

Basic public services and the restructuring of the public finance system in China

Retrospect and prospect

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Abstract

Purpose – The purpose of this paper is to examine the financing and provision of basic public services in China. The main issue addressed is how to reform the public finance system to achieve quality and fairness in the provision of basic public services.

Design/methodology/approach – Based on an historical analysis of the functional transformation of the public finance system in China and on an empirical analysis of the current public finance system and the public service provision system, a comprehensive understanding was gained about the relationship between the financing and provision of basic public services.

Findings – The paper argues that there is a close relationship between the provision of basic public services and the functional changes made to the public finance system. Based on a systematic retrospective study of the Chinese Government's efforts to improve basic public services over the last three decades, this paper offers policy suggestions on further public finance restructuring that would support better service provision.

Originality/value – By analyzing issues in the public service provision system, this paper contributes to the debate about the efficiency improvement made to governmental functions in China.

Keywords Public finance, Basic public service, Equalization, Fiscal support

Paper type General review

1. Introduction

Along with its continuous development, the public finance system in Mainland China (herein referred to as China, excluding Hong Kong, Macao and Taiwan) has experienced a series of restructurings. The system has been transformed from one that used mainly to support economic growth into a system that focusses on providing basic public services. Although the structure of financial expenditures and the quality of basic public services have improved in recent years, the gap between the urban and rural areas regarding the quality of their basic public services is still of concern.

In the process of urbanization, the rapidly increasing demand for public services by citizens has caused the Chinese government to exert remarkable efforts to reinforce its financial support for basic public services. However, the public finance system has not been able to operate efficiently due to the performance assessment system and the development gaps between different regions in China. Therefore, the public finance system, designed to support the provision of public goods and services, needs to be reformed and strengthened.



Public financing is an economic activity in which the government plays a central role. Governments concentrate part of their available economic resources to sustain necessary functions and use additional resources to supply public services (Peiyong, 2004). The modern concept of public financing should be distinguished from that of the period of central economic planning in China (1953-1978), which emphasized public finance as a tool to support the construction of key industries, the maintenance of industrial production and the operation of state-owned enterprises (SOEs). China's public finance system has already been transformed from a system with the characteristics of a planned economy to a system that aims to achieve the equalization of basic public services.

Many scholars in China have studied related issues concerning public services and the public finance system. Xia Jiechang (2007), Liu Shangxi *et al.* (2008) and Xiang Jiquan and Fancheng (2008) focussed their studies on problems in the public service supply process. One of these problems is the equalization of basic public services, which has become a matter of wide concern recently. Some economists abroad have used quantitative and qualitative analysis to study fiscal decentralization, the structure of fiscal expenditure, the relationship between economic growth and fiscal transfer payments, and other problems concerning basic public services. For example, Chen Kang *et al.* (2002) described how China's reforms of its public finance system in the mid-1990s accelerated behavioral changes at the local government level, changing it from a "helping hand" to a "grabbing hand." Regarding public spending structures, Lin Shuanglin (2014) argued that the Chinese government had spent too little on education, health care and scientific research. The public expenditure system had been distorted by an unbalanced distribution of fiscal responsibilities between different levels of the local and central governments. Yilin Hou (2011) provided a review of the establishment of the intergovernmental fiscal transfer system in China since 1994. Bihong Huang and Kang Chen (2012) examined the equalization effects of different types of transfer payment.

By investigating the functional transformation of China's public finance system, this paper conducts a comprehensive analysis of the relationship between basic public service provision and public finance in China. First, we examined the course of the functional transformation since the beginning of the period of economic reform. Then, we analyzed the structural changes in public spending and studied the relationship between basic public service provision and fiscal transfer payments. Policy suggestions on building a better public finance system to support public service provision are offered at the end of this study.

2. Development of the public finance system in China: changed functions

This section provides an analysis of the development of the public finance system in China. In October 2003, the Central Committee of the Communist Party of China (CPC), the ruling party of China, passed a resolution, known as the "Decision of the Central Committee of the CPC on Some Issues Concerning the Improvement of the Socialist Market Economy." According to this document, the supply of public services was confirmed as one of the main tasks of government. In October 2007, the 17th National Congress of the CPC decided to strengthen the government's ability to supply public services. In November 2013, the Third Plenary Session of 18th CPC Central Committee further emphasized the importance of the public finance system and the urgent requirement to modernize this system to support the modernization of the national

governance system better. In March 2011 “The Outline of the Twelfth Five-Year Plan for the National Economic and Social Development of the People’s Republic of China” approved by the Fourth Session of the 11th National People’s Congress of the People’s Republic of China (NPC, the supreme organ of state power in China), made the promotion of the equalization of basic public services more and more prominent than it had been before. The State Council of the PRC (the Central People’s Government of China) issued “the Plan for the National Basic Public Service System during the Period of the Twelfth Five-Year Plan” in July 2012 to plan the details of targets and policy measures for the provision of basic public services according to the 12th Five-Year Plan. Thus, there has been a remarkable trend in China to promote the provision of basic public services.

2.1 New functions of public finance: from a system supporting economic growth to a system providing basic public services

As mentioned before, the public finance system in China has been transformed from a system designed to focus on national economic planning and SOE operation to one providing financial support for public service provision under the socialist market system.

During the period of the centrally planned economy (1953-1978), most economic activities were kept under the control of government planners. In urban areas, most public services were offered by particular organizations, namely, *danwei*, such as SOEs or public institutions. The urban *danwei* provided residents with jobs, food, pensions, education and housing security. In the rural areas, there were very limited public services, provided by the collective agricultural units. Most budget spending was used on the construction of infrastructure and the operation of SOEs, and spending on public services was limited. This was a main reason for the long-term scarcity of basic public services before 1978.

After 1978, as part of the reforms that changed China from a planned economy to a socialist market economy, government functions changed, as the market began to play a decisive role in resources allocation.

Whether the government could provide basic public services efficiently became a more important issue, as the government’s provision function focussed more on fulfilling people’s needs in areas such as social security, education, sciences and arts, and public health. Still, intervening and regulating economic activities was still an active function of the government in this model of a socialist market economy.

2.2 Consumers of public services in China: from discrimination to equality

During the period of the centrally planned economy, the quality and quantity of public services accessible to citizens varied significantly between rural and urban areas. Citizens’ residences across the country were categorized as either “rural” or “urban” by the household registration system. People in urban areas had better opportunities to receive public services, while those in rural areas had very little. With the establishment of the socialist market economy and rapid urbanization, rural-urban migration became prevalent in China. It became important to narrow the gaps in public service provision between rural and urban regions. According to the report of the 18th National Congress of the CPC, an “equalized public services supply system” would be established by 2020. This represents the primary objective of the government’s future efforts.

3. The level of public service supply and the structural modification of public spending

Government appropriation of expenditure for public services such as compulsory education has been increasing, which will greatly promote public service construction. Since most of the fiscal resources were provided by all levels of governments, the quality and quantity of public services largely depended on the fiscal expenditure of the governments (Xiang Jiquan, Yuan Fangcheng). Particularly, fiscal spending on education had steadily increased during recent decades. Data from 1992 to 2012 showed that the share of total fiscal expenditure consumed by education rose gradually (Figure 1). In 1993, the Chinese government put forward an objective stipulating that fiscal expenditure on education should be 4 percent of total GDP. It was 2.46 percent in 1993 and much lower than the world average level then. Finally, in 2012, more than 2.2 trillion yuan (RMB) had been put into the education system, accounting for 4.28 percent of total GDP for the first time in the history of the PRC. We can see from Table I that national appropriation expenditure on compulsory education per-student greatly increased from 1993 to 2013.

The structure of public spending gradually became reasonable and healthy. Data from selected years were used for analyzing public spending. Fiscal revenue and expenditure were reclassified in 2007, rendering it impossible to put all expenditure comparisons in one table. Fiscal spending on education, science, health, pensions and other social assistance made up 28.6 percent of total fiscal expenditure in 1993, and this number decreased to 25.5 percent in 2003 (Table II). However, it increased a lot in 2007 (Table III). In 2013, fiscal spending on these basic public services accounted for 40.57 percent of the total fiscal expenditure, of which education, social security and medical care shared a relatively large percentage (Table III).

With increased public revenues, the public service provision system in China was built up gradually. Data collected after 2010 were used to analyze the development of public service provision, as shown in Table III. Recent efforts made by the Chinese government have focussed on improving the living conditions of citizens. Residents could get more public services of a better quality, as shown in the following analysis (Table IV).

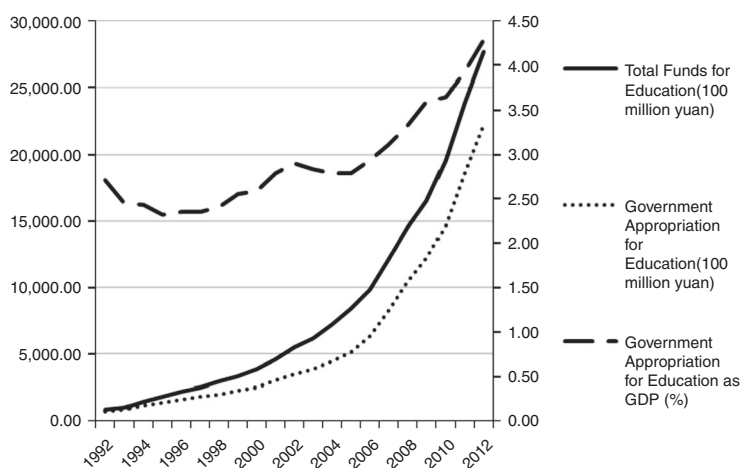


Figure 1.
Data for
fiscal investments
into the field of
education 1992-2012

Source: China Statistical Yearbook (2014)

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Table I.

Data of national appropriation expenditure on compulsory education per-student 1993-2013 (Yuan)

	Total appropriation expenditure per primary student	Government's appropriation expenditure per primary student	Total appropriation expenditure per secondary student	Government's appropriation expenditure per secondary student
1993	162.80	17.09	364.24	62.72
1994	236.06	17.73	450.37	50.86
1995	265.78	22.79	492.04	65.96
1996	302.54	28.46	549.24	81.93
1997	333.81	33.97	591.38	93.05
1998	370.79	34.35	610.65	79.82
1999	414.78	35.72	639.63	76.97
2000	491.58	37.18	679.81	74.08
2001	645.28	45.18	817.02	83.40
2002	813.13	60.21	960.51	104.21
2003	931.54	83.49	1,052.00	127.31
2004	1,129.11	116.51	1,246.07	164.55
2005	1,327.24	166.52	1,498.25	232.88
2006	1,633.51	270.94	1,896.56	378.42
2007	2,207.04	425.00	2,679.42	614.47
2008	2,757.53	616.28	3,543.25	936.38
2009	3,357.92	743.70	4,331.62	1,161.98
2010	4,012.51	929.89	5,213.91	1,414.33
2011	4,966.04	1,366.41	6,541.86	2,044.93
2012	6,128.99	1,829.14	8,137.00	2,691.76
2013	6,901.77	2,068.47	9,258.37	2,983.75
2014	7,681.02	2,241.83	10,359.33	3,120.81

Source: Statistical bulletin of the implementation of national education funding 1993-2013

Table II.

Data for the structure of public finance expenses by basic public services area 1993 and 2003 (100 million yuan)

Year	Public government expenditure	Education, science, health	Pensions and other social assistance	Other expenditure
1993	4,642.30	957.77 20.63%	75.27 1.62%	3,609.26 77.75%
2003	24,649.95	4,505.51 18.28%	498.82 2.02%	19,645.62 79.70%

Sources: China Statistical Yearbook and the 1994 National Economic and Social Development Statistics Bulletin 2004

Table III.

Data for the structure of public finance expenses by basic public services area 2007 and 2013 (100 million yuan)

Year	Public government expenditure	Education	Science	Arts	Social security	Medical care	Housing	Others
2007	49,781.35	7,122.32 14.31%	1,783.04 3.58%	898.64 1.81%	5,447.16 10.94%	1,989.96 3.99%	na	32,540.23 65.37%
2013	140,212.1	22,001.76 15.69%	5,084.3 3.63%	2,544.39 1.81%	14,490.54 10.33%	8,279.9 5.91%	4,480.55 3.20%	83,330.66 59.43%

Sources: China Statistical Yearbook and the 2008 National Economic and Social Development Statistics Bulletin 2014

Dimension	Index	2010	2011	2012	2013	2015
Primary education	Nine-year compulsory education (%)	89.7	na	91.8	92.3	93
	High school entry percentage (%)	82.5	84	85	86	87
Employment	Urban unemployment rate (%)	4.1	4.1	4.1	4.1	< 5
	New urban employment (10,000 persons)	na	1,221	1,266	1,310	4,500
Social insurance	The number of towns participating in basic old-age insurance (100 million)	2.57	2.89	3.25	3.34	3.57
Health	The urban and rural basic medical insurance rate (%)	na	na	na	95%	Increased by 3 percentage points, ahead of target
Housing	Urban construction of affordable housing projects (10,000 sets)	na	1,043	781	544	3,600

Note: na, indicates that data are unavailable

Sources: “Mid-term evaluation report on the implementation of the 12th Five-Year Development Plan (2011-2015),” “2013 National Economic and Social Development Statistics Bulletin,” and “2013 National Educational Development Statistical Communique”

Table IV.
Progress of the main indicators of basic public services

In education, a free urban and rural compulsory education policy had been implemented and education retention rates and high school enrollment rates had continued to rise. The Chinese government continued to make progress to secure children’s fair access to education. The government strengthened its efforts to provide compulsory education in poor areas by improving badly built and poorly operated schools, increasing fiscal aid to poor students, and significantly increasing the amount available per eligible student for national school loans. A subsidization scheme for waiving tuition fees at schools for secondary vocational education was extended to cover three years of study. Policies had been introduced to ensure that children could receive compulsory education at schools close to where they lived without having to take entrance examinations, and 28 provincial-level administrative areas began to allow children who lived with their migrant worker parents to take the college entrance examination in the cities of their residence. Government spending on education has risen above 4 percent of GDP since 2012.

The reform of the medical service system and the medical pricing system was actively pursued by local government administrations everywhere. For example, the city of Beijing piloted an innovative practice called the “Medical Conjoined Project” (Beijing Regional Medical system guidance, 2013). This is a new medical service support system run in close collaboration with various medical institutions at all levels. The establishment of large hospitals had enabled the integration of medical service resources and promoted the flow of high-quality medical resources to populations.

In the area of social security, the Chinese government implemented a new round of pension reforms, moving from a two-tiered pension system to a unified one and it established the occupational annuities system in January 2015. Under the new system, employees of government and public institutions could enjoy the same pension benefits as private sector employees. As part of this system, a unified national social security card was issued to every citizen. A remote province medical billing platform had been established in 27 provinces (including autonomous regions

and municipalities). About 90 percent of the rural areas were covered by a New Rural Medical Cooperation Program which enabled rural residents to clear their medical payments instantaneously.

4. The promotion of equality in public service provision and the public finance transfer system

The equalization of basic public service provision had been an important manifestation of the public finance system. Generally, public service provision systems are more mature in developed countries. In China, the eastern regions, which were economically better developed, could provide better public services than the western and central regions. The Chinese government's increased attention on public service provision gradually spread from the eastern to the central and western regions, indicating that the development of public service provision worked with the pace of economic development. This shift explained the transformation of functions in the government and the public finance system.

4.1 Factors influencing the equalization of basic public service provision in China

There are several factors that have influenced the degree of equality in China's basic public service provision.

4.1.1 Economic development. A higher level of economic development is conducive to fiscal revenue growth, however, scholars such as Wang Wenjian and Qin Chenglin (2008) have concluded that the tax-sharing system had benefited the eastern regions, while it hindered the economies of the western regions. Scholars such as Ekaterina V. Zhuravskaya (2000) argued that:

In poor regions suffering from acute shortages of fiscal resources, local leaders desperate to raise fiscal revenues to meet government wage obligations and other recurrent expenditure needs must compromise development objectives and divert funds away from basic services and investments.

4.1.2 Immigration. According to the Tiebout model, citizens could choose to live in areas that have better public services and this mechanism facilitates the competition between governments in different regions. The result of such competition will be a higher quality of public services in most areas. However, several institutional factors have rendered this mechanism less relevant in China. The household register system, for example, was one factor that had decreased population mobility in China. The core of reform in the household registration system has had to be the gradual equalization of basic public service provision, so that residents could eventually enjoy the same level of public services and social welfare regardless of their household registration status. At present, migrant workers and their families in urban areas cannot enjoy the same level of basic public services as the local residents, although the Chinese government has made great efforts to speed up the pace of reform of the household registration system in recent years.

4.1.3 Development strategy. Top-down decisions could change the performance evaluation system that is applied to local officials. In the area of health, for example, Albert Park *et al.* (1996) have argued that: "Economic reform and growth do not necessarily improve health status, nutrition, and health care for all. Rational health sector policies and organized health development are critical."

In 1995, the strategy of "Invigorating China through Science and Education" shifted the pattern of development, and gave a higher priority to science and education in

economic and social development. In March 2004, at the Second Meeting of the 10th National People's Congress, an amendment of "The Constitution of the People's Republic of China" was approved which added the statement "The State establishes a sound social security system compatible with the level of economic development" to Article 14. In April 2009, "Opinions of the CPC Central Committee and the State Council on Deepening the Reform of the Medical and Health Care System" was issued and in it, for the first time, the government clearly stated that a basic health care system should make sure all citizens could get access to medical services.

4.1.4 Local democracy and governance. Contrary to traditional views (Kaiyun *et al.*, 2010), which have insisted that local economic and financial strength determine the capability of a government to provide public services, we believe that citizens' participation, non-governmental organizations (NGOs), communications, technology and e-government could each exert a profound influence on a local government's capacity to provide public services. By using means such as e-mails, mobile devices and other communications tools, a more efficient management system could be established and public service provision could be enabled to target public services at their beneficiaries with greater accuracy.

With the development of democratic elections in villages and autonomous communities, local governments have been encouraged to meet public needs in order to strengthen their legitimacy with the citizenry. The transparency of government operations, social expectations and government accountability have thus been enhanced.

Additionally, under international influence, sound public service provision systems in developed economies have established good examples for China, providing it with a great opportunity to learn from other nations in theory and in practice in the context of globalization.

4.2 The progress of equality in China's public service provision

Due to the uneven economic and social development in different regions of China, the ability of the government to provide public services has differed largely between the eastern, the central and the western regions. A similar difference has also existed between the country's urban and rural areas.

4.2.1 Imbalances in the supply of public services between urban and rural areas. As mentioned earlier, there had been a remarkable gap between different areas regarding the planned economy's supply of basic public services until the 1980s. The Chinese government has made great efforts to narrow the gap in basic public service provision between urban and rural areas since the economic reform period began. However, the government has taken different approaches to social security, infrastructure development and sanitation services in urban and rural areas, resulting in a basic public service provision system that has been focussed on the cities. Reformation of the household registration system could not be completed overnight and citizens who lived in different areas were treated unequally due to this system.

4.2.2 Uneven provision of public services between regions. Since the economic reform began in 1978, the development of the eastern regions of China had been more rapid than that of the central and western regions. The government's ability to provide public services in the eastern regions was relatively better. Although the central government has increased fiscal support for the central and western regions in recent years, that fiscal support was focussed on building public infrastructure. This policy failed to narrow the gap between the basic public services available in the western regions

compared to those accessible in other areas. For example, by analyzing the data in Table V and comparing the eastern and western regions, it is easy to see that a significant shortfall existed in the provision of several health-related items in Western China. According to “The national planning of main functional areas” document that was issued in 2011, most western regions in China were categorized as areas where certain economic activities were restricted. For example, governments in the western regions took more action to protect the environment which weakened economic development. However, residents in the western regions also needed the government to make up for the lacking basic public services.

Data in Table V show that there was a substantial gap in medical services provision between the eastern and western regions, in terms of the number of beds in hospitals, the number of beds in hospitals per thousand people, and the number of medical organizations operating in each part of the country.

In Table VI, the data were collected from Beijing City, Henan Province, Gansu Province and Jilin Province as representative areas of the eastern, the central, the western and the northeastern regions of China. Using factors such as education, labor services, social insurance, basic medical services, basic social services, and arts and entertainment, the condition of public service provision was assessed.

Although the governments in Beijing, Henan, Jilin and Gansu had put a lot of fiscal resources into areas such as education, social care and employment services, the gaps between different regions were still wide in some areas of basic public service provision.

4.3 The fiscal transfer system to support the public services supply system

The 17th National Congress of the CPC decided that local governments’ abilities to supply basic public services needed to be strengthened. The 17th Party Congress Report made it clear that the transfer payment system should play a more active role in narrowing the development gap between different regions in China to ensure that citizens have relatively equitable access to basic public services. Also, it was decided that fiscal transfer payments should be made to increase the disposable fiscal resources of government levels at the grassroots of Chinese society. Furthermore,

	Eastern	Central	Western
<i>Number of beds in hospitals</i>			
Total	2,323,857	1,791,308	1,609,610
Urban	1,280,600	812,726	640,077
Rural	1,043,257	978,582	969,533
<i>Number of beds in hospitals per 1,000 people</i>			
Total	4.16	4.21	4.42
Urban	7.07	7.12	6.28
Rural	3.23	2.83	3.32
<i>Number of medical organizations</i>			
	343,064	306,978	300,255
<i>Number of medical personnel</i>			
Total	3,950,917	2,783,467	2,374,321
Urban	21,115,347	1,097,997	927,714
Rural	1,835,570	1,685,470	1,446,607

Table V.
Data of medical
care services in
China – 2013

Source: China Health Statistics Yearbook 2013

Area	Indicator	Beijing	Henan	Gansu	Jilin
Education	Government education expenditure per capita (yuan)	3,219	1,245	1,460	1,534
	Student-teacher ratio in primary schools	14.36	19.01	13.30	11.83
	Student-teacher ratio in junior secondary schools	9.75	13.75	12.28	9.65
Medical	Beds of medical institutions per 1,000 people	4.92	4.57	4.49	4.84
	Medical technical personnel per 1,000 people	15.46	4.24	4.33	5.45
	Government health expenditure per capita (yuan)	1,306	523	642	660
Basic social care	Number of social workers	3,467	936	140	460
	Number of social organizations	10,467	2,924	5,147	631
	Residents receiving minimum living allowance (10,000 persons)	Urban 10.4 Rural 6.0	131.0 390.9	87.5 343.3	85.0 80.9
Culture	Population coverage rate of radio programs (%)	100	98.09	97.69	98.59
	Public library stocks owned per person (book copies)	0.98	0.24	0.47	0.58
Social security and employment	The proportion of urban populations covered by basic medical care insurance (%)	83	55.7	60.1	92.4
	Unemployment rate (%)	1.2	3.1	2.3	3.7
	Government social Security expenditure per capita (yuan)	2,218	777	1,343	1,309

Notes: Government expenditure per capita is that public government expenditure divided by population at the year-end by region (2013). The proportion of urban basic medical care insurance covered is that number of people covered by an urban basic medical care insurance program compared to the total urban population by region (2013)

Source: China Statistical Yearbook 2014

Table VI.
Data of basic public services in Beijing, Henan, Gansu and Jilin – 2013

it was deemed important to improve the fiscal relationships between different levels of governments. The “Decision on Deepening the Reform of the Budget Management System” of the Central Committee of the CPC introduced a number of reform measures in 2014 to promote interregional equality for basic public service provision. By this decision, the Chinese government promised to increase the proportion of general transfer payments from the central to local governments gradually to more than 60 percent. The current fiscal transfer payment system has failed to solve the fiscal problems of local governments. The low efficiency of the fiscal transfer payments schemes has hindered the progress made toward equalizing public service provision across the country.

Since the reform of the public finance system in 1994, China’s public finances have experienced a long period of transformation. Yin Heng *et al.* (2007) concluded that, between 1993 and 2003, transfer payments focussed on the fiscal responsibility undertaken by local governments rather than the equalization of basic public service provision. Yin Heng and Zhu Hong (2009), after analyzing data collected from 2,000 rural villages between 2002 and 2005, found that fiscal transfer payments had a positive effect on equalizing public service provision in the areas studied.

Many scholars have attempted to make a normative analysis of the transfer payment system, of the utilization of financial resources, and of transparency problems. Scholars such as Guo Qingwang and Jia Junxue (2008) have suggested that the central government’s transfer payment system has focussed on different aspects of the fairness and efficiency of public service provision in different areas, resulting in different fiscal incentives for different local governments.

Scholars such as Martin Raiser (1998), Song Xiaoning and Yuan Deyu (2008), Bihong Huang and Kang Chen (2012), and Fan Ziyang and Li Xin (2014) have noted that the government's primary considerations with regard to the transfer payment system have been political factors such as safeguarding state stability and reducing the resistance of interest groups. The equality of public service provision was generally not of the highest priority in the enactment of policies.

The transfer payment system was designed to achieve equality in basic public service provision, but the policy implementation was prone to inefficiency. Some scholars have suggested that the fiscal transfer payment system did little to equalize basic public service provision. For example, Bihong Huang and Kang Chen (2012) stated that:

To a large extent, these elements exist due to the mechanism designed to shrink the tax rebates that bear the legacy of the pre-1994 system; to a small extent, these elements exist due to the rule-based general-purpose transfer whose share in total transfers remains small but has increased since 2002. However, the equalization effects of the largest component of transfers, specific-purpose transfers, are anti-equalizing.

On the other hand, Song Xiaoning *et al.* (2012) believed that, although the transfer payment system suffered from various problems, the special financial transfer projects could still facilitate the promotion of equality in public service provision.

Moreover, due to multidimensional measurements and because different indicators had been chosen to analyze equalization, greater standardization in the implementation of the transfer payment system should be emphasized more. For example, special transfer payment projects often encountered many obstacles during their implementation processes. A lack of transparency in the financial information system had resulted in instances of rent-seeking behavior. Pressures on local public finance systems to match funds given centrally and inefficient financial coordination had also led to the inefficient use of funds.

Furthermore, Fu Wenlin and Shen Kunrong (2012) have argued that transfer payments had not only brought about a flypaper effect in local government costs, but it had also led to a fungible problem in local public expenditure. This fungible problem has meant that some local governments have pursued more productive fiscal expenditures for economic gains and deviated from the responsibility of providing services that attended to the basic public good. Rather, more transfer payment monies were spent on industrial development, and fewer transfer payments were spent on the supply of basic public services in some underdeveloped areas. The direct result of the general transfer payments scheme was to enhance local fiscal resources. In order to achieve an equality of basic public service provision, it would be necessary to adjust the spending preferences of local governments and ensure their efficient use of fiscal resources.

5. Prospect: increasing the ability of the public finance system to support basic public service provision

In order to improve the efficiency and equality of basic public service provision, the government needs to implement an in-depth reform program, including a reshaping of the public finance system as a whole. The fiscal system should be improved according to the requirements of the transformation of government functions. Relevant measures include enhancing the fiscal capacity of local governments, dividing the responsibilities for provision between central and local governments, promoting a fiscal democratization process, optimizing government spending preferences and improving efficiency in the use of fiscal resources.

5.1 Restructuring the public finance system on the basis of the transformed functions of governments, strengthening the concept of public finance governance, ensuring the public finance system's non-profitable nature and promoting the diversification of public service provision modes

The goal of a public finance system should not be simply to maintain general economic growth. There is a need to look beyond economic considerations. The public finance system should be transformed from a platform of government revenue and expenditure activities to a platform of governance. It should be an important pillar of the national governance system rooted solidly in its foundations (Peiyong, 2014).

It is important to promote fiscal democratization and enhance the transparency of fiscal information. The government should establish an information mechanism and a response mechanism to link the supply and demand of public services. By having bottom-up channels that allow citizens to express their needs, the government can mobilize citizens to participate in the process of supplying public services. This linkage should enhance the supply of targeted public services based on demand information. As Xiaobo Zhang *et al.* (2004) have stated:

Participation should go in tandem with checks and balances to ensure the efficiency of public goods provisions.

It is also important to accelerate the implementation of budgetary law, to improve accountability and the operation of financial supervision, to improve the efficiency with which financial resources are used, and to enhance the control of the state over financial corruption.

The boundaries between the government and markets in public service supply should be drawn more clearly. The government should optimize the structure of fiscal expenditure, enlarge the share of public service expenditure in its total spending, and strengthen fiscal inputs in the areas of education, medical care, social security and other basic public services. The government should also speed up the reform of government purchasing services for the benefit of the public and a multicenter public service provision system should be built.

5.2 The essence of fiscal federalism regression: improving the efficiency of the public services provision system by properly dividing intergovernmental fiscal powers and motivating rivalry among regional governments

In addition to the development of a tax-sharing system, China should improve its fiscal systems below the provincial level. As Jia Junxue *et al.* (2014) have suggested:

To mitigate the opportunistic urge, a feasible reform for the current fiscal regime would be to grant the local governments more power of revenue collection or to give them a lighter expenditure burden.

The efficiency of the public finance system could be improved further by seeking an understanding of the basic needs of local citizens. By creating a top-down basic needs survey mechanism and a bottom-up demands expression mechanism, the flow of information between citizens and authorities would be guaranteed, and the results of public service provision could be improved.

A proper incentive mechanism should be built for the public service provision system. Due to the decentralization of financial powers to governments, the model of

over-pursuing GDP growth has remained at some local levels when government officials have tended to maintain financial competitiveness in order to pursue what has been perceived as successful for a political career.

The challenge now is to create a mechanism that incentivizes improved performance in public service provision. The promotion criteria for government officials should be linked to their performance in the local public service provision system.

The household registration system has been reformed gradually. The results of public service provision could be improved via competition among local governments. Talented people will migrate to areas where equality in public service provision has been better achieved. The reform of the household registration system is still underway. It has been estimated that a new form of the household registration system would be created in China around 2020. The reform should be completed by combining top-level design and local innovation that links upper and lower tiers of government efficiently.

5.3 Defining clear lines between fiscal authority and responsibility for expenditure based on government functions

The government should pay attention to the improvement of fiscal systems below the provincial level. The responsibilities between central and local governments should be adjusted according to the principles of externalities, information complexity and incentive compatibility. A reasonable fiscal contribution proportion to be provided by governments below the provincial level should be set, and basic public service standards should be established in accordance with the principle of matching responsibility for achievement to the fiscal resources furnished. The central government should concentrate expenditure on the construction and maintenance of social security, public health, education and major cross-regional projects. We have focussed on three areas: education, health and social security.

In the area of education, the central government's role should be to create a good top-level design and offer a plan for public education development. Gaps in educational achievement across different areas will be narrowed and education spending should be coordinated through the fiscal transfer payment system. Although the implementation of education investment is county-based in China, provincial governments need to support all kinds of public education at all levels. Clarification on the fiscal responsibilities of all tiers of governments is needed in order to achieve a better supply of education services.

In the area of medical services, the central government should strengthen its top-level design function and promote the integration of urban and rural medical insurance systems. After clarifying the responsibilities of different levels of governments, a fiscal burden-sharing mechanism should be built to provide fiscal transfers, especially to the central and western regions and ethnic minority areas. Local governments should be responsible for handling specific medical and health issues and implementing the central government's concrete plans. Provincial governments should initiate a project to establish a new health care system that concentrates on the prevention of major diseases in rural areas. Health insurance systems in urban and rural areas should be integrated. Market-driven forces and private organizations should be encouraged to participate in health insurance schemes.

In the area of social security, based on the principle of externality and the complexity of information, the central government should take responsibility for

providing basic social security and for building a countrywide pension system. A united social security coding system should be established. The local government should take responsibility for maintaining minimum support for low-income families and for establishing a relief system for extremely low-income households. The government should make efforts to care for abandoned children, women, the elderly, the disabled and other special groups in rural areas and make sure that they have primary access to a social security system. In addition, enabling commercial insurance markets is equally important for meeting the diversity of consumers' needs.

5.4 Improving the fiscal transfer payment system and enhancing local governments' fiscal capacity to provide basic public services

It is important to promote the process of legalizing the standardization of fiscal transfer payment systems. Provincial governments should expand their direct controls over the county-level fiscal management systems and improve county governments' capabilities to provide fiscal support. It is important to concentrate on gaps between urban and rural areas and any uneven development of basic public services, as well as to focus on the support provided by the transfer payment system to underdeveloped and minority areas. It is important to standardize existing special transfer payment projects and to evaluate the implementation of these projects periodically. The supervision of general transfer payment projects should be improved. It is also important to build a cross-regional horizontal model to manage the transfer payment mechanism.

5.5 Strengthening expenditure management, improving the management of funds used to support basic public services

Due to the lack of pressure to reduce costs, coupled with the difficulty in measuring the output of public services, governments have continued to increase their budgets and staff, which is a serious waste of public resources that results in lower efficiency in public service provision. Increasing financial inputs alone cannot solve this problem effectively.

The government's performance evaluations should include the performance of public service provision. A proper and comprehensive incentive mechanism should be built to encourage improvement. It is important to encourage the participation of NGOs and citizens to help increase the system's efficiency. The efficient use of fiscal resources should be maximized and a budget execution schedule should be linked to the budgetary arrangements. The supervision of fiscal expenditures should be strengthened. A comprehensive evaluation program should be built to encompass public service budgeting, implementation and completion. It is important to carry out frequent auditing and monitoring. All measures should have one objective alone: to make sure that the public finance system has supported the creation of equality in the public service provision system efficiently.

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Further reading

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