

A New Approach to Fiscal Federalism in China

By

Ting Xu

(3710050)

**Major Paper presented to the
Department of Economics of the University of Ottawa
In partial fulfillment of the requirement of the M. A. Degree**

Supervisor: Professor Vicky Barham

Eco 7997

**Ottawa, Ontario
November 2005**

1.0 Introduction:

The Canadian Minister of Finance, Paul Martin, said the following during a speech at the University of Laval:

Throughout the world, there are conflicting pressures both for larger political organizations and for smaller, more regional ones. The pressure for larger units has been generated by a growing awareness of worldwide interdependence and a need for greater influence in international decision-making. A demand for smaller, self-governing political units has arisen from a need to make governments more responsive to citizens and their primary attachments: linguistic and cultural ties, religious connections, historical traditions and social practices. These are the pillars of community. (Martin 1996)

Federalism is a political system that was created with the intention of combining the advantages, which result from both the magnitude and smallness of nations. (de Tocqueville 19c). Nations such as Australia, Switzerland, and Canada can be considered the pioneers of federalism; they have set models for other nations who want to follow their route. Relatively new federalists such as South Africa can also provide lessons to recent or potential members, such as China, which has features of fiscal federalism as a result of recent policy changes.

The reforms in tax sharing and the devolution of the budget of 1994 were the beginning of Chinese efforts to construct a pattern of centralized politics and inter-governmental relations. Despite regional fiscal disparities and the technical difficulties involved in equalization transfer payments, the Ministry of Finance of China still attempted in 1995 to introduce and regulate them with the following rule: "The Method for Intergovernmental Transfer in Transitional Period". Despite the sticky problems related to intergovernmental transfers, fiscal federalism is a plausible way out for certain countries, such as China, which hope to maintain sustainable growth. With well chosen amendments to certain regulations, such as those dealing with inter-governmental financial transfers and government account management, China should be able to increase the efficiency of its economy and smooth the tension between the central and local governments, to the ultimate benefit of its many citizens.

This paper will first review China's financial reforms as well as intergovernmental transfers from 1949 to 2005. It will then discuss the conceptual framework of fiscal federalism as practiced by Australia, Canada and South Africa, and analyze the current problems with the existing transfer system in China. This paper will propose three specific measures that could result in a more developed fiscal system and increase the efficiency of China government finances. As a first measure, China should adopt a modified version of the Canadian formula for equalization transfers; secondly, China should set up an independent monitoring and auditing body for verifying government accounts; and finally, China should implement legal reforms with regard to the devolution of power to different governmental levels. It will be argued that the above amendments will be conducive to more efficient, transparent and equitable intergovernmental transfers in China.

2.0 Review of Intergovernmental Transfer Arrangements: 1949-2005

China, the Middle Kingdom, has a long history of central governance with revenues collected by local officials and shared with Beijing, the capital. There have been three major reforms in the Chinese financial system since 1949, when the People's Republic of China was founded. The first took place in 1958-1961 and the second in 1970-1976, both under a planned economy. The third took place in 1994 and introduced market economy elements to China. (China 2005a) Section 2 studies in greater detail the underlying reasons for the changes in 1994, as well as the underlying circumstances that led to such a dramatic policy shift.

2.1 The Pre-Market Reform Period: 1949-1994

The background of the 1994 reforms can be traced back to 1980 when the state council announced the Temporary Regulations on implementing a new financial management system entitled the "division of revenues and expenses and financial contracting responsibility". The financial contract system meant that each government unit was responsible for its own surplus and deficit. Under this regulation, the central government and local governments negotiated for "the contract" every year. If

the local government fulfilled its financial quota, it could keep a significant portion of any future increase in revenue it collected, only having to share a small portion with the central government. The tax retention rates were decided through negotiation for the following year's budget, and were not part of "the contract". It is interesting to note that there was no unified system or rules guiding each year's negotiations. Contracts were negotiated directly between officials from the central level and the local ones, and there was significant variance in the terms obtained across different regions.

The *ad hoc* nature of the process meant that each sub-national government's budget heavily depended on the negotiation skills of local officials and representatives. Equality among different provinces could hardly be guaranteed. In most cases, results were not disclosed to the public. Moreover, since the following year's contract was based on last year's *ad hoc* tax income, the more the local tax levy, the more they would have to turn in the following year and thus the less they would get from the central government. Therefore, this policy had the unintended consequence of encouraging local governments to provide enterprises with tax relief and to grant tax incentives not authorized by the central government. As decentralization progressed, growth-oriented local governments used the flexibility accorded to them by China's system of tax administration to reduce their tax burden and thereby avoided having to share local resources with the central government. (World Bank Country Study, China, 1995) This tendency was reinforced by the fact that until 1994 local tax bureaus were administered by the local government, which instructed tax collection agents to maximize tax exemptions and to minimize the tax rate for local enterprises so as to retain all of the benefits locally. As a result, total tax revenue declined sharply each year and the central government's share became smaller and smaller. In 1985, the total revenue was 22.4% of GDP and in 1993, only 12.6%. In 1985, 38.3% was the central government's share and in 1993, only 22%.(China 1993 a)

2.2 The 1994 Reform

In 1992, the 14th Congress of the Communist Party of the People's Republic of China made a decision to create "a market economy with Chinese characteristics". A revised Constitution was adopted by the 8th National People's congress in 1993, which paved the road for substantial economic and fiscal reforms, including the area of taxation. This was followed by the Decision on Tax Sharing of January 1st, 1994, enacted by the State Council. Most of the practices established at that time are still being used at present.

In the Decision on Tax Sharing Financial System (enacted January 1st, 1994 by the State Council), the local governments' responsibilities were substantially increased along with the increased assigned revenue. It stipulates that the center is responsible for national level expenses, including: national security, foreign affairs and expenses incurred from central government agencies and transfers to coordinate the development among different regions and areas (such as national defense, military police, foreign affairs and foreign aid), central government administration expenses, infrastructure investment managed at the central level and other cultural, educational, health and scientific expenses. The local government, on the other hand, is responsible for the expenses for its local district and administration costs, such as local government agencies, local administration fees, police, procurator and court's expenses, R&D of local enterprises, urban maintenance and construction, and local cultural, educational, health-related and other expenses. (China 2005b)

In the same Decision on Tax Sharing, it was also established that the central government, and only the central government, could set the tax rates and bases. Sub-national bodies have no such authority. With regards to Tax Sharing, taxes are classified into three categories- fixed central government taxes, local government taxes, and shared taxes. All taxes are collected by a national tax service, the State Tax Administration, but the locals, up to the lowest level of tax bureau, have been reorganized to be the collection machinery. Revenue collected from central and local government

taxes accrues, respectively, to the central and local governments, whereas revenues from shared taxes is divided between both levels of government according to a fixed sharing rule. Fixed central government taxes comprises taxes that are critical for macroeconomic management, including customs taxes, VAT and consumption taxes on imported goods; domestic consumption taxes; business income taxes levied on all central government enterprises; business income taxes collected from foreign and domestic banks and other financial institutions; the business tax on railroads, bank headquarters and insurance company headquarters; the profit remittances from central government enterprises, etc. Local government taxes are taxes that are more closely related to the local governments or have little significance to the central government, including: sales taxes (excluding those from railway, banks and insurance company headquarters), business income taxes from local enterprises (excluding those of banks, foreign and domestic banks and other financial institutions), personal income taxes, land usage taxes and taxes for fixed capital investment adjustment. Other taxes include those for urban maintenance and construction (UMCT), housing, vehicle utilization, stamps, slaughter, agriculture and farming, as well as a special taxes for agriculture and forest products, taxes for occupancy of farm land, property transaction tax, heritage tax, taxes on land capital gain and urban land use tax. Shared taxes are both central and local government have divided up the total tax revenue, including Value Added Tax (25% for the local, and 75% for the central), resources tax (ocean and Petroleum related to the central and others for the local) and security transaction tax (50% and 50%). (China 2005c)

Another important feature of the fiscal reform of 1994 was devolution of budgeting. With the implementation of the Budgetary Law in 1995, the local government was responsible for its own budget. Under the planned economy, the central government planned the next fiscal budget for each province through negotiation or another similar process. The local government had no control of the following year's fiscal budget. This fiscal change increased the local government's motivation, as

budgeting power is one of the most important economic political powers that local governments would like to control. In practice, the budgeting power is carried out through a hierarchy structure (from top to the bottom). That is, the provincial government is responsible for the budget at the provincial level and oversees the budget report from the city level. The city level government is responsible for the budget at the city level and oversees the budget report from the county level, which in turn oversees the budget report from the village level.¹ In summary, it is a complete reversal of the old system. Moreover, the local government has more tax legislation authority. For example, the local government has sole freedom to decide if they want to levy a slaughter or banquet tax that falls into the category of a local tax. They can also, within the range of 5%-20%, decide the sales tax rate for local enterprises. This independence, even though still very limited, has enhanced the stability of the fiscal year, i.e., the local government can anticipate the next fiscal year and plan a long-term program without worrying about the prospect of uncertain negotiations with the central government.

2.3 Comparison of Revenue and Expenses for Each Region and Province.

Differing in terms of geography, population, and level of economic development, the various provinces and regions have been differently able to react to these new policy changes. This section examines regional fiscal disparities and the extent to which there are compensatory transfer equalization payments

A crude indicator of the extent of inter-regional fiscal disparities is to compare the differences in local government revenues which range from 1315.52 (Guangdong) to 8.15 (Tibet) million Yuan. More revealingly, per capita budgetary revenue (Yuan/per person) ranges from 5179.60 (Shanghai) to 301.85 (Tibet), indicating a great imbalance horizontally. Next to last is Qinghai with 450.1 Yuan

¹ There are five administrative levels in China such as central, provincial, city, county and village level.

per person. The rest of the lower rung provinces are Ningxia, Gansu, Guizhou and Hainan. Except for Hainan, the other three in the Far West were not priorities for economic development until 2002.² Coastal areas like Guangdong, Zhejiang, Jiangsu, Shandong and Shanghai were among the first beneficiaries of the Chinese open-up policy and economic reforms. In 2003, the five provinces and regions with the highest levels of total budgetary revenue raised 4420.21 million Yuan, which amounted to around 45% of total revenue, with only raised 55% of the total coming from the other 26 provinces and regions. Shanghai, Beijing, Tianjin, Guangdong and Zhejiang had the highest levels of per capita income, raised 37.6 percent of revenues, and accounted for about 13 percent of the national population in 2003. (Statistics Year book China 2003) Disparities across the different regions are clearly very pronounced.

In terms of expenditures, Shanghai has the highest per capita budgetary expenditure with 6361.43 (Yuan/per person) and Tibet and Qinghai are ranked No. 2 and No.5 respectively. The result is not unexpected since Shanghai, an economic pioneer, raises the highest per capita revenue and spends the most on public service. Tibet and Qinghai are regions in which reside ethnic minorities and have been enjoying transfers from the central government since the founding of China. These are also amongst the areas with the lowest populations in China. Therefore, looking at their total budgetary expenditures, they are behind most of the regions with a ranking of 28 and 29 respectively. Another feature of the expenditure pattern of 2003 is that, with a per capita variation from 6361.43 Yuan in Shanghai to 741.28 Yuan in Henan. and 791.64 Yuan in Anhui, the five highest income provinces and regions accounted for 27.44 percent of total expenditures, although only having 13 percent of the population. (Statistics Year Book of China 2003) One reason higher income regions spend more is because of greater demand for public services by their citizens, as well

²At 1999 the state council start the campaign for western forward.

as short term and visiting workers (i.e., min gong³ and traveling professionals), and by local businesses; they also have a greater ability to raise more local taxes. The third feature of the expenditure pattern is that the interior provinces rank the lowest in spending. Henan, Anhui, Hunan, Sichuan and Guizhou, with 27.5 percent of the population, accounted for only 16.9 percent of expenditures. These five provinces seem to have been left behind by the “let part of China become richer first” policy first advocated by the previous Chairman Deng Xiaoping.⁴ The above pattern in revenues and expenditures leads us to the next topic of interest: transfer equalization payments.

2.4 Intergovernmental Transfer

The origins of the intergovernmental transfer system in China can be traced back to 1995. Along with the tax sharing reforms of 1994, MOF set up an administrative regulation in 1995, “The Method for Intergovernmental Transfer in Transitional Period”. At present the existing mechanism for intergovernmental transfer comprises six methods: tax revenue returns; subsidies under the old economic system; transitory period grants; equalization grants for minority regions; special purpose subsidies such as grants for increasing the standard of wages of civil servants, sub-provincial equalization grants, fiscal balance subsidies and other subsidies. Of these different instruments, tax revenue returns account for almost 80 percent of the total transfer, attracting some controversy. (Wang, 2004)

Before the 1994 tax reform, subsidies under the old economic system were referred to the contracted fixed grants. At present, only about 16 provinces and regions are still eligible to receive this type of grant. For example in 2000, the receiving provinces and regions were Inner Mongolia, Jilin, Fujian, Jiangxi, Shangdong, Guangxi, Hainan, Sichuan, Guizhou, Yunan, Tibet, Shannxi, Gansu, Qinghai, Ningxia, Xinjiang. Among these, most are located in the west and central more back ward (less

³ It is a special term for those who migrate from country to city. This is one of the highest causes for public expenditures for the top three higher income cities.

⁴ Mr. Deng was the first one who opened China’s door to reforms and introduced market elements to China’s planned economy

prosperous) areas. See table 2.6 for details.

Transitory period grants is a temporary formula system set up by the Ministry of Finance of China to act as a complementary matching measure to the 1994 tax sharing reform. The total pool of the funds for this grant is determined by the center, based on an *ad hoc* annual budgetary demand. In 1995, the funds for this grant was only 2.1 billion RMB while it jumped to 13.8 billion in 2003, more than six times of that in 1995. (Zhang and Martinez-Vazquez 2003) See table 2.7 for the grant amounts from 1995 to 2001.

Equalization grants for minority regions is a grant system established by the center to offer preferential support to minority regions for the purpose of political stability. There are eight provinces and eight minority prefectures in 2000. This particular grant is the first in China that has an explicitly stated growth mechanism. The minority grant is 2.5 billion RMB for 2001 and 3.3 for 2001.

Grants for increasing the standard of wages of civil servants were set up to help the less prosperous provinces, such as the interior and west regions, to increase the wages of civil servants based on the mandate from the central government. Many provinces may lack fiscal resources to implement the mandate without financial support from the central government. Up to now there have been five pay raises. The increase in July 1999 was 120 Yuan per capita per month, January 2001 was 100, and Oct 2001 was 80. The fourth increase was one month of wages in the form of bonuses and the fifth was a subsidy system for remote areas.

Sub-provincial equalization grants have several forms. They are pre-tax sharing system grants, transitory period grants, grants for wage increases and other grants, most of which follow the structure of central government grants.

The local government's share of the total tax revenue return is received through a transfer of its share of the tax revenue collected by the central government. The tax return equation is stipulated by the transitional method:

*The province's tax return of 1993 = the net tax revenue on the center's side of 1993 generated from the said province *(1+the same year's growth rate of consumption tax and VAT at the national level)*

The following year's (1994) tax return for the province = the ad hoc return for the province of 1993(1+the same year's (1994) growth rate of consumption tax and VAT at the national level) (Wang, Yu Ming, 2004)*

This method is what we call the Base Rate Method. Even though the equation is the same for each local government, the outcome is very different for each. (Comparative studies of Social Systems Issue No 5, 1994) Since the growth rate at the national level is the same for each province, the discrepancy of tax return between different provinces results only from the previous year's return, according to the equation. The previous year's tax return ultimately depends on the base year, which is 1994. Due to China's reform policy, the disparity between coastal and inland provinces and areas was prominent as early as 1993. Urbanized regions such as Guang Dong, Shanghai and Zhejiang with a higher per capita income tend to have more enterprises, therefore generating more tax revenues. Based on the equation for the transfer, the higher per capita income provinces, with higher 1993 net generated tax revenue, will get a higher transfer from the central government. For example, in 1999, four east coast regions, including Shanghai, Guang Dong, Zhejiang and Jiangsu,

received 595 billion Yuan as tax return. This amounts to 28% of a total of 2120 billion in transfer payments. The twelve west inland provinces only got 477.16 billion, which amounts to only 22.5% of the total, even though those 12 less developed provinces might be in more needy situations. This violates the justice and equity principle. (Song and Shao, 2005) Roy Bahl's (1994 b) empirical analysis shares this view: "On a per capita basis, higher income provinces receive significantly more in earmarked grants. The pattern is counter-equalizing. These results also show that less populous provinces receive significantly less in per capita grants." This type of grant does not consider disparity, revenue-raising capability and need for capital. There is a great need to improve efficiency.

2.5 Critical Analysis of the Current System of Intergovernmental Transfer

There are a few problems with intergovernmental transfers worthy of mentioning here. There is no standard objective method used to calculate transfers. Central and local governments also lack a clear mandate and fiscal responsibility is not clearly regulated, which results in tensions between different levels of government. Moreover, there is little clarity with respect to the services sub-national governments are supposed to provide and a lack of transparency. Implementing transfers are not audited, even though government at each of the different levels is required to report to the People's Congress. Finally, there is the burden of costly administration fees; China can not simply implement a single system for every province.

3.0 A Brief Review of Fiscal Federalism: Theory and Practice

The great 19th century liberal thinker, de Tocqueville, puts federalism like this: "The federal system was created with the intention of combining the advantages which result from the magnitude and smallness of nations." Kenneth C. Wheare defined federalism as "the method of dividing

powers so that the general and regional governments are each, within a sphere, co-ordinate and independent". While *The Stanford Encyclopedia of Philosophy* (Fellesdal, 2003) defines federalism as the theory or advocacy of federal political orders, where final authority is divided between sub-units and a center. Unlike a unitary state, sovereignty is constitutionally split between at least two territorial levels so that units at each level have final authority and can act independently of the others in some areas. Citizens thus have political obligations to two authorities. The allocation of authority between the sub-unit and center may vary. Typically the center has powers regarding defense and foreign policy, but sub-units may also have international roles. The sub-units may also participate in central decision-making bodies.

Wallace Oates (1972) suggested a similar economic definition of federalism. He defined federal government as a public sector with both centralized and decentralized levels of decision-making in which choices made at each level concerning the provision of public services are determined largely by the demands for these services by the residents of (and perhaps others who carry on activities in) the respective jurisdiction.

Oates (1972) He also points out why federalism is a desirable form of government.

"Federalism represents, in one sense, a compromise between unitary government and extreme decentralization. In a federal government unit, each makes decisions concerning the provision of certain public services in its respective geographical jurisdiction. From an economic standpoint, the obvious attraction of the federal form of government is that it combines the strengths of unitary government with those of decentralization. Each level of government, rather than attempting to perform all the functions of the public sector, does what it can do best".

Fiscal federalism has attracted much attention in the economic fields. There are many recent literatures on this subject. However, the foundations that they build on are originated from the same source.

3.1 Why is Decentralization Is Appropriate for Dealing with Intergovernmental

Disparity?

Firstly, taking into consideration possible variations in the tastes of residents of differing communities, lower levels of government may be better placed to obtain information about the preference of the jurisdiction and can tailor the government's provision of services to local tastes. Economic efficiency is attained by providing a mix of output that is more responsive to the preferences of the individuals who make up the community.

Secondly, decentralization fosters intergovernmental competition. With closer connections to the local governments, citizens may be able to observe better performance in other neighboring jurisdictions and put pressure on their own policy-makers, which will compel the adoption of the most efficient techniques of production. Such pressure will also lead to 'Yardstick competition'. As pointed out by Tiebout (1959), when citizens are free to move from one jurisdiction to another, local governments must compete with each other to provide a package of taxes and services that will attract residents. This leads to greater efficiency in the provision of public services. Finally, decentralization may lead to more efficient levels of public output, because expenditure decisions are tied more closely to real resource costs. If a community is required to finance its own public programs through local taxation, residents are more likely to weigh the benefits of a program against its actual costs. In contrast, if funds for local public projects come wholly from a central government, residents of a given community have an incentive to expand levels of local public services as far as possible, since they may bear only a negligible part of the costs of the program. (W. E Oates 1972)

On the other hand, we have to bear in mind that decentralization is not a cure-all medicine, and has its share of disadvantages. For example, it may give rise to fiscal externalities and spillovers between different jurisdictions and thus cause inefficiencies in the decision-making process of government officials. The author will not elaborate further on this subject as it is not the focus of the paper.

3.2 Practice of Fiscal Federalism

Many countries have implemented a system of intergovernmental fiscal relations based on the principles of fiscal federalism. Among them, Germany Australia and Switzerland are the older ones and Canada is the most decentralized. Developing countries include Korea, Brazil, Argentina, India and Mexico. In this section we briefly review some salient features of the practice of fiscal federalism in existing federations

3.2.1 Australia

The Australian federation was formed in 1901, which comprises the commonwealth government, the six original colonial state governments and two self-governing mainland territories. There are also about 900 local governmental bodies. The Constitution stipulates few exclusive powers for the center. Levying customs and excising duty is one of them, which include defense, taxation, foreign affairs, social welfare benefits and pensions, post and communications, currency and banking and insurance. The six original colonial states kept certain legislative powers in areas such as law and order, education, health, housing and urban development, road and rail transport, provision of electricity, gas and water, etc. In the national accounts, the consolidated public sector is comprised of the general government sector and the net operating surplus of non-financial enterprises. (Ter-Minassian 1997)

Vertical imbalance between revenue and expenditure assignments at the national sub-national level is quite pronounced in the Australian federation. About 70 percent of total public sector revenue was raised by the center. However, it only has about half of public service responsibilities. As a result, the rents and loans from the center must fill the resulting "vertical gap" at the lower state and local government levels. Meanwhile, following the guidelines jointly agreed upon by the center and the involved government, territory and local governments and their public enterprises can also borrow

on their own account. (Ter-Minassian 1997)

In terms of expenditure, social welfare and health expenditures are the lion's share of the Commonwealth sector's own fiscal budget; state government expenditures include government-education, health services, housing and community amenities, law, order, public safety, transport and communication, and social services at their own level; local governments' expenditure responsibility lies in providing transport service (mainly roads and public transit services), recreational and cultural facilities, housing, and community services such as the provision of local roads and parks. At present non-financial public enterprises delivering water, electricity distribution, and transport services are still operating at about 350 local councils. (Ter-Minassian 1997)

Four major sources of national tax revenue - personal income tax, customs and excise duties, company income tax, and sales tax - contribute to most of the Commonwealth's revenue.

Commonwealth grants and advances are about 40 percent of state government sector revenue. Tax revenues, which share about 40 percent of total revenue, come from a number of diverse sources. Payroll taxes constitute the largest single source. (Ter-Minassian 1997)

Grants and advances from the center have a dominant equalization role in Australia due to its substantial vertical imbalance. Specific purpose (functional) payments constitute over 50 percent of the payments to the states even though a big chunk of them just pass "through" the states' channel. General-purpose payments remain less than 50 percent of these. Revenue (current) grants to state or local governments, which are made for both recurrent and capital purposes, often are unconditional. Financial assistance grants top all the payments to the state. They are usually established by reference to formula. Specific purpose payment can be classified into four categories. (Ter-Minassian 1997) They are: general program requirements; requirements that the payment be spent

for a specific purpose, or be passed on to other entities, including universities and non-government schools and to local governments; agreement covering service provision and program delivery mechanisms; detailed conditions on the operation of joint expenditure programs, including program or project approval, arrangements for matching contributions, and information requirements.

A concern with horizontal equity across the states has long been a distinguishing feature of the Australian federation. This concern underlay the creation of a permanent and independent authority—the Commonwealth Grants Commission (CGC). The CGC operates independently subject to terms of reference. The Commonwealth establishes these constraints after consultation with states and territories. The CGC plays a major role in reviewing the fiscal capacity relativities of states and territories which encompasses both revenue-raising capacities and expenditure needs. Every five years they review the relativities with updates in intervening years. The commonwealth and state governments involved usually accept the recommendations by the CGC without hesitation. (Ter-Minassian 1997)

A separate grants commission is also maintained at each state level to decide the allocation of general-purpose grants among their local governments. Those funds are paid to each state on an equal per capita basis. These independent commissions operate on equalization principles, subject to terms set out in the commonwealth legislation. (Ter-Minassian 1997)

Generally speaking, the Australian federation system is circumscribed by constitutional requirements and historical conventions. Due to considerable vertical imbalance favoring the center and the need to consider the retained influence of state and local governments over commonwealth policies, especially in structural reforms areas, implementing centralized stabilization policies is more difficult and complicated in Australia even though its finances are relatively centralized. To balance, the

commonwealth also has the financial power to exert influence on the decision of sub-national governments. How to cooperate and coordinate among sub-national government bodies so as to attain national objectives has dominated the recent political debate. At the same time, horizontal fiscal balance remains the focus of equalization of the Australian federation. (Ter-Minassian 1997)

3.2.2 Canada

Canadian federalism is comprised of heterogeneous provinces, which includes 10 provinces, 2 territories, and nearly 5,000 local governments, including cities, towns, villages and townships, counties, and special service districts. The legislative powers of the federal parliament and the provinces are clearly defined by the British North American Act (BNA) of 1867. The federal government is responsible for the national public debt and property, the regulation of trade and commerce defense, money and banking, criminal law, the raising of money by any type of taxation and the authority to legislate in any areas not explicitly allocated to the provinces. (Boadway and Hobson 1993) Provincial legislatures were given the exclusive rights to make laws within the province in areas that are generally local or private in nature, such as property and civil rights, public institutions (hospitals, asylums, prisons, and charitable institutions), education, management and sale of public lands, and the administration of justice. Provincial activities can be financed through the provincial right to use direct taxation or by the exercise of the “spending power” of the federal government. (Clark 1997)

In 1982, Canada enshrined the principle of equalization in the Constitution. The commitment to equalization is found in Section 36 (2) of the *Constitution Act*, 1982, which states:

Section 36(2) Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

The last 40 years' steady decentralization of fiscal expenditures in Canada from the federal to the provincial level reflects the expenditures expansion in areas assigned to the provinces, such as health and welfare. This rapid expansion increases the provincial taxation and federal grants to the provinces. Provinces received less federal grants as a share of GDP recently since the appointment of the former Minister of Finance, Paul Martin, and his efforts to cut the federal budget deficit. (Ter-Minassian 1997)

Canadian tax revenue is dominated by personal income tax, corporate income tax, and goods and services tax at the federal level; personal income tax, corporate income tax, retail sales tax, and resource taxes dominate the provincial level; and property tax is primary at the local level. Currently, nine provinces and two territories participate in this tax collection agreement while Quebec collects its own personal income tax. Those nine provinces set their own tax rate with a base defined as basic federal tax, which is different from the federal tax payable, in that certain federal surtaxes and tax credits are excluded. In this way, provincial revenue could avoid unnecessary changes when the federal tax base changes. This mechanism maintains relative tax harmony while allowing each province to set its own tax-on-tax rate. (Ter-Minassian 1997)

The corporate income taxes of seven provinces, other than Ontario, Quebec, and Alberta who collect by themselves, are collected by federally. A 10 percent tax credit is provided by the federal to make room for the provincial corporate income tax. (Ter-Minassian 1997) The goods and services tax (GST) constitutes the major part of federal indirect tax. The tax law for GST, enacted on January 1, 1991, provided for a single rate of 7 percent and a threshold level of Can\$30,000 in annual sales for small traders. (Ter-Minassian 1997)

In Canada, intergovernmental grants have played an important role in the federal fiscal system in the

postwar period when the federal government initiated several major social welfare programs. Unemployment insurance, family allowances, universal old age insurance, and national health insurance are among them. (Leslie 1993) The Medical Care Act and Canada Assistance Plan established in 1966 are the major share-cost programs. By 1971, all provinces had adopted acceptable Medicare plans. Based on per capita costs, the open-ended federal grant covered more than half their costs in low-cost provinces and less in high-cost provinces. In the mid-1970s, along with the weakening of federal fiscal capacity, the federal government attempted to rebuild the grants system to provinces. In 1977, the Established Programs Financing Act merged hospital insurance, Medicare, and postsecondary education into a block grant, made on an equal per capita basis. (Ter-Minassian 1997)

Canada's federal funds are allocated based on formulas designed to equalize the tax capacities. Expenditure needs in each province, which are assumed to be equal on a per capita basis, are not explicitly assessed. No attempt has been made to incorporate the expenditure needs into the equalization transfer system partly due to the technical difficulties in measurement. (Clark 1997) There are two basic forms for the federal grants to sub-national governments: general purpose transfers (equalization payment), which is on an unconditional base only distributed to those provinces with below-average tax capacity, and special purpose transfers, which is the newly established Canada Health and Social Transfers. (Ter-Minassian 1997)

In Canada, the Constitution entrenches the equalization principle, which receives broad support. The three major transfer programs until 1996 - equalization payments, EPE, and CAP - attempted to equalize on different bases: capacity, population, and need. The "for equalization" formula system is designed to transfer funds only to the seven "have not" provinces, whose tax raising capacities are below national average. The formula was called the representative national average standard

(RNAS) when it is based on the national average. It is called the representative five-province standard (RFPS), which is based on only British Columbia, Manitoba, Saskatchewan, Ontario, and Quebec. The actual formula is:

$$\sum E_{ij} = \sum T_j (B_{rj}/Pr - B_{ij}/P_i) P_i$$

Where E_{ij} =entitlement under revenue source j in province i ; B_{rj} =the tax base for revenue source j in the five provinces; Pr =the population in the five representative provinces; B_{ij} =tax base for revenue source j in province i ; P_i =the population in province i ; T_j =the national average tax range for revenue source j : $T_j = \sum TR_j / \sum B_{ij}$ (Ter-Minassian 1997)

Equalization transfer brings the have-not provinces/regions up to a comparable level while the have provinces/regions' service level is not brought down resulting from this program. (Boadway and Hobson 1993)

Local governments rely deeply on intergovernmental transfers from the provincial governments and not that much on the federal government. Conditional grants dominate provincial grants such as education, health, social services, transportation, and other uses. Among these the major category is education funds, which are provided in all provinces except New Brunswick. These grants are under the form of direct funding and revenue pooling. Unconditional grants are only a small portion. Depending on the split between provincial and local responsibilities, the portion may vary in different provinces. (Boadway and Hobson 1993)

In general, the Canadian federal system shows many of the desirable characteristics of a federal system such as appropriately assigned spending and revenue-raising responsibilities, remarkably flexible federation, decentralized federal-provincial relations, and strongly re-distributive capability. Intergovernmental grants can function as a correction mechanism for spillovers and equalizing the ability to pay for public services. However, with the reduction in intergovernmental grants, the fiscal deficit may increase as the federal cuts back its spending. How Canada will reconcile this imbalance with its strong desire for equalization remains an unsolved dilemma. (Ter-Minassian 1997)

3.2.3 South Africa:

On February 2, 1990, President F. W. de Klerk released Nelson Mandela and officially legalized the political activities of the ANC and the South African Communist Party. This particular day is remembered as the official commencing point of South Africa's long journey from autocratic white party rule to a multi-race, majority rule democracy. For the next three years, representatives of the NP, the ANC, and Chief Buthelezi's Inkatha Freedom Party (IFP) got together to negotiate the new South African Constitution. Minority rights (particularly economic rights) versus majority rules remained as the focus of discussion. (edo Rui and Barry1997)

The Constitutional Assembly finally approved the constitution on October 11, 1996. The heart of the agreement reached by the NP, the ANC and Chief Buthelezi's Inkatha Freedom Party (IFP) was a constitutional commitment to majority rule at all levels of government to satisfy the ANC and, to satisfy the minority parties, approved nine constitutionally created federal provinces with projected NP majorities in two (Western Cape and Northern Cape), an IFP majority in another (Kwazulu-Natal), and finally, an unspecified "handshake agreement" that those provinces would have real fiscal powers. (edo Rui and Barry 1997) To formalize the handshake on fiscal assignment, the interim constitution designated a Financial and Fiscal Commission (FFC). It comprises 18 experts, with one approved by the NP (or IFP or Kwa-Zulu Natal) and one by the ANC to jointly represent each of the nine provinces. The appointees were required constitutionally to have expertise in either finance, economics, accounting, or public administration. From the very beginning, a central tax rate or provincial grants that were well below any plausible estimate of South Africa's revenue maximizing rate was agreed upon by the commission. (Inman and. Rubinfeld 2005)

Each year, after consulting with the Finance Ministry, a vertical division, i.e., a division of tax revenues between the national and provincial governments, was recommended by the FFC to the

National Assembly. The commission then set up the provinces as the primary financial source of K-12 education, health services, public housing, public transportation, and welfare services. The final recommended provincial grants averaging 1600 Rand per resident in 1995 (about \$500) constitute about 50 percent of all government taxation and 20 percent of per resident national income. (Financial and Fiscal Commission of South Africa 1995)

South Africa is a developing country that is trying to adopt federalism. The devolution of power problems and other equalization problems are intricate to the success of federalism. How to be more responsive to the regional linguistic and cultural ties, religious connections, historical traditions and social practices while maintaining national harmony is the heart of the pressures for South Africa. Throughout the world, many developing governments are facing this conflicting pressure. China is no exception. As a developing country, it is also passing through its transitional but crucial period to resolve similar problems faced by South Africa. How to direct its effort to turn the national boat with one fifth of the world's population from centralization to a federalism route is a huge challenge not only for China but also for the international community. How to guarantee the aforementioned pillars are properly respected under federalism is a huge task for countries at their transitional period, such as Africa and China.

4.0 Fiscal Federalism Benefits China.

Even though, to some extent, the Chinese economy has features of fiscal federalism, there are certain obvious differences in the nature of fiscal federalism between China and other developed countries. In developed countries, provincial premiers or state senators are elected through a democratic process. Politicians are accountable to the electorate, which have clear rights and can influence a politician's behavior and decisions. Most rational politicians want to provide optimal public services so as to win maximum support at the next round of elections. In China, however, the

provincial level cadres are appointed by the center, instead of being elected by the local citizenry. To a very high degree, they are accountable to the center and not to local residents. Another key difference is that, in a developed country, such as Canada, each citizen is entitled to clear rights under the Constitution. In China, however, the Constitution is largely ignored in practice and has little value in the eyes of most Chinese citizens.

With the implementation of the Budgetary Law in 1995, the local government was responsible for its own budget. Assignment of expenditure responsibility between the Center and the local government are regulated like most other countries. As for the existing transfer payment system, it is China's tradition for the richer provinces to help the have-not provinces, despite many problems in the transfer payment systems. However, under a unitary political system, there exist many traits of centralized economy such as arbitrary intergovernmental transfer, mismanagement of government accounts/misuse of public funds, and lack of legislation to discipline the behavior of the officials involved, which need to be tackled to increase the efficiency and transparency of the economic operation. Therefore, the following section studies the desirable amendments to those three areas.

4.1 Desirable Amendments

One can ask how China, a unitary system with very strong centralist tendencies, could learn from developed and developing countries, such as Canada and South Africa. In particular, can fiscal federalism be applied to the advantage of the Chinese economy? The author proposes that with desirable amendments and changes, Fiscal Federalism will benefit Chinese. Changes to regulations dealing with inter-governmental financial transfers and government account management are most needed so as to increase the efficiency of the economy and smooth the tension between the local and central government.

4.2 Intergovernmental Financial Transfer

Recall that the existing mechanism for intergovernmental transfer comprises six methods: tax revenue returns; subsidies under the old economic system; transitory period grants, equalization grants for minority regions, special purpose subsidies such as grants for increasing the standard of wages of civil servants, sub-provincial equalization grants, fiscal balance subsidies and other subsidies.

There is much literature on the principle of equalization transfer. Martinez-Vazquez and Boex (2002) believe, “The system should support an equitable allocation of resources by providing more resources to local governments with lower tax capacities and greater expenditure needs; be predictable in a dynamic sense and be stable over a period of years to promote revenue predictability and overall budget stability; be simple and transparent. The distribution of the grants should be understandable to all stakeholders, and should avoid political manipulation or negotiation in any of its aspects.”

As indicated in section 2.5, intergovernmental transfers lack a clear legislative framework. In fact, the only guidance is the Transitional Method (Method) mentioned in this paper. Other than the Method, which was designed to guide public finance operations and came into force on September 25, 2005, there seems to be no other legislation. This regulatory void results in random and often fruitless negotiations between the center and provincial governments. As a result, the transfer negotiations are fundamentally a very subjective process.

With respect to the issue of regional disparity, no standard objective method is used to calculate transfers. Regional revenue generating capacity and expenditures are not fully considered.

Disparities in revenue and expenditures among different regions can be very pronounced. Here the author uses post 1994 tax reform data to see if the hypothesis “Provinces with higher per capita incomes, others things being equal, collect more revenues” will hold. The same hypothesis was also tested by Roy Bahl. The analysis of test results show that all the provinces have considerable revenue generating capacity and the costs of public services are comparatively even.

With respect to equalization transfers, Bahl’s (1994b) empirical analysis gives mixed results. It shows that per capita transfers to the center are significantly higher in provinces with higher per capita incomes. There is some equalization in the distribution of transfers. However, on a per capita basis, the results show that transfers (earmarked grants) from central government are in fact counter equalizing, and do not shore up the disparities between different regions.

Clearly, there are improvements that can be made towards China's equalization system. Firstly, the determination of the amount of grant for some equalization programs are very uncertain due to the fact that the level of the funding is decided by the *ad hoc* fiscal budget such as transitory period grants. Secondly, the system is overly repetitious and complex. As of 2005, there are nine equalization grants that have been set up by the central government of China; whereas most decentralized economies only have one equalization formula such as Canada. Not only owing to the number of equalization grants but also the repeated nature of the construction of them, simplification and rationalization are needed to adjust the complex grants system. (Zhang and Martinez-Vazquez 2003)

Based on the above, it seems clear that an objective transfer payment system is needed. Canada and

China share certain similarities in terms of the size of their respective landmasses, varieties of cultures and nationalities, e.g., although China, unlike Canada, is not a country of immigrants, it does have 56 different ethnic minorities, including Muslim, Han and Tibetan. Moreover, each country has significant cultural groups, such as the Northern Indian Natives, French Canadian, Mongolians and Tibetans, which are nationalistic. Each country also has to deal with huge contrast: China has big, rich metropolitan centers such as Shanghai and Beijing, yet also has deserts and high lands, whereas as Canada with its large Southern cities also has a very sparsely populated North.

In addition to these similarities, both Canada and China have two main levels of government; federal and provincial levels for Canada, and center and province for China. Even though China is a unitary country, certain functions of the center can be regarded as amounting to federalism; for example, since the founding of China, rich provinces have traditionally helped the poor ones. In practice, the central government simply decides how much resource a certain province, say Zhejiang, a relatively rich province in recent history, is required to transfer out of the province. Another similarity is that the provincial governments of both countries do their own budgets and are responsible for the budgets of lower level governments, such as at the city and county levels. In China, provinces have had budgetary autonomy since 1994. A final similarity is that both countries share tax revenues between the central and the provincial government. Canada's tax revenues are collected by the Tax Bureau, both at federal and provincial level while in China collection is carried out by Tax Bureaus at all levels, from central to the lowest possible level.

Given these many points of commonality, China might consider dealing with its transfer payments in the same way as Canada. China could adopt the Canadian formula of intergovernmental grants based

on the national average, called the representative national average standard (RNAS). The grants that the central government of China provides to sub-national governments should consist of two basic forms: general purpose transfers (equalization payment), which are unconditional grants to only those provinces with below-average tax capacity, and special purpose transfers, which are policy-specific grants helping the central government to fulfill certain national wide welfare programs. The modified version of RNAS is called the representative five-province standard (RFPS) and includes only British Columbia, Manitoba, Saskatchewan, Ontario, and Quebec. (See section 3 for details)

Following this method, the inter-governmental grant, which up to now has been an arbitrary negotiation between individual provinces and the center, would be formulated and calculated pursuant with an objective formula. Like Canada, this equalization formula could bring the have-not Chinese provinces/regions up to a comparable level to the have Chinese provinces/regions. The above formula could be applied to both conditional and non-conditional grants. Three beneficial results would become obvious following its adoption. First, there would be no need for the center to negotiate with provinces on an individual basis. This would increase the efficiency of the administration of government at all levels. The allocation of resources would become a purely objective task, and could be calculated by computer. Valuable time and resources would be saved to the benefit of the public. Secondly, a scientific and objective formula, which has been agreed upon by all the provinces and regions, would increase the transparency of public services. The third and the last point is that intergovernmental grants would “equalize up” the comparative poor regions and not “equalize down” the comparative rich regions.

4.3 Transparent Financial Systems

Legislation in most developing countries is still in infancy, especially with respect to public finance. However, even a perfectly designed financial program, without accompanying monitoring or

auditing programs, means little, especially in a developing country. In the past, most governments in China had at least two levels of accountability: one was to be shown to the supervising body whereas the other was secret and non-accountable. The existence of this type of latter account was common knowledge to most ordinary citizens and was called a “Xiao jin ku” (“ little gold warehouse”). Under this system, the governments’ accounts could never reflect the true picture of public finances.

Recognizing that many underground accounts were funded by unregulated fees charged by local government, the State Council eliminated all sub-national fees not approved from above. In his article Four Eye-catching Finance Reforms, journalist Jianxing Li (2002) reported in 2002 that the State Council required that all illegal fees be removed and that all other service charges approved by above were to be paid to a designated (and the only credit account) government account. All other forms of income should also go directly to the same account or be submitted directly to the bank by the individuals or institutes who require the service. All government agents are now only permitted two separate accounts: one is an income account (credit account) and the other is the expense account (debit account). In this way the State Council eliminated underground accounts. Following the 2002 reform, the government account balances provide a more accurate picture of public finances, though they are not perfect.

A transparent financial system with explicit monitoring and auditing programs will strengthen the implementation of government policy so as to diminish waste of public funds. There appear to be three main problems related to the current auditing system in China. First is a lack of auditing expertise. Under current regulations, Finance Reports will be submitted the People’s Congress to review. However, only a few members of the People’s Congress have financial or accounting

expertise. Chances are quite high that they do not understand the content of the reports, let alone how to review them critically. The second problem is with respect to the origins of the members. For example, a representative from Shanghai may not be interested in an auditor's report for Tibet, and vice versa. The finance report submitted to the People's Congress includes all the provinces and regions and thus may not get equal attention from each representative. The third is a technical problem with respect to the timing of the submission of the report. Given the lack of financial expertise of the members, much more time should be given to allow each member sufficient time to review the report at least once. Unfortunately, in practice, most of the reports are submitted in haste and members barely have enough time to scan the lengthy report, much less to provide constructive critiques. In light of the above, review of financial reports by the People's Congress adds very little value to the process and serves very little function as a monitoring mechanism.

The author suggests setting up a pilot institute composed of select financial and accounting experts, independent from any level of government. The institute's budget should be divided up equally between provincial and central governments. This auditing institute should have the right to review any government account and decide freely whether to investigate further if they suspect malfeasance. Once an irregularity has been spotted, they would report directly to the Procurator or appointed justice official in order that appropriate legal action could be taken.

4.4 Legislation and Governance Amendments

Like other developing countries, governance legislation in China is at its infancy stage. Amendments and improvements are needed to enhance the efficiency of governance and at the same time provide an objective and fair process for personnel promotion and appointments. For example, one such amendment could be an act that ensures that residents of different regions all have the right to a comparable level of public service. Another example is the enactment of regulations that provides a

mechanism to evaluate the performance of public servants, especially officials at the higher level.

In the Constitution it is clearly written that all the citizens have the same rights to be educated, to be protected against crime, etc. However, the Constitution in China only has its paper value. It has not much practical guidance value due to the ambiguity resulting from the general and broad terms used in it. A comprehensive, concrete and practical act, code or manual is needed to govern officials' behaviors or decisions closely related to the public's rights. With a detailed and practical regulation, not as ambiguous as the present Constitution, officials can easily understand what they should do and what they should not just by consulting the regulation or manual. The public, in turn, can also easily notice if officials are not following the guidance. Transparency is once again enhanced.

Under China's current political system, provincial and other sub-national level officials are appointed by higher-level officials rather than being elected by their constituency. Therefore, to some extent, the provincial officials are the extension of the center instead of the regionally elected leaders of local citizens. Chinese economists indicate that the provincial governments, in some sense, are nothing more than a tool of the center. The closer the links between provincial and central officials, the less effective are the leadership practices of the provincial officials. Thus inefficiency arises from an unhealthy inbred, institutional closeness between the two levels of officials. (Wen and Yao, 2004) Due to the entrenched communist nature of China, this is a rather difficult issue to avoid entirely. A bottom-up objective evaluation system could perhaps be used to measure the performance of officials. Randomly selected representatives from the jurisdiction could be invited to a ballot station to complete a performance evaluation sheet for a certain official. The average or the total score of this evaluation could be weighted against the recommendation made from high-level

officials. This combined method of appointment would drive officials to provide a higher level of service to local citizens, so as to win higher evaluations and a better chance at promotion.

4.5 Fiscal Federalism Benefits China

With desirable changes such as a combined performance evaluation system, more scientific equalization payment method, and an independent, pilot institute to audit government accounts, fiscal federalism would rationalize equalization transfers and lead to an improved level of service and commitment by the public sector.

A combined performance evaluation system would reduce the closeness between the central and sub-national governments and would drive public officials to provide optimal service to the public so as to attract more political grass root support. If officials make decisions that are more in line with the interests of their respective local constituents, it stands to reason that their respective jurisdiction will benefit much more over the long term. According to a working paper by Yingyi Qian, empirical tests have shown that decisions made by provincial officials are less effective when there exists a close link between center and provincial officials. (Wen and Yao 2003)

A more scientific equalization payment method, instead of face-to-face negotiation, would limit any possible arbitrariness to a minimum. This would increase the efficiency and effectiveness of intergovernmental transfers and provide true equal opportunity for each region. Moreover, in time, this might result in each region truly being at the same level and make it easier to implement policies that benefit citizens countrywide.

An independent, pilot institute to audit government accounts would serve to discipline public servants, especially higher-level officials, and help to encourage very high, transparent standards and practices. Such an institute should have the discretion to act unilaterally and to publicize its findings.

5.0 Conclusion

Despite all the political barriers and technical difficulties facing China, China should adopt appropriate changes to its fiscal system and political structure. Fiscal federalism could be very beneficial to China, as has been proven in the case of many other nations. It can optimize, amongst other things, the provision of public services as well as rationalize equalization transfer payments, to the benefit of the many citizens of China. Moreover, this could have a stabilizing effect on the world economy and thus benefit all international citizens.

I would like to end this paper by quoting former China chairman, Deng Xiao Ping who launched the opening-up policy and commenced China's long journey to a market economy. "Development is a hard truth." Development is an unchangeable theme for every nation. Since fiscal federalism will help China to develop, China should follow this route of development in accordance with the history of the mankind.

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Appendix:

Table 1. Expenditures for the central and local government and its ratio⁵

| Year | National, 100M | Central | Local |
|-----------|-------------------|---------|----------|
| 1978 | 1122.09 | 532.12 | 589.97 |
| Ratio (%) | | 47.4 | 52.6 |
| 1980 | 1228.83 | 666.81 | 562.02 |
| Ratio (%) | | 54.3 | 45.7 |
| 1985 | 2004.25 | 795.25 | 1209.00 |
| Ratio (%) | | 39.7 | 60.3 |
| 1989 | 2823.78 | 888.77 | 1935.01 |
| Ratio (%) | | 31.5 | 68.5 |
| 1990 | 3083.59 | 1004.47 | 2079.12 |
| Ratio (%) | | 32.6 | 67.4 |
| 1991 | 3386.62 | 1090.81 | 2295.81 |
| Ratio (%) | | 32.2 | 67.8 |
| 1992 | 3742.20 | 1170.44 | 2571.76 |
| Ratio (%) | | 31.3 | 68.7 |
| 1993 | 4642.30 | 1312.06 | 3330.24 |
| Ratio (%) | | 28.3 | 71.7 |
| 1994 | 5792.62 | 1754.43 | 4038.19 |
| Ratio (%) | | 30.3 | 69.7 |
| 1995 | 6823.72 | 1995.39 | 4828.33 |
| Ratio (%) | | 29.2 | 70.8 |
| 1996 | 7937.55 | 2151.27 | 5786.28 |
| Ratio (%) | | 27.1 | 72.9 |
| 1997 | 9233.56 | 2532.50 | 6701.06 |
| Ratio (%) | | 27.4 | 72.6 |
| 1998 | 10798.18 | 3125.60 | 7672.58 |
| Ratio (%) | | 28.9 | 71.1 |
| 1999 | 13187.67 | 4152.33 | 9035.34 |
| Ratio (%) | | 31.5 | 68.5 |
| 2000 | 15886.50 | 5519.85 | 10366.65 |
| Ratio (%) | | 34.7 | 65.3 |
| 2001 | 18902.58 | 5768.02 | 13134.56 |
| Ratio (%) | | 30.5 | 69.5 |
| 2002 | 22053.15 | 6771.70 | 15281.45 |
| Ratio (%) | | 30.7 | 69.3 |
| 2003 | 24649.95 | 7420.10 | 17229.85 |
| Ratio (%) | | 30.1 | 69.9 |

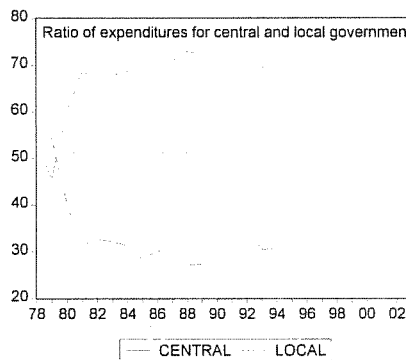
⁵ Collected from the government website of the Statistic Bureau of China. <http://www.stats.gov.cn/tjsj/nds/>

Table 2 Ratio of revenue for central and local government⁶

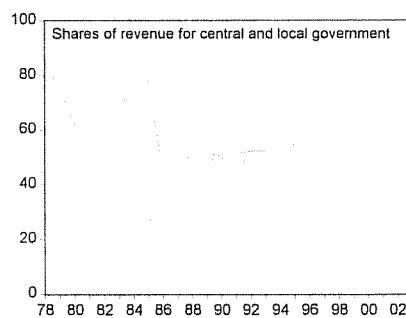
| Year | National, 100m | Central | Local | Central % | Local % |
|------|----------------|----------|---------|-----------|----------|
| 1978 | 1132.26 | 175.77 | 956.49 | 15.52382 | 84.47618 |
| 1980 | 1159.93 | 284.45 | 875.48 | 24.52303 | 75.47697 |
| 1985 | 2004.82 | 769.63 | 1235.19 | 38.38898 | 61.61102 |
| 1989 | 2664.9 | 822.52 | 1842.38 | 30.9 | 69.1 |
| 1990 | 2937.1 | 992.42 | 1944.68 | 33.78911 | 66.21089 |
| 1991 | 3149.48 | 938.25 | 2211.23 | 29.79063 | 70.20937 |
| 1992 | 3483.37 | 979.51 | 2503.86 | 28.11961 | 71.88039 |
| 1993 | 4348.95 | 957.51 | 3391.44 | 22.01704 | 77.98296 |
| 1994 | 5218.1 | 2906.5 | 2311.6 | 55.70035 | 44.29965 |
| 1995 | 6242.2 | 3256.62 | 2985.58 | 52.17103 | 47.82897 |
| 1996 | 7407.99 | 3661.07 | 3746.92 | 49.42056 | 50.57944 |
| 1997 | 8651.14 | 4226.92 | 4424.22 | 48.9 | 51.1 |
| 1998 | 9875.95 | 4892 | 4983.95 | 49.5 | 50.5 |
| 1999 | 11444.08 | 5849.21 | 5594.87 | 51.1 | 48.9 |
| 2000 | 13395.23 | 6989.17 | 6406.06 | 52.2 | 47.8 |
| 2001 | 16386.04 | 8582.74 | 7803.3 | 52.4 | 47.6 |
| 2002 | 18903.64 | 10388.64 | 8515 | 54.96 | 45.04 |
| 2003 | 21715.25 | 11865.27 | 9849.98 | 54.64026 | 45.35974 |

Note: 1. The revenue for each level is those raised by the said level of government. The following graphs will give us a clear brief illustration of the above analysis.

Graph 1. Ratio of Expenditures for Central and Local Government



Graph 2. Shares of Revenues for Central and Local Government



⁶ Collected from the government website of the Statistic Bureau of (CENTRALREV LOCALREV)/nds/

Graph 3. Ratio of Expenditures and Shares of Revenues for Central and Local Government

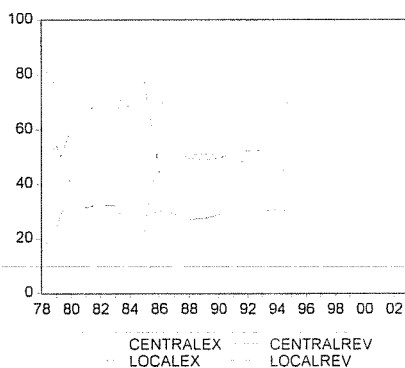


Table 3. Breakdown of revenues and expenses for each region and province.⁷

| Rgion | Abs Rev | Se q | PP Rev | Se q | Abs Exp | Sequ | PP Exp | Seq |
|----------------|---------|------|---------|------|---------|------|---------|-----|
| Beijing | 592.38 | 6 | 4068.54 | 2 | 734.8 | 7 | 5046.7 | 3 |
| Tianjin | 204.53 | 17 | 2023.05 | 3 | 312.08 | 26 | 3086.84 | 4 |
| Hebei | 335.83 | 10 | 496.13 | 19 | 640.74 | 10 | 946.58 | 23 |
| Shanxi | 186.05 | 19 | 561.41 | 15 | 415.69 | 20 | 1254.35 | 18 |
| Inner Mongolia | 138.72 | 24 | 582.86 | 13 | 447.26 | 17 | 1879.24 | 9 |
| Liaoning | 447.05 | 7 | 1061.88 | 7 | 784.38 | 6 | 1863.14 | 10 |
| Jilin | 154 | 23 | 569.53 | 14 | 409.23 | 21 | 1513.42 | 12 |
| Heilongjiang | 248.86 | 14 | 652.32 | 11 | 564.91 | 13 | 1480.76 | 13 |
| Shanghai | 886.23 | 2 | | 1 | 1088.44 | 2 | 6361.43 | 1 |
| Jiangsu | 798.11 | 3 | 1077.65 | 6 | 1047.68 | 3 | 1414.64 | 14 |
| Zhejiang | 706.56 | 5 | 1509.74 | 5 | 896.77 | 5 | 1916.18 | 7 |
| Anhui | 220.75 | 16 | 344.38 | 28 | 507.44 | 15 | 791.64 | 30 |
| Fujian | 304.71 | 11 | 873.6 | 8 | 452.3 | 16 | 1296.73 | 17 |
| Jiangxi | 168.17 | 21 | 395.32 | 25 | 382.1 | 22 | 898.21 | 26 |
| Shandong | 713.79 | 4 | 782.24 | 9 | 1010.64 | 4 | 1107.55 | 21 |
| Henan | 338.05 | 8 | 349.69 | 27 | 716.6 | 9 | 741.28 | 31 |
| Hubei | 259.76 | 13 | 432.79 | 22 | 540.44 | 14 | 900.43 | 25 |
| Hunan | 268.65 | 12 | 403.2 | 24 | 573.75 | 12 | 861.1 | 27 |
| Guandong | 1315.52 | 1 | 1653.91 | 4 | 1695.63 | 1 | 2131.8 | 6 |
| Guangxi | 203.66 | 18 | 419.31 | 23 | 443.6 | 18 | 913.32 | 24 |
| Hainan | 51.32 | 28 | 632.8 | 12 | 105.4 | 31 | 1299.63 | 16 |
| Chongqing | 161.56 | 22 | 516.17 | 18 | 341.58 | 24 | 1091.31 | 22 |
| Sichuan | 336.59 | 9 | 386.89 | 26 | 732.3 | 8 | 841.72 | 29 |

⁷ Collected from the government website of the Statistic Bureau of China. <http://www.stats.gov.cn/tjsj/nds/>

| | | | | | | | | |
|----------|--------|----|--------|----|--------|----|---------|----|
| Guizhou | 124.56 | 26 | 321.86 | 30 | 332.35 | 25 | 858.79 | 28 |
| Yunnan | 229 | 15 | 523.31 | 16 | 587.35 | 11 | 1342.21 | 15 |
| Tibet | 8.15 | 31 | 301.85 | 31 | 145.91 | 28 | 5404.07 | 2 |
| Shaanxi | 177.33 | 20 | 480.57 | 20 | 418.2 | 19 | 1133.33 | 20 |
| Gansu | 87.66 | 27 | 336.77 | 29 | 300 | 27 | 1152.52 | 19 |
| Qinghai | 24.04 | 30 | 450.19 | 21 | 122.04 | 29 | 2285.39 | 5 |
| Ningxia | 30.03 | 29 | 517.76 | 17 | 105.78 | 30 | 1823.79 | 11 |
| Xinjiang | 128.22 | 25 | 662.98 | 10 | 368.47 | 23 | 1905.22 | 8 |

Notes

Abs Rev: Total absolute revenue

Seq: Total absolute revenue sequence

PP Rev: Per capita budgetary revenue (Yuan/per person)

Sequ.: Per capita budgetary sequence

Abs Exp: Absolute amount of expenditure (100 million)

Sequ.: Total expenditure sequence

PP Exp: Per capita budgetary expenditure

Sequ.: Per capita budgetary expenditure sequence

1. Revenues and expenditures in this table are local level government figures.

Table.6 Subsidies under the old economic system in 2000(Billion RMB)

| Subsidies under the old economic system in 2000(Billion RMB) | |
|--|-------|
| Inner Mongolia | 18.42 |
| Jilin | 1.07 |
| Fujian | 5.42 |
| Jiangxi | 0.45 |
| Shangdong | 1.59 |
| Guangxi | 6.08 |
| Hainan | 1.71 |
| Sichuan | 3.43 |
| Guizhou | 7.42 |
| Yuanna | 6.73 |
| Tibet | 27.87 |
| Shannxi | 1.2 |
| Gansu | 1.26 |
| Qinghai | 6.56 |
| Ningxia | 5.33 |

| | |
|----------|-------|
| Xinjiang | 19.37 |
| Total | 114.0 |

Table 7 Transitory period grants for 1995-2001 (billion Yuan)

| Year | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|--------|------|------|------|------|------|------|------|
| Amount | 2.1 | 3.5 | 5.0 | 6.0 | 7.5 | 8.5 | 13.8 |