalent to township level. The number of the tiers is shown in TABLE 1.

TABLE 1\_

YEAR	PROVINCE*	PREFECTURE**	ADMINISTRATIVE DIVISIONS		COUNTIES**	
			TOTAL***	CITIES**		
			EQUIVALENT TO PREFECTURE	EQUIVALENT TO COUNTY_		
1985	30	165	321	162	159	2046 _

- \* The number of this item includes Taiwan province.
- \*\* The number of these items excludes those in Taiwan province.
- \*\*\* The number of this item excludes 3 municipalities: BEIJING, SHANGHAI, TIANJIN. \_

(source: STATE STATISTICS BUREAU PRC, 1986b)

With the purpose of judging the Chinese fiscal decentralization, we firstly intend to measure the Chinese fiscal decentralization.

Unfortunately, there is no best indicator for measuring the fiscal decentralization. Every indicator has its own advantages and disadvantages. However, every indicator can be used to show some elements of the fiscal decentralization. A brief discussion of the indicators will be helpful for us to describe the fiscal decentralization.

There are two common indicators to measure the fiscal decentralization: (see BAHL, R. W. & NATH, S. 1986)

#### 1. THE SHARE OF REVENUES GENERATED

$$D1 = RL / (RL + RC) \_$$

where: D1 is the first indicator of the fiscal decentralization

RL is the revenue collected by the local governments

RC is the revenue collected by the central government

Actually, this indicator shows that the more the share of revenue collected by the local governments the more the fiscal decentralization

Let us have a look at the Chinese data of the indicator above.

According to the TABLE 2, 3 and 4, we can see that contrary to the general idea, the indicator D1 have been becoming less and less (from 83.0% to 54.6% with revenue from foreign debts and from 85.7 to 63.6 without revenue from foreign debts) in the period from 1979 to 1988 which was the Chinese economic reform era. In the last 40 years, the trend was slightly different from that in the last 10 years. The indicator D-1 increased from 54.6% in the period 1953-1957 to 85.3% in 1971-1975, and decreased to 69.4% in 1981-1985.

TABLE 2

REVENUE OF CENTRAL AND LOCAL GOVERNMENTS (1)

VALUE (RMB 100M)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL	DOMESTIC*
1979	1103.27	1067.96	188.03	152.72	915.24	915.24
1980	1085.23	1042.22	209.75	166.74	875.48	875.48
1981	1089.46	1016.38	224.74	151.67	864.71	864.71
1982	1123.97	1083.94	258.48	218.45	865.49	865.49
1983	1248.99	1211.16	372.05	334.22	876.94	876.94
1984	1501.86	1467.05	524.47	489.66	977.39	977.39
1985	1866.40	1837.16	707.87	678.63	1158.53	1158.53
1986	2260.26	2184.52	916.67	840.93	1343.59	1343.59
1987	2368.90	2262.42	905.84	799.36	1463.06	1463.06
1988	2628.02	2489.41	1045.54	906.93	1582.48	1582.48

\* DOMESTIC revenue excludes foreign debts.

(source: THE GENERAL PLANNING DEPARTMENT OF  
MINISTRY OF FINANCE, 1989)

TABLE 3

REVENUE OF CENTRAL AND LOCAL GOVERNMENTS (2)

PERCENTAGE (TOTAL AS 100%)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL
1979	100	100	17.0	83.0	85.7
1980	100	100	19.3	80.7	84.0
1981	100	100	20.6	79.4	85.1
1982	100	100	23.0	77.0	79.8
1983	100	100	29.8	70.2	72.4
1984	100	100	34.9	65.1	66.6
1985	100	100	37.9	62.1	63.1
1986	100	100	40.6	59.4	61.5
1987	100	100	38.2	61.8	64.7
1988	100	100	45.4	54.6	63.6

\* DOMESTIC revenue excludes foreign debts.

(source: idem quod TABLE 2)

TABLE 4

REVENUE OF CENTRAL AND LOCAL GOVERNMENTS (3)



YEAR	TOTAL VALUE (RMB 100M)	CENTRAL	LOCAL	TOTAL PERCENTAGE (TOTAL AS 100%)	CENTRAL	LOCAL
1953-1957	1354.88	615.17	739.71	100	45.4	54.6
1958-1962	2116.62	480.43	1636.19	100	22.7	77.3
1963-1965	1215.11	335.80	879.31	100	27.6	72.4
1966-1970	2528.98	790.09	1738.89	100	31.2	68.8
1971-1975	3919.71	576.43	3343.28	100	14.7	85.3
1976-1980	4960.66	774.53	4186.13	100	15.6	84.4
1981-1985	6830.68	2087.61	4743.07	100	30.6	69.4

(source: idem quod TABLE 2)

Based on such information, can we draw a conclusion that the fiscal system was more centralized in 1953-1957 than in 1981-1985? Can we say that there was not a trend of fiscal decentralization but a trend of fiscal centralization in the last 10 years? Can we use this indicator as the measure of the fiscal decentralization in China?

The answer is not very simple.

We can say yes for the first question. Although the indicator D1 in 1953-1957 was much less than that in the following periods, we have to note the fiscal system in that period was most centralized not only because of the lowest figure but also, and more important, because of the strictly-centralized budget system. The indicator D1 in 1988 was close to that in 1953-1957, but we can't make a conclusion that the fiscal decentralization in 1988 was close to that in 1953-1957. We must pay attention to some elements behind the indicator. Because there was the "unified revenue and expenditure" principle applying to the budget system in the early of 1950's, no matter how many percent of revenue collected by the local governments, the fiscal system was not

decentralized but centralized indeed. \_

Why do we consider there is a more decentralized fiscal system of China in the period 1981-1985 than that in early of 1950's? The indicator here does show what percentage of the total revenue is collected by the local governments, but this is only the result of the implementation of a kind of fiscal system. The comparison between the fiscal systems in the period 1981-1985 and the early of 1950's shows us that different fiscal systems can lead to the same result. Musgrave pointed out that "centrally collected but shared taxes do not constitute true revenue decentralization." (see BAHL, R. W. & NATH, S. 1986.) We can add something to his idea: no matter who raises the revenue, no matter whether the revenue is shared or not, only the ratio of the revenue collected by the local governments (the central government as well) does not mean anything about the fiscal decentralization.

According to the information in CHAPTER 1 and CHAPTER 2 and the analysis above, We can draw a conclusion: the standard for judging whether a fiscal system is centralized or decentralized is mainly the nature or mechanism of it. The indicator D1 can measure the extent of the fiscal decentralization in the same fiscal system or in two similar ones.

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Now that the indicator D1 can't be used as the measure of the fiscal decentralization without anything else, is it meaningful for the indicator?

The answer is absolutely positive. Although we can not say a fiscal system is more decentralized only because it has a higher indicator, a real more decentralized fiscal system does has a higher indicator. If a local government raises and/or spends very little money, can we say it has more autonomy? Real local autonomy must be supported and, as the result, reflected by more raising and/or spending. \_

## 2. THE SHARE OF EXPENDITURES MADE

$$D2 = EL / (EL + EC)$$

where: D2 is the second indicator of the fiscal decentralization

EL is the expenditure made by the local governments

EC is the expenditure made by the central government

Similarly, this indicator shows that the more the share of the expenditure made by the local governments the more the fiscal decentralization.

Let us check the indicator D2 of the fiscal decentralization in China. The TABLE 5, 6 and 7 show clearly that based on the figure of the indicator D2, there was an increasingly trend of fiscal decentralization in the last 10 years, from near 50% in 1979-1980 to more than 60% in 1988. In view of the trend in last 40 years, in general, with the exception of that in 1958-1962, the fiscal decentralization has been developing obviously, from one quarter in 1953-1957 to 50% in 1981-1985. This shows that the share of expenditure made by the local governments became twice as

much as that in early of 1950's.

TABLE 5

## EXPENDITURE OF CENTRAL AND LOCAL GOVERNMENTS (1)

## VALUE (RMB 100M)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL
1979	1203.04	1203.04	576.26	576.26	626.78
1980	1164.10	1139.70	602.08	577.68	562.02
1981	1114.97	1041.89	602.21	529.13	512.76
1982	1153.31	1113.28	575.14	535.11	578.17
1983	1292.45	1254.62	642.53	604.70	649.62
1984	1546.40	1511.59	738.70	703.89	807.70
1985	1844.78	1815.54	836.54	807.30	1008.24
1986	2330.81	2255.07	962.26	886.52	1368.55
1987	2448.49	2342.01	1031.94	925.46	1416.55
1988	2706.57	2567.96	1060.40	921.79	1646.17

DOMESTIC\* excludes repayment for the foreign debts.

(source: idem quod TABLE 2)

TABLE 6

## EXPENDITURE OF CENTRAL AND LOCAL GOVERNMENTS (2)

## PERCENTAGE (TOTAL AS 100%)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL	DOMESTIC*
1979	100	100	47.9	47.9	52.1	52.1
1980	100	100	51.7	50.7	48.3	49.3
1981	100	100	54.0	50.8	46.0	49.2

1982	100	100	49.9	48.1	50.1	51.9
1983	100	100	49.7	48.2	50.3	51.8
1984	100	100	47.8	46.6	52.2	53.4
1985	100	100	45.3	44.5	54.7	55.5
1986	100	100	41.3	39.3	58.7	60.7
1987	100	100	42.1	39.5	57.9	60.5
1988	100	100	39.2	35.9	60.8	64.1

DOMESTIC\* excludes repayment for foreign debts.

(source: idem quod TABLE 2)

\_TABLE 7

EXPENDITURE OF CENTRAL AND LOCAL GOVERNMENTS (3) \_

YEAR	TOTAL VALUE (RMB 100M)	CENTRAL	LOCAL	TOTAL	CENTRAL PERCENTAGE (TOTAL AS 100%)	LOCAL
1953-1957	1345.68	997.25	348.43	100	74.1	25.9
1958-1962	2288.67	1101.57	1187.10	100	48.1	51.9
1963-1965	1204.98	718.92	486.06	100	59.7	40.3
1966-1970	2518.52	1537.98	980.54	100	61.1	38.9
1971-1975	3919.44	2125.14	1794.30	100	54.2	45.8
1976-1980	5247.35	2590.18	2657.18	100	49.4	50.6
1981-1985	6951.91	3356.92	3594.99	100	48.3	51.7

(source: idem quod TABLE 2) \_

We have said that we can't use the indicator D1 to measure the fiscal

decentralization in different fiscal system. What about the indicator D2?

— There is a contradiction between the two indicators. According to the first indicator D1, the fiscal system became less decentralized in 1980's. Whereas, the indicator D2 showed that the fiscal system has been becoming more centralized gradually from the early of 1950's till now, especially in last 10 years.

Which one is better? Which one is the good indicator for measuring the fiscal decentralization in the same period from the end of 1970's to the end of 1980's in China?

Same as we stated above, the second indicator D2 can be used to measure the extent of the fiscal decentralization in the same fiscal system or in two similar ones. In fact, the trend of the indicator D2 describes the process of the fiscal decentralization in the last 40 years in China exactly,(see YINONG TIAN, HUACHENG XIANG, FULIN ZHU, 1988) though we have to note that theoretically, it can't be used as the measure of the fiscal decentralization without anything else. —

BAHL, R. W. & NATH, S. gave a good comment on the comparison between the two indicators: "The fiscal 'importance' of subnational government might be measured in terms of the share of revenues generated or the share of expenditures made. The revenue measure would help determine the extent to which local governments are mobilizing an increasing or decreasing share of public resources through their tax and

charge systems, but would ignore the division of final expenditure and service \_delivery responsibility. Alternatively, one could measure the subnational government share of expenditures and ignore the question of where the funds are raised. Indeed, it is important to note that an increasing expenditure share at the subnational level might indicate increasing 'fiscal decentralization', even though revenue-raising authority remains highly concentrated at the central government level. such a result could occur if there were subnational use of intergovernmental grants." (BAHL, R. W. & NATH, S. 1986,)

They prefer using the second one (i.e. D2) as the better indicator to measuring fiscal decentralization. Meanwhile, they pointed out an important limitation of the second indicator: "subnational government expenditure responsibility may or may not indicate subnational government fiscal autonomy. On this issue, Musgrave (1959, page 342) has properly pointed out that local governments which act as central expenditure agents do not reflect expenditure decentralization in a meaningful sense, just as centrally collected but shared taxes do not constitute true revenue decentralization. This difference between the constitutional and the 'just for the sake of administrative convenience' division of fiscal functions cannot be discerned from the expenditure decentralization measure used here." (idem)

It is correct for Musgrave to point out that the main elements of



fiscal decentralization are not only the indicator but also, more meaningful, the autonomy of local governments. I, however, prefer saying that the key element of the fiscal decentralization is only the autonomy of the local governments, and the indicators are only the supplementary measurement of the fiscal decentralization, though they are necessary as well.

Having acknowledging that there is a more decentralized fiscal system in China now than that in the past, We can check it further using the indicators. \_

Within the prevailing tax-sharing system, the expenditure of the local governments is more related to the revenue collected by themselves. (see THE WORLD BANK, 1989) A new indicator might be better to measure the fiscal decentralization in China. The indicators D1 and D2 show the share of revenue and expenditure separately. No relationship between revenue and expenditure can be shown by them. In order to overcome this shortcoming, a new indicator D3 is introduced. \_

### 3. THE RATIO OF LOCAL EXPENDITURE TO LOCAL REVENUE

$$D3 = EL / RL$$

where: D3 is the third indicator of the fiscal decentralization

EL is the expenditure made by the local governments

RL is the revenue collected by the local governments

This indicator can be used to measure the ratio of the expenditure of the local governments to the revenue collected by them. If all the expenditure of the local governments must be paid by the local governments themselves, no grant comes from the central government, we can say there is more fiscal decentralization than when part of the expenditure is paid by the grant coming from the central government. It shows to what extent the local governments have their independent budgets. The closer the indicator is to 1, the more accountability the local governments have.

Let us look at the data of this indicator of the Chinese fiscal system.

It is true that this indicator can't show the fiscal decentralization precisely without the distinction between the responsibilities of the levels of the governments. If a local government has only less responsibilities, though this indicator is close to 1, we can't say there is more fiscal decentralization. \_

We can use this indicator and D1 or D2 simultaneously to measure the fiscal decentralization. If D1 or D2 is higher, and D3 is close to 1, we can say that there is more fiscal decentralization.

The TABLE 8 and 9 show us that  $D3 = EL / RL$  has been increasing sharply since 1953. It increased from less than 50% in 1953-1958 to more than 75% in 1981-1985. In 1979, it was only two-third and its average became slightly more than 1 in 1986-1988. Based on such figure with the

increase of the indicator D1 and D2 in the same period, we can draw a conclusion that the general trend of the Chinese fiscal system is steady decentralization. Although the Chinese economy has many success and failure, the trend of fiscal decentralization has been being unchanged. It became much more decentralized in last 10 years indeed.

TABLE 8

THE SHARE OF LOCAL EXPENDITURE TO LOCAL REVENUE (1)

YEAR	LOCAL EXPENDITURE VALUE (RMB 100M)	LOCAL REVENUE VALUE (RMB 100M)	RATIO
1979	626.78	915.24	68.5%
1980	562.02	875.48	64.2%
1981	512.76	864.71	59.3%
1982	578.17	865.49	66.8%
1983	649.62	876.94	74.1%
1984	807.70	977.39	82.6%
1985	1008.24	1158.53	87.0%
1986	1368.55	1343.59	101.9%
1987	1416.55	1463.06	96.8%
1988	1646.17	1582.48	104.0%

(source: idem quod TABLE 2)

TABLE 9

THE SHARE OF LOCAL EXPENDITURE TO LOCAL REVENUE (2)

YEAR	LOCAL EXPENDITURE VALUE (RMB 100M)	LOCAL REVENUE VALUE (RMB 100M)	RATIO
------	---------------------------------------	-----------------------------------	-------

1953-1957	348.43	739.71	47.1%
1958-1962	1187.10	1636.19	72.6%
1963-1965	486.06	879.31	55.3%
1966-1970	980.54	1738.89	56.4%
1971-1975	1794.30	3343.28	53.7%
1976-1980	2657.18	4186.13	63.5%
1981-1985	3594.99	4743.07	75.8%

(source: idem quod TABLE 2)

More over, we can go further by analysing another meaningful element. It is the tiers of the governments. As we stated above, in China, there are 5 tiers of the governments: central, provincial, municipal, county, and township governments.(It should be noted that "municipal" here means cities equivalent to the prefecture level.) All the indicators above describe the fiscal decentralization between the central and the whole local governments. The same relationship exists between the provincial and the municipal governments, the municipal and the county governments, and the county and the township governments as well. Therefore, we can use the same indicator to describe the fiscal decentralization at provincial, municipal, and county level. If we intend to measure the general fiscal decentralization, we'd better introduce a new indicator to reflect it wholly.

#### 4. THE GENERAL RATIO OF LOCAL EXPENDITURE TO LOCAL

## REVENUE OF TOTAL LEVELS OF THE LOCAL GOVERNMENTS

$$D4 = (ELP/RLP) * (ELM/RLM) * (ELC/RLC) * (ELT /RLT)$$

where: D4 is the fourth indicator of the fiscal decentralization

ELP is the expenditure of the local governments at and under the provincial level

RLP is the revenue collected by the local governments at and under the provincial level

ELM is the expenditure of the local governments at and under the municipal level

RLM is the revenue collected by the local governments at and under the municipal level

ELC is the expenditure of the local governments at and under the county level

RLC is the revenue collected by the local governments at and under the county level

ELT is the expenditure of the local governments at the township level

RLT is the revenue collected by the local governments at the township level

Because most (54.3 thousand, as 94.1% of the total.) township governments had got their independent budget and finance branches only by the end of the last year (see SHAOCHUN CHANG & JIANJUN YAN,

1990) and no tax authorities at the township level, we have to ignore the fiscal decentralization between the county and the township governments. In other words, we can consider the township governments as the agencies of the county governments to make expenditure, though the establishment of the finance at the township level has great importance. The finance at the township level has more special features worthy to analysis in another paper. By now we can say that only the establishment of the finance at the township level can show that the fiscal decentralization has gone further. A report by the World Bank named " China: Growth and Development in Gansu Province " gives a simple introduction about the finance at the township level in Gansu Province of that time.( The World Bank 1988b, P.65, P.94.)

Because of the nature of revenue and expenditure of the township governments, the transformation of D4 is:

$$D4 = (ELP/RLP) * (ELM/RLM) * (ELC/RLC)$$

There are still two difficulties for us to use the formula above to measure the general fiscal decentralization. The first one is all the data of expenditure and revenue of the local governments at municipal and county level are not available. So, we can't calculate the precise numbers of (ELM/RLM) and (ELC/RLC). It means that the exact estimate of D4 can't be made out.

The second difficulty is that there are two kinds of the relationship

between the provincial and the county level. In some provinces, e.g. Jiangsu, there is no direct fiscal relationship between the provincial and the county governments. This means that direct fiscal relationship exist between the provincial and municipal governments and between the municipal and the county governments. In others, e.g. Anhui, there is. More complicated, even though in those with the direct fiscal relationship, not all the county governments have the direct relationship with the provincial government. Some do, others do not. Of course, the data of such relationship are not available either. As for the nature of the budget systems in different provinces, it is too complicated for us to judge whether the lower governments should be considered basically as the agencies of the upper one.

Nevertheless, we can use some related information to measure the general fiscal decentralization roughly. Firstly, we calculate the fiscal decentralization within three tiers of which  $D3 = EL / RL$  is the data of the first tier we have got. What we need to do is calculate the number of (ELM/RLM) and (ELC/RLC).

\_ (1) estimate of (ELM/RLM) and  $D4 = (ELP/RLP) * (ELM/RLM)$

We'll calculate the number of the indicators above in turns.

A. We have got the data of revenue and expenditure of key cities. In CHINA FINANCE STATISTICS, there are two tables named "REVENUE OF KEY CITIES" and "EXPENDITURE OF KEY CITIES".

They includes the data of revenue and expenditure of 75 key cities in the period 1983-1987. All these cities are equivalent to prefecture.

The TABLE 10 tells us that the estimates of the indicator (E-LM/RLM) in the period 1983-1987 are: 40.6%, 47.2%, 49.0%, 52.8%, 53.2%.

TABLE 10

THE SHARE OF EXPENDITURE TO REVENUE OF KEY CITIES

YEAR	LOCAL EXPENDITURE VALUE (RMB 100M)	LOCAL REVENUE VALUE (RMB 100M) _	RATIO
1983	123.09	303.07	40.6%
1984	157.90	334.40	47.2%
1985	229.19	467.97	49.0%
1986	302.88	520.54	52.8%
1987	286.08	537.60	53.2%

1. all figures shown here are from 75 cities which are under the jurisdiction of the provincial governments.

2. the data of Guiyang and Kunming cities (1983), of Hangzhou and Lanzhou cities (1984), of Zunyi city (1986), of Zunyi, Jiangmen, Qingdao, Urumqi cities are excluded here.

(source: idem quod TABLE 2)

According to TABLE 8 and TABLE 10, we can estimate D4 at both the provincial and the municipal levels. We can see that no matter at which level, the indicator shows an increasing trend. At the provincial



level, the indicator (ELP/RLP) increased from 68.5% in 1979 to 104.0% in 1988. At the municipal level, the indicator (ELM/RLM) from 40.6% in 1983 to 53.2% in 1987. We can get the data of indicator  $D4 = (ELP/RLP) * (ELM/RLM)$  in the period 1983-1987: 30.1%, 39.0%, 42.6%, 53.8%, 51.5%. \_

B. We have got another set of data of revenue and expenditure of all cities in 1984 and 1985 in "PUBLIC FINANCE" of "CHINA URBAN STATISTICS" (1985, 1986). Three of them are equivalent to provincial level, i.e. BEIJING, TIANJIN and SHANGHAI, Some of these cities are equivalent to prefecture and others to county. We can deduct all the numbers of BEIJING, TIANJIN, and SHANGHAI, and get the data of all the cities equivalent to prefecture and county level. It is unfortuate that we are unable to distinguish the cities equivalent to prefecture level from those equivalent to county level.

According to TABLE 11, we know that for all the cities excluding BEIJING TIANJIN and SHANGHAI, the data of (ELP/RLP) are 42.4% in 1984, and 47.6% in 1985.

TABLE 11

PUBLIC FINANCE OF CITIES\* \_

UNITS SHARE	LOCAL REVENUE			LOCAL EXPENDITURE			VI AS OF III
	TOTAL VALUE (RMB 100M)	CITIES SHARE (%)	SHARE (%)	TOTAL VALUE (RMB 100M)	CITIES SHARE (%)	SHARE (%)	

	I	II	III	IV	V	VI	VII	VIII
TOTAL	_							
1984	977.39	628.75	64.3	807.70	236.96**	29.3	37.7	
1985	1158.53	778.91	67.2	1008.24	31.35***	33.9	43.8	
BEIJING	_							
1984	45.62	42.41	93.0	27.15	24.00	88.4	56.6	
1985	52.44	48.29	92.1	32.99	28.70	87.0	59.4	
TIANJIN								
1984	42.06	38.26	91.0	19.83	17.46	88.0	45.6	
1985	48.21	46.23	95.9	26.97	25.50	94.5	55.1	
SHANGHAI								
1984	161.10	144.52	89.7	27.69	24.40	88.1	16.9	
1985	181.59	160.80	88.6	42.07	37.76	89.8	23.5	
OTHER								
1984	728.61	403.56	55.4	633.03	171.10	27.0	42.4	
1985	876.29	523.59	59.8	906.21	249.39	27.5	47.6	

\* the "cities" here refers to those equivalent to prefecture and county level. It includes 292 in 1984, and 321 in 1985.

\*\* the data of Putian city of Fujian province are not available.

\*\*\* the data of Panjin city of Liaoning province are not available.

(source: idem quod TABLE 2, STATE STATISTICS BUREAU PRC, 1985, 1986a) \_

So based on the TABLE 8 and TABLE 11, we get the estimate of the indicator  $D4 = (ELP/RLP)*(ELM/RLM)$ : 35.02% in 1984, and 41.41% in 1985.

Although the first set of the data are from 75 key cities excluding some cities equivalent to prefecture level (total number of the cities equivalent to the prefecture level is 162 in 1985) and the second 292 in 1984, 321 in 1985, which include the cities equivalent to both the prefecture and the county level, the  $D4 = (ELP/RLP)*(ELM/RLM)$  of two sets are very close to each other. —

(2) estimate of  $(ELC/RLC)$  and  $D4 = (ELP/RLP)*(ELM/RLM)*(ELC/RLC)$

We have got a set of data of revenue and expenditure of the local governments at county level. In CHINA URBAN STATISTICS, there are the data of revenue and expenditure of those counties which are under the jurisdiction of the municipal governments. This means that the data of those counties which are under the jurisdiction of provincial (via prefecture) governments are not available.

TABLE 12

PUBLIC FINANCE OF COUNTIES*			
UNITS	LOCAL REVENUE	LOCAL EXPENDITURE	III AS SHARE TO II
	VALUE (RMB 100M)		(%)
I	II	III	IV
TOTAL	—		
1984	135.93	107.98	79.44

1985	181.47	158.23	87.19
BEIJING_			
1984	3.21	3.19	99.38
1985	4.15	4.29	103.37
TIANJIN			
1984	1.67	1.33	79.64
1985	1.98	1.47	74.24
SHANGHAI			
1984	15.66	3.29	21.01
1985	20.79	4.13	19.87
OTHERS			
1984	115.39	100.17	86.81
1985	154.55	148.34	95.98

\* the "counties" here refers to those under the jurisdiction of the cities in TABLE 11. It includes 520 counties in 1984, and 620 in 1985.

(source: STATE STATISTICS BUREAU PRC, 1985, 1986a)

From TABLE 12, we can see that the indicator (ELC/RLC) for those counties which are under the jurisdiction of the municipalities equivalent to prefecture level are 86.81% in 1984 and 95.98% in 1985. It means as a whole, the expenditure of those counties relied more and more on their own revenue.

The indicator  $D4 = (ELP/RLP)*(ELM/RLM)*(ELC/RLC)$  can be

estimated as follows: 30.40% in 1984 and 41.14% in 1985.

## 5. INTERNATIONAL COMPARISON

Although we don't think that we can use the indicators to measure the extent of the decentralization in different fiscal systems, we still think the indicators in different fiscal systems can provide much information for us. Our international comparison below should be confirmed by the analysis of every individual country.

### (1) COMPARISON OF THE INDICATOR D1

We have got a set of data about the general revenue, central revenue, and local revenue in all over the world as shown below.

TABLE 13

### THE SHARE OF LOCAL REVENUE TO GENERAL REVENUE PERCENTAGE (%)

YEAR	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
I	27.23	26.91	26.66	26.07	26.26	25.93	26.10	26.15		
II	28.26	27.68	27.16	26.25	26.55	26.38	26.31	26.71	26.96	26.93
III	17.92	19.89	20.99	21.33	20.79	19.64	20.44	19.75		

I : the figures here are the average of the world including 21 industrial countries and 112 developing ones.

II : the figures here are the average of 21 industrial countries.

III : the figures here are the average of 112 developing countries.

(source: IMF 1987)

We compare TABLE 13 with TABLE 3 and we can see that the numbers of the indicator in the same period of China are much bigger

than those of the average of the world, industrial, and developing countries. Although in the period 1979-1988 the share of local revenue to general revenue in China decreased sharply (from more than 85% to 60-65%) and it remained unchanged basically in other countries, the difference between China and other countries is still very large. \_

But we can't say China has a more decentralized fiscal system based on such data. The reason is very simple: China has a special revenue raising system in which the main part of the total revenue is collected by the local governments. (THE WORLD BANK, 1989)

## (2) COMPARISON OF THE INDICATOR D2

A. BAHL, R.W. and NATH, S. in their article give us an useful information about fiscal decentralization as below:

" TABLE 1. TREND IN FISCAL DECENTRALIZATION, 1960(1973)a

(source: WORLD BANK, 1976, table 7).

Countries b, c,	developing	developed	total
Federal	39.5 (32.5)	53.8 (61.2)	48.4 (50.4)
Nonfederal	20.0 (21.4)	42.6 (48.4)	28.4 (31.4)
Total	22.4 (22.7)	45.7 (52.0)	32.1 (35.0)

a Figures shown are percentages.

b Eight federal, thirty-five nonfederal.

c Twenty-five developing, eighteen developed. \_

The figures shown in this table are the calculated results of the indicator D2. We can see that the highest figure is that of the developed federal countries in 1973: 61.2%. The lowest one is that of the developing nonfederal countries in 1960: 20.0%. Generally speaking, "the subnational government share of total government expenditures increased more in the developed than in the developing countries. On average, subnational government expenditures increased by 6.3% of total spending in advanced countries but by only 0.3% of total expenditures in LDCs (see table 1)." and "Federal countries, advanced or developing, are more fiscally decentralized than are countries governed under unitary countries,... the data in table 1 do not indicate increased decentralization to the trend for federal LDCs." (BAHL, R.W. & NATH, S. 1986)

China is not a federal county. But the figures of D2 show that (a) China was deeper decentralized than the developing countries, federal or nonfederal, in the same period. In 1958-1962, the figures of China were 51.9% and in 1971-1975 45.8%, although only 40.3% in 1963-1965 and 38.9% in 1966-1970. All this figures were higher than that of the developing countries in BAHL, R.W. & NATH, S.s' table. (b) Compared with those figures of the developed countries, the figures of China were close to that of the nonfederal developed countries. In the last 10 years, although the figures of China moved up and down in the first 6 years, they increased to 60%-65% in 1986-1988. It was near that of federal

developed countries in 1973.

B. We have got another set of data about the share of local expenditure to general expenditure as below:

TABLE 14

THE SHARE OF LOCAL EXPENDITURE TO GENERAL  
EXPENDITURE PERCENTAGE (%)

YEAR	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
I	23.47	22.56	24.75	24.59	24.80	24.10	23.88	23.57		
II	26.53	23.24	25.48	25.09	25.43	24.94	24.66	23.85	23.98	23.53
III	18.19	18.53	17.88	16.83	17.00	18.65				

I : the figures here are the average of the world including 21 industrial countries and 112 developing ones.

II : the figures here are the average of 21 industrial countries.

III : the figures here are the average of 112 developing countries.

(source: idem quod TABLE 13)

Firstly we compare the data in TABLE 14 with those in BAHL, R.W. & NATH, S.s' table. Clearly, the data in TABLE 14 are smaller than those in BAHL, R.W. & NATH, S.s' table. The reason is that the data in TABLE 14 come from 21 developed countries (more than 18 in BAHL, R.W. & NATH, S.s') and 112 developing countries (much more than 25 in BAHL, R.W. & NATH, S.s'). In general, the less developed, the less the indicator. Therefore, the more countries included, the less the indicator. It is normal for the data in TABLE 14 to be less than those in BAHL, R.W. & NATH, S.s'. Because the data in TABLE 14 come from the period



1976-1986 which is later than the period 1960-1973 and there was a trend of the fiscal decentralization indeed, that the data in TABLE 14 are less than those in BAHL, R.W. & NATH, S.s' reveals the data of the countries other than those included in BAHL, R.W. & NATH, S.s' must be much smaller than the average.

Of course, the numbers of the indicator  $D2=EL/(EL+EC)$  in China are much bigger than those in TABLE 14 as well.

According to the comparison above, based on the indicator  $D2=EL/(EL+EC)$ , we can say that China has a more decentralized fiscal system than the general developing and many developed countries.

### (3) COMPARISON OF THE INDICATOR D3

Based on TABLE 13 and TABLE 14 we can get the estimates of D-3 as below by dividing the figures in TABLE 14 by those in TABLE 13 correspondingly.

TABLE 15

#### THE SHARE OF LOCAL EXPENDITURE TO LOCAL REVENUE

		PERCENTAGE (%)									
YEAR		1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
I		86.19	83.84	92.83	94.32	94.45	92.96	91.51	90.13		
II		93.88	83.97	93.82	95.58	95.77	94.55	93.73	89.28	88.94	87.38
III		86.65	86.90	85.99	85.72	83.17	94.41				

I : the figures here are the average of the world including 21

industrial countries and 112 developing ones.

II : the figures here are the average of 21 industrial countries.

III : the figures here are the average of 112 developing countries.

(source: idem quod TABLE 13)

It is very interesting for us to compare the data in TABLE 15 with those in TABLE 8 and TABLE 9. Although the comparisons of the indicators D1 and D2 show us that the numbers of these two indicators are bigger in China than the average in other countries, TABLE 15 tells us another story. All the data of China before 1985 were less than those in TABLE 15. After 1985, the average of the indicator in 1986-1988 is slightly more than 100% in China. Although the data of the indicator for other countries are not available in the period from 1986-1988, we can say that the figures of China would not be, at least, less than those of other countries based on the trend of them.

It is worth noting that the figures of the indicator D3 became more than 100% when the figures of the indicators D1 and D2 were much higher than those of other countries. We can reach a conclusion that China has a more decentralized fiscal system than all of other countries on average, though we can't say this based on the higher figures of the indicator D1 and D2 only.

By now, we have finished all we can do with our limited information. In the end of this chapter, we should summarize our main arguments about the measurement of the fiscal decentralization.

Firstly, the key element of the fiscal decentralization is the autonomy of the local governments. All the indicators are only supplementary measurements of it.

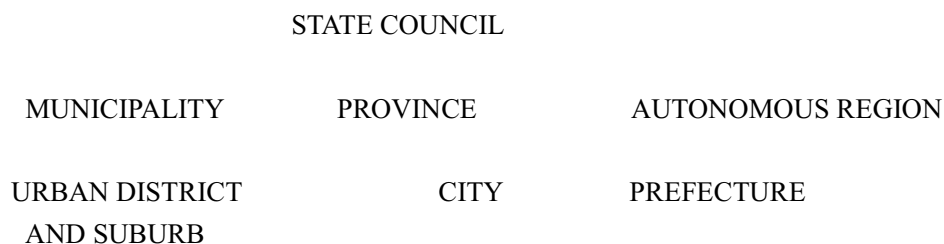
Secondly, no indicator can be used only to measure the fiscal decentralization in different fiscal systems, but they can be used to measure the extent of the fiscal decentralization in the same fiscal system.

Thirdly, the system of the fiscal decentralization has to be supported by the indicators. Without more collection or spending or both, no local government has real autonomy. This is just the meaning of the indicators. This is just the reason for us to compare them with each other.

### CHAPTER 3

#### MEASURING THE FISCAL DECENTRALIZATION IN CHINA

Before we measure the fiscal decentralization, we should make clear the government system in China. The following is the main structure of the Chinese government system.





firstly intend to measure the Chinese fiscal decentralization.

Unfortunately, there is no best indicator for measuring the fiscal decentralization. Every indicator has its own advantages and disadvantages. However, every indicator can be used to show some elements of the fiscal decentralization. A brief discussion of the indicators will be helpful for us to describe the fiscal decentralization.

There are two common indicators to measure the fiscal decentralization: (see BAHL, R. W. & NATH, S. 1986)

#### 1. THE SHARE OF REVENUES GENERATED

$$D1 = RL / (RL + RC) \_$$

where: D1 is the first indicator of the fiscal decentralization

RL is the revenue collected by the local governments

RC is the revenue collected by the central government

Actually, this indicator shows that the more the share of revenue collected by the local governments the more the fiscal decentralization

Let us have a look at the Chinese data of the indicator above. According to the TABLE 2, 3 and 4, we can see that contrary to the general idea, the indicator D1 have been becoming less and less (from 83.0% to 54.6% with revenue from foreign debts and from 85.7 to 63.6 without revenue from foreign debts) in the period from 1979 to 1988 which was the Chinese economic reform era. In the last 40 years, the trend was slightly different from that in the last 10 years. The indicator D-

l increased from 54.6% in the period 1953-1957 to 85.3% in 1971-1975, and decreased to 69.4% in 1981-1985.

TABLE 2

REVENUE OF CENTRAL AND LOCAL GOVERNMENTS (1)

VALUE (RMB 100M)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL	DOMESTIC*
1979	1103.27	1067.96	188.03	152.72	915.24	915.24
1980	1085.23	1042.22	209.75	166.74	875.48	875.48
1981	1089.46	1016.38	224.74	151.67	864.71	864.71
1982	1123.97	1083.94	258.48	218.45	865.49	865.49
1983	1248.99	1211.16	372.05	334.22	876.94	876.94
1984	1501.86	1467.05	524.47	489.66	977.39	977.39
1985	1866.40	1837.16	707.87	678.63	1158.53	1158.53
1986	2260.26	2184.52	916.67	840.93	1343.59	1343.59
1987	2368.90	2262.42	905.84	799.36	1463.06	1463.06
1988	2628.02	2489.41	1045.54	906.93	1582.48	1582.48

\* DOMESTIC revenue excludes foreign debts.

(source: THE GENERAL PLANNING DEPARTMENT OF  
MINISTRY OF FINANCE, 1989)

TABLE 3

REVENUE OF CENTRAL AND LOCAL GOVERNMENTS (2)

PERCENTAGE (TOTAL AS 100%)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL
1979	100	100	17.0	14.3	85.7
1980	100	100	19.3	16.0	84.0
1981	100	100	20.6	14.9	85.1
1982	100	100	23.0	20.2	79.8
1983	100	100	29.8	27.6	72.4
1984	100	100	34.9	33.4	66.6
1985	100	100	37.9	36.9	63.1
1986	100	100	40.6	38.5	61.5
1987	100	100	38.2	35.3	64.7
1988	100	100	45.4	36.4	63.6

\* DOMESTIC revenue excludes foreign debts.

(source: idem quod TABLE 2)

TABLE 4  
REVENUE OF CENTRAL AND LOCAL GOVERNMENTS (3)

YEAR	TOTAL VALUE (RMB 100M)	CENTRAL	LOCAL	TOTAL PERCENTAGE (TOTAL AS 100%)	CENTRAL	LOCAL
1953-1957	1354.88	615.17	739.71	100	45.4	54.6
1958-1962	2116.62	480.43	1636.19	100	22.7	77.3
1963-1965	1215.11	335.80	879.31	100	27.6	72.4
1966-1970	2528.98	790.09	1738.89	100	31.2	68.8
1971-1975	3919.71	576.43	3343.28	100	14.7	85.3
1976-1980	4960.66	774.53	4186.13	100	15.6	84.4
1981-1985	6830.68	2087.61	4743.07	100	30.6	69.4

(source: idem quod TABLE 2)

Based on such information, can we draw a conclusion that the fiscal system was more centralized in 1953-1957 than in 1981-1985? Can we say that there was not a trend of fiscal decentralization but a trend of fiscal centralization in the last 10 years? Can we use this indicator as the measure of the fiscal decentralization in China?

The answer is not very simple.

We can say yes for the first question. Although the indicator D1 in 1953-1957 was much less than that in the following periods, we have to note the fiscal system in that period was most centralized not only because of the lowest figure but also, and more important, because of the strictly-centralized budget system. The indicator D1 in 1988 was close to that in 1953-1957, but we can't make a conclusion that the fiscal decentralization in 1988 was close to that in 1953-1957. We must pay attention to some elements behind the indicator. Because there was the "unified revenue and expenditure" principle applying to the budget system in the early of 1950's, no matter how many percent of revenue collected by the local governments, the fiscal system was not



decentralized but centralized indeed. \_

Why do we consider there is a more decentralized fiscal system of China in the period 1981-1985 than that in early of 1950's? The indicator here does show what percentage of the total revenue is collected by the local governments, but this is only the result of the implementation of a kind of fiscal system. The comparison between the fiscal systems in the period 1981-1985 and the early of 1950's shows us that different fiscal systems can lead to the same result. Musgrave pointed out that "centrally collected but shared taxes do not constitute true revenue decentralization." (see BAHL, R. W. & NATH, S. 1986.) We can add something to his idea: no matter who raises the revenue, no matter whether the revenue is shared or not, only the ratio of the revenue collected by the local governments (the central government as well) does not mean anything about the fiscal decentralization.

According to the information in CHAPTER 1 and CHAPTER 2 and the analysis above, We can draw a conclusion: the standard for judging whether a fiscal system is centralized or decentralized is mainly the nature or mechanism of it. The indicator D1 can measure the extent of the fiscal decentralization in the same fiscal system or in two similar ones.

\_

Now that the indicator D1 can't be used as the measure of the fiscal decentralization without anything else, is it meaningful for the indicator?

The answer is absolutely positive. Although we can not say a fiscal system is more decentralized only because it has a higher indicator, a real more decentralized fiscal system does has a higher indicator. If a local government raises and/or spends very little money, can we say it has more autonomy? Real local autonomy must be supported and, as the result, reflected by more raising and/or spending. \_

## 2. THE SHARE OF EXPENDITURES MADE

$$D2 = EL / (EL + EC)$$

where: D2 is the second indicator of the fiscal decentralization

EL is the expenditure made by the local governments

EC is the expenditure made by the central government

Similarly, this indicator shows that the more the share of the expenditure made by the local governments the more the fiscal decentralization.

Let us check the indicator D2 of the fiscal decentralization in China. The TABLE 5, 6 and 7 show clearly that based on the figure of the indicator D2, there was an increasingly trend of fiscal decentralization in the last 10 years, from near 50% in 1979-1980 to more than 60% in 1988. In view of the trend in last 40 years, in general, with the exception of that in 1958-1962, the fiscal decentralization has been developing obviously, from one quarter in 1953-1957 to 50% in 1981-1985. This shows that the share of expenditure made by the local governments became twice as

much as that in early of 1950's.

TABLE 5

## EXPENDITURE OF CENTRAL AND LOCAL GOVERNMENTS (1)

## VALUE (RMB 100M)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL
1979	1203.04	1203.04	576.26	576.26	626.78
1980	1164.10	1139.70	602.08	577.68	562.02
1981	1114.97	1041.89	602.21	529.13	512.76
1982	1153.31	1113.28	575.14	535.11	578.17
1983	1292.45	1254.62	642.53	604.70	649.62
1984	1546.40	1511.59	738.70	703.89	807.70
1985	1844.78	1815.54	836.54	807.30	1008.24
1986	2330.81	2255.07	962.26	886.52	1368.55
1987	2448.49	2342.01	1031.94	925.46	1416.55
1988	2706.57	2567.96	1060.40	921.79	1646.17

DOMESTIC\* excludes repayment for the foreign debts.

(source: idem quod TABLE 2)

TABLE 6

## EXPENDITURE OF CENTRAL AND LOCAL GOVERNMENTS (2)

## PERCENTAGE (TOTAL AS 100%)

YEAR	TOTAL	DOMESTIC*	CENTRAL	DOMESTIC*	LOCAL	DOMESTIC*
1979	100	100	47.9	47.9	52.1	52.1
1980	100	100	51.7	50.7	48.3	49.3
1981	100	100	54.0	50.8	46.0	49.2

1982	100	100	49.9	48.1	50.1	51.9
1983	100	100	49.7	48.2	50.3	51.8
1984	100	100	47.8	46.6	52.2	53.4
1985	100	100	45.3	44.5	54.7	55.5
1986	100	100	41.3	39.3	58.7	60.7
1987	100	100	42.1	39.5	57.9	60.5
1988	100	100	39.2	35.9	60.8	64.1

DOMESTIC\* excludes repayment for foreign debts.

(source: idem quod TABLE 2)

\_TABLE 7

EXPENDITURE OF CENTRAL AND LOCAL GOVERNMENTS (3) \_

YEAR	TOTAL VALUE (RMB 100M)	CENTRAL	LOCAL	TOTAL	CENTRAL PERCENTAGE (TOTAL AS 100%)	LOCAL
1953-1957	1345.68	997.25	348.43	100	74.1	25.9
1958-1962	2288.67	1101.57	1187.10	100	48.1	51.9
1963-1965	1204.98	718.92	486.06	100	59.7	40.3
1966-1970	2518.52	1537.98	980.54	100	61.1	38.9
1971-1975	3919.44	2125.14	1794.30	100	54.2	45.8
1976-1980	5247.35	2590.18	2657.18	100	49.4	50.6
1981-1985	6951.91	3356.92	3594.99	100	48.3	51.7

(source: idem quod TABLE 2) \_

We have said that we can't use the indicator D1 to measure the fiscal

decentralization in different fiscal system. What about the indicator D2?

— There is a contradiction between the two indicators. According to the first indicator D1, the fiscal system became less decentralized in 1980's. Whereas, the indicator D2 showed that the fiscal system has been becoming more centralized gradually from the early of 1950's till now, especially in last 10 years.

Which one is better? Which one is the good indicator for measuring the fiscal decentralization in the same period from the end of 1970's to the end of 1980's in China?

Same as we stated above, the second indicator D2 can be used to measure the extent of the fiscal decentralization in the same fiscal system or in two similar ones. In fact, the trend of the indicator D2 describes the process of the fiscal decentralization in the last 40 years in China exactly,(see YINONG TIAN, HUACHENG XIANG, FULIN ZHU, 1988) though we have to note that theoretically, it can't be used as the measure of the fiscal decentralization without anything else. —

BAHL, R. W. & NATH, S. gave a good comment on the comparison between the two indicators: "The fiscal 'importance' of subnational government might be measured in terms of the share of revenues generated or the share of expenditures made. The revenue measure would help determine the extent to which local governments are mobilizing an increasing or decreasing share of public resources through their tax and

charge systems, but would ignore the division of final expenditure and service \_delivery responsibility. Alternatively, one could measure the subnational government share of expenditures and ignore the question of where the funds are raised. Indeed, it is important to note that an increasing expenditure share at the subnational level might indicate increasing 'fiscal decentralization', even though revenue-raising authority remains highly concentrated at the central government level. such a result could occur if there were subnational use of intergovernmental grants." (BAHL, R. W. & NATH, S. 1986,)

They prefer using the second one (i.e. D2) as the better indicator to measuring fiscal decentralization. Meanwhile, they pointed out an important limitation of the second indicator: "subnational government expenditure responsibility may or may not indicate subnational government fiscal autonomy. On this issue, Musgrave (1959, page 342) has properly pointed out that local governments which act as central expenditure agents do not reflect expenditure decentralization in a meaningful sense, just as centrally collected but shared taxes do not constitute true revenue decentralization. This difference between the constitutional and the 'just for the sake of administrative convenience' division of fiscal functions cannot be discerned from the expenditure decentralization measure used here." (idem)

It is correct for Musgrave to point out that the main elements of

fiscal decentralization are not only the indicator but also, more meaningful, the autonomy of local governments. I, however, prefer saying that the key element of the fiscal decentralization is only the autonomy of the local governments, and the indicators are only the supplementary measurement of the fiscal decentralization, though they are necessary as well.

Having acknowledging that there is a more decentralized fiscal system in China now than that in the past, We can check it further using the indicators. \_

Within the prevailing tax-sharing system, the expenditure of the local governments is more related to the revenue collected by themselves. (see THE WORLD BANK, 1989) A new indicator might be better to measure the fiscal decentralization in China. The indicators D1 and D2 show the share of revenue and expenditure separately. No relationship between revenue and expenditure can be shown by them. In order to overcome this shortcoming, a new indicator D3 is introduced. \_

### 3. THE RATIO OF LOCAL EXPENDITURE TO LOCAL REVENUE

$$D3 = EL / RL$$

where: D3 is the third indicator of the fiscal decentralization

EL is the expenditure made by the local governments

RL is the revenue collected by the local governments



This indicator can be used to measure the ratio of the expenditure of the local governments to the revenue collected by them. If all the expenditure of the local governments must be paid by the local governments themselves, no grant comes from the central government, we can say there is more fiscal decentralization than when part of the expenditure is paid by the grant coming from the central government. It shows to what extent the local governments have their independent budgets. The closer the indicator is to 1, the more accountability the local governments have.

Let us look at the data of this indicator of the Chinese fiscal system.

It is true that this indicator can't show the fiscal decentralization precisely without the distinction between the responsibilities of the levels of the governments. If a local government has only less responsibilities, though this indicator is close to 1, we can't say there is more fiscal decentralization. \_

We can use this indicator and D1 or D2 simultaneously to measure the fiscal decentralization. If D1 or D2 is higher, and D3 is close to 1, we can say that there is more fiscal decentralization.

The TABLE 8 and 9 show us that  $D3 = EL / RL$  has been increasing sharply since 1953. It increased from less than 50% in 1953-1958 to more than 75% in 1981-1985. In 1979, it was only two-third and its average became slightly more than 1 in 1986-1988. Based on such figure with the

increase of the indicator D1 and D2 in the same period, we can draw a conclusion that the general trend of the Chinese fiscal system is steady decentralization. Although the Chinese economy has many success and failure, the trend of fiscal decentralization has been being unchanged. It became much more decentralized in last 10 years indeed.

TABLE 8

THE SHARE OF LOCAL EXPENDITURE TO LOCAL REVENUE (1)

YEAR	LOCAL EXPENDITURE VALUE (RMB 100M)	LOCAL REVENUE VALUE (RMB 100M)	RATIO
1979	626.78	915.24	68.5%
1980	562.02	875.48	64.2%
1981	512.76	864.71	59.3%
1982	578.17	865.49	66.8%
1983	649.62	876.94	74.1%
1984	807.70	977.39	82.6%
1985	1008.24	1158.53	87.0%
1986	1368.55	1343.59	101.9%
1987	1416.55	1463.06	96.8%
1988	1646.17	1582.48	104.0%

(source: idem quod TABLE 2)

TABLE 9

THE SHARE OF LOCAL EXPENDITURE TO LOCAL REVENUE (2)

YEAR	LOCAL EXPENDITURE VALUE (RMB 100M)	LOCAL REVENUE VALUE (RMB 100M)	RATIO
------	---------------------------------------	-----------------------------------	-------

1953-1957	348.43	739.71	47.1%
1958-1962	1187.10	1636.19	72.6%
1963-1965	486.06	879.31	55.3%
1966-1970	980.54	1738.89	56.4%
1971-1975	1794.30	3343.28	53.7%
1976-1980	2657.18	4186.13	63.5%
1981-1985	3594.99	4743.07	75.8%

(source: idem quod TABLE 2)

More over, we can go further by analysing another meaningful element. It is the tiers of the governments. As we stated above, in China, there are 5 tiers of the governments: central, provincial, municipal, county, and township governments.(It should be noted that "municipal" here means cities equivalent to the prefecture level.) All the indicators above describe the fiscal decentralization between the central and the whole local governments. The same relationship exists between the provincial and the municipal governments, the municipal and the county governments, and the county and the township governments as well. Therefore, we can use the same indicator to describe the fiscal decentralization at provincial, municipal, and county level. If we intend to measure the general fiscal decentralization, we'd better introduce a new indicator to reflect it wholly.

#### 4. THE GENERAL RATIO OF LOCAL EXPENDITURE TO LOCAL

## REVENUE OF TOTAL LEVELS OF THE LOCAL GOVERNMENTS

$$D4 = (ELP/RLP) * (ELM/RLM) * (ELC/RLC) * (ELT /RLT)$$

where: D4 is the fourth indicator of the fiscal decentralization

ELP is the expenditure of the local governments at and under the provincial level

RLP is the revenue collected by the local governments at and under the provincial level

ELM is the expenditure of the local governments at and under the municipal level

RLM is the revenue collected by the local governments at and under the municipal level

ELC is the expenditure of the local governments at and under the county level

RLC is the revenue collected by the local governments at and under the county level

ELT is the expenditure of the local governments at the township level

RLT is the revenue collected by the local governments at the township level

Because most (54.3 thousand, as 94.1% of the total.) township governments had got their independent budget and finance branches only by the end of the last year (see SHAOCHUN CHANG & JIANJUN YAN,

1990) and no tax authorities at the township level, we have to ignore the fiscal decentralization between the county and the township governments. In other words, we can consider the township governments as the agencies of the county governments to make expenditure, though the establishment of the finance at the township level has great importance. The finance at the township level has more special features worthy to analysis in another paper. By now we can say that only the establishment of the finance at the township level can show that the fiscal decentralization has gone further. A report by the World Bank named " China: Growth and Development in Gansu Province " gives a simple introduction about the finance at the township level in Gansu Province of that time.( The World Bank 1988b, P.65, P.94.)

Because of the nature of revenue and expenditure of the township governments, the transformation of D4 is:

$$D4 = (ELP/RLP) * (ELM/RLM) * (ELC/RLC)$$

There are still two difficulties for us to use the formula above to measure the general fiscal decentralization. The first one is all the data of expenditure and revenue of the local governments at municipal and county level are not available. So, we can't calculate the precise numbers of (ELM/RLM) and (ELC/RLC). It means that the exact estimate of D4 can't be made out.

The second difficulty is that there are two kinds of the relationship

between the provincial and the county level. In some provinces, e.g. Jiangsu, there is no direct fiscal relationship between the provincial and the county governments. This means that direct fiscal relationship exist between the provincial and municipal governments and between the municipal and the county governments. In others, e.g. Anhui, there is. More complicated, even though in those with the direct fiscal relationship, not all the county governments have the direct relationship with the provincial government. Some do, others do not. Of course, the data of such relationship are not available either. As for the nature of the budget systems in different provinces, it is too complicated for us to judge whether the lower governments should be considered basically as the agencies of the upper one.

Nevertheless, we can use some related information to measure the general fiscal decentralization roughly. Firstly, we calculate the fiscal decentralization within three tiers of which  $D3 = EL / RL$  is the data of the first tier we have got. What we need to do is calculate the number of (ELM/RLM) and (ELC/RLC).

\_ (1) estimate of (ELM/RLM) and  $D4 = (ELP/RLP) * (ELM/RLM)$

We'll calculate the number of the indicators above in turns.

A. We have got the data of revenue and expenditure of key cities. In CHINA FINANCE STATISTICS, there are two tables named "REVENUE OF KEY CITIES" and "EXPENDITURE OF KEY CITIES".

They includes the data of revenue and expenditure of 75 key cities in the period 1983-1987. All these cities are equivalent to prefecture.

The TABLE 10 tells us that the estimates of the indicator (E-LM/RLM) in the period 1983-1987 are: 40.6%, 47.2%, 49.0%, 52.8%, 53.2%.

TABLE 10

THE SHARE OF EXPENDITURE TO REVENUE OF KEY CITIES

YEAR	LOCAL EXPENDITURE VALUE (RMB 100M)	LOCAL REVENUE VALUE (RMB 100M) _	RATIO
1983	123.09	303.07	40.6%
1984	157.90	334.40	47.2%
1985	229.19	467.97	49.0%
1986	302.88	520.54	52.8%
1987	286.08	537.60	53.2%

1. all figures shown here are from 75 cities which are under the jurisdiction of the provincial governments.

2. the data of Guiyang and Kunming cities (1983), of Hangzhou and Lanzhou cities (1984), of Zunyi city (1986), of Zunyi, Jiangmen, Qingdao, Urumqi cities are excluded here.

(source: idem quod TABLE 2)

According to TABLE 8 and TABLE 10, we can estimate D4 at both the provincial and the municipal levels. We can see that no matter at which level, the indicator shows an increasing trend. At the provincial

level, the indicator (ELP/RLP) increased from 68.5% in 1979 to 104.0% in 1988. At the municipal level, the indicator (ELM/RLM) from 40.6% in 1983 to 53.2% in 1987. We can get the data of indicator  $D4 = (ELP/RLP) * (ELM/RLM)$  in the period 1983-1987: 30.1%, 39.0%, 42.6%, 53.8%, 51.5%. \_

B. We have got another set of data of revenue and expenditure of all cities in 1984 and 1985 in "PUBLIC FINANCE" of "CHINA URBAN STATISTICS" (1985, 1986). Three of them are equivalent to provincial level, i.e. BEIJING, TIANJIN and SHANGHAI, Some of these cities are equivalent to prefecture and others to county. We can deduct all the numbers of BEIJING, TIANJIN, and SHANGHAI, and get the data of all the cities equivalent to prefecture and county level. It is unfortuate that we are unable to distinguish the cities equivalent to prefecture level from those equivalent to county level.

According to TABLE 11, we know that for all the cities excluding BEIJING TIANJIN and SHANGHAI, the data of (ELP/RLP) are 42.4% in 1984, and 47.6% in 1985.

TABLE 11

PUBLIC FINANCE OF CITIES\* \_

UNITS SHARE	LOCAL REVENUE			LOCAL EXPENDITURE			VI AS OF III
	TOTAL VALUE (RMB 100M)	CITIES SHARE (%)	SHARE (%)	TOTAL VALUE (RMB 100M)	CITIES SHARE (%)	SHARE (%)	



	I	II	III	IV	V	VI	VII	VIII
TOTAL	_							
1984	977.39	628.75	64.3	807.70	236.96**	29.3	37.7	
1985	1158.53	778.91	67.2	1008.24	31.35***	33.9	43.8	
BEIJING	_							
1984	45.62	42.41	93.0	27.15	24.00	88.4	56.6	
1985	52.44	48.29	92.1	32.99	28.70	87.0	59.4	
TIANJIN								
1984	42.06	38.26	91.0	19.83	17.46	88.0	45.6	
1985	48.21	46.23	95.9	26.97	25.50	94.5	55.1	
SHANGHAI								
1984	161.10	144.52	89.7	27.69	24.40	88.1	16.9	
1985	181.59	160.80	88.6	42.07	37.76	89.8	23.5	
OTHER								
1984	728.61	403.56	55.4	633.03	171.10	27.0	42.4	
1985	876.29	523.59	59.8	906.21	249.39	27.5	47.6	

\* the "cities" here refers to those equivalent to prefecture and county level. It includes 292 in 1984, and 321 in 1985.

\*\* the data of Putian city of Fujian province are not available.

\*\*\* the data of Panjin city of Liaoning province are not available.

(source: idem quod TABLE 2, STATE STATISTICS BUREAU PRC, 1985, 1986a) \_

So based on the TABLE 8 and TABLE 11, we get the estimate of the indicator  $D4 = (ELP/RLP)*(ELM/RLM)$ : 35.02% in 1984, and 41.41% in 1985.

Although the first set of the data are from 75 key cities excluding some cities equivalent to prefecture level (total number of the cities equivalent to the prefecture level is 162 in 1985) and the second 292 in 1984, 321 in 1985, which include the cities equivalent to both the prefecture and the county level, the  $D4 = (ELP/RLP)*(ELM/RLM)$  of two sets are very close to each other. —

(2) estimate of  $(ELC/RLC)$  and  $D4 = (ELP/RLP)*(ELM/RLM)*(ELC/RLC)$

We have got a set of data of revenue and expenditure of the local governments at county level. In CHINA URBAN STATISTICS, there are the data of revenue and expenditure of those counties which are under the jurisdiction of the municipal governments. This means that the data of those counties which are under the jurisdiction of provincial (via prefecture) governments are not available.

TABLE 12

PUBLIC FINANCE OF COUNTIES*			
UNITS	LOCAL REVENUE	LOCAL EXPENDITURE	III AS SHARE TO II
	VALUE (RMB 100M)		(%)
I	II	III	IV
TOTAL	—		
1984	135.93	107.98	79.44

1985	181.47	158.23	87.19
BEIJING_			
1984	3.21	3.19	99.38
1985	4.15	4.29	103.37
TIANJIN			
1984	1.67	1.33	79.64
1985	1.98	1.47	74.24
SHANGHAI			
1984	15.66	3.29	21.01
1985	20.79	4.13	19.87
OTHERS			
1984	115.39	100.17	86.81
1985	154.55	148.34	95.98

\* the "counties" here refers to those under the jurisdiction of the cities in TABLE 11. It includes 520 counties in 1984, and 620 in 1985.

(source: STATE STATISTICS BUREAU PRC, 1985, 1986a)

From TABLE 12, we can see that the indicator (ELC/RLC) for those counties which are under the jurisdiction of the municipalities equivalent to prefecture level are 86.81% in 1984 and 95.98% in 1985. It means as a whole, the expenditure of those counties relied more and more on their own revenue.

The indicator  $D4 = (ELP/RLP)*(ELM/RLM)*(ELC/RLC)$  can be

estimated as follows: 30.40% in 1984 and 41.14% in 1985.

## 5. INTERNATIONAL COMPARISON

Although we don't think that we can use the indicators to measure the extent of the decentralization in different fiscal system, we still think the indicators in different fiscal system can provide much information for us. Our international comparison below should be confirmed by the analysis of every individual country.

### (1) COMPARISON OF THE INDICATOR D1

We have got a set of data about the general revenue, central revenue, and local revenue in all over the world as shown below.

TABLE 13

### THE SHARE OF LOCAL REVENUE TO GENERAL REVENUE PERCENTAGE (%)

YEAR	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
I	27.23	26.91	26.66	26.07	26.26	25.93	26.10	26.15		
II	28.26	27.68	27.16	26.25	26.55	26.38	26.31	26.71	26.96	26.93
III	17.92	19.89	20.99	21.33	20.79	19.64	20.44	19.75		

I : the figures here are the average of the world including 21 industrial countries and 112 developing ones.

II : the figures here are the average of 21 industrial countries.

III : the figures here are the average of 112 developing countries.

(source: IMF 1987)

We compare TABLE 13 with TABLE 3 and we can see that the numbers of the indicator in the same period of China are much bigger

than those of the average of the world, industrial, and developing countries. Although in the period 1979-1988 the share of local revenue to general revenue in China decreased sharply (from more than 85% to 60-65%) and it remained unchanged basically in other countries, the difference between China and other countries is still very large. \_

But we can't say China has a more decentralized fiscal system based on such data. The reason is very simple: China has a special revenue raising system in which the main part of the total revenue is collected by the local governments. (THE WORLD BANK, 1989)

## (2) COMPARISON OF THE INDICATOR D2

A. BAHL, R.W. and NATH, S. in their article give us an useful information about fiscal decentralization as below:

" TABLE 1. TREND IN FISCAL DECENTRALIZATION, 1960(1973)a

(source: WORLD BANK, 1976, table 7).

Countries b, c,	developing	developed	total
Federal	39.5 (32.5)	53.8 (61.2)	48.4 (50.4)
Nonfederal	20.0 (21.4)	42.6 (48.4)	28.4 (31.4)
Total	22.4 (22.7)	45.7 (52.0)	32.1 (35.0)

a Figures shown are percentages.

b Eight federal, thirty-five nonfederal.

c Twenty-five developing, eighteen developed. \_

The figures shown in this table are the calculated results of the indicator D2. We can see that the highest figure is that of the developed federal countries in 1973: 61.2%. The lowest one is that of the developing nonfederal countries in 1960: 20.0%. Generally speaking, "the subnational government share of total government expenditures increased more in the developed than in the developing countries. On average, subnational government expenditures increased by 6.3% of total spending in advanced countries but by only 0.3% of total expenditures in LDCs (see table 1)." and "Federal countries, advanced or developing, are more fiscally decentralized than are countries governed under unitary countries,... the data in table 1 do not indicate increased decentralization to the trend for federal LDCs." (BAHL, R.W. & NATH, S. 1986)

China is not a federal county. But the figures of D2 show that (a) China was deeper decentralized than the developing countries, federal or nonfederal, in the same period. In 1958-1962, the figures of China were 51.9% and in 1971-1975 45.8%, although only 40.3% in 1963-1965 and 38.9% in 1966-1970. All this figures were higher than that of the developing countries in BAHL, R.W. & NATH, S.s' table. (b) Compared with those figures of the developed countries, the figures of China were close to that of the nonfederal developed countries. In the last 10 years, although the figures of China moved up and down in the first 6 years, they increased to 60%-65% in 1986-1988. It was near that of federal

developed countries in 1973.

B. We have got another set of data about the share of local expenditure to general expenditure as below:

TABLE 14

THE SHARE OF LOCAL EXPENDITURE TO GENERAL  
EXPENDITURE PERCENTAGE (%)

YEAR	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
I	23.47	22.56	24.75	24.59	24.80	24.10	23.88	23.57		
II	26.53	23.24	25.48	25.09	25.43	24.94	24.66	23.85	23.98	23.53
III	18.19	18.53	17.88	16.83	17.00	18.65				

I : the figures here are the average of the world including 21 industrial countries and 112 developing ones.

II : the figures here are the average of 21 industrial countries.

III : the figures here are the average of 112 developing countries.

(source: idem quod TABLE 13)

Firstly we compare the data in TABLE 14 with those in BAHL, R.W. & NATH, S.s' table. Clearly, the data in TABLE 14 are smaller than those in BAHL, R.W. & NATH, S.s' table. The reason is that the data in TABLE 14 come from 21 developed countries (more than 18 in BAHL, R.W. & NATH, S.s') and 112 developing countries (much more than 25 in BAHL, R.W. & NATH, S.s'). In general, the less developed, the less the indicator. Therefore, the more countries included, the less the indicator. It is normal for the data in TABLE 14 to be less than those in BAHL, R.W. & NATH, S.s'. Because the data in TABLE 14 come from the period

1976-1986 which is later than the period 1960-1973 and there was a trend of the fiscal decentralization indeed, that the data in TABLE 14 are less than those in BAHL, R.W. & NATH, S.s' reveals the data of the countries other than those included in BAHL, R.W. & NATH, S.s' must be much smaller than the average.

Of course, the numbers of the indicator  $D2=EL/(EL+EC)$  in China are much bigger than those in TABLE 14 as well.

According to the comparison above, based on the indicator  $D2=EL/(EL+EC)$ , we can say that China has a more decentralized fiscal system than the general developing and many developed countries.

### (3) COMPARISON OF THE INDICATOR D3

Based on TABLE 13 and TABLE 14 we can get the estimates of D-3 as below by dividing the figures in TABLE 14 by those in TABLE 13 correspondingly.

TABLE 15

#### THE SHARE OF LOCAL EXPENDITURE TO LOCAL REVENUE

		PERCENTAGE (%)									
YEAR		1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
I		86.19	83.84	92.83	94.32	94.45	92.96	91.51	90.13		
II		93.88	83.97	93.82	95.58	95.77	94.55	93.73	89.28	88.94	87.38
III		86.65	86.90	85.99	85.72	83.17	94.41				

I : the figures here are the average of the world including 21

industrial countries and 112 developing ones.



II : the figures here are the average of 21 industrial countries.

III : the figures here are the average of 112 developing countries.

(source: idem quod TABLE 13)

It is very interesting for us to compare the data in TABLE 15 with those in TABLE 8 and TABLE 9. Although the comparisons of the indicators D1 and D2 show us that the numbers of these two indicators are bigger in China than the average in other countries, TABLE 15 tells us another story. All the data of China before 1985 were less than those in TABLE 15. After 1985, the average of the indicator in 1986-1988 is slightly more than 100% in China. Although the data of the indicator for other countries are not available in the period from 1986-1988, we can say that the figures of China would not be, at least, less than those of other countries based on the trend of them.

It is worth noting that the figures of the indicator D3 became more than 100% when the figures of the indicators D1 and D2 were much higher than those of other countries. We can reach a conclusion that China has a more decentralized fiscal system than all of other countries on average, though we can't say this based on the higher figures of the indicator D1 and D2 only.

By now, we have finished all we can do with our limited information. In the end of this chapter, we should summarize our main arguments about the measurement of the fiscal decentralization.

Firstly, the key element of the fiscal decentralization is the autonomy of the local governments. All the indicators are only supplementary measurements of it.

Secondly, no indicator can be used only to measure the fiscal decentralization in different fiscal systems, but they can be used to measure the extent of the fiscal decentralization in the same fiscal system.

Thirdly, the system of the fiscal decentralization has to be supported by the indicators. Without more collection or spending or both, no local government has real autonomy. This is just the meaning of the indicators. This is just the reason for us to compare them with each other.

## CHAPTER 5

### THE NEW PRINCIPLES OF THE FISCAL DECENTRALIZATION IN CHINA

Fiscal decentralization, as a common problem, exists in every country, no matter whether it is unitary or federal country, and in every stage, no matter it is a developed or a developing country.

In view of the Chinese fiscal decentralization, there is an important distinction between the fiscal decentralization in the present and in the past. Although in the last 40 years, we have got a great achievement in the fiscal decentralization, we have to make clear that the fiscal decentralization in the future is quite different from that in the past. In the past, the basic feature of the economic system of China is the planned economy with limited commodities exchange between the different ownerships. In the process of the economic system reform, introducing the commodity principle into the public ownerships especially into state-ownership has been forming a totally new kind of economic system. The whole economic system is to be reformed on the commodity principle. Every thing will change a great deal. The state-ownership, as the base of socialist economy, must be changed into a new form in order to accept the commodity principle, and in the same time maintain its "public" nature. This is the same for the fiscal decentralization. The new fiscal decentralization must be based on the combination of the new public-ownership and the commodity principle.

Introducing the commodity principle into public ownership is a totally new task for us. No theory, no experience. We have to fulfill this historical task or we shall stay at the nearly least developed position. It is just why it is impossible for us to design a complete fiscal system in detail now. What we should and can do now is only making clear the main principles of the new

fiscal decentralization. Having done so, we can use them as the base to design the new fiscal system and put it into practice step by step.

In general, the following principles can be considered as the base of the new fiscal decentralization:

#### 1. GUARANTEEING THE CONTROL OF THE CENTRAL GOVERNMENT

What is the reason for us to list "GUARANTEEING THE CONTROL OF THE CENTRAL GOVERNMENT" as the first principle? In the long history of China, the commodity economy developed very very slowly because the feudalism hindered it seriously. The unitary system and the feudal separatist rule existed simultaneously. The feudal separatist rule blocked the development of the commodity economy much more seriously than the unitary feudal system.

Such a history imposes a strong effect on the present development of the commodity economy. Many leaders of the local governments are used to protecting their enterprises by restricting the entry of the goods from other areas. The information in CHAPTER 4 is only parts of the experience. In fact, nearly every local government, no matter at which level it is, issues, to different extent, the similar policies to those we mentioned above.

In recent decades, in order to stimulate the efficiency of the economy, many common markets are in process. The Europe Common Market is the most important one. It is a very hard work for all the EC countries to establish such a common market indeed, but it is in process. The purpose of such a common market is to eliminate various blocks to commodities circulating among the EC countries so that the efficiency of the economy of every country will be increased more significantly and every country will be more competitive in the world market.

There are different trends between the evolutions of the economic systems of China and the EC countries. The blocks to the development of the commodity economy become more and more in China and less and less in the EC countries. If such a trend continues, how can the Chinese economy develop faster than that of the EC countries?

— To avoid the blocks to the development of the commodity economy, a strong central government is absolutely necessary. The stronger and stronger EC parliament is a good example. Without a powerful central government, there must be more and more blocks to the development of the commodity economy emerging in every local area and no one can expect that the economy of a large country, especially of China having a strong feudal separatist rule historical effect, can develop rapidly and steadily.

The central government must have the power to eliminate any block for the development of the commodity economy set by the local governments at any levels. It can use the legal power, economic power, administrative power to prohibit any local government from damaging the commodity economy. This should be one of the key principles.

#### 2. REASONABLE DIVISION OF THE RESPONSIBILITIES AMONG VARIOUS LEVELS OF THE GOVERNMENTS

Generally speaking, nobody would oppose the control of the central government or the upper one on the lower ones. What the leaders of the local governments are concerned with is the extent to which the central government or the upper one controls. Now that the control of the central government or the upper one on the lower ones is necessary for every country at any time, what is the difference of the control in between the past planned economy and the new socialist commodity economy? Actually, this is the point of the division of the responsibilities among various levels of the governments.

Just as mentioned in CHAPTER 4, there are many troubles in the implementation of the "jurisdiction" principle. In the near future, what we can do is only improving the "jurisdiction" principle.

(1) Central control without interference

The central government should allow the local governments to do whatever they like, as long as no interests of the centrality and other localities are damaged. This is a similar regulation to that in U.S.A. Although China is a unitary country, this regulation is suitable to the condition of the public ownership. We must eliminate the regulation that every level of the local governments can't do anything before getting permission from the government at the upper level, even the central one. The central government is in charge of maintaining the implementation of the commodity principle. This does not mean that the central government is not in charge of the industry policy, fiscal policy, monetary policy, price policy, etc. This only means, at least, most of the "plan" made by the central government is not an order any more but a guidance for the local governments. In the sense of "plan based on the commodity principle", what the central government should do is not the same as before. The "direct" plan will become less and less and the "indirect" (guidelines) plan will be more and more.

There is a contradiction between the responsibility of the local finance bureau to the local congress and to the Ministry of Finance. The budget of a province is made by the provincial finance bureau. But, who is in charge of approval of it? According to the law of the structure of the Chinese government, it is not the Ministry of Finance but the local congress who is in charge of the approval. In fact, the approval of the Ministry of Finance is more meaningful than that of the local congress. This shows the central government may or may not allow the local government to make this or that expenditure. The experience has shown only the administrative power is not strong enough to guarantee the implementation of the orders from the central government. Such an administrative power should as much as possible be instead of the legal or economic powers. Only the economic power is the most effective one.

Another major argument issued by some economists and accepted by many officials at high level is the ratio of the central revenue to the total should be increased to 60-70% in order to guarantee the central control over the whole economy. (see YINONG TIAN HUAICHENG XIANG FULIN ZHU, 1988, P.85) As far as I think, there is another choice for us to deal with the matter of the resource of the central revenue. The alternative is re-distribution of the responsibilities among the various levels of the governments. The main point is transferring more responsibilities from the central government to the local ones. The reasons are as follows:

If the ratio of the central revenue becomes 60-70% and accordingly, the amount of the local expenditure is reduced, this must damage the initiative of the local governments, because only the capital expenditure but not the current expenditure can be reduced by the local governments. This is not desirable.

If the ratio of the central revenue becomes 60-70% and the level of the local expenditure is kept unchanged, this must lead to more grants from the central government to the local ones. Although the central government has more power to control the expenditure of the local governments, the negotiations between the central government and the local ones will become more and more and inevitably, unnecessary interference will accompany the grants. This is undesirable as well.

If the ratio of the central revenue is kept unchanged, even reduced to some extent, and

some kinds of the expenditure are transferred from the central government to the local ones, such expenditure must become an element of the accountability of the various levels of the local government. This method will provide us a chance to decrease the heavy burden of the central government and prompt the accountability of the local governments. Although it is not easy to design a new structure of the expenditure, the direction of the reform is correct and desirable.

#### (2) Enforcing initiative of the local governments

The special responsibility of the Chinese local governments is prompting the economic development. This is necessary for China to develop faster. Since 10 years ago, the initiative of the local governments at various levels to develop the economy in their areas has been playing an important role. Much limitation on the local economic development has been broken. Where there are much more uses of the local resources, there would be a much higher level of income gained by the people in these areas. Without such an initiative of various levels of the local governments, the Chinese economy can't make so great an achievement. Along with that the central government regains powers to maintain the implementation of the commodity principle, the central government has to enforce the initiative of the local governments to develop the economy in their areas. It is not less important than that the central government regains powers to maintain the implementation of the commodity principle.

### 3. LOCAL INITIATIVE WITH SELF-RESTRICTION (ACCOUNTABILITY)

Every leader of the local governments is the representative of the interests of the people living in that area. What he thinks and does depends on what the people in that area ask him to do. Although the basic interests of the people in that area are in accordance with that of the people in the whole country, it is normal that there are some contradictions. If the central government allows the local governments to do what they want to do as long as no damages of the welfare of the whole country and/or other areas, it is necessary to prompt the accountability of the local governments. Undoubtedly, the local governments can be restricted by the legal and administrative powers of the central government, but, the best way in which the local governments restrict themselves to damage the welfare of the whole country and/or other areas is economic accountability. Indeed, the central government can use legal and administrative powers to prohibit the local governments from doing something damaging the welfare of the whole and/or other areas, but it will cost less for the local accountability to do so. What we should do is establishing a new fiscal system in which the local governments will get much more loss if they do something damaging the welfare of the centrality and/or other localities. The experience of the fiscal decentralization in U.S.A is very helpful for us to deal with the matter in China. We should consider the accountability of the local governments as the\*\_ necessary condition of the fiscal decentralization. The stricter the accountability of the local governments is, the more decentralized the fiscal system could be.

Briefly speaking, with the purpose of making the local governments become economically accountable, we should establish a new budget system. In the new budget system, on the one hand, the shared revenue should be as less as possible; the central government and the local ones have their independent taxes and are in charge of them separately; the new tax-sharing system can be divided into 3 categories: developed regions, general regions, and less developed regions to deal with the great economic gap among the different regions. On the other hand, apart from the absolutely necessary responsibilities, the central government should transfer many of the present responsibilities i.e. expenditures to the local governments, including those increased sharply in the

last 10 years, e.g. subsidy for price.

With such a new budget system, we can achieve the following targets: firstly, the sources of the revenues of the central and the local governments are very clear and independent. the transfer (including submitting and grant) between them becomes much less. This means every level of the governments has to rely on its own source of the revenue. Less negotiation, less illegal transfer. This is the necessary condition for the fiscal decentralization. The local governments can get more powers to deal with their own business. secondly, more responsibilities i.e. expenditures transferred to the local governments impose much heavier burden on them. The local governments have to spend part of the increase of the revenue to make such kinds of increasing expenditures. The local governments will be more economically accountable: collecting more will lead to destroy the source of their own revenue; collecting less will make the residents unsatisfied, if they reduce the public services and destroy the source of their own revenue in the future, if they reduce the economic expenditure. Of course, this is only the rough ideas. It needs careful design.

All in all, in order to develop economy faster, we should decentralize fiscal system. This means an reasonable division of the responsibility among the various levels of the governments. Therefore, we need both the central control without interference and the local initiative with accountability. This is my main conclusion about the fiscal decentralization in China.

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