

INFORMATION TO USERS

This manuscript has been reproduced from the microfilm master. UMI films the text directly from the original or copy submitted. Thus, some thesis and dissertation copies are in typewriter face, while others may be from any type of computer printer.

The quality of this reproduction is dependent upon the quality of the copy submitted. Broken or indistinct print, colored or poor quality illustrations and photographs, print bleedthrough, substandard margins, and improper alignment can adversely affect reproduction.

In the unlikely event that the author did not send UMI a complete manuscript and there are missing pages, these will be noted. Also, if unauthorized copyright material had to be removed, a note will indicate the deletion.

Oversize materials (e.g., maps, drawings, charts) are reproduced by sectioning the original, beginning at the upper left-hand corner and continuing from left to right in equal sections with small overlaps.

ProQuest Information and Learning
300 North Zeeb Road, Ann Arbor, MI 48106-1346 USA
800-521-0600

UMI[®]

The Political Capacity of Beijing Still Matters:
Political Leadership and Institutionalization of Fiscal Systems during the Period of
Economic Decentralization in China: 1979-1997

By

Heung-Kyu Kim

A dissertation submitted in partial fulfillment
of the requirements for the degree of Doctor of Philosophy
(Political Science)
in The University of Michigan
2002

Doctoral Committee:

Professor Kenneth Lieberthal, Chair
Professor Ronald Inglehart
Associate Professor Pradeep Chhibber, University of California at Berkeley
Associate Professor Albert Park

UMI Number: 3068901

UMI[®]

UMI Microform 3068901

Copyright 2003 by ProQuest Information and Learning Company.

All rights reserved. This microform edition is protected against
unauthorized copying under Title 17, United States Code.

ProQuest Information and Learning Company
300 North Zeeb Road
P.O. Box 1346
Ann Arbor, MI 48106-1346

© **Heung-Kyu Kim** 2002
All Rights Reserved

For my son Dong-Ho with deepest love,

**Who made his lonely journey through this world while I was far away
from him writing this dissertation**

ACKNOWLEDGEMENTS

How much pain, patience, and sacrifice of many people have I expended over this dissertation? The amount and number are almost incredible, but to all I am grateful from the bottom of my heart.

First, my parents' silent prayers went with me through the long, dark tunnel. Their unconditional love for me was the source of my energy. Hye-young and her family also helped me study in the United States. Without them, I could not have succeeded.

I am very grateful and proud to have been a member of this Michigan academic community. The education I received here molded the concerns and orientation of this dissertation. David Singer made it possible for me to become a Michigan graduate student with his personal endorsement. Teaching me how a great scholar should have passionate devotion to his field, he insisted that he would be the very person to take care of me at Michigan. The late A.F.K. Organski and Harold Jacobson opened my eyes to the themes of political development and organizational capacity that led to this dissertation.

Yasheng Huang unhesitatingly provided his valuable data on elite reshuffling. Steven Levine, visiting scholar from Harvard University at that time, provided me the confidence to participate in classroom academic discussion, allotting time for me to speak in every session, patiently listening to me, and encouraging me to speak on despite my poor spoken English. Ellis Joffe, founding father of the PLA study and visiting scholar from the Hebrew University of Israel at that time, taught me of great deal about Chinese military issues and provided substantial influence in writing Chapter V of this dissertation. However, all errors and misinterpretations herein, if any, must be attributed solely to me.

My dear friends Donald Schaefer, Lili Kivisto, and Sufeng Cheng also eased my life here. Schaefer was a buddy who showed deep concern about the difficulties I experienced while so far from my Korean home and continued to be a good friend even after he left Michigan for the University of Washington Law School. Kivisto as the Student Affairs secretary at the Department of Political Science paid much warm-hearted attention to my problems and was quick to find solutions for me. I also must to pay

special thanks to Cheng the researcher at the Election Study Center in Taiwan's National Chengchi University. She arranged a space for my field work at the Center for International Relations of the same university and provided me with enormous help.

Jean Hung, Assistant-director of the Universities Service Center at Chinese University in Hong Kong, and her associates deserve very special thanks as well. It was a great asset for the student of Chinese issues to have such well-organized materials under one Chinese Center roof, coupled with their unflagging professionalism. I am also very grateful to my Chinese friends for facilitating my field trips although I cannot here list all their names. Without their help, this dissertation would have been impossible. Kate Musgrave edited my poorly written drafts and so upgraded the level of writing in this dissertation.

Various and generous grants from the Department of Political Science, the Center for Chinese Studies, and Rackham Graduate School at the University of Michigan made it possible for me to endure the muddy writing process and emerge with a sense of dignity, achievement, and pride.

Fortunately, I was tremendously advantaged at being a student of my committee members Kenneth Lieberthal, Ronald Inglehart, Pradeep Chhibber, and Albert Park not only because of their intellectual ability but also their patience and affection for their students. To get me through this process smoothly, Professor Inglehart quickly read my massive dissertation. Professor Chhibber got up in the middle of night in Berkeley to receive my long-distance call, and Professor Park phoned at 11 PM for more than two hours from Qinghai in China. All provided valuable comments and constructive criticism in my arduous process.

My mentor Professor Lieberthal, chaired of my dissertation committee, illustrates just what a mentor should be. While setting high standards for his students, he remained straightforward and critical throughout my Michigan life. As a student, I experienced pain out of which he guided me with his enormous energy whenever necessary. He also showed a great deal of patience for me as I struggled to develop my potential. In spite of his extremely busy schedule at the White House, he checked my requests for help and quickly resolved my problems when I experienced financial difficulty during my Chinese field trip. Twice he read about 400 pages of draft in a few days time and provided

detailed line-by-line comments to let me have more time to think over the issues raised. Without his patience, help, and affection, I could not have completed this dissertation. After I completed my defense, he passed down the words and a memory with his mentor Doak Barnett, saying “You do the same for your future students.” I am very proud to have worked in line with legends of these virtuoso scholars. Their legends will live on.

The limit of my language is not the limit of my appreciations. It is difficult to express appropriately in a few words --- or even in many--- just how much I owe to so many people. With their help, I grew like a tree aspiring to provide as much fruit and shelter in the future as I received from others. Then I too may hear a bird humming songs on a tree.

Table of Contents

Chapter

List of Tables

List of Figures

List of Abbreviations

List of Glossary

I. Political Capacity of Beijing	1
A. Analytical Framework	3
B. Approaches in the Study of Intergovernmental Fiscal Relations	19
1. Theoretical Trends in Chinese Studies	
2. Theoretical Framework of Chinese Intergovernmental Fiscal Relations	
C. Discourse of Political Capacity and Institutions	28
D. Data Collection	34
1. Reliability of Chinese Data	
2. Sources on Fiscal System	
E. Research Structure	45
II. Analytical Issues on Intergovernmental Fiscal Relations in China	51
A. Review of Studies on Chinese Fiscal Relations	52
B. Analyses by the state GDP and Revenue Elasticity Methods	66
C. Politics of Coordination:	75
A Norm in Policy-Making during the Post-Mao Period	
1. Democratic Centralism as a Basic Decision Rule	
2. Policy-Making in Practice	
III. Restructuring Fiscal System after Mao: Toward <i>Replacement of Profit by Tax Reform</i>	99
A. Historical and Institutional Legacies of Chinese Fiscal System under Mao	99
B. Restructuring Formal Fiscal System during the Early 1980s	104
1. Formal Policy-Making Organization in the Fiscal System	
2. Efforts for Expansion of Institutional Capacity	
3. Initial Experiments in the Fiscal Management System	
C. Toward the <i>Replacement of Profit by Tax Reform</i>	128
D. Political Legacy in the <i>Replacement of Profit by Tax Reform</i>	147
IV. Aborted Mission for Fiscal Institutionalization	154
A. Evolving Institutional Interests and Fiscal Standardization	156
1. Initial Efforts for Fiscal Standardization	

2. Evolving Bureaucratic Interests	
B. Efforts to Strengthen the Monitoring Mechanism and Institutionalization	179
C. Revival of Fiscal Contract System	187
D. Incomplete Mission	210
V. Fiscal Contract System and Politics toward Realization of Tax-Sharing Scheme	217
A. Impetus for Fiscal Institutionalization in the Early 1990s	217
B. Evolving Web of Interests	233
1. <i>Tiaotiao</i> Interests	
2. <i>Kuaikuai</i> Interests	
C. Two Ratio Debates and Amassing Supports	249
D. Increasing Military Influence in Domestic Politics and the Fiscal Reform	260
1. Macro Economic Control	
2. Succession Crisis	
3. Linkage of Fiscal Reform with External Security Factor	
VI. The 1994 Fiscal Reform and Remaining Issues	286
A. Gaining Legitimacy for Fiscal Reform: Applying Democratic Centralism	286
B. Implementation and Organizational Changes	299
C. Nomenclature Politics and Revenue Efforts	318
D. Tentative Evaluation and Remaining Issues	330
VII. Characteristics of the Fiscal Reforms and Implications	340
Bibliography	350

List of Tables

- 1-1. Five-Year Plans and Implementation
- 2-1. Various Fiscal Relations of China
- 2-2. Size of Irregular Budget in 1996
- 2-3. Degree of Fiscal Control including Banking Sector during the Early Period of Post-Mao Reforms
- 2-4. Comparison of Socialist Government Tax Revenues in 1986
- 4-1. Tax Contracts: Estimation of Effective Tax Rates
- 4-2. Fiscal Contracts between the Center and Provinces
- 4-3. Awarded Provincial Finance Bureaus for Final Settlement of Account
- 4-4. Fiscal Relationship between the Center and Heilongjiang
- 4-5. Fiscal Relationship between the Center and Ningxia
- 5-1. Self-Reliance Index of Various Levels of Governments
- 5-2. Proportion of the Beijing Government in Revenues and Expenditures
- 5-3. Amounts of Local Remittance
- 5-4. Comparison of Tax Burdens on Village and Township Enterprises under Two Fiscal Systems in Jiangsu Province
- 5-5. Comparison of Political Reports at the CPC Congress
- 5-6. Ratios of Military Expenditure over GDP, Budgetary Revenue, and central Revenue
- 6-1. Taxation Management Power of Shanghai
- 6-2. Taxation Management Power of Guangdong
- 6-3. Separation of Taxation Bureaus
- 6-4. Intergovernmental Fiscal Relations after the 1994 Fiscal Reform
- 6-5. Personnel Integration Scores across Regions during the Period 1979-1998
- 6-6. Regional Proportion of Insider Party Secretary and Governor during the Period 1979-1998
- 6-7. Mean Values of Fiscal/Economic Performance and Local Party and Government Personnel Integration during the Period 1979-1998
- 6-8. Regression Analysis on the Effects of Personnel Reshuffling and Regional Differences over Provincial Fiscal/Economic Performance
- 6-9. Budgetary Integration Index
- 6-10. Regional Differences in Budgetary Integration Index

List of Figures

- 1-1. Flow of Influence in Policy-Making and Implementation
- 2-1. Elasticity Coefficient of Revenue and GDP
- 2-2. Elasticity of Local Revenue per Capita over GDP
- 2-3. Policy-Making Structure in China
- 3-1. Level of Revenue Extraction during the Maoist Period
- 3-2. GDP and Revenue Increase Rates during the Maoist Period
- 4-1. Formal Leadership over Think-Tanks in the Economic Reforms as of 1985
- 4-2. Ratio of Extra-budgetary Revenue over Budgetary Revenue
- 4-3. Revenue Increase rate over GDP Increase Rate during the Reform Era
- 4-4. Fiscal Situations during the Reform Era
- 4-5. Level of Deficits during the Reform Era
- 5-1. Comparison of GDP, Revenue, and Military Expenditure Growth Rates
- 6-1. Revenue Sharing Structure before and after 1994 Fiscal Reform
- 6-2. Authority Structure in the Fiscal System after 1994
- 7-1. Influence on the Level of Compliance by Local Preference and Consensus Building

List of Abbreviations

CAS: Chinese Academy of Sciences

CASS: Chinese Academy of Social Sciences

CC: Central Committee

CFY: Finance Yearbook of China

CMC: Central Military Commission

CPC: Communist Party of China

CSY: China's Statistical Yearbook

CTY: China's Taxation Yearbook

DRC: Development Research Center

EB: Extra-budget

GDP: Gross Domestic Product

GNP: Gross National Product

MOF: Ministry of Finance

MOFA: Ministry of Foreign Affairs

NPC: National People's Congress

OB: Off-Budget

PRC: People's Republic of China

SCRE: State Commission for Restructuring the Economy

SEC: State Economic Commission

SOE: State-Owned Enterprises

SPC: State Planning Commission

SPFRC: Shanghai Finance University, Public Finance Research Center

SRDS: Sudden Regime Death Syndrome

SSB: State Statistical Bureau

VAT: Value-Added Tax

ZST: Zhongguo Shuiwu Tongji 1950-1994 [China's Taxation Statistics, 1950-1994]

List of Glossary

Bianda kuainiu [Whip a fast horse]: It refers to a criticism that the Beijing government more exploited provinces with better fiscal performance. In particular, the policy was criticized that it discouraged enthusiasm of localities that did better fiscal efforts under the *tongshou tongzhi* system.

Chifan caizheng: subsistence finance refers to a tight government budget that is barely able to cover payment of wages to administrative personnel.

Dizeng baogan: a principle of an increment quota system.

Fangshui Yangyu, Yangji Shengdan: Turn on the water to breed fishes and cultivate chickens to hatch eggs. It refers to various fiscal preferential policies and special treatments to encourage economic activities of enterprises, in particular during the period of the fiscal contract system.

Feigaishui [Replacement of fees by tax]. The size of extra/off-budgetary funds and fees were very large in the Chinese fiscal system. To reduce such irregularity, the Beijing government placed a great effort on the *feigaishui* reform in the late 1990s.

Fenshuizhi [Tax sharing system]: Tax sharing arrangements at various levels of the government. The Beijing government replaced the former fiscal contract system in 1994 with standardized fiscal management practices and strengthened the macroeconomic control.

Fenzao chifan [A fiscal system of “eating in separate kitchens”]: In 1980, this *fenzao chifan* policy was related to a delegation of fiscal power to local governments by setting the central and local revenue and expenditure bases separately on quota assignments for local revenue retention/remittance and central subsidies.

Gudingbili baogan [A fixed-rate responsibility system]: the so-called *Jiangsu* model and a version of the sharing total revenue (*zongshou fencheng*) arrangement. It was one of two major experiments in the post-Mao fiscal management system and was implemented in December 1976. The system had three characteristics: (a) It is a contract system; (b) After fixing the ratio of remittance to the central government, provincial expenditure was linked with their revenue efforts (*shouzhiguagou*) - the more revenue collection, the more expenditure; (c) Instead of annual adjustments, the sharing rate was fixed for a period of four years beginning in 1977. This system allowed provincial governments to have more latitude in revenue/expenditure managements.

Huafenshouzhi, Fenjibaogan [classifying revenue and expenditure, level by level responsibility system]: the so-called *Sichuan* model. It was one of major fiscal experiments with the *Jiangsu* model and was launched from the beginning of 1980 under the consensus among the MOF and provincial delegates at the national tax administration

work conference for the fiscal reform held in October 1979. The new system was more advanced in characteristic in that it identified regional responsibility of revenue and expenditure management based on previous experiences and natural conditions of each region as well as fiscal management power between the Beijing and provincial governments. It required a much more complicated method than the Jiangsu system and an intense process of clarification and negotiations to finalize *base figures* for revenue and expenditure of each province.

Ligaishui [Replacement of profits by tax]. In an effort to change the former distribution system under the socialist system between the state and enterprises to a more market oriented system, state-owned enterprises paid taxes instead of remitting all profits to the state, while keeping profits after tax for their own sake. The first *ligaishui* reform was implemented from 1983 and the second started in 1984 to completely replace profits by taxes.

Shajixiahou: Kill the chicken to frighten the monkey. It refers to discretionary and random surveillance mechanism during the period of economic decentralization.

Shuiqianhuandai [Repayment of loans before tax]. It refers to the common practice during 1980s that state-owned enterprises repaid their loans with profits before taxes. It certainly reduced the size of the state finance, but it helped enterprises possess more resources.

Tiaotiao vs. Kuaikuai: departmental control vs. regional control. Along with the economic reforms, the regional control became strengthened over the departmental control.

Tizhi buzhu: subsidies from a higher to lower level of government. Under the 1994 tax division system, *tizhi buzhu* includes quota subsidies (*ding'er buzhu*) and central transfer of tax revenues (*shuishou fanhuan*).

Tongshou tongzhi: A typical fiscal management system under the socialist planned economy. A principle of unified state control over revenue and expenditure. The revenue and expenditure at each level of administration were annually adjusted according to the central guidance.

Yindizhiyi: suiting measures to local conditions

Yinsufa [factor method]: it was recommended to use in determining the scope of transfer payment with the new fiscal transfer system in 1994, based on various factors. It would help reduce the regional disparity because the previous “*qishu*” method tended to secure the given interests of coastal regions.

Tizhiwai Shangjie: A discretionary appropriation by the Beijing government that was

not included in the formal contract. During the fiscal contract system period, the Beijing government forced rich provinces such as Guangdong to hand over more than the amount contracted to reduce insufficient finance.

Zhuanyizhifu: A fiscal transfer between various levels of governments. Under the tax sharing scheme, it was supposed to be a mechanism for the Beijing government to support poor provinces.

Zhuhou Jingji [Dukedom economy]: It indicates a strong upsurge of local protectionism and local autonomy during the period of economic decentralization. After the local responsibility system was introduced along with the economic reforms, every locality was seeking self-development; each ruled its own territory. In particular, it became apparent during the fiscal contract system period of 1988-1992.

Zong'e fencheng: A principle of revenue sharing between the Beijing and local governments before the economic reforms in 1978. All revenues were pooled and divided by negotiations between the Beijing and local governments.

Chapter I

Political Capacity of Beijing

China's economic development during the last two decades has proven more than stirring. In spite of the sudden regime death syndrome (SRDS)¹ in the former Soviet bloc circa 1990, China has successfully upheld its political stability and economic development while maintaining its political system. Since the introduction of economic reforms in 1978, the growth rate of its gross domestic product (GDP) has averaged around 10 percent during the last two decades, and per capita gross domestic product has also increased by more than 8 percent each year (CSY 1997, 42). That 8 percent represented the highest level of increase in the world during the period. The success was extraordinary considering the prior conditions in which the reforms occurred: an unfavorable financial situation and the strong presence of an inefficient socialist system.²

A group of scholars, however, claimed that the state capacity crisis of China became obvious in the middle of this economic success. The inability of the Beijing government³ to command a meaningful level of fiscal resources placed the crisis hypothesis at the core of discourses during the early half of the 1990s. The extractive capacity in terms of revenue ratio in the GDP has steadily decreased from the 1978's 31.24 percent to the 1998's 12.44 percent.⁴ Some analysts even imply that the state crisis

¹ I borrowed this term from Baum (1996), 153.

² Some can argue the advantage of economic backwardness. However, it is not a sufficient condition for success because we have seen numerous failures in developing their economies in the third world countries.

³ In the context of China, I use the term Beijing government or Beijing to refer to the central government of China; local governments or localities to provincial governments and below. If necessary, I will distinguish explicitly between province, municipality, prefecture, or county. I also distinguish the terms of state bureaucracies and political leaders, in that the former is affiliated to organizational interests and rules, and the latter is assumed to be national level policy-makers beyond logic of certain organization.

⁴ If we count the extractive capacity in more comprehensive fashion, which includes extra-budgetary revenue and national debts, the gap became much larger from 40.82 percent in 1978 to 15.41 percent in 1997. See CSY (1999).

may lead to the break-up of the Chinese State.⁵ It is puzzling that a scenario of political catastrophe strongly emerged in the middle of such economic success due largely to the waning capacity of the Beijing government to control macro-economy.

Instead of taking outcomes for granted, a natural starting point for this dissertation entails looking into the dynamics of the political system during the Deng Xiaoping era, 1978-1997, in which such remarkable economic performance was achieved. I attribute the economic success to the political capacity of the Chinese state, which possessed an effective political leadership and decision-making institution capable of eliciting compromise among conflicting parties and eventually of contributing to policy implementation and political stability. Many studies have taken into account preconditions, leadership, organizational structures, and institutional norms in explaining the factors for the success. While keeping the fruits of previous studies in mind, this study takes the intentional aspect of political actors back into the analysis. The political leaders' ability might not be explained by merely looking at outcomes in an isolated fashion. For example, if poor fiscal performance were an inevitable result of a policy choice by the Beijing leadership, it would be too naive to conclude that the political capacity of the Beijing government was low. We need to examine the reasons why the Beijing government chose a certain policy over others and what factors influenced the policy priority. To answer to the questions, I seek to bridge intention and outcome by restructuring dynamics within institutional arrangements in which the intentional aspect works. Thematically, I focus on the fiscal arena and in particular, on taxation. Study of the fiscal arena will provide powerful sources with which to understand the dynamics of politics because of the magnitude of taxation in resource distribution among various political and social actors in the nation-states. China is not an exceptional case in this respect.

Let me briefly mention the structure of this chapter. To begin with, I introduce three competing perspectives explaining economic success in comparative studies and

⁵ See, for example, Chang (1992), Segal (1994), Goldstein (1995), and Wang (1995). Also compare eight major scenarios after Deng by Baum (1996).

⁷ Kuznets (1971) also suggested the possible dependence of the modern economic growth of the presently developed countries on high initial levels of per capita product, but the gap is widening by the rapid growth of the developed than the less developed (Argentina, Mexico, Jamaica, Ghana, Philippines, Egypt, and India). He, however, rebuffed Gerschenkron's hypothesis by indicating a generalization problem.

then, synthesize an analytic framework for this study. In the section B, I critically review how theoretical trends in comparative fields have been integrated in studies of China's intergovernmental relations, in particular, in the fiscal arena. The review leads to the conclusion that the study of China's fiscal relations needs a broad perspective, which includes interactions with other issue areas and inter-dynamics among actors and institutions. *Political capacity* is a key concept in measuring the political ability of the Chinese state/government. Section C explains the concept and its sub-concepts. Finally, I discuss data-relating issues and the entire structure of this dissertation.

A. Analytical Framework

In comparative studies, there are three competing perspectives explaining the factors behind rapid economic development. These perspectives place emphasis on preconditions, structural factors, and non-structural factors such as actor and procedural factors respectively. Scholars emphasizing preconditions mainly focus on previous economic conditions, historic experiences, and cultural aspects. According to Gerschenkron (1962), economic preconditions (backwardness) showed a substantial relation to industrial structure and high economic growth rates.⁷ Ranis (1991) also placed emphasis on the relative shortage of natural resources as a precondition of economic success in East Asia's so-called newly industrializing countries (NICs).⁸ Elsewhere, many studies have sought clues indicating economic performance or consequence in areas of historical and cultural legacy.⁹ In particular in the East Asian context, Confucian legacies such as discipline, rationality, and the passion for education center the arguments. Although there are excellent works in this field, such as ones by Putnam and

⁸ As for the same line of argument, also see Gustav Ranis, "The Comparative Development Experience of Mexico, the Philippines and Taiwan from a Political Economy Perspective." *Growth and Change* Vol. 28 (Fall 1997): 393-437. However, Perkins (1994) argued that the conditions for economic development in East Asian NICs were in fact different. Historical tradition of egalitarianism in this region and honest somewhat insulated economic technocrats are not duplicable in other areas. In East Asian Development three models at least existed: Laissez-faire (Hong Kong) with a lesser degree version (Singapore); Interventionist states (Korea and Taiwan); and resources-rich countries of Southeast Asia.

⁹ In particular, the seven articles in *Confucianism and Economic Development: An Oriental Alternative* are the typical examples in this area (see, Tai ed., 1989). Robert Putnam's *Making Democracy Work* (1993) is a monumental piece in this cultural study by tracing how the degree of previous social capitals accordingly shaped civic culture in inducing democracy in Italy. Johnston's content analysis study (1995) persuasively related the strategic culture of the Ming dynasty to contemporary orientation of Military strategy of China.

Johnston, the main problem of this analysis arises from the difficulty of empirically testing or verifying the argument.¹⁰ The other problem is that similar preconditions may not lead to corresponding results. Post-procedural and actor variables may be more influential on outcomes.

Structural analysis provides a powerful tool in terms of its parsimony and generalization in the study. There already exist studies on the economic consequences of the regime type. Bhagwati (1992) argued that as long as market reforms are in place, authoritarianism can facilitate more rapid economic growth. He categorized four types of countries in terms of polity type and economic system: democratic with market, democratic without market, authoritarian with market, and authoritarian without market. Olson (1971 & 1982) also implies in his logic of *collective action* that an authoritarian regime with relative autonomy from special interest groups can achieve rapid economic development.¹¹ However, some aggregate statistical studies found little association between the regime type and rapid economic growth.¹² While some authoritarian regimes successfully promote rapid economic development, others do not. Cheng and Krouse (1991) provided the reason by means of separating authoritarianism in the developmental type from predatory authoritarianism; with the strengths of relative insulation from social interests and policy consistency, rapid economic growth is more likely to take place under a developmental authoritarian regime.¹³ A world system or dependency analyses

¹⁰ Regarding a serious empirical test on this issue, see Ronald Inglehart (1990).

¹¹ According to his logic, since selective incentives of special interest groups for collective action are larger than encompassing large group, special interest groups are more active, which is conducive to resist change and renovation and results in low productivity and low economic growth. An authoritarian regime is capable of suppressing special interest groups, and it can induce a rapid economic development than can democratic states. Kuznets (Kuznets 1996, 85) presented a similar idea of Olson, but more concretely: "Because this [Korean] regime has been authoritarian and has no economic interest base, it could hold down wages and consumption, largely ignore rural interests, and concentrate on rapid development through industrialization." As for criticism on the assumptions of Olson, see David Cameron, "Distributional Coalitions and Other Resources of Economic Stagnation: On Olson's *Rise and Decline of Nations*." *International Organization* 42, 4, (Autumn 1988).

¹² See the examples, William G. Dick, "Authoritarian versus Non-authoritarian Approaches to Economic Development." *Journal of Political Economy* 82 (1974): 817-27; Robert M. March, "Does Democracy hinder Economic Development in the Latecomer Developing Nations?" *Comparative Social Research* 2 (1979): 215-48; and Atul Kohli (1986).

¹³ To categorize what conditions separate developmental from predatory can be subjective. All leaders in less developed countries rhetorically place their policy goals on developing the economy. Adding the adjective of developmental or predatory means that this analysis requires intuitive/speculative judgment.

can also be placed in this structural analysis.¹⁴ The position of a country in the world system or world economy (core, semi-periphery, and periphery) determines performance and development trajectories although the outcomes can vary within certain limits. For example, Bruce Cumings (1987) explains the similar economic success of Taiwan and Korea but the different political consequences in the 20th Century in the context of the Japanese Imperium and American hegemony.¹⁵ Structural analyses achieve parsimony of variables and make it relatively easier to generalize cross-country data to capture the gist of characters under study. In practice, however, considerable variation exists across countries in which many different historical and procedural factors insert influence on economic growth. For example, as North (1990) implies in his concept of “path dependence,” the path explains why countries with similar regime types vary in their degrees of performance. We can find counter-generalization without difficulty. Considering the nature of comparative study, we are fully aware that it is not easy to overcome this problem. A ready solution requires help from area specialists and a certain strategy focusing on specific issues to reduce the complexity of each country.

The other perspective focuses more on actors or procedural factors. For example, Callaghy (1984) and Verhaegen (1993) show that the failure of economic development in Zaire is not only related to structural and historical factors but also to predatory leadership.¹⁶ Studies by Boycko, Shleifer, and Vishny (1993) and Solnick (1996) show how leadership factors were crucial for economic transformation and development in Russia and China. This issue has, however, been relatively neglected because of the generalization problem. However, leadership factors can be crucial in policy-making and

¹⁴ See, the examples, Fernando Cardoso, “On the Characterization of Authoritarian Regimes in Latin America.” in *The New Authoritarianism in Latin America*, edited by David Collier. (Princeton: Princeton University Press, 1979); Peter Evans, *Dependent Development: The Alliance of Multinational, State and Local Capital in Brazil* (Princeton: Princeton University Press, 1979); Gary Gereffi, *The Pharmaceutical Industry and Dependency in the Third World* (Princeton: Princeton University Press, 1983); James Petras and Stephen Gundle, “A Critique of Structuralist State Theorizing.” In *Capitalist and Socialist Cries in the Late Twentieth Century*, edited by Petras, (Totowa: Rowman & Allanheld, 1983); and Immanuel Wallerstein, *The Politics of World Economy* (Cambridge: Cambridge University Press, 1984).

¹⁵ Bruce Cumings, “The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles, and Political Consequences.” In *The Political Economy of the New Asian Industrialism*, edited by Frederic C Deyo, (Ithaca: Cornell University Press, 1987), 44-83.

¹⁶ Thomas Callaghy, *The State-Society Struggle: Zaire in Comparative Perspective* (NY: Columbia University Press, 1984); Benoit Verhaegen, “The Temptation of Predatory Capitalism.” *International Journal of Political Economy* No. 3 (Spring 1993).

implementation in most third-world countries where the level of institutionalization is relatively low. Procedural aspects became popular when efforts are made to unpack the state within the comparative discipline. The characters of bureaucracy, organization, and party system within the state can influence the degrees of economic growth. Chalmers Johnson's account (1982) of the autonomy of Japanese bureaucracy as represented by its Ministry of International Trade and Industry (MITI), Peter Evans's concept (1979) of "imbedded autonomy" and Kim's study (1987) of "competent bureaucratic organization" in Korea follow a similar vein of argument in that competent bureaucratic organizations are crucial for economic success.¹⁷ Some scholars argue that policy choices between the gradual and big bang approaches had a major impact on the direction of reforms and performances.¹⁸ Partisan configuration also brings economic consequences. Alesina, Lodregan, and Rosenthal (1993) illustrate via their rational partisan model that there is a significant partisan effect on the economic growth rate of the United States.¹⁹ According to them, in the first half of Republican administrations, the economic growth rate is slower than in Democratic administrations; but in the second half, no partisan difference exists.²⁰

¹⁷ Peter Evans, *Dependent Development* (Princeton: Princeton University Press, 1979); Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford: Stanford University Press, 1982) and also see the same author, "Political Institutions and Economic Performance: the government-business relationship in Japan, South Korea, and Taiwan." in *The Political Economy of the New Asian Industrialism*, edited by Frederic C Deyo, (Cornell: Cornell University Press, 1987); and, Byoung-Kook Kim, "Bringing and Managing Socioeconomic Change: The State in Korea and Mexico." Ph.D diss., (Department of Government, Harvard University, 1987).

¹⁸ Regarding the debates, D. Lipton and J. Sachs, "Privatization in Eastern Europe: the Case of Poland." *Brookings paper on Economic Activity* No. 2 (1990): 293-341; O. Blanchard, R. Dornbusch, P. Krugman, R. Layard, and L. Summer, *Reform in Eastern Europe* (Cambridge: MIT Press, 1991); R. Frydman and A. Rapaczynski, "Markets and Institutions in Large-Scale Privatization." in *Reforming Central and Eastern European Economies*, edited by V. Corbo, F. Coricelli, and J. Bossak, (World Bank, 1991); and P. Bolton, and G. Roland, "Privatization in Central and Eastern Europe." *Economic Policy* no. 15 (1992): 276-309.

¹⁹ See, Alberto Alesina, John Lodregan, Howard Rosenthal, "Models of political Economy of the United States," *American Political Science Review* 87(1) (March 1993). Hibbs reaches a similar conclusion with Alesina et al. in his quarterly post-war time series analyses and class-oriented model of both the US and Great Britain: Inflation rate has been driven upward by leftist administration (democratic party in the US), while downward by Republican and Conservative government. See more, Douglas A. Hibbs, "Political Parties and Macro-economic Policy." *American Political Science Review* 71 (December 1977).

²⁰ Additionally, regarding how the emergence of political competition leads to increase of government expenditure, see Pradeep Chhibber, "Political Parties, Electoral Competition, Government Expenditure, and Economic Reform in India," *Journal of Development Studies* 32 (1995), 75-96. In addition, there are many studies on relations between the size of government and political factors. For examples, Daniel Tarschey, "The Growth of Public Expenditure: Nine Models of Explanation."

This procedural approach provides research with flexibility in selecting its objects. Mid-range modeling can also be an alternative to the structural approach, which could not predict the change of structure as seen in the failure of democratic transition theory.²¹ However, the major problem in this research is to define acceptable operating rules. Various operating rules and definitions have often been raised about the robustness of findings in the procedural approach. Since no consensus has been reached on rules of analysis and definition of institutions, most results may prove sensitive to changes of model specification.²²

In Chinese studies, the Chinese advantage in terms of preconditions prior to the reforms is often compared to the Soviet Union. While rebuffing the gradualist perspective, Sachs and Woo (1993) argue that different post-reform performances primarily reflected different structures prior to reforms. Compared to Eastern Europe, China's successful reforms were due to a low-productive agricultural sector, political disasters such as the Cultural Revolution, a limited social welfare system, less-penetrating central planning, and a relatively weak state sector. Because of these preconditions, the level of expectation level from the reforms proved low, agricultural reforms brought quick results; and reformers confronted relatively weak resistance within the party and state sectors. Aslund and Brzezinski (Aslund 1989) produce a similar emphasis in positing that a worsening economic situation and relatively lack of ideological constraints in China more seriously affected the degree of difficulties for reforms than in the Soviet Union. The extent of family farming and small-scale consumer industries also made it easy to initiate reforms and resulted in better economic performance in China. This approach explains how pre-conditions can affect the launching of economic reforms. However, no nexus between the successful launch and performance has been established. The approach simply just assumes that lower

Scandinavian Political Studies 10 (1975); Gary Miller, and Moe Terry, "Bureaucrats, Legislators, and the Size of the Government," *American Political Science Review* (1983), 293-308; John Ferejohn and Keith Krehbiel, "The Budget Process and the Size of the Budget." *American Journal of Political Science* 31 (1987), 296-320; and, Jeffrey Sachs and Roubini Nouriel, "Political Economic Determinants of Budget Deficits in the Industrial Democracies." *European Economic Review* 33 (May 1989).

²¹ To see tough criticism on structuralism, Riker and Weimer (1995).

²² Chung also made this point in his outstanding article (Chung 2000).

launching costs and favorable conditions lead to better performance. The process of economic reforms remains a black box.

The structural approach focuses on centralization/ decentralization dichotomy.²³ As long as costs and inefficiencies of the centralized planning system are considered as the main problem of socialism, scholars, in particular, institutionalists took decentralization and authority delegation for granted as means of improving economic performance. By taking decentralization for granted, the debate focused on political consequences. Accordingly, the fashion in Chinese studies has moved to local autonomies and power at the cost of Beijing government.²⁴ Scholars sharing this perspective argue that as a result of decentralizing decision-making authority in the process of reforming the economy, the Beijing government gradually lost control over resources to the extent that it would be difficult to regain. In their views, localities have enough power to thwart or subvert demands of Beijing governments with increasing resources in hand. It was far from the image of efficient political system controlled by the top leaders in Beijing, which became less efficient and effective in implementing macro-level policies. Even scholars such as Chang (1992), Segal (1994), Goldstein (1995), and Wang (1995) provided various scenarios portending a break-up of the country along regional lines as the result of Beijing's declining control over localities.

During interviews with localities, scholars heard stories and saw evidence of how localities have proven themselves capable of making autonomous decisions and distorting central directives in their practice. The anecdotal stories are too numerous to mention. In spite of such colorful evidence, however, there is still no practical way to explain to what extent and how far and effectively localities control resources and exercise authorities against Beijing's policy priorities. Two-dimensional thematic and methodological limits operate. Thematically, scholars supporting this view mainly focus mainly on the issue of resource distribution. However, this issue as an indicator has limited explanatory power. The data regarding resources distribution is so static that it can not reveal the dynamics of the power relationship between Beijing and provincial governments. For example, a

²³ An image of the cellular system existed even before the economic reforms were the stage. For a most vigorous advocate of this idea, see Andrey Donnithorne (1972).

²⁴ There are numerous works in this popular line of argument. See, for examples, Kelliher (1986), Naughton (1992), Oi (1992), Zheng (1994), Wu (1994), Wang & Hu (1994), Weingast, Montinola, & Qian (1995), Park, Rozelle, Wong, & Ren (1996), and Gu (1997).

higher rate of revenue sharing does not necessarily mean more power. On the other hand, looking into other issues such as agenda setting, personnel shuffling, and information control, we may observe more centralized power of the Beijing government than in the economic arena.

Methodologically, the structural approach implicitly or explicitly takes a zero-sum assumption for granted as a feature of the relationship between the Beijing government and provincial governments.²⁵ However, the economic area is less likely to have a zero-sum nature than political and security-related ones (Chung 2000). As Ekiert (1991) pointed out in his study of Eastern Central Europe, the rapid collapse of the party-state in the region followed simultaneous diminution of the state and society. The relationship between the state and society are often mutually collaborative.

Oppositely, the other view refuted the notion of local strength while emphasizing the capacity of the Beijing government. In the fever for studying local autonomy and power, some scholars such as Kueh (1990), Chung (1995), Goldstone (1995), Solinger (1996), and Huang (1996) urged giving greater weight to the role of central authorities in Chinese politics.²⁶ According to this view, the roles of the Beijing government in controlling the direction and pattern of economic development and resource distribution are still very much in evidence. The government still possesses sufficient power and leverage to control localities in spite of economic decentralization and deregulatory measures. In particular, political power in China has resided firmly in the Beijing government/Chinese Communist Party (CPC). Perhaps the Beijing government has attempted more effective control over local policy implementation through decentralization by means of rewards and co-optation. In addition, the penetration of the market economy to the localities might allow the Beijing government to control the local economy more efficiently (Shue 1988). During their in-depth interviews, scholars often recognize that local cadres and scholars look for signals from Beijing to perceive their policy stances. This explains what has not been changed even in the midst of the

²⁵ I am indebted to Chung (1995) for this argument. In China, the structural discrepancy between power (resources) distribution in the system and roles of localities caused conflict and ineffectiveness of policy-implementation. Therefore, the solution to the problem according to the structural approach is decentralization.

²⁶ Roderick MacFarquhar presented this feature of a political system during Mao period prior to the Cultural Revolution (See, MacFarquhar 1983).

transformation of the Chinese socialist system. The focus of analysis centers on the political power of socialist or authoritarian political system, which has existed even prior to reforms. As seen in other structural approaches, the static character of the existing approaches often prevents researchers from looking into what has been changed and what factors have made the change possible in which ways. To understand the dynamics of changes in China, interaction with procedural factors and actors should be supplemented.

Chinese official publications often attribute the success of economic performance during the reform era to the collective leadership of political leaders and the role of paramount leader Deng Xiaoping.²⁷ However, in keeping with the fashion for institutionalism, few western scholars have taken the leadership factor seriously. In this sense, Hamrin's study (1992) of personalized small groups in the high echelons is important. According to Hamrin, reforms have changed leadership and authority at the low and middle levels, but not at the high level. Chen's study (1995) on the decision-making behind the 1986-89 political reform and Yang's study (1995) on mechanism of foreign policy-making also revealed Deng's crucial role.²⁸ Solnick (1996) explains Chinese success in terms of policy choice, that is, postponement of political reform. In the transitional stage of reforms, to prevent rent-seeking behaviors by agents, effective political authority coupled with a monitoring system are required, and China has proven successful in maintaining government authority during this stage. However, these studies do not provide direct clues as to why such leadership and policy choices have stimulated economic development during the post-Mao period.

There have been serious efforts to posit behaviors of individual actors in broader institutional contexts.²⁹ Furthermore, studies focusing on the procedural aspects of the Chinese system have become more fashionable in keeping pace with *dissolution of the state* phenomenon in comparative discipline. In this sense, the approach of "fragmented

²⁷ Recently, several books dealing behind scene of important decision-making have been published. The features of these books lie on their emphasis on political figures, in particular, Deng Xiaoping. To see, for examples, CPC Central Policy Studies ed. *Gaigekaiifang 20nianzhongdajueceshuyao* [Abstracts of Crucial Policy-Making during 20 years' period of Reforms and Opening-up]. Beijing: Zhongguojingjichubanse, 1999; Pingping Long, Jintian Liu, and Yi Gao, eds. 1998. *20nianzhongdajuecebeiwanglu* [Memorandum of Crucial Policy-Making for 20years]. Fuzhou: Fujianjiaoyu Chubanshe; and Jianqiu Huang, and Xiaoping Yang, *Licheng* [Course]. Guangzhou: Zhongshandaxue Chubanshe, 1998.

²⁸ Regarding highly personalized military command system, see Swain (1992).

²⁹ For examples, Oi (1989); Huang (1990); and Shirk (1993).

authoritarianism” shed a light on this issue (Lieberthal and Oksenberg 1988; Lieberthal and Lampton 1992, Chapter 1). According to Lieberthal, the Chinese authority system is highly fragmented. In the system, consensus building is central to the policy-making process and is sought at both the vertical and horizontal levels although the authoritarian nature of the political system posits the strong influence of top political leaders in decision-making. As a consequence of the fragmentation, the policy process is often protracted, disjointed, and incremental. In theoretical perspectives, this view answers why Beijing commands policies in the broad outlook, but in examining the details, we often find that the authorities are dispersed and localities have been able to find more leeway in seeking their own interests under this fragmented system. Lieberthal’s study on national energy development policy gives powerful proof of the fragmented nature of the Chinese authority system (Lieberthal and Oksenberg 1988, Chapter 6).

The explanatory power of each perspective may vary according to issue areas and temporal domains although all these views give sufficient evidence and cases in support.³⁰ For example, negotiation and compromise among various political actors are more likely to occur in economic issue areas rather than in political and security issue areas. Localities are likely to have more power and leeway in economic areas as well. In the temporal domain, more directives and forceful policies were likely issued during the earlier period of the economic reforms than during the later period. During the initial stage of reforms, leadership factors could be more crucial in policy-making since the level of institutionalization for reforms was low. Therefore, empirical verification across issues and time is required for each perspective.

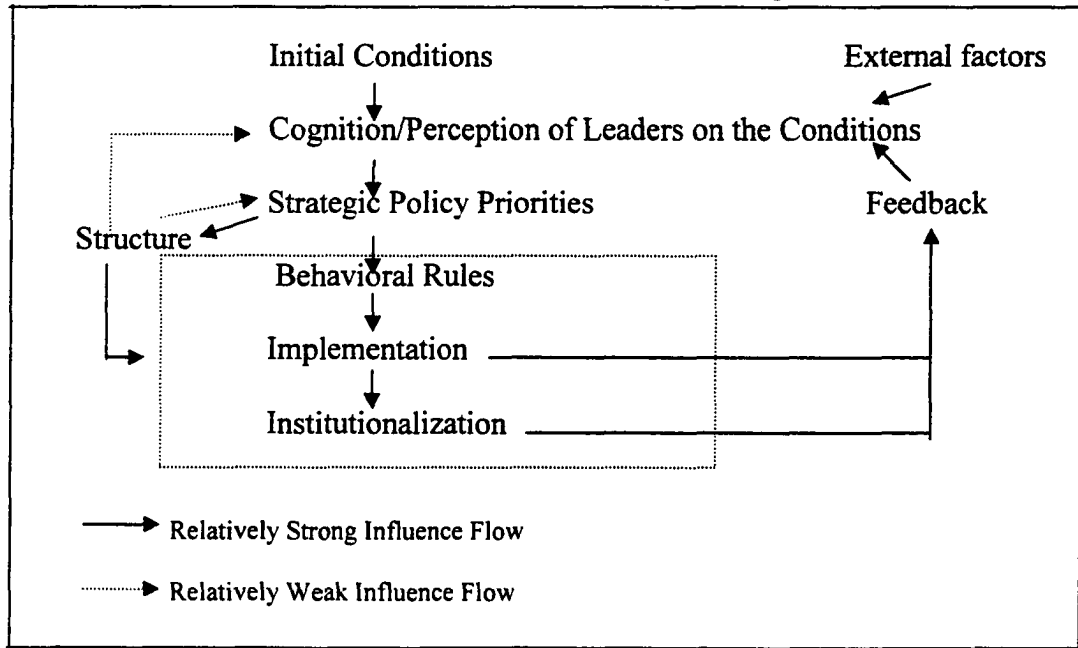
In the comparative perspective, China is unique in terms of its combination of size, level of economic development, historical experience, and transitional from socialist planning to marketization.³¹ However, it can be generally defined as a transitional and developmental country under authoritarian rule. The composite of unique and universal characters both frustrates and gives hope for empirical research. As discussed, in studies

³⁰ Lieberthal also recognize that fragmented authoritarian model has different explanatory power according to issue areas. See Lieberthal and Lampton ed. (1992), 18-20.

³¹ The uniqueness means that the solution of increasing number of cases or focusing matched cases are not available. No counterfactual or actual case strategy is persuasive. To see the comparison between counterfactual and actual case research strategies, James Fearon, “Counterfactuals and Hypothesis Testing in Political Science.” *World Politics* 43 (January 1991), 169-95.

of the transitional political system and its performance, three perspectives respectively focus on initial conditions (culture, history, and circumstantial factors) with rather subjective eyes, objective structure with macro-oriented analysis, and individual actors and procedures with detailed manners including informal aspects.

Figure 1-1 Flow of Influence in Policy-making and Implementation



This study does not neglect the fruits of given approaches. While absorbing the fruits of each approach, my research has different foci. Figure 1-1 shows the flow of policy-making and implementation depicted in my approach. Initial conditions help in understanding why the Chinese leadership had developed certain decision-making norms and policy choices that differ from those in the Soviet Union. Structural analysis shows how structural mechanisms can influence institutional changes and individual behaviors. The introduction of the market-oriented economic system brought the following institutional changes, which certainly relaxed the political constraints of the traditional socialist system on the socio-political actors. The presence of bureaucratic politics and interests has been apparent in the fiscal arena as well as other issue-areas in Chinese politics. Rule and organizational changes have certainly bound the behaviors of individual actors. Strictly speaking, however, each perspective has its own limitations in

explaining why China has proven successful since they failed to uncover the dynamic nature of the Chinese system during the transitional period. Only fractured facets are encased. In this approach, the changing perception of leaders as to certain conditions and external environments are regarded as crucial factors in devising and then eventually implementing policy priorities.

Let me briefly summarize what this study will contribute in light of previous studies of Chinese politics. First, it will focus on the dynamics of change rather than attempting to grasp a static mechanism of one or another stage of the policy flow. In the flow, a policy is not considered to be the outcome of cost/benefit calculation of leaders with perfect rationality. It is rather a response and a choice with bounded rationality under the constraints of given norms and changing situations. Changing/ existing features of bureaucracies, leadership factors, and institutions constrain policy choices. In this strategy, I illustrate how each stage of perception/cognition, decision-making, and policy implementation organically interrelates. Individual leaders are crucial, but their behaviors are often checked by structures, institutions, and external incidents. In particular, the decision norm of coordination theorized in the principle of democratic centralism constrained the arbitrary and predatory exertion of power by political leaders in policy-making and subsequently influenced policy outcomes. Under the structural perspective, the structure is considered stable, with implementation reflecting the structure. In my research, the structure is not taken as a priori but under formation and is subject to change according to changes of a strategic policy priority with feedback from the implementation and institutionalization stages. Therefore, the decentralization and marketization processes can be reversible by other factors. Then, once a structure is set up, it asserts itself against actors and institutions with lasting effects. The structure is mutually enforcing with actors and institutions. Existing institutions certainly influence and constrain behaviors of actors and eventually performance. However, they are still subject to change according to policy prioritization and structural change.³² Structure and institution certainly constitute constraints on actors and organizations but are not necessarily deterministic. In this approach, each phase of given structure, actor's

³² In the case of China, it is not deniable that as reforms proceed, new structuralization and institutionalization fortifies along with Beijing's strategic policy lines. It is also a part of political capacity of the Beijing government.

intention, external factors, policy-making, and implementation is *organically* interrelated and reinforces each other.³²

I identify three procedural factors affecting local implementation and performance. First, I look into pre-institutional arrangements, which constrain the maneuverings of political leaders. Could the Beijing leadership reach consensus on a strategic policy priority within the institutional constraints? Then, what mechanism or symbolic behaviors are used of certain issue in authoritative manner? Finally, how did the leadership create organizations and implement them toward the goal of institutionalization? With respect to these three factors, local leaders receive a clue about Beijing's policy priorities on a certain issue, and accordingly, seek the best possible strategy for their own interests under those constraints. The degree of implementation in fiscal policies is likely then a function of how well provincial governments decipher Beijing's policy priorities and other practical constraints on both the Beijing and local governments. The main focus of the organic research strategy is to introduce the intentional/cognitive factors affecting political leaders in the form of strategic policy priority and linkage with external factors,³³ and then to compare the level of performance in policy implementation according to it.

Second, I pay special attention to the political leadership in Beijing in explaining the dynamic. Under authoritarian political systems, political leadership is more likely to influence and shape a policy when characterized by a personalized power. Subordinates and localities are agile in finding signs of intention in policy-makers in terms of the intensity and priorities of a certain policy, which constrains the behavior of them and eventually influences the implementation. However, my focus is not on individual leaders but on leaders as a group, producing policy priorities that are empirically traceable.³⁴

³² The organic research strategy is also issue-sensitive. The degree of change can be different over issues.

³³ Some scholars already raised this issue. See Naughton (1992), 76-77; Yang (1994), 74, and Chung ed. (2000), 177. The major obstacle in dealing with this issue is how to test it empirically or prove it according to academic standards. In international relations, Harvey Starr developed the concept of "willingness", which is of the goals and motivations of policy makers and focuses on why they choose one course over another. See, Most and Starr (1989), Chapter 2.

³⁴ I am indebted to Johnston for the intuition of the term "strategic." I use it mostly from content analyses of (political) reports of Communist Party Congress held every five years, also reports at intermediary sessions of the Party, and annual government reports on specific issues. It is also noteworthy that this study is not about perception or cognition itself, which is difficult to generalize.

Numerous internal and publicized reports and documents within the party and the Beijing government reveal the existence of *policy priorities*.³⁵ In particular, the five-year plan, the reports of the CPC Congress, and the annual government report by Premier crystallize the changes of policy priorities in Chinese politics. For example, the national five-year plans (the strongest feature of the Chinese socialist economic system) were formulated after about a two-year drafting period by the SPC working with the SEC, SSB, People's Bank of China, and other economic ministries/organs under the State Council. Then, the plan was finalized after getting through the so-called documentation process.

Although economic and political uncertainty as the chief attributes of the transitional period made the plan almost impossible to implement as planned, it still sufficed to guide annual planning and provided a light in the period lacking a blue print for reforms. To tackle the new challenge of uncertainty, the plan often left leeway for adjusting the original plan as seen in the changes during the seventh and eighth five-year plan periods. In general, at the end of the second year of the five-year plan period, the CPC Congress was being regularly held. Congress politically endorsed or reexamined the targets and policy priorities according to changing conditions. However, a look at the relationship between targets and achievements revealed that the overall practice was, as illustrated in Table 1-1, quite impressive.

Table 1-1: Five-Year Plans and Implementation

Plan Growth Rate (%)	6 th FYP (81-85)	7 th FYP (86-90)	8 th FYP (91-95)	9 th FYP (96-2000)
GDP Target	7.2	7→Higher than 7	6→8~9, or even higher than 10	8
Actual GDP	10.8	7.9	11.7	7.7

Source: CFY 1999, 447; CSY 2000, 53; Cong and Zhang eds. 989-1020; Shen Liren et al, 794; Central Document Research Office ed. 1987, 932-933.

The reasons for the success come from the *democratic* process of coordination in the drafting stage³⁶ as well as the deeply embedded transmission system in the planning

³⁵ The concept of "strategic policy priority" helps to identify intention/perception factors in terms of policy. While the term "strategic" is still undefined, it explicitly and implicitly tends to be a guideline in making policies and tactics. It is more fundamental in character than a policy and induces all behavioral, institutional, and even structural changes.

³⁶ Here the term *democratic* does not refer to the Western style of democracy. It comes from the principle of democratic centralism. Although it was often referred as an ideological rhetoric, it still provides an important source of legitimacy and practical arrangements for policy enforcement. I will discuss this matter in detail in Chapter II.

process down to the village level. Planned targets were delivered via the transmission system in the administrative hierarchy, and individual production units generally organized schedules in accordance with ten-day, one-month, three-month, and six-month plans. Although the Chinese system was not neatly institutionalized, it did provide leaders and subordinates with a complicated but still transmittable symbolic system. In particular, important documents and the documenting process provided crucial sources for the symbolic system. Through analyses of such documents, I decipher the policy intention and priorities of the Beijing leadership during a specified period. In the popular view of the waning political capacity of Beijing and the rising power of local governments, the aspect of intention seems to have been neglected. If poor fiscal performance is an inevitable result of Beijing's policy choices, any conclusion that Beijing's political capability is waning along with the economic reforms, may if arrived at by merely looking over the area of finance, well prove precarious. In discussing an ability of an actor, a deliberate factor should be taken much more seriously than mere outcome.

Third, I introduced the role of the external factor into this analysis. Most studies of procedural and structural perspectives construe outside factors as a black box. However, changing international relations provided a crucial motivation for the 1994 fiscal reform caused by depleting of Beijing's coffers consequent to the reallocation of resources to the military sector. The unstable international situation at the time certainly proved a heavy security burden to the Beijing government and precipitated the fiscal reform ahead of its scheduled timing. In practice, the outside factors might not be the sole motives for reform, but simply comprise some of the important factors of change in combination with inside factors such as a succession crisis. The dynamics of the change cannot be explained only by inside factors.

To measure Beijing's political ability, I adopt the concept of political capacity to explain the changing nature of political interactions and institutions.³⁸ Political capacity is

³⁸ I am indebted this concept to Organski & Kugler (1980, Chapter 2). According to Organski's definition, "political capacity" is effectiveness of a political entity in penetrating and in extracting resources from its constituents while keeping political stability.

defined as the ability of political leadership of a sovereign unit to achieve the policy goals assumed to be national interests or political priorities. The concept should be able to integrate the adaptation ability of political leadership to changing conditions, and appropriateness, efficiency and effectiveness in policy-implementation instead of merely counting on a size factor.³⁹ In this sense, Beijing's ability to garner support from central and local elites and cadres is crucial. The ability to create institutions is also critical in insuring policy implementation. I argue that the political capacity of the Beijing government has been crucial to China's economic development and social and political system stabilization during the transitional periods. I choose the fiscal arena as the proxy to examine for political capacity.⁴⁰ This area is most likely to prove the locus in which negotiations and compromises between Beijing and provincial governments occur and in which localities enjoy autonomies during periods of economic reform. Other areas are much more centralized than this. Therefore, the choice of the fiscal arena is straightforward and effective. The other historical and academic reason to choose it comes from my understanding of the importance of taxation in modern nation-state building and industrialization.⁴¹ Taxation has proved to be a major material base in strengthening sovereignty in the nation-state international system and in imposing the

³⁹ I will discuss this concept in the next chapter.

⁴⁰ Some focus on other channels to control resources, such as the banking system and price control (See, for examples, World Bank 1995; Sehart 1999). Under non-market circumstances, dependence on bank loans and price control in extracting resources is very likely to convey a negative side effect on political capacity. It reduces the size of formal budgetary capacity and distorts formal fiscal structure by worsening the soft-budget problem, which most socialist countries have sought to overcome by reforms. If I just focus on the extractive capacity of the government by size, combining the volume in taxes and the banking sectors can be a strategy to measure it. However, I focus not only on the size but also the efficiency factor in political capacity. The summation of taxes and banking loans by the central government increases the size, but the heavy dependence on the banking sector decreases efficiency and has a negative impact on economic development in the long run.

⁴¹ It is important to notice that the nation-state system is a comparatively recent phenomenon of Western European origin, which was created in the struggle for survival of pre-modern states (See, for further description Bull, 1979). After the medieval world order of Christendom had collapsed around the fifteenth-century, several hundred states struggled to survive until the number of the new nation-states settled in the nineteenth-century to less than thirty members in Europe. Only the strongest survived. Under this kind of harsh environment, effective and efficient extracting capacity of the state was crucial to meet the demands for building strong economies and armies. However, generating taxation at the national level is often difficult, costly, and unwanted by most people and local powers. For example, in 1991, more than 3000 tax collectors were attacked and five were killed while performing their duties in China (See, *The Chinese Economy in 1991 and 1992*, 8). That's why the state's ability of tax extraction is often mentioned as an indicator of the political capacity of the state. Evolving various relations in the area of taxation between centripetal and centrifugal forces within the jurisdiction of each political entity tell us something important about the political structure of the country.

will of state governors over the populace for the last several centuries. Chubais, Russia's first Vice-Premier, succinctly described the importance of taxation in an interview with *USA Today*.

Tax collection is particularly important because it involves the fundamental role of the state. A government that cannot collect taxes is a weak, bad government. (*USA Today*, November 7, 1997).

Although in my view there is a danger of reductionism, the creation of a modern administration and institutions is closely related to the ceaseless efforts of state governors in extracting or mobilizing resources within their jurisdiction. A modern tax system is the institutional and legitimate device for effectively extracting resources in the efforts to build a modern nation-state system.⁴²

Methodologically, I do not only aim at a descriptive explanation of the subject but also seek a universal research strategy. In analysis, both qualitative and quantitative approaches are utilized. In area studies as well as in social science, the usefulness of this strategy is broadly accepted. Both approaches could be mutually supplemented if researchers are skillful enough to handle them. First, through a documentary analysis I provided comprehensive information about fiscal data, critical meetings, and various views according to organizational affiliation and so on. Second, I interviewed officers and scholars at various organizations at the central and provincial levels of China's government. The Chinese Academy of Social Science (CASS), Development Research Center (DRC), and Ministry of Finance (MOF) were major places at the central level, and local Academies of Social Science, finance bureaus, and scholars at the provincial level. Geographically, I visited Beijing, Shanghai, Sichuan, Anhui, and Guangdong during two separate periods: first, from April to December 1999 and, second, from December 2000 to February 2001. These interviews provided a wealth of details from inside stories, details I could not get from documents. Third, I adopted regression and correlation analysis and tested fiscal performance at the provincial, central, and national levels and other variables.

Although outcomes are rather suggestive due to data reliability issues, I found that quantitative methods alone evince certain limitations in explaining some discretionary

⁴² One of main reasons comes from its characteristic of formality, which reduces side effects of arbitrary manipulation by certain groups or individuals in the pre-modern society.

policies adopted by the Beijing government. Policy is often selectively applied to a specific region in accordance with the strategic policy priority of Beijing. The averaged effect in regression analysis is not capable of capturing the feature. In particular, since the Beijing government has handled fiscal reforms in a discretionary fashion, the importance of this mechanism analyzed through regression analysis on the national level becomes difficult to understand. Therefore, qualitative research must follow to provide in-depth information as well as to supplement our understanding of how political systems and intergovernmental relations work.

B. Approaches in the Study of Intergovernmental Fiscal Relations

1. Theoretical Trends in Chinese Studies

In the comparative field, in the late 1970s through the 1980s, the state emerged as a key domain of analysis for scholars working during the height of the cold war.⁴³ Responsive to society-centered approaches such as pluralist and structure-functionalist perspectives,⁴⁴ the statist approach argues that the state or state structure has a crucial and independent impact on social, economic, and political developments within its jurisdiction. State or state structures are more than, as pluralists assume, a mere reflection of individual actions. Although there were critics of the statist perspective,⁴⁵ the major challenge to it came from the vagueness of the state concept and an inability to explain multi-functional dimensions within the state often resulting in a view of the state as a black box.⁴⁶ With statism's contribution in bringing state structures and the formal state system back into the academic eye, a new approach attempted to focus on institutions within the state in order to avoid the short-comings of previous statist approaches. The

⁴³ Theda Skocpol's "Bringing the State Back In" highlights the statism as an important perspective. For others with this perspective, see Katzenstein, 1978; Krasner, 1978; Stepan, 1978; and Evans, 1979.

⁴⁴ Regarding criticism on pluralist approach, see Harry Eckstein, 1960. *Pressure Group Politics*, Stanford: Stanford University Press. Neo-Marxist/dependency theory places its focus on the state's position in the global political and economic structure. See, for examples, Valenzuela and Valenzuela (July 1978); Migdal (1983). On the criticism of Neo-Marxist approaches, see Theda Skocpol (1985). For the review of the history of the discipline up to the 1960s, see Harry Eckstein, "A Perspective on Comparative Politics, Past, Present and Future." In *Comparative Politics*, edited by H. Eckstein and D. Apter. (New York: The Free Press, 1963). For the review afterward 1960s, see Gabriel Almond, ed. (1990).

⁴⁵ See, Whiting (1995), 4-9.

⁴⁶ Skocpol's starting point of research is to explain policies in terms of state structures and policy legacies. In this sense, she avoided the trap of taking the state as a black box.

new approach gradually became the dominant one in comparative politics during the late 1980s through the 1990s.⁴⁷

The main impact of the Cultural Revolution on studies of China was to dissolve the state-focused perspective.”⁴⁸ Failure of the *totalitarian model*⁴⁹ to anticipate the Cultural Revolution induced a sense of theoretical crisis in Chinese studies by the end of the 1960s. The totalitarian model as a holistic approach described socialist countries as a party-state system underpinned by monolithic political power. Under a totalitarian system, policies were supposed to be formulated and implemented by top-down procedures. This approach evinced certain limits in crystallizing the dynamics of domestic politics. In particular, the Cultural Revolution magnified how the assumedly monolithic totalitarian system of China could appear to be so fragile in the internal struggle for power and how it could be divided into various interest groups and individuals. The plural approach emerged as a major response of the American academic

⁴⁷ See, for examples, Almond (1987), Shue (1988), Oi (1989), Migdal (1988), Kohli (1990), Kornai (1995), Walder (1995), and Solnick (1996).

⁴⁸ A list of works introducing Chinese studies is as follows: Howard Boorman, “The Study of Contemporary Chinese Politics: Some remarks of Retarded Development.” *World Politics* Vol. XII, NO.4 (July, 1960); Chalmers Johnson, “The Role of Social Science in China Scholarship,” *World Politics*, Vol XVII, No.2 (January 1965); Michel Oksenberg, “Sources and Methodological Problems in the Study of Contemporary China.” In *Chinese Communist Politics in Action*, edited by A. Doak Barnett, (Seattle, University of Washington Press, 1969); Richard Wilson, “Chinese Studies in Crisis.” *World Politics*, Vol XXIII, No.2 (January 1971); Karl Li, “Methodology and data in the study of Chinese Political System,” *Asian Forum*. Vol.V, No.1 (January-March 1973); Myeong Chey, “Theoretical Model for the Analysis of Chinese Political System.” *Sa-heui-gwa-hak Nonmunjib* [Research in Social Science] No.1 (January-March 1973); Chalmers Johnson, “What’s Wrong with Chinese Political Studies?” *Asian Survey*. Vol. XXII, No. 10 (October 1982); Harry Harding, “From China, With Disdain: New Trends in the Study of China.” *Asian Survey* Vol. XXII, No. 10 (October 1982); Harry Harding, “The Study of Chinese Politics: Toward a Third Generation of Scholarship.” *World Politics* 36 (January 1984); David Shambaugh (ed.), *American Studies of Contemporary China* (Armonk: M.E. Sharpe, 1993); The University Service Center at the Chinese University of Hong Kong (ed.), *The Development of Contemporary China Studies* (Hong Kong: The University of Service Center, 1994); Yingming Li, *Zhonggong yanjiu fangfalun* [Methodology of Communist China Studies] (Taipei: Yangzhiwenhua, 1996).

⁴⁹ The Totalitarian model was a by-product of the cold war. In contrast to democratic capitalism, it was depicted as a system of over all control over the society by the party-state and top-down style of policy-making. In addition, other features of the system are mentioned by Fitzgerald and Brzezinski as follows: mass-mobilization party by a demagogue leader, centrally controlled economy, control of mass-media, ideological unity, and government of terror by the policy (Carl Fitzgerald and Z. Brzezinski, 1963). Scholars under this perspective in China studies are called as the first generation by Harding (1984, 286-290). Major works by them are as follows: Leadership in Communist China by John Lewis (1963); Ideology and Organization in Communist China by Franz Schurmann (1966); Mao Tsetung by Stuart R. Schram (1966); Cadres, Bureaucracy, and Power in Communist China by A Doak Barnett (1967); Participation in Communist China by James R. Townsend (1967) and so on.

world to the Cultural Revolution.⁵⁰ Methodologically, the focus moved from state structure as a whole to individuals and their motivations. The plural approach considered elite group conflicts, bureaucratic interests, and the relative autonomy of social groups from the state apparatus as the main factors explaining Chinese politics.⁵¹ According to this approach, politics and policy are mostly determined by the relationship of two variables: relevant competing interests and their relative political strengths. Pluralism is often exclusively defined by competing elite interests in Chinese Studies although it generally referred to competing social interests in American politics (Halpern, 124). This approach broadened the research domain in Chinese Studies to include the informal patterns of power, attitudes of leaders, and processes by which Chinese institutions actually worked (Harding 1994, 22).

China in starting its economic reforms introduced the market mechanism much earlier than most other socialist countries did. During the reform era, the delegation of economic authority to localities has remarkably changed the previous distribution of authority and resources at the intergovernmental and sub-state levels, these changes then becoming the key to understanding Chinese politics. In Chinese Studies it became urgent in the early 1980s to introduce new perspectives to understand the country's dynamics in methodological and thematic terms. Under the pluralist tradition, some scholars attributed the economic reforms to the power struggle among elite groups.⁵² However, the plural approach inadequately explained the dynamics of economic reforms causing the tremendous structural changes. It often ignored the role of state structures while focusing

⁵⁰ I am indebted in the use of this concept of pluralism to Li (1996) and Halpern (1993). In particular, Li categorizes trends of China studies since 1949 into four perspectives with certain temporal domains: totalitarianism (classical institutionalism) for the period of pre-cultural revolution; pluralism for the period from the cultural revolution to Mao's death; structuralism for the period from the third plenum in 1978 to the Tiananmen incident in 1989; and post-structuralism for the period after the Tiananmen Incident. However, each perspective was not necessarily a dominant perspective during respective period as Li described. For example, a plethora of works had been produced under the influence of the plural approach even after 1980 (Harding 1981 & 1987, Shirk 1982, Solinger 1984, Nathan 1985, Burns 1987, Dittmer 1987, Lieberthal & Oksenberg 1988, Zweig 1989, Hamrin 1990, O'Brien 1990, and Bachman 1991). In international relations, the pluralist approach developed in the 1970s as a response to realist perspectives, which describe international relations as involving relations among states with strikingly similar character and behavior.

⁵¹ Two major works describing elite politics at the national level are (Teiwes 1979; Pye 1981).

⁵² For examples, analyzing characteristics of economic reforms as the results of factional or elite struggles, Maurice Meisner, *Mao's China and After* (NY: The Free Press, 1986); Harry Harding, *China's Second Revolution* (Washington D.C.: M.E. Sharpe, 1986), and Frederick Teiwes, *Politics at Mao's court: Gao Gang and Party Factionalism in the Early 1950s* (Armonk: M.E. Sharpe, 1990).

on elite actors. Since it seriously limits any analysis of intergovernmental and sub-governmental dynamics, rediscovering the basic blocks of the Chinese political economic system would become one of the primary tasks in Chinese Studies (Harding 1993, 25; Halpern 1993). Political scientists started paying more attention to state bureaucratic institutions and sub-state level institutions in keeping with the general trend in comparative studies.⁵³ In the new approach, state structures such as bureaucracies and inter-governmental relations were considered to be critical in shaping political actions and outcomes.⁵⁴ Policy outcomes, however, are no longer simple products of competing interests among powerful actors or coalitions. Policies and policy implementation are analyzed as the function of or placed under heavy influence of structurally dictated systems. This approach opened the window to intermediate-level research strategies likely to both facilitate comparative research and advance explanatory power. Studies of the bureaucratic policy process by Lampton (1987) and Lieberthal and Oksenberg (1988) are considered the best products of such efforts.

There is another noteworthy intermediate-level research approach, one which is often difficult to distinguish from the structural approach. This is the *new* institutional approach. Under the influence of other social science fields, it integrated the (bounded) rational choices and informal rules and regulations of the pluralist tradition into an institutional analysis. Meanwhile, the structural approach tended to focus more on the formal aspects of the system. However, the new institutional approach still can be considered as a structural approach in that both rules and institutional structures regulate individual choices.⁵⁵ A research by Walder (1986) on the control mechanisms used with

⁵³ For example, Melanie Manion "The Cadre Management System, Post-Mao: The Appointment, Promotion, Transfer, and Removal of party and State Leaders," *China Quarterly* no. 102 (June 1985): 203-33; David M. Lampton, *Paths to Power: Elite Mobility in Contemporary China* (Ann Arbor: Center for Chinese Studies at the University of Michigan, 1986); and John P. Burns, "China's Nomenklatura System," *Problems of Communism* No. 36 (September-October 1987): 36-51.

⁵⁴ Institutional setting does not necessarily mean formal structures. It includes informal behavior and policy process, which was the main contribution of the plural approach in China studies.

⁵⁵ For interesting studies in this area, see Jean Oi (1989); Susan Shirk (1993), and Susan Whiting (1995). Li Yungming (1996) indicates Walder's study as a case of post-structuralism, which integrates a cultural analysis into a structural approach. However, I argue that Walder's study focuses on a network of patron-client relations, which has been nurtured in the structural feature of China's socialist state-owned enterprises, and their influence over individual behaviors rather than cultural aspects of the patron-client relations.

urban factory workers and by Shue (1988) on the relationship between the Chinese State and peasants illustrate this approach.

The difference between the old state approach (totalitarian model) and the new approaches was that the former mainly paid attention to the central state organs/elites and top-down processes in policy-making, the latter paying more attention to interactions between the state organs and the overall interactive policy-making process. The introduction of the market economy also placed limits on the old statist perspective because it diversified and thus complicated authority and resource distribution within the state. The top-down approach has certain limits in analyzing the dynamics. The delegation of economic power to localities during the reform era does not, however, mean that the so-called civil society came to the fore of the Chinese political system as a main actor.⁵⁶ The eruption of the Tiananmen Incident in 1989 and the dramatic increase of the number of non-governmental organizations are the examples of burgeoning importance of civil-society in China. However, it is questionable that the civil society had played as an important actor in the domain of policy-making and political process during the two decades of economic reforms. The locus of authorities remains at state institutions. The dynamics of Chinese politics during the reform era have aimed at changing relations between the central–local state institutions.⁵⁷ The main concern centered on the relationship between the structural/institutional arrangement of authority and resources by the central government and the responses of localities under such arrangements. (Oksenberg and Tong 1991, Oi 1992, Wong 1991, Wang and Hu 1993, Yang 1994, Tsang and Cheng 1994, Herscher 1995, Wong, Heady, and Woo 1995, and Park, Rozelle, Wong, and Ren 1996)

⁵⁶ Oksenberg (1993) predicted that research of state-society relations is likely to engender even greater attention to analysis of Chinese politics. Since the economic transformation to market economy started in China, the importance of the civil society has certainly grown in China's studies.

⁵⁷ The study of the central-local relations of China has been done much earlier than in the field of comparative politics in general. The main reason is likely to come from cyclic phenomenon, like a pendulum, between "Shou: centralization" and "Fang: decentralization" throughout Chinese history. Chinese dynasties have been changed every two to three hundred years with the cyclical patterns. Within the period, the pendulum between centralization-decentralization swung once or twice (Kim 1976, 124-25). The swing of the pendulum took place even under Mao's totalitarian rule.

⁵⁹ One of the efforts is Edwin A. Winckler (ed.). *Transition from Communism in China: Institutional and Comparative Analysis* (Boulder: Lynne Rienner Publishers 1999). Chung also raised this issue (1995).

In sum, the pervading paradigm in Chinese studies can be characterized as a renaissance of intermediate-level approaches. Few studies,⁵⁹ however, have done multi-level analyses to bridge the macro-micro nexus, the relationship between institutions (structure), and individual preferences in a dynamic flow. To overcome the static nature of the structural paradigm, the dynamics of individual cognition and preference, institutions (including informal rules), and implementation should be explained in the study of Chinese politics. This is the level we pursue.

2. Theoretical Framework of Chinese Intergovernmental Fiscal Relations

Various methodological experiments have been introduced in studies of Chinese intergovernmental fiscal relations as they align with Chinese Studies in general since the 1980s. As discussed previously, as a main theme of Chinese Studies elite-oriented totalitarian and pluralist models have been replaced with structural and institutional approaches. In the midst of theoretical transformation, some scholars applied principles of methodological individualism such as principal-agent theory⁶⁰ and game-theoretic model to Chinese Studies.⁶¹ Compared to the individualism of the previous behavioral school, these studies integrated an individual's behavior within a broad social, economic, or political context. Individual strategies and rationalities are influenced by their position in the context. However, it is methodologically individualism in that it places more emphasis on the motivations of, constraints to, and strategies of individual actors. Nonetheless, structural/institutional approaches became popular in the study of intergovernmental fiscal relations. Structural/institutional approaches are believed most likely to explain the key feature of reforms, decentralization of decision-making authority and resources in a systematic way. These approaches are in opposition to the basic idea of

⁶⁰ For example, Bird (1993) and Shuling Liu, *Zhongguodaluzuanxingqi Zhongyangdifangzhengfu yu Difangqiyezhi Caishuihudongguanxi (1979-1994)* [Fiscal Interactions between the Central and Local Governments, and Local Enterprises in the Transitional Period]. Master thesis in Political Science at National Taiwan University, Taipei: National Taiwan University, 1998.

⁶¹ For examples, Jun Ma, "Central Government Credibility and Local Tax Efforts: A game Theoretic Model." In *Intergovernmental Relations & Economic Management in China* (New York: St. Martin Press, 1997); Jiwei Luo, *Zhonggongcaizhengtizhi yu Zhongyangdifang Caizhengguanxizhijianjiu* [Study on Chinese Fiscal System and its Central-local Fiscal Relationship] (Taipei: Master Thesis in Zhongshan xueshuyanjusuo, 1996); and Qijian Xu, & Jiayu Cai, "Zhongguodalufenshuizhixiade Zhongyangdifangguanxi" [Fiscal Relationship between the Central and localities]. A Paper presented in The Fifth Conference of Taiwan Academy of Political Science (Taipei: TAPS, 1998).

methodological individualism in that individual behaviors are constrained not by their individual motives and strategies, but by environments and conditions. However, the structural/institutional approaches are also opposed to holistic ideas. The environments and conditions in these approaches do not mean the whole political, social, or economic structures/systems. Instead, they indicate mid-level environments, that is, institution/ sub-state structures, in which individuals operate.

The dimension of centralization-decentralization has been frequently used to describe changing intergovernmental fiscal relations under the assumption of zero-sum relations.⁶² Much literature seeks to explain the relations between the central and local forces in terms of state capacity or the strength of civil society while focusing on the downward or upward direction of that power. Three views of the evolving fiscal relations emerged among scholars. Those who emphasize the rise of a strong local power include Naughton (1992), Oi (1992), Wang and Hu (1994 & 1996), Zheng (1994), Park, Rozelle, Wong, and Ren (1996), and Gu (1997). Others who disagree with the popular view that fiscal reforms helped strengthen control of the Beijing government over localities include Shue (1988), Nee (1989), Wong (1992), and Huang (1996a). Meanwhile, Oksenberg and Tong (1991), Yang (1994), and Zhang (1999) observed a non-zero sum nature to varying degrees in the Chinese fiscal system.

Yet the study of the fiscal arena has not fully been exhausted in spite of the abundance of works and thus is still crucial in understanding central-local relations as well as economic reforms in general. Some scholars indicated problems of heavy focus on fiscal issues. For example, Chung (1995) argued that the relative neglect of non-fiscal factors (such as personnel /information control and legislative authority) in central-local government relations can lead researchers to myopic conclusions. The studies on fiscal issues tended to over-emphasize the capability of local governments vis-à-vis Beijing

⁶² Audrey Donnithorne and Nicholas Lardy underlined the utility of this dichotomy in their debates over whether the Chinese economy was centralized or cellular. According to Oksenberg, Fanz Schumann formulated this dichotomy in studying Chinese politics (Oksenberg, 30). For the debate between Lardy and Donnithorne, see Audrey Donnithorne, "China's cellular economy: some economic trends since the Cultural Revolution." *The China Quarterly* No. 52 (October-December 1972): 605-619; Audrey Donnithorne, "Comment." *The China Quarterly* No. 66 (June 1976): 328-340; Nicholas Lardy, "Centralization and decentralization in China's Fiscal Management." *The China Quarterly* No.16 (March 1975): 26-60; Nicholas Lardy, "Centralization and Decentralization in China's Fiscal Management, Reply." *The China Quarterly* No 66 (June 1976): 340-354.

during the pre-1994 fiscal reform period. However, no study on information handling, legislative authority, or personnel appointment system is able to reveal an accurate picture of the dynamics of the relations because the Beijing government still possesses a tight control in those areas.

Different and often oscillating views regarding fiscal relations emerged from failure to explain the complex nature of the fiscal system systematically.⁶³ Policy-oriented impromptu approaches, not based on theoretically founded ones, lead to fluctuating views subject to political tides. The decentralization of economic decision-making power during the 1980s provided fertile grounds for ideas about strong local powers and society in Chinese Studies, while the literature sounded a fanfare for state strength after the Tiananmen Incident of 1989. Lacking a theory-based approach, one can easily be tempted to change views according to the political tides.

Narrow focus on economic and quantitative relations also undermines efforts to capture the dynamic characteristic of Beijing and its provincial relations. For example, economic indicators such as the ratio of revenue retention between Beijing and provincial governments do not explain actual power relations let alone the effectiveness of Beijing's penetration. The character of the data in fiscal relations tends to lead us to a dichotomous view of centralization-decentralization. Although the dichotomy is a useful tool for the purpose of academic training, it may not capture the extent of what actually happens in the fiscal arena. Studies of bureaucratic politics and other institutional traditions teach us that politics does not in most cases end up as a zero-sum game because there is no absolute power that exclusively encompasses information and other resources. This feature is quite evident in China's taxation arena. Under certain circumstances, a win-win situation can still exist. An "increasing pie" strategy exemplifies such a case as long as legitimacy of "among us" remains superior to "us against them." Both central and local governments can eventually acquire benefits from the policy they implement although in adopting a policy there is a winner or a loser in the short term. A strong emphasis on the non-zero sum feature of Chinese reforms may also lead to an incorrect assumption that political actors wield similar powers to infuse their own interests into the decision-

⁶³ Goodman (1986) categorizes four models of centre-province relations: Totalitarian (Barnett, 1967), Centralist (Schurmann 1968; Lardy 1975), Cellular (Donnithorne 1969 and 1972), and Decentralist (Whitney 1969; Whitson 1969; Whitson and Chen-hsia Huang 1973).

making process, which inevitably produces a deadlock situation. However, problems of unbalanced information and resources exist in practice. The government in Beijing made exhaustive efforts to create a win-win mechanism while strengthening its control over the fiscal arena in the fiscal reform of 1994.

Dichotomized views often underestimate the area of the politics of procedure, that is, the politics of bargaining and negotiation. The Beijing government is neither a neutral arbiter between economic actors nor a maximizer of economic utility, but an actor with its own preferences. In particular, in transitional and reforming societies such as former communist countries, soft policy-making behaviors and political leaders' preferences play critical roles because previously dominant rules and norms are being replaced by new emerging ones.⁶⁴ The conflict between Beijing's control and local autonomy are interwoven with the often-conflicting tasks of political stability and economic efficiency in subsequent fiscal reforms. In this regard, it is necessary to absorb the fruits of new approaches such as the new institutionalism and bureaucratic political approaches in the study of fiscal relations. It fills the gap by integrating informal rules and procedures with attention to interactions of individual actors based on incentive analysis.

More importantly, an external validity problem exists in the study of fiscal systems. Those who study fiscal issues tend to relate the conclusion in their studies of fiscal performance to state/political capacity. For example, the declining ratio of state revenue to GDP often leads to the conclusion that state power is declining. In the comparative perspective, socialist systems and developed countries are more likely to have higher ratios of revenue collection to capitalist and developing countries and accordingly, government expenditure than do others. However, that was not the case in China, which developed a decentralized fiscal system even under the Maoist regime. In addition, the ratio depends on a choice by leadership of the kind of government that accords with developmental strategies. China increased its economic capacity while the ratio of state revenue to GDP declined with the reform drive. The Beijing government made a policy choice in choosing such a risk- loosening control over fiscal resources for economic development during the stage of rapid economic development. To overcome

⁶⁴ Janos Kornai's concept "soft-budget constraint" posits "politics of bargaining and negotiation" as a structural character of socialist system. Lieberthal and Lampton indicated that there already existed politics of informal bargaining and negotiation even during the Maoist period.

the external validity problem, the study of fiscal relations needed to explain the evolving fiscal system in a broader context, beyond, in fact, the fiscal system itself. In the study of fiscal relations as well as in studies of China in general, the dynamics among strategic policies, political actors, institutions, and policy implementation have not been taken into account in an organic manner. In this study, these dynamics are analyzed in order to reveal how the Chinese political system works.

C. Discourses of Political Capacity and Institutions

The political development approach popularized the concept of state capacity during the 1960s to explain various developments in colonial and formerly-colonized states after World War II.⁶⁵ In the international arena, the nation-state as a unique territorial institution possessing legitimate force has been the foremost actor during the Cold War period. Therefore, it is not surprising that the state remained the key analytical unit throughout the period. Many scholars dedicated themselves to measuring state capacity as a predictable variable, in order to posit the state's behavior in the international arena.⁶⁶ Scholars believe that the degrees of state capacity/power capability, in particular that related to military capacity, are the best indicators of state behavior in the international arena. State capacity has often been defined as the ability to penetrate society, extract resources, and regulate social relationship although there is no consensus as to what composes the state's capacity.⁶⁷ The ability to control resources often focuses on the size of the public sector and on resources mobilized (Deutsch 1961; Almond and Powell 1966; Rustow 1967; Eckstein 1982; Organski and Kugler 1980). The bigger the size it is, the larger the state capacity. This indicator has been popular because of its

⁶⁵ See, for examples, Gabriel Almond and James Coleman, eds. *The Politics of the Developing Areas* (Princeton: Princeton University Press, 1960); Seymour Martin Lipset, *Political Man* (London: Heineman, 1960); Karl Deutsch, "Social Mobilization and Political Development." *American Political Science Review* 55 (September 1961): 493-514; J. F. K. Organski, *The Stages of Political Development* (New York: Alfred A Knopf, 1965); and Samuel Huntington, *Political Order in Changing Societies* (New Haven: Yale University Press, 1968).

⁶⁶ For the most known and controversial measurements, see Organski and Kugler 1980 and Wayman, Singer, and Goertz 1983.

⁶⁷ See Katzenstein's argument about various dimension of state capacity in comparison of Austria and Switzerland. According to him, there are at least two dimensions: the state capacity as a size and as a penetration capability (1985).

explicitness empirically. In the study of the China's fiscal system, this method has been frequently adopted as well. Another approach emphasizes the range of degrees of state autonomy in making policy decision as capacity while avoiding the issue of size (Karl Marx; Max Weber; Korpi 1983; Kohli 1986; Katzenstein 1985, 236). As described previously, some political economists argue that the degrees to which the state or political institutions are embedded or insulated are crucial in national economic development.

In addition to these two elements, there are other important components in measuring state capacity as well.⁶⁸ The third kind of capacity is related to the control of cognition/perception by dominating value systems that use symbols, create norms and values, and mobilize ideology (Gramsci 1973). With dominance over the cognition and value systems, political leaders can increase their ability to gain compliance from their constituents and thereby to justify their behavior as legitimate.⁶⁹ This issue is often neglected, chiefly because the roles of cognition/value are difficult and vague to pinpoint and test empirically. In particular, the market-oriented reforms effected throughout the former Soviet-bloc countries exhibit reduced interest in this issue because the roles of ideology have diminished in those areas. However, it is still worthwhile to note why Chinese leaders have so tenaciously justified their policies ideologically, even during the reform period.

The final element, the capacity for institutionalization, originated with Samuel Huntington, who states that political development is closely related to the creation of autonomous political institutions which must be capable of preserving order and stability (Huntington 1968, vii). The approach takes the view that, in terms of the issue of political capacity, studies of political development are best broached as creating viable

⁶⁸ The capacity to dominate force or violence is considered as a priori of governance. In the formation of nation-states, it would not be an overstatement to emphasize how crucial the role of force or violence was (e.g. Tilly 1975; Cohen, Brown, and Organski 1981; McNeill 1982). The dominance over force is also important in their sustenance. Because the use of force eventually results in a loss of power and legitimacy in modern governance, the role can often be underestimated. However, *the threat of force* is an essential and ultimate instrument in politics, which can elicit compliance from subordinates. It is not surprising that the Chinese leadership used force in 1989 as an ultimate means when they believed that the ongoing situation would destroy their core interests or national interests. There is no doubt that military force is still exclusively controlled by the CPC. However, I take this element as a priori of governance instead of a component of political capacity.

⁶⁹ There are two bases of legitimacy. Some scholars, such as Epstein (1984) and White (1986), assert that the legitimacy can only be judged by policy outcomes. But, still others, such as Lane (1984) and Hobsbawm and Ranger (1983) claim legitimacy on the basis of tradition and given norms and values.

organizations. Jackman reformulates the importance of institutions by adding legitimacy to Huntington's formula; political capacity hinges on the creation of *legitimate* institutions (Jackman 1993, 47), whose legitimacy is often measured by the age of institution (Starbuck 1965; Carroll 1983; Levinthal 1991). Since then, institutions have become a central subject in the study of contemporary comparative politics, although Jackman argues that the institutional factor has been neglected in studying political/state capacity.

There is, however, still no agreement on what institution means. The classical answer is that it means "the rules of game." For scholars, institutions include informal practices such as routines, customs, social norms, constraints, and even culture (March and Olson 1989; Nabli and Nugent 1989; Hall 1986). North (1981 & 1990) puts institutions into three categories: formal constitutional rules, operating codes, and moral /ethical behavioral norms. The constitutional rules are fundamental political, social, and legal rules grounding political and economic activities. Operating codes are the institutional arrangements and governing economic activities. Moral/ethical behavioral norms are a set of normative codes entailing social sanctions, customs, and ideologies. Including informal rules has the advantage of incorporating most forces that guide individual behaviors. However, an obvious disadvantage lies in diluting the concept too far. As Rothstein has put it, "If it means everything, then it means nothing" (Bo Rothstein, 145).

On the other hand, for Levi and Pontusson institutions can be defined as "formal arrangements" that aggregate individuals and regulate their behavior through the use of explicit rules. The advantage of this definition is that it is easy to trace changes in formal institutions and to define what they mean. However, a great deal of informal but nonetheless taken-for-granted rules that exist in political institutions and constrain political behavior may be missed. Peter Hall suggests that incorporating standard operating procedures in addition to analyzing the formal system is one way out of this dilemma. Then, though cultural and social norms are excluded from the definition, political rules in institutions are assured of inclusion whether or not they are explicit or tacit.

In this paper, I define institutions in a fairly narrow sense while seeking to integrate operating procedures or codes used in political and economic activities. By reformulating Lieberthal's usage (Lieberthal 1995, 183), I define institution as "a *formal* configuration of practices, relationships, and organizations that have *documented* sufficient regularity and perceived importance to shape behaviors of their members."⁷⁰ In transitional societies, the regularities collapse because members of the society start doubt on the utility and importance of the institutions, and new institutionalization starting up even while conflicting with the established institutions. I distinguish an institution from a structure in order to avoid conceptual vagueness. Institution is a set of fundamental political, social, and legal rules that are the guidelines of political and economic activities. Structure is a durable and comprehensive framework enabling interconnected institutional and behavioral variables; it limits the formation and roles of institutions as well. For example, the market economy is a structural variable, but executive-legislative relation within the market economy,⁷¹ electoral rules, and business organizations can be categorized as institutions.

The concept of institution is sometimes interchangeable with organization (Peter Hall 1986). It will be also useful to distinguish an institution from an organization in studying Chinese politics. Organizations are coherent, internally interdependent administrative or functional mechanisms or groups bound by some common purpose to achieve objectives. Organizations can be understood as *intermediate stages or agents of institutional change*; organizations are created to take advantage of opportunities in a society, and, as organizations evolve, they alter institutions (North 1990). Since the economic reforms in 1978, China has experienced *structural* changes moving a socialist economy toward a market oriented-economy and from a centralized system to a more decentralized system. In the transitional period, "the Chinese system is diffused with *organizations* that have not become *institutions*" (Lieberthal 1996, 183). The struggle to create or reshape institutions in accord with structural change outlines a contour of Chinese politics. Epidemic bargaining behaviors in the taxation area between Beijing and

⁷⁰ I define it more narrowly by adding "formal" and "documented" in Lieberthal's definition. For me, informality is considered as a lack of institutionalization.

⁷¹ For example, see Arend Lijphart, *Electoral Systems and Party System: A Study of Twenty-Seven Democracies, 1945-1990* (Oxford: Oxford University Press, 1994).

local governments can be explained by their institutional settings (i.e., the fiscal contract system and introduction of the tax-sharing system).

To change or retain given institutional settings, several organizational changes have been effected in China. As the inefficiency of a given institution increases and fiscal control by the Beijing government weakens, China sought to create a more centralized organization, which would collect central and shared taxes directly under the control of the central government in addition to other institutional settings. However, creating a political institution and implementing it do not occur in a vacuum. Rules and constraints cannot function as institutions unless they can be effectively implemented and can acquire regularity. Noticeably, China's leadership was able to utilize old institutions to introduce new institutions; old institutions were not merely cast off. For example, China actively utilized the principle of *democratic centralism* in introducing its tax-sharing system in 1994.

Yet the concept of state capacity as conventionally used by many scholars has its flaws. A critical problem with the concept in comparative studies is its confusion with political capacity. Certainly, political capacity is very closely related to the state capacity or state strength, but they do still differ. The concept of state capacity or strength is used to compare states; political capacity is a functional part of state capacity. The concept of state capacity does not distinguish the relative importance of different functional areas within the state. The degree of economic development and the size of the resource base can influence the size of resource extraction. However, the concept of political capacity explains why there are so many varieties of economic and political success among states with similar economic and international conditions. Looking back at the development processes of the so-called third world countries, one can see that pre-economic conditions could not strongly correlate with economic performance in many countries. Then too, in explaining the nexus between economic performance and domestic politics, the concept of state capacity has not been very helpful. In China's case, economic capacity has certainly increased along with economic reform. A crisis hypothesis is more likely to be based upon weakening political capacity during a transitional period of economy. Thus, it is premature to conclude that the political capacity of the Beijing government has weakened along with decentralization of its economic management and authority.

As a research strategy, therefore, I separate political capacity from state capacity and explain successful reforms in China along the lines of the notion of political capacity, which is not just a function of economic size factors. Politics must make some performative difference regardless of economic factors. Producing rules, policies, and institutions often aim at reducing or increasing resources and powers for a certain group of people or institutions.⁷² However, such political actions are far beyond efficiency-maximized behaviors or perfectly rational choices as assumed by earlier economists such as Theodore Schultz (1968), Vernon Ruttan (1969), and the early works of Douglass North (1973 and 1981). Preferences, tastes, and beliefs in a polity may lead to suboptimal choices. Political leaders may ascribe varying quality to different policy priorities and goals. In transitional authoritarian politics, political capacity is crucial in deciding the success of economic performance. Any study of the fiscal area must illustrate this point.

I phrase political capacity as the ability of political leadership to make workable policy priorities and to achieve the goals set by the policy priorities without resorting to force. In this respect, I pay greater attention to the deliberateness factor of political leaders. There is no empirical indicator yet developed to measure political capacity. In this study, I measure and evaluate it by its degree of implementation in accordance with policy priorities over a specific period. This study also seeks to integrate cognitive/preferential factors into the analysis of political capacity while avoiding falling into individual cognitive/psychological level analysis.⁷³ I rather focus on strategic policy priority, the quintessence of group preferences/beliefs of Beijing's political leaders during a stated period of time. The strategic policy priorities have represented Beijing leaders's perception to conditions and preferences as a group, and they tended to appear in compromise with various political actors, and became the guideline of actions for various sub-national actors.

As political/economic conditions change, the main mechanism with which to tackle challenge has been changed. During the Maoist period, ideological mobilization

⁷² Politics is often described as "allocation" or as "us against the other" (cited from Jackman, 34; Poggi 1978). Politics produces rules, policies, institutions, which (aim to) influence allocation. In this sense, I interpret that "politics as allocation" is rather outcome-oriented, but "politics as us against the other" is more process-oriented. "Politics as us against the other" and "politics as allocation" can be understood as a series of sequence.

⁷³ As a rare study in this line, see Yang (1996).

and mass movement were frequently used in constructing the socialist system. Mao's institutionalization of revolution, which focused more on human subjectivity and discretion than on objective factors, failed to raise Chinese economy to the so-called *xiaogang* [moderately developed] level. Under Deng's leadership, policy tools were changed to economic logic, consensus building, and institutionalization. Political priority was placed on "economic development" as opposed to any other goals. A certain exception could be seen in the Tiananmen Incident of 1989. In the fiscal arena, political goals have dictated fiscal policies with varying priorities over time. Either decentralization or centralization could be a valid choice given changing policy priorities.

D. Data Collection

1. Reliability of Chinese Data

During the Cold War period, data from Eastern European socialist countries and the Soviet Union proved unreliable because they often were for propaganda purposes and so intentionally increased figures relating to their social and economic achievements. Accounting methods in variance with Western countries also contributed to the confusion regarding accuracy of data issuing from socialist countries.⁷⁴ As indicated by Lieberthal,⁷⁵ China as most countries with a vertically integrated system also experienced a reliability problem concerning its data. The problem was not only technical but also systematic. Monitoring a problem in centrally-planned economies often produced this data credibility problem (Hayek 1974; Huang 1995). Even the leaders of these countries including China found it difficult to obtain accurate information. With political upheavals and fluctuations, there existed over- or under-reporting problems. In particular, under Maoist socialism, China often focused its focus its development strategy on subjective will rather than on objective data. Political movements and ideological zeal often created policies and targets not based on objective data. A series of politically roiled events made localities extremely sensitive to political demands issuing from Beijing. Localities were

⁷⁴ For instances, figures of military expenditures and governmental expenditures.

⁷⁵ Lieberthal (1995, 174-175). Here is an interesting episode quoted in Lieberthal's book. "Shortly after the Sino-American rapprochement of the early 1970s the Chinese government asked Washington to provide it with American satellite information on the area under cultivation in China. American did so-and in this way Beijing found out that roughly 20 percent of its cultivated land was not being reported by local officials."

accustomed to deliberately producing documents in Beijing's flavor. Therefore, Chinese policy-makers found it nearly impossible to get accurate information from localities; as a result, China seldom released data publicly during the Cold War period. Since the economic reform's inception, however, the Chinese leadership recognized the importance of accurate information and started making various data available publicly. Still, when objective data were required for setting up reform policies the Chinese leadership did not have sufficient resources to obtain them due to a lack of personnel and institutions which could handle this issue within government walls.

Before the 1990s, it was not unusual to find inconsistency even between provincial and state data as well as between different ministries on the same subject. Therefore, many scholars including Chinese officers often expressed their doubt about the accuracy of Chinese data.⁷⁶ The data reliability problem also manifested in two other factors and even after the inception of reforms. One was that numerous enterprises, in particular at the village and county levels, were unable to report accurate information due to a lack of knowledge of accounting procedures. The other and more important factor was that there was a problem of intentional false reporting by local officers and enterprises. In particular, under the fiscal contract system with relatively loose monitoring, localism prevailed. Local officers underreported to protect their resources from confiscation and sometimes over-reported to meet the targets from the Beijing government. Some Chinese scholars indicate that the problem of false reportage was severer during the post-Mao reform era than during the period of the Great Leap Forward.⁷⁷

It was crucial for Chinese policy-makers to collect accurate information for successful economic reform. From reform's inception, the Chinese leadership placed emphasis on objective conditions rather than human and ideological factors. Since then, Beijing has made great strides in improving the accuracy of data because they recognized that accurate and objective data are indispensable for inaugurating correct policies leading to successful economic reform. They strengthened the data-handling capability

⁷⁶ See World Bank reports. As a recent example, Qiong Sheng, "Tongji Buneng Chengwei Shuziyouju [Statistics can not be a Play of Numbers]." *Liaowang* No. 15 (1998): 10-15. Chen Zongli's report, *Guangming Ribao*, 25 July 1998.

⁷⁷ Wang and Hu (1999), 84.

by introducing organizational changes and increasing the number of people in this field. The General Auditing Administration (GAA) was established in 1983 for the purpose of auditing the economic affairs of the government and its enterprises. In addition, emphasis was placed on increasing the statistical auditing capability of the State Statistical Bureau (SSB). Chinese policy makers began to centralize some SSB local operations, in part to provide the SSB with a degree of institutional power to conduct statistical auditing.⁷⁸ New statistical techniques in the area of sampling and general tests have also been introduced. The level of standardization in revenue and expenditure accounting was considerably improved by clarifying terms in detail after the introduction of the tax sharing system.⁷⁹ With such efforts, the quality of data seems to have been improving steadily. My interviews with an officer in the MOF and with scholars also confirmed the efforts made by the Beijing government and the considerably increased accuracy of data at the provincial level and below (also see Wong 1993, 8-12). You Hongren, the director of the Chinese Statistical Bureau, announced at a 1998 conference for officers of national statistical bureaus that, in general, numbers relating to the macro-economy are reliable.⁸⁰

Yet data in the fiscal arena still had a reliability problem during most periods of the era of economic reforms.⁸¹ Along with the problems above, lack of reliability results from the nature of the Chinese fiscal system itself. During the period from 1988 to 1993, the Beijing government had adopted a fiscal contract regime, under which provinces collected most of the revenues and remitted to the Beijing government according to a preset contract.⁸² The regime required a considerable amount of bargaining and negotiation between the central and provincial governments in China, with the character of both the bargaining and negotiation proving quite informal. However, in the

⁷⁸ Huang (1995), 839-840. In 1981, the state council authorized the SSB veto power over the appointment of the directors, deputy directors and principal statisticians of its local branches. However, there are still institutional problems in controlling SSB local branches. Vertical leadership and payment by the central government have not yet established, which indicates that local governments still command a great deal of authority in operating the local SSB branches.

⁷⁹ For example, see MOF, Department of Budget 1999.

⁸⁰ Wang and Hu (1999), 86.

⁸¹ Chinese standards in measuring government revenue and expenditure were different from international practices until 1992 when they were corrected to conform to the international standards. It means that Chinese data are not consistent between pre- and post-1993. Therefore, we have to readjust them to maintain consistency when using the data prior to 1993.

⁸² For example, during the years from 1971 to 1980, the provinces collected around 85 percent of the total budgetary revenue (Zhang 1999, 118).

negotiations, the Beijing government still possessed the ultimate power of determining the contracts under negotiation. In addition, Beijing did not construct a meaningful reward mechanism during most periods of the economic reform but rather tended to exploit provinces with better fiscal performance as described in the phrase *bianda kuainiu* [whip a fast ox]. Accordingly, provinces had a strong incentive to underreport information.⁸³

Another problem was related to criteria determining how to measure the size of extra-budgetary [EB] and so-called off-budgetary [OB: *zhiduwai*] funds, which had steadily increased during the reform periods. Although China's Statistical Yearbook (*Zhongguo Tongji Nianjian*) and Financial Yearbook of China (*Zhongguo Caizheng Nianjian*) revealed the totals of extra-budgetary funds since 1982 in China's official data, the actual size remained controversial.⁸⁴ The size of the extra-budgetary funds was about 110 percent of the size of the budgetary revenue at its peak in 1992, but it drastically dropped to 33 percent in 1993 with a definition change in the extra-budget. Along with the implementation of "provisions for transforming the operating mechanisms of the state-owned enterprises,"⁸⁵ the extra-budget of the SOEs was withdrawn from the official figures of the extra-budget. Due to the definitional change, the volume of the extra-budget was much reduced. However, several field researches and other evidence reveal that the size of off-budgetary funds drastically increased since the change.⁸⁶ According to Zhang's estimation (Zhang 1999, 124), the size of the off-budgetary funds⁸⁷ was about 68

⁸³ My interviewee reveals that there are two kinds of statistical data relating to the fiscal arena. One is for the public as in China's Statistical Yearbook and China's Financial Yearbook, The other is for internal use. The latter contains the details of data relating to the bargaining.

⁸⁴ As a part of efforts to tighten control over the extra-budgetary funds, the central government set up a task force with people from various central departments, such as the Ministry of Finance, the State Planning Commission, the State Audit Agency, and the People's Bank, to investigate the fund. The team revealed the true figure of the extra-budgetary funds in 1995 was 384.3 billion *yuan*, which was 1.6 times higher than reported figure in the official statistics. (Zhang 1999, 124 and the original source in *Renmin ribao*, 8 June 1996).

⁸⁵ It allows SOEs various rights including the right to use their retained funds and the rights to refuse to pay *ad hoc* charges imposed by administrative units. See *Renmin ribao* 25 July 1992.

⁸⁶ See Fan (1995), Sun (1995), Jian (1996), Lu (1998), He (1998), Gu and Bai (1998), *Liaowang* 20 July 1998, and Zhang (1999). Since 1993, the size of extra-budgetary funds had increased from 36 percent of the budgetary revenue in 1994 up to 53 percent in 1996. However, after the State Council made a decision to strengthen the management of extra-budgetary funds in 1996, the size of extra-budgetary funds in 1997 decreased to the level of 33 percent of the budgetary revenue.

⁸⁷ It is composed of total fixed asset investment in SOEs financed by fundraising minus the portion by the EB funds and number of total rural population multiplied by per capita levy in the country side

percent of the budgetary revenue for the two years following the fiscal reform in 1994. This is much larger than the extra-budgetary funds. The sum of the extra-budgetary and the off-budgetary funds is equal to the size of budgetary revenue for the period from 1993 to 1995. Regarding the size of the off-budgetary funds, estimates since 1994 range from about 30 percent of the budgetary revenue to 200 percent.⁸⁸

My intention in this study is not to measure the potential size of fiscal resources that the Chinese government could utilize; rather, I am more concerned with how much local fiscal resources the Beijing government can control in practice. Because of the reliability problem of fiscal data, therefore, I still use the official data such as in *China's Statistical Yearbook* and *Finance Yearbook of China*. The official figures are the ones that the Beijing government can count on when they set policies. The figures also provide an idea of the extents to which the Beijing government integrates irregular budgetary funds and fees into its budgetary system. The proportions of the official fiscal figures over GDP are regarded as the capacity of the Beijing government to extract resources from Chinese society. Beyond these amounts is the area which the Beijing government cannot control.

2. Sources of the Fiscal System

During the 1960s and 70s, several prominent Sinologists had deplored the “retarded development” and “qualitative isolation” of Chinese Studies.⁸⁹ Although the criticism dealt mainly with methodological/theoretical backwardness of Chinese Studies in social science, it is also true that the backwardness was due to lack of reliable data during most periods of the Maoist era and even the first decade of early economic reforms.⁹⁰ Recent Chinese Studies no longer suffer from barrenness of data but, rather,

⁸⁸ To see the ongoing debates, refer to (Fan 1995, Sun 1995, Jian 1996, Lu 1998, He 1998, Gu and Bai 1998, and *Liaowang* 20 July 1998).

⁸⁹ See Howard Boorman, “The Study of Contemporary Chinese Politics: Some Remarks on Retarded Development” *World Politics* Vol. XII, No.4, (July 1960): 589-99; Charmers Johnson, “The Role of Social Science in China Scholarship.” *World Politics* Vol XVII No.2 (January 1965): 256-71; and Richard W. Wilson, “Chinese Studies in Crisis.” *World Politics* Vol. XXIII, No.2 (January 1971): 297.

⁹⁰ Regarding source-dependence problems in early China studies, see (Oksenberg, 1969; Chey 1975, 398-99; Harding 1993, 25). During the Maoist period, it was hard to have comprehensive access to China sources for western scholarship. Therefore, the perspective of the research often relied on the nature of information available during the research period. For examples, those who used red guard sources tend to focus contention within the elite and the conflict among contending organizations

from a flood of data. Numerous materials on the fiscal system and relations between the national and provincial governments are currently available in China.

First, the State Statistical Bureau (SSB) publishes a wide range of publications that contain key information and data on the national and provincial-level fiscal activities and structure. *China's Statistical Yearbook (zhongguo tongji nianjian: CSY)* is the most well known annual among them. *Finance Yearbook of China (zhongguo caizheng nianjian: CFY)* and *China's Taxation Yearbook (zhongguo shuiwu nianjian: CTY)* provide on a yearly basis sample information concerning financial and fiscal situations both at the national and provincial levels. *China Finance Statistics (CFS) (1950-1991)*⁹¹ edited by the General Planning Department in the Ministry of Finance (MOF) provides data on revenue, expenditure, and extra-budgetary revenue and expenditure at the province level. *Statistics of Chinese Taxation (zhongguo shuiwu tongji)* is another important source for taxation data at the national and provincial levels for the period of 1950-1994.⁹² In addition, *China's Provincial Statistics 1949-1989 (SPS)*,⁹³ a co-work by several institutions in Hong Kong and China including the SSB, contains the most comprehensive data in 45 issues on the 30 provinces. *The Gross Domestic Product of China, 1952-1995 (SSB 1997)*,⁹⁴ is a good source of GDP-related data at the national and provincial levels for the period 1952-1995 compiled by organizations dealing with national and provincial accounts. All CYS, CFS, SSP (1997), and SPS contain data on the thirty provincial-level governments as well as those of the central government since the establishment of the People's Republic of China. Because of a revealing data reliability problem prior to 1990, some data are inconsistent with others on the same item.

(Lindbeck, ed.; Scalapino, ed.). Dependence of extensive interviews of refugees and former Chinese cadres in Hong Kong by Barnett leads his view on Chinese communist system to be a massive bureaucratic society (Chey).

⁹¹ MOF, *China Finance Statistics 1950-1991* [Zhongguo Caizheng Tongji] (Beijing: Kexue Chubanshe, 1992).

⁹² State Taxation Bureau, *Zhongguoshuiwutongji: 1950-1994* (Beijing, Zhongguo Shuiwu Chubanshe, 1997).

⁹³ Tien-tung Hsueh, Qiang Li, and Shucheng Liu, eds., *China's Provincial Statistics 1949-1989* (Boulder: Westview Press, 1993).

⁹⁴ China started to estimate GDP from 1985, so the data of previous years are replenished by using the following methods: "value added of agriculture, industry, construction, transportation, post and telecommunications derives by adjusting net production value of their corresponding industries in the context of Methods of Products Standardization (MTS) with related business accounts data: value added of other industries is estimated in terms of the data of relative business accounts, business operations, fiscal accounts and labor salary." SSB (1997), 3-4.

However, since 1990 this problem has been corrected. In case of data conflicts, I chose the data of China's Statistical Yearbook because it officially represents the SSB. In addition, every provincial-level government publishes various yearbooks, and each provincial statistical yearbook contains information on the fiscal flow of the respective provinces. Some provinces also published a forty-year' (*sishinian*) review (1949-89).⁹⁵

Major Chinese organizations publish their own journals on a monthly, bimonthly, or quarterly basis. Most provinces have at least one journal relating to social science and economy issues. Most of them place their provincial name in the title, but some of them do not.⁹⁶ Almost all started publishing since 1979. In addition to provincial governments and organizations, the major functional organizations I deal with in my research are the Ministry of Finance (MOF), the State General Taxation Bureau (*zhongguo shuiwu zongju*: SGTB),⁹⁷ the SPC (State Planning Commission), the State Commission for Restructuring the Economy (SCRE), the Chinese Academy of Social Science (CASS), the Development Research Center (DRC), and the Shanghai Academy of Social Science (SASS). Each major functional organization also has its own publication and journals.

MOF publishes the monthly *Caizheng* [Finance]. *Jingji Yanjiu Cankao* [References on Economy Studies] and *Caizheng Yanjiu Ziliao* [Resources on Finance Studies] are published at least once a week and provide timely sources of MOF views. The department of Local Affairs under MOF published *Difang Caizheng* [Local Finance] from 1995 until 1999. It provides various provincial statistical data. In addition, the MOF in 2000 published a series of collected articles for the purpose of training finance bureau cadres at various levels of government. The SGTB was previously an auxiliary organization under MOF but was placed under direct supervision of the State Council. It publishes the annual *Shuiwu* [Taxation] yearbook and monthly *Shuiwuyanjiu* [Taxation Review]. *Zhongguo Shuiwu Tongji* (1950-1994) [China's Taxation Statistics, 1950-1994]

⁹⁵ Yunnan, Jiangsu, Tianjin, Guangxi, Shangdong, Shaanxi, and Henan published in 1990. In addition, cities such as Ningxia, Tongchuan, and Benjin also independently published a 40-year review.

⁹⁶ For example, *Shehuikexue Zhanxian* [Frontier of Social Science] is published by Jilin Academy of Social Science on a quarterly basis; *Shehuikexue Yanjiu* [Study on Social Science] by Sichuan Academy of Social Science on bimonthly; *Shehuikexue Jigao* [Edition on Social Science] by Liaoning Academy of Social Science on bimonthly; and *Zhenming* by Jiangxi Academy of Social Science on bimonthly.

⁹⁷ It was renamed from State Taxation Bureau (until 1993) and General Taxation Bureau (before 1988).

provides detailed taxation figures at the national and provincial levels during the period 1950-1994 (SGTB 1997). The DRC produces a monthly *Guanlishijie* [Management World] and its internal circulation *Jingji Gongzuozhe Xuexiziliao* [Study Materials for People working in Economic Field]. The CASS has a bimonthly *Zhongguo Shehuikexue* [China Social Science] and its *Jingji Yanjiusuo* [Economy Research Center] publishes a monthly *Jingjiyanjiu* [Economy Review].⁹⁸ In addition, its monthly periodical, *Jingjiyanjiu Ziliao* [Resources on Economy Review], also provides various timely views and information. The monthly *Jingjiguanli* [Economy Management] is co-published by the government, academy, and enterprises and boasts its largest quantity. Among ten institutions supporting this periodical are the CASS, and the SPC, and China Enterprise Management Association.

The CPC produces numerous books and internal documents.⁹⁹ The SCRE also published *Zhongguo Jingjitizhigaige* [China's Economy Structure Reform] from 1986 and its internal circulation *Jingjitizhigaige Neibucankao* [Economy Structure Reform Internal Reference].¹⁰⁰ However, the most crucial document is the reports addressed by the party secretary in the Party Congress that is held in every five years.¹⁰¹ The three volumes of *Huimou Shijichao* [Looking Back at the Trend of the Century] provided important information and all major documents relating to major party issues from the first CPC congress (1921) to the fifteenth CPC Congress (1997), which included various ideas and policies regarding the fiscal reforms (Wu Jie et al, 1998b). The first volume of *Zhongguo Zhengfu yu Jigougaige-II* [Chinese Government and Institutional Reform] provided detailed information on various organizational changes over time under the

⁹⁸ According to my interview, the most important periodicals, which local scholars and officers refer, are *Jingji yanjiu* [Economy Review] and *Guanlishijie* [Management World]. It is related with institutional affiliation of the journals. During the reform period, CASS and DRC have played as major think tank roles although its role varied according to period and personal connection with political leaders.

⁹⁹ The University Service Center in Chinese University of Hong Kong has a great deal of internal documents for the periods of 1980s.

¹⁰⁰ In addition, there are other numerous periodicals such as *Caizheng Yanjiu* [Finance Review], *Caiwu jingji* [Finance and Trade Economy], *Caizheng Yanjiuziliao* [References on finance studies], *Caijing Kexue* [Finance and Economy Science], *Caishui Yanjiu* [Public Finance Review], *Jingji Gaige* [Economic Reform], *Zhongguo Caizheng* [China Finance], and *Jihua Jingji* [Planned Economy].

¹⁰¹ The State Council Research Office and Central Party Policy Research Office also jointly produce a monthly *Xuexi, Yanjiu, Cankao* [Study, Research, Reference].

State Council. These include the Taxation Bureaus (Wu Jie et al, 1998a).¹⁰² The English language periodical, *Chinese Economic Studies*, introduces unabridged English translations of Chinese articles from major Chinese journals such as *Difang caizheng*, *Jingji yanjiu*, and *Jingji guanli*. Furthermore, provincial-level periodicals provide anecdotal data, fiscal policy information, suggestions, official views, and ongoing debates in the fiscal arena of each institution involved.¹⁰³

Since the *ligaishui* [replacement of profits by taxes] reform was introduced in 1984, a variety of encyclopedic references on fiscal system have been produced both inside and outside China. Some comprehensively include the formal and general structures of the Chinese fiscal system, while others are more specifically issue-oriented. In particular, Liu Zuo (from the SGTB)'s *Zhongguo Shuizhi Wushinian 1949-1999* [Fifty Years of Chinese Taxation System] proves extremely valuable in providing plentiful internal anecdotes on the drafting and decision-making processes regarding taxation reforms in view of the SGTB. The other valuable publication is *Zhongguo Caizheng Wushinian* [Fifty Years of Chinese Finance] edited by Xiang Huaicheng, the MOF Minister. Reference books, which provide general sketches of the taxation system, flood the society. For example, there are *Zuixin Zhongguo Shuizhitongshi* [A General Guide of the New Chinese Taxation System] (Xi, Yang, Qin eds. 1994); *Zhongguo Xinshuishouzhidu Yingyongzhinan* [A Guide to Chinese New Taxation System] (Yao and Hao 1994); *Xinshuifa Zonglan Zongshi* [An Overview and Explanation about New Tax Law] (Hu et al. eds. 1994); *Zhongguo Xinshuizhi Yewu Quanshu* [A Complete Textbook of Chinese New Tax System] (Wang and Wang 1994); *Zhongguo Shuifa Jingjie* [Introduction to Chinese Tax Law] (Li and Xu, 1994); *Guoshui Yewu Shouce* [Working Manual for State Taxation] (Yuan and Men 1995); *Zhongguo Shuishou Zhidu* [Tax

¹⁰² Regarding the organizational changes under the State Council, see more in Qingkui Xie, et al. eds. *Dangdai Zhongguo Zhengfu* [Contemporary Chinese Government] (Shenyang: Liaoning Renmin Chubanshe, 1996); State Council General Office and Central Publishing Committee Office, eds. *Zhongyangzhengfu Zuzhi Jigou* [Organizational Structure of the Central Government] (Beijing: Zhongguo Fazhan Chubanshe, 1995); State Council General Office and Central Publishing Committee Office, eds. *Zhongyangzhengfu Zuzhi Jigou* [Organizational Structure of the Central Government] (Beijing: Gaige Chubanshe, 1998).

¹⁰³ Many administrative units of the provincial government, provincial party committees, provincial people's congresses, and academic associations have their official outlets. Most government reports (*Zhengbao*) are monthly, while a few such as those of Guangdong and Shaanxi are bi-weekly. More details in Jae-ho Chung, "Reference and source Materials in the Study of Provincial Politics and Economics in the Post-Mao Era," *Provincial China* No. 1 (March 1996): 2-8.

System of China] (MOF, Department of Tax Policy. ed. 1996); and *Zhongguo Shuiwu Dacidian* [Encyclopedia of Chinese Taxation System] (Wang et al. eds. 1996); *Zhongguo Caizheng Gongzuo Zhishishou* [Handbook on Knowledge of Fiscal Works in China] (MOF, editorial board. 1999), and so on.

Zhongyang yu Difang Caizheng Guanxi Yanjiu (1996) [On Central and Local governmental Fiscal Relations], sponsored by the Dalian Municipal Government, provides information on research for understanding fiscal relations between the Beijing and local governments, with an emphasis on the inter-governmental transfer system as a regulator of centralization and decentralization. In 1999, the Center for Public Policy Studies at the Shanghai University of Finance and Economics, a consulting institution for fiscal and economic decision-making, published *Zhongguo Caizheng Fazhan Baogao* [Report on Fiscal Development in China], which comprehensively describes overall fiscal and economic development in China.¹⁰⁴ In addition, nine volumes of collected training material for cadres in the fiscal area by the MOF covered a broad range of fiscal issues.¹⁰⁵

Taiwan also provides various sources on Chinese fiscal relations by government institutions as well as academies sources ranging from introductory books to experimental research studies. Luo, Nengqing's *Zhonggong Fushuizhidu zhi Yanjiu* [A

¹⁰⁴ In addition, plenty of historical reviews relating to the fiscal reforms are available for the public. For example, see Guoguang Liu, ed. *Caishui* [Finance and Taxation] (Beijing: Zhongguo Caizheng Jingji Chubanshe, 1993); Xinzhong Song, *Dangdai Zhongguo Caizhengshi* [Contemporary History of Finance of China] (Beijing: Zhongguo Caijing Jingji Chubanshe, 1997); SCRE and Central Party School, eds. *Zhongguo Caizheng Gaige 20Nian* [Twenty Years of Fiscal Reform in China] (Zhengzhou: Zhongguo Guji Chubanshe, 1998); Zhenpeng Ye, and Shangmin Liang, *Zhongguo Caizheng Gaige Ershinian Huigu* [Review of Twenty Years of Fiscal Reform in China] (Beijing: Zhongguo Caijingjingji Chubanshe, 1999). Regarding pre-reform fiscal history, Guangyan Chen, *Zhongguofushui Fazhan Yanjiu* [Study on Development of Taxation in China] (Beijing: Zhongguo Caijing Jingji Chubanshe, 1996) and Zhenpeng Ye, *Zhongguolidai Caizheng Gaige Yanjiu* [Study on Fiscal Reforms of Successive Dynasties in China] (Beijing: Zhongguo Caijing Jingji Chubanshe, 1999). Major articles in the fiscal area and discussions in the various fiscal and finance conferences were introduced. For example, the Chinese Academy of Taxation ed. *1996 nian Quanguo Shuishou Lilun Yantaohui* [1996 National Tax Theory Conference] (Beijing: Zhongguo Shuiwu Chubanshe, 1997); Youcai Zhang, eds. *Caishui Gaige Conglun I-III* [Discussion in Depth regarding Fiscal Reforms I-III] (Beijing: Jingjixue Chubanshe, 1997); Editorial group, *Zhongguo Caishui Gaige Redian Wenti Yanjiu* [Study on Hot Issues of Fiscal Reforms in China] (Beijing, Zhongguo Caijing Jingji Chubanshe, 1998). Hongguang Wu, ed. *Zhongguo 20nian Jingjitizhi Gaige Lunwen Jingxuan 1979-1998* [Fine Collection of Articles on Restructuring the Economic System for Last Twenty Years in China] (Beijing: Jingjixue Chubanshe, 1998).

¹⁰⁵ They were published by *Jingjixue Chubanshe* in Beijing in 1999. The subject covered fiscal transfers, tax policies, rising fiscal issues, fiscal reforms, fiscal management system, and so on.

Study of Tax System in China] (Luo 1989), Zhong Ding's *Dalu Caizheng Xiankuang* [Current Financial Situation in Mainland China] (Zhong 1993), *Dalu Shuizhi Yanjiu* [A Study of Tax System in Mainland China] produced by Tax System Commission of the Ministry of Finance in Taiwan (MOF 1994), and Kuo's *Zhongguo Dalu Shuishouzhidu: 1950-1994* [Taxation System in Mainland China] (Kuo 1996) are the introductory books. The studies on China's fiscal system in the Taiwan Academy evolved from introductory and basic content analyses¹⁰⁶ to more theory and research based ones. For example, studies by Xu and Cai (1998) and Liu (1998) adopted a game-theoretic model in the study of the fiscal relations between the Beijing and local governments. Su's study on the fiscal relationship between the Beijing and Shanghai governments is a rare field research study (Su 2000). Although the studies mainly focused on the inability of the Beijing government to command its fiscal system, they still provided us with information and data on the fiscal system. The Center for International Relations at National *Chengchi* University in Taipei has since the 1980s collected news clippings on various issues including finance.

However, relatively few reference books on the Chinese tax system have been published in the Western academic world. Oksenberg and Tong's study is one of the few works in this field. It covers the period 1971-1984 and explains some details of the changes in the fiscal system although it does not comprehensively cover all the features of the Chinese tax system. A comprehensive introduction and analysis are done by the

¹⁰⁶ For example, see Jingming Fan, *Zhonggong Fushui yu Jingji Fazhan Guanxi zhi Yanjiu* [A Study of Relationship between Taxation and Economic Development in China] (Taipei: Zhonghua Jingji Yanjiuyuan, 1983); *Zhonggong shuizhi juegou yanbian zhi yanjiu* [A study of tax system change in China] (Taipei: A master thesis in Zhengzhi Daxue, 1993); Zhongwu Xu, *Zhonggong Xianxing Caizhengguanlitizhi* [Current Finance Management System of China] (Taipei: A MA Thesis at the National Chengchi University, 1997); Ruanli Cheng, *Zhonggong Shuizhi Juegou Yanbian zhi Yanjiu* [A Study of Changes of Taxation Structure in China]. (Taipei: A MA Thesis at the National Chengchi University, 1993); As for articles, see Xiaozhu Liu, "Congzhongguodalu Caizhengtizhide Yanbian kan Zhuhoujingjide Xingcheng [Formation of "Dukedom" Economy in context of Changes of Fiscal System in mainland China]." *Zhongguo Dalu* (September 1992): 53-56; Rende Huang, and Wenfa Cheng, "Zhonggong Caizheng Shouzhi Zhidu yu Caizheng Nengli Bianhuadetantao [A Study of Revenue and Expenditure System and Changes of Fiscal Capability in China]." *Zhongguo Daluyanjiu* Vol. 39 No. 11 (November 1996): 16-37; Rende Huang, and Wenfa Cheng, *Zhonggong Caizheng Diaokong Waiziyunong yu Zhuhoujingji* [Financial Adjustment and Control, Foreign Capital Exercise, and Economic Warlordism in China]." *Zhongguo Daluyanjiu* Vol. 39 No. 12 (December 1996): 24-59; and Jianzhong Kuo, "Zhongguodalu Zhongyang yu Difangde Guanxi [Relations between the Central and Local Governments in Mainland China]." A Paper presented at the Conference in Taiwan Academy of Political Science (December 1997).

China Tax Guide (Moser 1987) and *The Government Budget and Fiscal Policy in Mainland China* (Hsiao 1988). Additionally, there are *China: Revenue Mobilization and Tax Policy* (The World Bank 1991); *Taxation in the People's Republic of China* (Li 1991); *Fiscal Management and Economic Reform in the People's Republic of China* (Wong et al. 1995); and *China in the 1980s* (Breslin 1996). *China: Macroeconomic Stability in a Decentralized Economy* (The World Bank 1995) also provides a good source in helping scholars to understand the limits of the fiscal contract system of China in 1988. In particular, a World Bank study strongly supported recentralization of the fiscal system in the middle of the political battle for the fiscal contract system and the tax sharing system. However, no book has recently updated comprehensive features and analysis of the Chinese tax system. A recent collection edited by Brean (1998), *Taxation in Modern China*, is a rare collection filling the gap by addressing the multi-dimensions of the Chinese fiscal system including intergovernmental fiscal relations.

Susan Shirk adopted the institutional approach in her case study, *Political Logic of Economic Reform in China* (Shirk, 1993), and explained how fiscal systems fluctuated according to struggles for leadership succession among top political leaders. Although they are not very informative, some articles provide insights on the evolving fiscal system. They are "Some Notes on Tax Reform in China" (Wang 1984), "the Evolving Role of Tax Policy in China" (Szapary & Blejer 1990), "Fiscal Reform and Local Industrialization" (Wong 1992), "China's Tax Reform: Breakthrough or Compromise" (Tsang & Cheng 1994), "The 1994 Tax Reforms: The Center Strikes Back" (Herscher 1995), "Distributional Consequences of Reforming Local Public Finance." (Park et al. September 1996), and the recent article "Chinese Central-Provincial Fiscal Relations, Budgetary Decline and the impact of the 1994 Fiscal Reform: an Evaluation" (Zhang 1999).

E. Research Structure

Before briefing my remaining chapters, let me raise some limits of this paper. This study is limited mainly to the dynamics of the taxation system. The banking system, management of the state-owned assets, foreign investments, and issuing bonds are not discussed. Instead, the thesis compares three different periods of fiscal reforms in China

after the Beijing government launched its post-Mao economic reforms. The replacement of profits by tax (*ligaishui*) reforms in 1983 and 1984, the introduction of the fiscal contract system (*caizheng baogan*) in 1988 and the tax-sharing system (*fenshuizhi*) in 1994 are the cases. To deepen understanding of the dynamics of the financial system of China, the studies on the banking sector, management of the state-owned assets, foreign investment, and issuing bonds will need to be integrated.

The data used are mostly pooled provincial and national data, which aggregate figures of all subordinate administrations including planned cities (*jihua danlieshi*). Therefore, it will require additional work to determine sub-provincial relations.

Chapter II starts with a critical review of given approaches on China's fiscal relations in terms of the conceptual framework of fiscal centralization and decentralization. Then I empirically re-examine the indicators that are most frequently used by scholars to evaluate the degree of Beijing's control over localities, and the ratios of revenue and expenditure over GDP. Furthermore, I also constructed data with and without the extra-budgetary revenues and expenditures in the analysis. Simple comparisons in revenue and expenditure sides reveal complicated trends in the fiscal capacity of the Beijing government, which are not equal to an one-sided spiral of either centralization or decentralization. Then I test the State GDP method, which is most common and the more advanced method in measuring political capacity.¹⁰⁷

After testing the State GDP method, I argue that changes in the policy priorities of the Beijing government were likely to be the most crucial factors in determining fiscal performance in China because certain patterns occurred along with Beijing's policy changes over periods. The Beijing political leadership formed its policy priorities under the current decision-making system. Who participated in the decision-making process? How did Beijing's leaders communicate with local leaders within the political system? I note the importance of the principle of democratic centralism as the framework for decision-making during the post-Mao period. It has functioned as a *semi-institutional* norm in that it was a written and acknowledged code that bound behaviors to regularity but did not have detailed written rules and still left room for discretion. The post-Mao

¹⁰⁷ Multiple regression analysis and representative tax system analysis are the other common methods. I experimentally tested these as a preliminary work, but in this paper, reliability and availability of the complete data still hindered applying these methods in China. It is left for the future studies.

leadership sought to abide by this set of procedural norms. The relative emphasis of the democratic principle of democratic centralism was the gist of the norms. Rather than requiring simple majority rule, this principle required an incessant and overlapped consulting, negotiating, and compromising process, creating a certain policy orientation. Efficiency was not the target of the norm; effectiveness and political stability were. This helps to explain why the Chinese reforms have resulted in gradual and non-linear outlooks. The democratic principle helped the authoritarian Chinese state and its political leaders not to become starkly predatory, a tendency that has been quite common in most developing countries, but to enhance policy enforcement in the huge and diverse land.

Chapter III focuses on the introduction of the *replacement of profit by tax (ligaishui)* reform during the period 1980-1984. Institutional and historical legacies left the Chinese fiscal system lacking institutionalization and more decentralized than the totalitarian and top-down images suggest. Politics overwhelmed the fiscal system during the Maoist period. During the early period of 1980s, the Beijing government placed great stress on stabilizing and standardizing the fiscal system in order to overcome the Maoist legacies. A bold expression of those efforts appeared in the introduction of the *replacement of profit by tax* system in 1983 and the more standardized fiscal management system in 1985. This was a potentially radical attempt in terms of ideas and potential influences of the reform, but the application of democratic principle, which allowed interests among bureaucracies and political leaders certainly to play in shaping the policy, made the policy more conciliatory and gradual in practice. During this period, major players were central bureaucracies and leaders in the fiscal reform rather than local leaders.

Chapter IV illustrates how the policy priorities in the fiscal area evolved in accordance with strategic policy priorities after urban reform was introduced in 1985. After that year, discourses in the Beijing leadership and scholars focused more on rapid economic development and further decentralization when both policies proved incompatible each other with policies for fiscal standardization. The discretionary fiscal contract system (*caizheng baogan*) had been introduced along with efforts to encourage local economic developments in spite of fiscal difficulties, in particular in the coastal area in 1988. The Beijing government allowed localities to reserve more fiscal resources,

including extra-budgetary funds for their own use. The decision in favor of fiscal decentralization constituted the formula for a win-win game between the Beijing and provincial governments. Beijing's leaders and financial organizations would attain economic development and stable revenue collection instead of effective fiscal control over localities. Even much earlier than the implementation of the fiscal contract system, Beijing's leaders manifestly recognized the defects of fiscal decentralization and rampant localism (called *zhuhou jingji*), but the choice of the Beijing leadership accelerated fiscal decentralization. Such a policy was effective under the circumstance that the Beijing government did not have its own effective monitoring mechanism and a sufficient number of trained personnel in the fiscal arena. The localities also welcomed the policy. Therefore, it did not require an extensive mechanism to implement and to monitor a new fiscal system. In practice, the Beijing government exercised lax fiscal inspection over localities. Institutional arrangements and the contents of the fiscal contracts during the period support my argument.

Chapter V explains how the Beijing leadership responded in the fiscal arena to new internal and external challenges and how dynamics between institutional constraints and various bureaucratic and regional interests determined the fate of fiscal reforms. A series of incidents and situations such as the Tiananmen Incident in 1989, a succession crisis, strong localism, and changing international security environments due to the collapse of the former Soviet-bloc in the early 1990s introduced an element of crisis in Chinese politics. In response, the Beijing government attempted to recentralize its fiscal system and to introduce a more standardized tax-sharing system. However, the initial attempts failed because of strong opposition from local leaders and lack of consensus among leaders in Beijing. I describe how an unstable security situation coupled with a sense of crisis brought a heavy burden on the finances of the Beijing government. Under the current fiscal contract system, the Beijing government was unable to find any solution to support rising military expenditure and other expenses. The weakness of the fiscal contract system triggered a fiscal reform in combination of the macroeconomic control factor. I argue that less effective macro-economic controls caused by strong localism, succession crisis, and changing international security caused Beijing's strategic policy priority to change to recentralization and standardization of the fiscal system in order to

obtain means for the Beijing government to control localities and the nation and to further economic development.

Chapter VI explains how the original contents of the tax-sharing reform have been changed after getting through the *democratic* process. Under the zero-sum nature of the fiscal reform of 1994, it was not an easy task to make the decision to introduce the tax-sharing system as well as to implement it. Strong presence of localism and bureaucratic interests interwoven and blocked any quick decisions. Democratic centralism as a mechanism to persuade and enforce Beijing's policy had been more extensively applied to insure implementation than in the previous period. The principle induced a series of negotiations and compromises, and still it delayed making a final decision to implement the tax-sharing system (*fenshuizhi*).¹⁰⁸ Local leaders were active participants, compared to the *ligaishui* reform of the early 1980s. The final decision required a political determination and compromise by Jiang Zemin or at least a group decision in the top echelons of political leaders beyond the bureaucratic decision-making hierarchy. Then a moderately successful implementation occurred in spite of all difficulties. This whole process was quite different from the top-down image of the totalitarian socialist system. It was not a perfect form of implementation as initially desired by the Beijing government. This example also reveals how feeble yet tough institutionalization was in the transitional period of reform. However, it also shows how the Beijing government was still able to command the fiscal area according to its primary policy goals and to implement them in spite of the strong presence of localism and a zero-sum circumstance. The ability of the Chinese decision-making institution and the Beijing government to adopt new policy and to enforce primary policy was well illustrated in this case.

The concluding chapter summarizes what factors influenced the outcomes of the fiscal reforms and how the institutional decision-norm made the fiscal policies different in practice in a certain pattern. I conclude that China's economic success can be attributed to the political capacity of Beijing's leadership. During the transition, they have been able to sustain consensus on strategic policy priorities within their current policy-

¹⁰⁸ Its original meaning in Chinese is division (*fen*) of taxes (*shui*). The term "tax assignment" system is also interchangeably used. However, the reason I use the term of tax-sharing is that this term better describes the essence of 1994 reforms in the Chinese fiscal system, which started sharing taxes with localities in legal constraints, instead of having exclusive power by the Beijing government on measures relating to taxes.

making system, create organizations and rules according to new challenges, give appropriate signals of their intention to localities, and draw up compromises to insure implementation while securing the policy's priority goals if necessary. Old institutional mechanisms were not removed at once but utilized in new ways according to new circumstances. The Beijing leadership was capable of getting what it wanted in the fiscal arena throughout fiscal reforms.

The principle of *democratic centralism* has been utilized to ensure policy implementation. The political contribution of the principle was to set certain constraints on predatory and discretionary behaviors of political leaders in the transitional period. Although the principle did not have a formal procedure set by the principle in decision-making, political leaders implicitly and explicitly subscribed to the efficacy of the principle and abided by it to legitimize their policies. The Chinese decision-making system and leadership proved effective during the transitional period where the uncertain nature of socio-economic transition required prudent and adaptable measures. It is obvious that the Chinese leadership has incessantly struggled for institutionalization and standardization of informal practices. As the institutionalization proceeds, it certainly conduces to more effective and efficient governance than before. However, as seen in the fiscal reform decision in 1994, the task of institutionalization and standardization has not yet been fully accomplished.

This study of successful economic reforms also reveals the weak side of the system. With reforms proceeding, the economy becoming market-oriented, and social interests diversifying, more complicated domestic and international challenges to the Beijing leaders are likely to rise. It is getting harder to reach consensus in the leadership as well as in society. The historical task of the semi-institutionalized *democratic* principle as a relatively flexible form of consensus-building mechanism during the volatile transitional period is likely close to the end because new and rising social and political demands will not be satisfied with the rather discretionary mechanism. Creating a more standardized system will be one of the key tasks for further economic success and political stability. Beijing's leadership should respond to the challenges by undertaking institutionalization in the area of succession and decision-making. The task has not yet been finished.

Chapter II

Analytical Issues on Intergovernmental Fiscal Relations

In this chapter, I will critically review existing studies on Chinese fiscal relations and then reevaluate the fiscal situations by using the state GDP and revenue elasticity methods. These analyses emphasized the importance of Beijing's policy changes. Then I will explain the principle of democratic centralism as a decision norm during the post-Mao era, which shaped policy priorities in the fiscal arena as well in others.

I argue as follows: First, a narrow focus on the revenue/expenditure side is not likely to reveal the state capacity. Most studies on Chinese fiscal relations implicitly or explicitly relate to the state capacity issue while focusing their analyses on the outcomes either in revenue or expenditure. However, it is crucial to understand that Chinese policy-makers deliberately guided the process of economic and fiscal reforms. Policy directions of the Beijing government in fact accounted for most key observable changes in the fiscal arena. Analyses performed by the state GDP and revenue elasticity methods reveal certain trends in the fiscal performance of localities in response to the changing policies of the Beijing government.

Second, in practice the Beijing government was more capable of controlling fiscal resources during the post-Mao reform era than statistics suggested. Beijing's control over extra-budgetary funds and quasi fiscal institutions such as bank loans was strong. Beijing was also able to take fiscal resources discretionarily away from local governments when necessary. Looking at the revenue elasticity index, I argue that Beijing extended its regional revenue bases by narrowing provincial differences in fiscal efforts, although the proportion of revenue collection over the GDP decreased along with the economic development. Beijing increased the number of provinces over time such that scores of their fiscal efforts are higher than average.

Third, in the third section I introduce the principle of democratic centralism as a decision norm in the Chinese political system during the post-Mao era and its application in practice. I argue that the policy process based on the principle of democratic centralism induces sufficient coalition-building to produce reasonably effective implementation of Beijing's policies, in particular when the leaders were united. The decision-making process filtered the intention of political leaders, as reflected in formal documents. This study argues that without attention to intentional aspects of policy-makers, a mere focus on the outcomes in the fiscal area is likely to misguide and produce a myopic view.

A. Review of Studies on Chinese Fiscal Relations

Three different views exist regarding Chinese fiscal relations during the post-Mao period. The first view is the rise of strong local power, the second is Beijing's dominance over local governments, and the third resides in between the two. A conventional view would be that the Chinese central-provincial fiscal relationship has been decentralized during the period of economic reforms, which weakened Beijing's control over local governments.

Wang Shaoguang, Hu Angang, and Gu Jialin in their series of writings argue that the power of the Beijing government has constantly decreased since the post-Mao economic reforms.¹ Wang and Hu indicate that the ratio of government revenue over GNP was 31.2 percent in 1978, dropped to 14.2 percent in 1992, and was expected to be around 11.3 percent in 2000. This figure is less than half that of developed countries such as England, Germany, France, the United States, and Canada. In addition, the shares of the Beijing government in revenue and expenditure over GNP have constantly dropped. In this aspect, the power of the Beijing government is comparable to that of Yugoslavia on the eve of its breakup. This view implied or explicitly stated that the decline of central power in the fiscal arena could lead to the collapse of the Chinese political system. Some

¹ Shaoguang Wang, and Angang Hu, *Zhongguo Guojia Nengli Baogao* [A report on National Capability of China] (Honk Kong: Oxford University Press, 1994) and Shaoguang Wang, and Angang Hu, "Zhengcui renshi he Chuli Shichangjingji Zhuanxingzhong Zhongyang yu Difang Guanxi [A Correct Understanding and Treatment of the Central and Local relations during the Transformation of Market Economy]" in *Jiquan yu fenquan* [Centralization and Decentralization], edited by Funai Dong et al, (Beijing: Jingji Kexue Chubanshe, 1996). In addition, Jialin Gu, *Congjigougaige Daoxingzhengtizhigaigede Shijian yu Sikao* [A Practice and Reflection of the Reforms from Institutions to Administration System] (Beijing: Zhongguo fazhan Chubanshe, 1997).

Western analyses of China's future also supported the *disintegration of China* hypothesis.² As a policy to overcome this problem, they emphasize the necessity of establishing fiscal centralization and authoritarian government.³ This view has brought a series of discussions in Chinese academic society.⁴ The direction of reforms adopted in the 1994 tax reform and in the 15th CPC congress in 1997 was based upon this view.

Park, Rozelle, Wong, and Ren's study on the distributional consequences of reforming local public finance (1996) also leads to a similar conclusion. Changes within provinces according to fiscal reforms have reduced the ability of the Beijing government to redistribute public financial resources. Naughton (1992) indicates that the lack of institutional arrangements after the breakdown of the traditional system of revenue mobilization at the national level may have resulted in both the chronic fiscal crisis and the weakness of the Beijing government.

Oi's analysis (Oi 1992) of local state corporatism in China highlights the waning capacity of the Beijing government in the midst of fiscal decentralization and marketization.⁵ The local state corporatist system helped to expand the local economy at the expense of Beijing's control over macro-fiscal management. Under the post-Mao reforms local governments faced greatly expanded expenditure. This situation forced local governments at all levels to be starved of revenue and thus to seek growth. The dependence of local budgets on the financial health of local industry induced local intervention to protect their enterprises. This situation allows local governments to perpetuate ties with their enterprises and exacerbate the tendency toward regional protectionism.

Faced with intense budgetary pressures, local governments cannot help but engage in industrial expansion and economic growth, which allows them to benefit economically and alleviate budgetary constraints. In response to those economic

² See Segal (1994) and Morse (1995).

³ Gordon White indicates the emergence of the notion of new authoritarianism in China since 1986. See Gordon White, *Riding the Tiger* (Stanford, Stanford University Press, 1993): 249-250.

⁴ Luo Xiaopeng, Zheng Yongnian, Zhou Xueguang, Wo Guoguang, and Zhang Shuguang are on the opposite side to Wang and Hu's view.

⁵ It is not clear in Oi's analysis how autonomous local governments are in making their own decision against the center and how strong they are in terms of revenue and expenditure-sharing scheme. Oi's focus, in general, seems to be on the strength of local governments over society (enterprises) rather than the central authority.

difficulties, a local state corporatist system has been formed in which local governments act like local corporations (Oi 1992, 121-22). They preside over the operation of their own enterprises through the selection of management personnel, control over the allocation of scarce production inputs, provision of services, and management of investment and credit decisions. The local state corporatist system, in which local government acts as the entrepreneur and re-distributor of the benefits of the industrial success, is noted for its ability to mobilize agencies and bureaus within local government to nurture selective enterprises.⁶ The formation of local state corporatism allows strong and effective local governments. Oi's view is supported by the concept of the constructive localism presented by Zheng in which local governments in a corporatist mode play a positive role in economic development (Zheng 1994). This line of argument implies that in the process of decentralization and marketization, an increase in local power over economic activities and political maneuverability are necessary and inevitable aspects of economic reforms. Luo Xiaopeng, Zheng Yongnian, Zhou Xueguang, Wu Guoguang, and Zhang Shuguang share similar views on increasing local power.⁷

This conventional view is in contrast to the theory of market transition (Nee 1989), which indicates that changes introduced during the reform period may have been less favorable to local governments than commonly assumed. In fact, the local share of budget revenues over that of the central share decreased from 85.37 percent in 1979 to 58.83 percent in 1990 (Wong 1991, 700). According to Shue (1988), marketization in nature destroys the cellular, or honeycomb, nature of Chinese rural society and allows for great penetration to the village level by the central state. Huang (1996a) supported the hypothesis of the strong state by looking at revenue collection data during the period of the economic reforms. On the eve of the fiscal reform in 1994, the share of the revenue collection by the Beijing government was still higher than its starting level of about 20 percent in 1979. This figure led Huang to conclude, contrary to the conventional view, that the Chinese taxation system was more centralized in the early 1990s than in the

⁶ These agencies also control investment and credit decision as well as routine and extraordinary service, which shape the course of development. In addition, local governments exert further control as the guarantor to secure a loan for enterprises within their districts. The head of the economic commission, the party secretary of a township, and the county head often use their influence to persuade bank officials for favored projects.

initial period of reforms and that the economic reforms strengthened the Chinese political system rather than weakened it.

Wong (1992) also argues that fiscal decentralization in the post-Mao period has reduced budgetary resources allocated by local governments, focusing her analysis on budgetary resources to the exclusion of extra-budgetary funds.⁸ Looking at the ranges of responsibilities of central-local governments under the new fiscal systems, she concludes that the present division of responsibilities is extremely unfavorable for localities. She states that “fiscal reforms did not alter the traditional roles whereby the Beijing government managed and financed the economic development program while leaving the chores of day-to-day public administration to local governments” (Wong 1992, 704). While the budgetary shares for local governments over total budget and GNP have shriveled, local governments take charge of over 70 percent of urban food subsidies including grain, oil, and meat as well as the costs of handling, transporting, storing and processing urban food subsidies over the excessive portion of the state quota.⁹ As of 1988, the costs of these were responsible for 35.5 percent of local budgetary expenditure, and they have increased over time since then.

Local governments are also under pressure to raise health and education standards. The budgetary burden in this sphere nearly doubled, from 10.1 percent in 1978 to 18 percent in 1988. In addition, local governments must cope with administrative costs, rising labor costs, and administrative demands along with the imperatives of economic growth. As a result, by 1985 12 provinces had joined the ranks of deficit provinces receiving central subsidies. At the sub-province level, only one-third of the counties nation-wide remitted funds to the center in 1986, while two-thirds received subsidies.¹⁰ Faced with a chronic shortage of funds and struggling simply to meet mandated targets, many local governments had little leeway to maneuver in spite of decentralization. Fiscal pressures also led to a proliferation of ad hoc levies and fees on taxpayers. Paradoxically, according to Wong, “fiscal decentralization has bestowed more

⁷ See in Guoguang Wu, ed. (1994), 9 and Shuguang Zhang, “Guojia Nengli Qianghao, Haishiluo?” in Funai Dong, ed. (1996), 52.

⁸ Wong treats the use of extra-budgetary funds by local governments as a dysfunctional outcome of fiscal reform, rather than as an intended product. See Wong (1991), 693.

⁹ For the arrangement, see Wong (1991), 703-705.

responsibilities than resources or formal powers on local governments (Wong 1992, 706).”

In regard to the centralization-decentralization dichotomy, Oksenberg and Tong’s study on the formal fiscal system during 1971-1984 (Oksenberg and Tong 1991) reveals a complicated web of the interrelationship between the central and local governments. They claim that China’s fiscal management has certainly been less centralized since the Cultural Revolution. Provinces have gained budgetary authority to arrange local spending, a share of budgetary surplus, and revenue-sharing rates fixed for several years. Despite record inflation, the budget deficits and the growth of provincial extra-budgetary funds during the reform period since 1978, the Beijing government has not been able to return to a more centralized system. Coincidentally, Beijing’s control of national revenue rebounded from 14.3 percent in 1979 to more than 30 percent in 1985. Additional revenue sources, such as a 25 percent tax on provincial spending on capital construction, were designated as central government income to increase the centers’ share of national revenue and to curb local spending. After examining the formal fiscal systems, Oksenberg and Tong cautiously concluded that it would be inappropriate to characterize the system as evolving towards either greater centralization or decentralization. They also indicated that the changes in the formal system must not be seen as a zero-sum game wherein one side only wins what the other loses (Oksenberg and Tong 1991, 30-31).

Yang’s study (Yang 1994) on the extractive capacity of the Chinese state also shows *Janus* faces of the fiscal reforms in terms of the centralization-decentralization scheme. On the revenue side, the Beijing government’s share of budgetary revenue has steadily increased over the post-Mao period, doubling from just over 20 percent in 1981 to around 39 percent in the late 1980s. However, on the expenditure side the Beijing government’s share of budgetary expenditures has declined from about 50 percent at the beginning of the post-Mao reforms to just less than 40 percent in 1991. These figures may lead to a different view from the conventional one about central-provincial relations, which were often perceived to be locked into a zero-sum power relationship. Yang,

¹⁰ See in Wong (1991), 706. The original source was from Bingqian Wang, “Maintain Budgetary Balance to Serve Economic Development and System Reform.” *Caizheng Yanjiu* No. 9 (1986): 1-6.

Chung (1995), and Huang (1996a) made similar observation and suggested a non-zero-sum view on central-provincial relations.

All these views are based upon observation and data analysis and certainly reveal a part of the truth. However, it is also necessary to indicate that these views had thematic and temporal constraints as well as methodological problems. Many studies mainly focus on one or two sides among various dimensions of the fiscal regime and draw myopic conclusions. Budgetary revenue, expenditure, and extra-budgetary and off-budgetary dimensions must be comprehensively taken into account. Methodologically, changes in actual tax collection over tax base and other factors influential to the fiscal outcomes must be considered. Another problem is that the existing studies did not fully cover the period of post-1994 fiscal reform, which brought drastic changes in the Chinese fiscal system and central-local relationship. I have the advantage of including in this study the crucial period of fiscal reform and implementation since 1994. Scholars also experienced a level of analysis problem not only in the thematic terms, but also in the geographical area to cover. The data of the nation as a whole does not necessarily represent the relationship between the Beijing and the provincial governments, or vice versa.

The other problem is the relative neglect of the Beijing policy makers' intentions. Clear pattern changes in local performance in the fiscal arena have been observed in basic PI and the MR methods analyses. Only changing policy priorities are likely to explain the changes. Unequal local development in economic and fiscal performance also can be attributed to the outcomes of the policy priorities. To discuss this issue of intention, let me divide the post-reform period into four fiscal regimes along the guidelines set by the State Commission for Restructuring the Economy (SCRE: *Guojia tizhigaige weiyuanhui*) under the State Council: 1980-1984; 1985-1987; 1988-1992; and 1994-present.¹¹ Temporal analysis helps in comprehending the policy orientation of each period in the fiscal arena as well as in the economic arena in general.

The fiscal regime during the first period of 1980-1984 was the so-called "cooking in separate kitchen system (*fenzaochifan*)."¹¹ Major Chinese reforms started from reforms in the fiscal arena (State Restructuring Office 1988, 2). The Beijing government gradually formulated and implemented post-Mao fiscal systems during the period. Its

¹¹ The SCRE (1998), 16-37.

policy foci were to stabilize Beijing's revenue and fiscal balance and to allow provincial governments relatively more autonomy in providing incentives for economic development. As a result, the Beijing government gained more revenues than in previous years. Meanwhile, provincial governments gained the power to arrange the structure of local spending. Beijing changed its practice from adjusting revenue-sharing rates annually to signing longer-term (up to five years) contracts. Provincial governments could direct fiscal arrangements with prefectures and counties under their jurisdiction (Tong 1989, 13-14). During this initial period, Beijing's overall economic focus was still on agricultural reform, but it did pave the way to urban reforms with its introduction of the *replacement of profit by tax (ligaishui)* reform during the years 1983 and 1984.

The political battles for introducing the replacement of profit by tax reform played out under a regimen of democratic centralism. After late 1984, the replacement of profit by tax reform had been implemented nationwide along with the urban reform. The new fiscal system standardized various types of taxes according to administrative jurisdiction. It enhanced the transparency of China's fiscal system, which guaranteed a certain range of fixed local funds. However, due to delays in changing enterprise ownership and lack of institutional capacity to handle the complicated new fiscal situation, fiscal reform was not completed during 1984-1987.

Along with the urban reform dating from 1985, policy priorities gradually changed to require more autonomy and funds for localities and enterprises in order to facilitate economic development more comprehensively. However, high tax rates on state-enterprises and remittance burdens on provincial governments reduced their incentives to produce rapid growth and thus reduced Beijing's revenues by way of return. As a result, the fiscal contract system gradually gained support over the standardized tax system during the period because it was believed to boost local enthusiasm and flexibility for the Beijing government. With the initiation of the coastal development strategy, the Beijing government encouraged localities to retain more resources in spite of its own declining fiscal position during the third period, 1988-1992. People called this period as the period of the fiscal contract system (*caizhengbaogan*), which was often cited as the main cause of strong localism. Under the contract system, the Beijing government negotiated the remittance rate/amount with provincial governments on a one-to-one basis

and adopted various types of contracts. The fiscal consequence was, however, to weaken Beijing's fiscal control. This situation was accelerated after the introduction of the fiscal contract system in 1988.

After 1994 Beijing determined to change its strategic policy priority so as to increase its own revenue share. There was a growing concern with Beijing's ability to control the macro-economy among Beijing's leaders and scholars. For that purpose, Beijing adjusted tax assignments and created a centrally-controlled taxation organization. These changes in fiscal systems along with changing policy priorities drastically altered fiscal performance throughout various levels of governments. I examine in the following chapters how political logic dominated the changes in China's fiscal system over the various periods under review.

Table 2-1: Various Fiscal Relations of China (%)

Year	R/GDP	E/GDP	AR/GDP	AE/GDP	CR/(CR+PR)	CE/(CE+PE)	ACR/AR	ACE/AE	ACR-ACE (100 Mil. Yuan)
1978	31.2	31.0	38.1	33.6	15.5	47.4	-	-	-
1984	22.9	23.7	39.5	39.3	40.5	52.5	40.1	46.7	-177.6
1985	22.4	22.4	39.4	37.7	38.4	39.7	39.8	40.2	48.3
1986	20.8	21.6	37.8	37.1	36.7	37.9	38.7	39.1	17.7
1987	18.4	18.9	35.3	34.3	33.5	37.4	37.0	38.7	-22.9
1988	15.8	16.7	31.6	31.1	32.9	33.9	35.7	36.4	-5.6
1989	15.8	16.7	31.5	31.5	30.9	31.5	35.6	35.0	30.1
1990	15.8	16.6	30.4	31.2	33.8	32.6	36.6	35.3	23.5
1991	14.6	15.7	29.6	30.0	29.8	32.2	36.3	36.3	-34.7
1992	13.1	14.0	27.5	27.8	28.1	31.3	36.6	37.4	-76.0
1993	12.6	13.4	16.7*	17.2*	22.0	28.3	20.8	25.4	-307.6
1994	11.2	12.4	15.1	16.0	55.7	30.3	45.1	26.3	1220.4
1995	11.0	11.7	14.8	15.7	52.2	29.2	41.3	25.6	1227.4
1996	10.8	11.6	16.6	17.3	49.4	27.1	40.8	27.1	1422.5
1997	11.6	12.4	15.4**	16.0**	48.9	27.4	38.1	22.5	1695.6
1998	12.4	13.6	16.3	17.3	49.5	28.9	39.0	23.8	1790.9

Sources: Extra-budgetary Revenue and Expenditure (1984-95) from CSY 1997, 248; Extra-budgetary Revenue and Expenditure (1996-98) from CSY 2000, 271; Extra-budgetary revenue figure of 1978 from Gu, 1999, 36; Extra-budgetary expenditure figure of 1978 from SPFRC, 249; Revenue and Expenditure figures from CYS 1999, 275; and GDP figures from CYS 1999, 55.

Note: 1. * Along with the implementation of "Provisions for transforming the operating mechanisms of the state-owned enterprises," the extra-budgetary revenue of the SOEs was withdrawn from the official figures. Mainly due to the definitional change, the size of extra-budgetary revenue drastically dropped to 33 percent of the size of budgetary revenue in 1993 from 110 percent in 1992 with a definition change.

2. ** Since 1997, the extra-budgetary revenue and expenditure do not include government fund (fee) within budgetary management.

3. GDP= Gross Domestic Product; R= Budgetary Revenue; E= Budgetary Expenditure; AR= Budgetary Revenue + Extra-budgetary Revenue; AE= Budgetary Expenditure + Extra-budgetary Expenditure; CR = Central Budgetary Revenue; PR = Provincial Budgetary Revenue; CE = Central Budgetary Expenditure; PE= Provincial Budgetary Expenditure; ACR= Central Budgetary Revenue + Central Extra-budgetary Revenue; and ACE= Central Budgetary Expenditure + Central Extra-budgetary Expenditure.

Chinese government funds can be classified into three categories: budgetary, extra-budgetary, and off-budgetary which should be taken into account collectively. However, the practical difficulty of measuring the exact sizes of these revenues prevents an understanding of the total extraction level experienced by the Chinese government. Since the official budgetary figures in the Chinese statistical yearbook may not accountably represent the total fiscal resources utilized by the Beijing government, I create Table 2-1 to include extra-budgetary funds. As for off-budgetary funds, no systematic data exists although they have been a dramatically increasing source of income for local public finance. However, several investigations in certain areas reveal extra-budgetary funds' approximate with variance according to locality and time period.

Some Chinese and western scholars have continued to argue that official figures underestimated actual revenues by neglecting extra-budgetary and off-budgetary funds. A look at Table 2-1 reveals that no hypothesis about dichotomous centralization-decentralization debates in previous studies can be convincing. On the revenue side, fiscal reforms along with the economic decentralization have generally brought higher revenue shares to Beijing, compared to those in the pre-reform periods. In 1978, Beijing's share of revenue across the provinces was only 15.5 percent, but it increased to more than 40 percent in 1984, then decreasing until the new fiscal reform was put into effect in 1994. However, even at the lowest point of 22 percent in 1993 it was higher than in 1978. The fiscal reform of 1994 then reversed the downward trend drastically. By reallocating large taxes to its own revenue sources, Beijing was able to tremendously increase its control over revenues although it still promised that it would return considerable amounts of revenues to the provinces to guarantee their expenditure levels of 1993.

On the expenditure side, Beijing's share had slightly increased up to 52.5 percent in 1984 from 47.4 percent in 1978. However, after the urban reform and the *ligaishui* [replacement of profit by tax] reform were implemented in 1985, Beijing's share dropped to its lowest point of 27.1 percent in 1995, then, starting upward in 1997. After the 1994 fiscal reform, as Zhang indicated (Zhang 1999, 121), "the current regime has represented a reduced role for the provinces in revenue collection but an increased role for the

provinces in expenditure in comparison with the pre-reform era. Therefore, it is misleading to simply characterize the reform era as one of fiscal decentralization.”

The extra-budgetary fund (*yusuanwai zijin*) is often called the second budget (*dierkuai caili*); its growth rate surpassed that of budgetary revenue during the economic transitional period. The extra-budgetary data has appeared in the *Chinese Statistical Yearbook* since 1982. According to the “notice on strengthening the management of extra-budgetary funds” issued by the State Council in 1986, the extra-budgetary fund is categorized into the extra-budgetary funds of local governments, the extra-budgetary funds of administrative units, and the extra-budgetary funds of SOEs. Throughout the Mao and post-Mao periods, most extra-budgetary funds belonged to SOEs. Until the extra-budgetary funds of the SOEs were removed from the government official statistics in 1993, they represented about 75 percent of total extra-budgetary funds in 1992 or the equivalency of about 68 percent of the government budget in the year. Budgetary revenue increased 6.4 times during the period from 1979 to 1996. Meanwhile, extra-budgetary revenues increased 8.5 times during the same period (Gu 1999, 34). The proportions of extra-budgetary revenue over budgetary revenue were 66 percent in revenue and 60 percent in expenditure in 1982. The proportions increased over time and reached the highest levels in 1992 with 111 percent in revenue and 98 percent in expenditure (CSY 1997, 247-248).

The extra-budgetary funds have often been the source of support for the strong localism argument due to the misunderstanding that only local governments control them. That, however, is not the case: both Beijing and local governments collected extra-budgetary revenues. When I integrated extra-budgetary revenues into budgets, contrary to the conventional view the ratios of Beijing’s total revenue and total expenditure proved higher than the ratios in revenue and expenditure until 1992. That is, the proportion of Beijing’s extra-budgetary funds over the provinces increased from 33.7 percent in 1982 to 44.3 percent in 1992 in the area of revenue and from 30.9 percent in 1982 to 43.6 percent in 1992 in the area of expenditure (CFY 1999, 477). Although Beijing’s shares experienced downward trends in both total revenue and expenditure during the pre-1994 fiscal reform period, changes in the ratios were not so great when the extra-budgetary funds were added. In particular, the size of total revenue over the provinces remained

almost constant. This finding is in striking contrast to certain scholars' hypothesis that the decline in Beijing's fiscal capacity provided the momentum for the fiscal reform in 1994.

The Beijing government was able to garner extra-budgetary revenues to maintain a sufficient level of total revenue in compensation for the weakening of Beijing's formal fiscal position both in revenue and expenditure before 1992. However, because this meant that Beijing increased its overall dependence on the extra-budgetary funds, this trend was an unhealthy one in terms of macro-economic stability. The extra-budgetary revenue of the SOEs was removed from the official figure in an effort to separate state-owned enterprise from government accounting from 1993 on. The efforts made by the Beijing government were closely related to the new fiscal reforms to make the budgetary process more transparent and rational in line with market-oriented reform. As a result, the size of extra-budgetary revenue drastically dropped to 33 percent of the size of budgetary revenue in 1993 from 110 percent in 1992. Since the Beijing government controlled most of the SOEs, the removal of the extra-budgetary funds in the SOEs in accounting considerably reduced the size of extra-budgetary funds of the Beijing government. The Beijing's extra-budgetary revenues dropped from about 170.8 billion *yuan* in 1992 to 24.6 billion *yuan* in 1993. The ratios of local extra-budgetary funds over the Beijing government's ones increased dramatically from 55.7 percent in 1992 to 82.8 percent in 1993 in revenue and from 56.4 percent in 1992 to 84.9 percent in 1993 in expenditure. Therefore, the figures in the *Chinese Statistical Yearbook* showing the sizes of Beijing's resource mobilization after 1993 must be underestimated if we apply the current criteria.

In addition, Beijing's decision to remove government funds (fees) in extra-budgetary figures in 1997 reduced further Beijing's share over the provinces in the extra-budgetary funds. For example, the share of the Beijing government dropped 24.3 percent in 1996 to 5.1 percent in 1997 in extra-budgetary revenue and 27 percent in 1996 to 5.4 percent in 1997 in extra-budgetary expenditure (CFY 1999, 477). As a result, the data of extra-budgetary funds since 1993 is problematic because of the definition changes in 1993 and 1997. Consequently, the declining ratios in the extra-budgetary funds of the Beijing government should not lead to the conclusion that Beijing's political capacity is declining. The decline actually mostly reflected a deliberate policy on Beijing's part. Looking at the total budgetary figures, it can be seen that after fiscal reform, Beijing has

enjoyed a tighter grip on the revenue side, while the more decentralized management of expenditure was left to the provinces.

Data on off-budget (*feiyusuan* or *zhiduwaiyusuan*) funds are the most controversial part in the fiscal arena because it is difficult to estimate the size of those funds in spite of their importance in the debates on the state capacity and intergovernmental relations. Off-budget funds refers to the funds which are raised from various sources by all levels of governments and spent on public projects or used for administrative expenses, but which are not covered by laws or institutional regulations.¹² In general, the funds comprise five areas: (a) social security deposits in administrative units relating to labor, personnel, and health; (b) funds and fees raised by various governments;¹³ (c) funds that must be remitted to extra-budgetary funds, but transferred later to off-budget funds;¹⁴ (d) secret treasuries (*xiaojinku*) illegally established by administrative units; and (e) self-finance funds raised by township governments (*zichouzijin*).¹⁵ Off-budget funds' importance in local finance has been growing as the Beijing government has attempted to tighten control over budgetary and extra-budgetary funds since the 1994 fiscal reform. In particular, at low levels of governments such as the township, county, and city levels, off-budget funds grow dramatically to finance various public goods under the institutionally-imposed shrinking revenues after the 1994 fiscal reform.¹⁶ The estimated size of the off-budget funds was 14.1 percent of the township government revenue in 1986 and about 20 percent in 1990 (CFY, 1993). However, as seen in the table 2-2, the funds appear to have increased to constitute almost half of the budgetary revenue (Lu 1998).¹⁷

¹² Many scholars including Chinese scholars misunderstand that only local governments raise off-budgetary funds. However, the central government also has the funds as in the case of extra-budgetary funds although most off-budgetary funds are raised by local governments, in particular, at the sub-provincial levels.

¹³ It includes a donation for specific public projects and revenue from the lease of land.

¹⁴ According to Gu and Bai (1998), about 30 percent of extra-budgetary funds are fallen into off-budgetary funds.

¹⁵ The profits of township and village enterprises are the main sources of township government.

¹⁶ Therefore, it is often called as the third finance (*disankuan caili*).

¹⁷ According to Zuo Liu (1999), the sum of off-budgetary revenues reached more than 400 billion yuan in 1996, which was equivalent to 60 percent of the budgetary revenue of the year. See, Zou Liu, *Feiguishui* [Replacement of Fees by Tax] (Beijing: Jingjixue Chubanshe, 1999).

Table 2-2: Size of Irregular Budget in 1996 (Billion, %)

GDP	TR	TR/GDP (%)	Tax Revenue		Non-Tax Revenue		Budgetary Revenue		EB		OB	
			Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
6859	1509	22	691	46	818	54	50	6	313	38	455	56

Source: SPFRC, 246. (Original sources: Chinese Statistical Yearbook, 1997)

TR= Total Revenue; EB= Extra-Budgetary Revenue; and OB= Off-Budgetary Revenue.

OB was calculated in the method that OB= TR-Tax-Non-tax Budgetary revenue-EB.

The figures are the result rounded off to the nearest number.

According to an investigation in some eastern and central areas during the period 1986-1995, the size of the off-budget revenues reached 100-200 percent of budgetary funds in many township governments (Gu and Bai 1998, 41).¹⁸ Furthermore, according to provincial data, the size of off-budget revenues was 96.3 percent of local budgetary revenues in Hebei and 120 percent in Sichuan in 1996 respectively (Gu 1997, 71).¹⁹ With various data regarding the size of the off-budget revenues Chinese scholars generally agree that the total size of the off-budget revenues is estimated to be around 50 percent of the official budget figure, with the trend showing growth after 1994's fiscal reform (Gu and Bai 1998; Lu 1998; He 1998; and SPFRC 1999). Overall, then, if the extra-budgetary revenues and the off-budget revenues are combined into a total revenue figure, total fiscal resources are about twice the size shown by official figures (Gu and Bai 1998, 45; SPFRC 1999, 248),²⁰ or about 22 percent of GDP in 1996.

Meanwhile, quasi-fiscal mechanisms such as bank loans, price controls, and exchange rates also influence the level of the state's extractive capacity. For example, Zhu took the size of an increased bank deposit to argue against conservative views on decreasing Beijing's 1987 fiscal capacity in the middle of debates on fiscal system reforms (Zhu 1987). Zhu argued that if the size of an increased bank deposit were added to revenues, China's fiscal capacity had not decreased since 1978 as seen in Table 2-3.

¹⁸ According to Sun, regional differences in the size of the OB exist. In general, the size of the OB over budgetary revenue in relatively developed regions is above 80%, but in less developed agricultural areas, about 50%. See for more details, Tanzhen Sun, *Xiandai zhongguo Nungcuncaizheng WentiyANJIU* [Study on Financial Problem in Agricultural Areas] (Beijing: Jingjixuechubanshe, 1995).

¹⁹ For more details, see Liu (1999) in the foot note 17.

²⁰ Zhang argued that the size reaches three times. See, SPFRC (1999), 247.

Table 2-3: Degree of Fiscal Control including Banking Sector during the Early Period of Post-Mao Reforms

Year	1953	1965	1975	1978	1979	1980	1981	1982	1983	1984	1985	1986
R/Nl(%)	30.1	34.1	32.6	37.2	31.9	28.3	25.8	25.5	25.6	26.1	26.9	25.0
BD/Nl	2.0	3.0	3.1	2.3	6.1	8.6	9.5	7.7	9.2	11.1	9.9	14.7
T/Nl	32.1	37.1	35.7	39.5	38.0	36.9	35.3	33.2	34.8	37.2	36.8	39.7

Source: Zhu 1987, 29.

R/Nl = Revenues/National Income; BD/Nl = Amount of New Bank Deposit/National Income; T/Nl = (Revenue + Amount of New Bank Deposit)/National Income.

The SPFRC estimates on policy loans from the central bank to SOEs also revealed that about 60 percent of all such loans were government-directed from 1987 to 1992 (SPFRC). The total of policy loans averaged 2.38 percent over GDP.²¹ If the size of the bank loan to SOEs is counted, the actual size of the state extractive capacity increases nearly to 25 percent of GDP. In addition, Beijing's control over other quasi-fiscal mechanisms indicates that its extractive capacity had been much larger than official fiscal statistics depicted even before the fiscal reforms in 1994. However, I do not deal with quasi-fiscal mechanisms in this analysis because of the difficulty of separating their fiscal and non-fiscal sides.

Looking at the cross time variance in the fiscal arena, four points can be made. First, the size of fiscal extraction before 1993 was not as small as many western and Chinese scholars originally thought. Including extra-budgetary funds, the Beijing government was also able to maintain more than 35 percent in both revenues and expenditures to the total revenue and expenditure respectively in spite of small downward trends. This indicates that the financial crisis accompanying weakening macro-economic control might not be the sole reason for the 1994 fiscal reform. Second, a main feature of the Chinese fiscal system during the 1980s was the system's increasing dependence on non-budgetary funds. Non-budgetary funds increased as the collection of budgetary funds stalled along with economic reforms. Soft-rule constraints and lack of institutionalization in the fiscal area under new circumstances would cause efficiency problems in management and damage economic development in the long run. The attempt by Beijing's political leadership and fiscal administration to set up hard-rule constraints and

²¹ Calculated from SPFRC (1999), 251. This kind of loan was notorious for more than 20.4 percent of bad loan (Kaya 1999, 40).

institutionalize a new fiscal system shaped the economic facet of Chinese politics in the early 1990s. Third, the Beijing government intended to function as a gate-keeper in the fiscal arena by controlling the revenue flow. Data after 1994 showed that the attempt was successful. However, the increasing control of expenditures by localities was not due to an increase in local power as conventional ideas suggested. A consensus existed on increasing the roles of localities in public finance and management though the degree of consensus varied. Fourth and last, anecdotal studies and investigations reveal that the size of off-budget funds in the local areas increased as Beijing tightened control over budgetary and extra-budgetary funds as a part of the 1994 fiscal reform. This poses a new challenge for the Beijing government in the process of fiscal institutionalization.

The simple comparison suggests the idea that Beijing's fiscal position has not been as weak as the official statistics suggests. However, it would be naïve to conclude that Beijing's capacity has been strong and the working mechanism of China's fiscal system has been effective and efficient. Since simple methods are not separated from certain influential factors such as size and inflation, when controlling these factors I produced a more rigorous and operational analysis in the next section to measure tax efforts nationally and locally. The results should pave the way to a further discussion of why in fact Beijing matters.

B. Analyses by the State GDP and Revenue Elasticity Methods

I adopt the concept of revenue efforts to measure the fiscal performance of central and provincial governments.²² The method adds the player's effort factor to the size factor; this formula is measured by the ratio of real revenue collection rate to estimated revenue capacity rather than by counting the size of actual revenue collection, and its formula was as follows: "Tax efforts = Real Tax Ratio/ Tax Capacity" used by Organski

²² The concept of revenue effort is a variation of the concept of "tax effort." The concept of tax efforts came into prominence by Giblin for the Australian Grant Commission in 1924. The concept of tax effort is defined as "closely related measure quantifying the extent to which a government actually uses its capacity to raise revenue through taxation." See, The Advisory Commission on Intergovernmental Relations 1962, 3. Giblin's work was published in "Taxable Capacity of the Australian States" as a pamphlet form. It is quoted by D.B.Copland in "Some Problems of Taxation in Australia." *Economic Journal* (September 1924): 96.

and Kugler (1980).²³ Although three methods (state GDP, multiple regression,²⁴ and representative tax system)²⁵ were broadly used to measure the revenue efforts, due to the genuine problem of data reliability in the Chinese official data in detail or lack of data I can only deal with the basic state GDP analysis, whose indicators are relatively reliable,

²³ In political science, Organsky and Kugler (1980) applied the concept of the tax effort to measure national differences of power in order to predict the outcomes of international wars.

²⁴ The multiple regression method is the attempt to explain variation in tax ratios. It employs a single-equation regression model to understand inter-governmental differences in the tax ratios. Since 1960s, this MR approach has been popular and the International Monetary Fund (IMF) has also employed this method in most studies of tax efforts in developing countries. The examples are K.V.S Sastri, *Federal-State Fiscal Relations in India* (London: Oxford University Press, 1966); K.N. Reddy, "Inter-State Tax Effort." *Economic and Political Weekly* No. 13 (December 1975); Alan A. Tait, W.M.L. Gratz, and B.J. Eichengreen (1979); G. Thimmaiah, *Revenue Potential and Revenue Efforts of Southern States* (New Delhi: Oxford India Book House, 1979); V.G. Rao (1984); and D. N. Dwivedi, "In Measurement of Tax Effort of Indian State Governments." *Arthavijnana* Vol. 24, No. 23 (June 1985). This MR approach separates tax effort from tax capacity factors, in which tax ratios are taken as the dependent variable. Then, the average degree relationship between the tax ratio and the tax capacity factors is derived through multiple regression analysis. The difference between the actual tax ratio and the estimated tax ratio at the basis of the equation is the unexplained variance and is attributed to the tax effort. The model is expressed such as $T/Y = f(X_1 + X_2 + \dots + X_n, E)$. T/Y is the tax ratio to GDP (or Personal Income), the X_i is a predictable variable that is proxy measures for the determinants of differentials in the taxable capacity and tax effort, and E is an error term (Bahl 1971, 571). Since the tax effort is defined as the extent to which a government makes use of its tax capacity, the tax effort is the ratio of actual tax collections to the tax capacity. The first step of the analysis is to estimate the tax capacity by using variables, which are classified as non-effort factors, and to understand an average practice of the population. Then, measure the ratio of actual tax collections to the tax capacity to get a tax effort index of each government. Finally rank governments on a basis of the tax effort index.

²⁵ The RTS defines the fiscal capacity of a state and its local governments as the amount of revenue it would raise if it applied a set of national uniform (average) tax rates (Gold 1986, 30). The RTS estimates are summed across all taxes and compared across states on a per capita basis. The distribution among the states of the resulting per capita estimates is advanced as a measure of the relative tax raising capacity in each state" (Aten 1986, 93). A major advantage of the RTS over the PI is that it implicitly but effectively captures the ability of states to export taxes to nonresidents. The second major advantage of the RTS is that it is more sensitive than the PI to the changing fortunes of state treasuries because the RTS relies on tax bases that most states actually use (Cohen, Lucke, and Shannon 1986, 15). The RTS method has certainly theoretical advantages over others in terms of its sensitivity and accuracy. However, the innate data problem in this method often prevents applying it in practice in spite of its theoretical merits. For example, Barro criticizes that the RTS confronts numerous serious data problem because it takes into account categories of taxable resources not reflected in the PI measure, which makes the RTS measure significantly more complicated and difficult to understand. The other problem in the RTS method is defining the appropriate tax base for each tax type, since different income sources may be subject to multiple and different taxes. Furthermore, according to Gold's study (Gold 1986, 47), the choice between the PI and the RTS measures doesn't have a big effect on the relative fiscal capacity except for the leading energy-producing states. The many elements of the RTS make accurate calculation impossible because needed data are not available and the calculation could appear arbitrary and capricious (Barro 1986, 70). In the case of China, it is extremely hard to trace each tax rate across regions and over time because of the drastic and various nature of change in the Chinese tax system. According to Yang (1996), Chinese scholars have also sought to measure the taxable capacity in the areas of value-added tax, land utility tax, and enterprise income tax. Regarding to the measurement suggestion, see Yuanwei Yang,

to provide a basic and broad idea on the Chinese fiscal system. In the state GDP method, the GDP is used as a proxy of the potential revenue (tax) base. The results from the other methods will be used rather suggestively.²⁶

The state GDP method is the current measurement used by the United States government in revenue sharing program with its states. Barro suggests using an inherently broader economic indicator capable of covering all types of income generated within a state, especially the portion received by nonresidents as well as the tax exportation problem. The state GDP method is not only a succinct method but also the broadest available measure of income produced in the current time period.²⁷ In this study, I also adopt this broader method to measure the efforts of the provinces to incorporate all fiscal bases in China where wealth has not yet been fully realized in individuals but has mostly resided in enterprises and government administrations.

Comparative studies on international fiscal systems reveal a tendency of revenue efforts measured by the GDP method to remain dependent to varying degree on the level of economic development and political system of each respective country. For example,

“Guanyushuishounenglide Gusuantixi [Regarding the Measurement of Taxable Capacity],” *Zhongguoshuiwu*, No. 11 (November 1996).

²⁶ In the area of the Chinese fiscal system, although his focus was not on measuring the tax effort, Zhang Wei (1999) applied a multiple regression approach to explain what factors influence tax and GDP increase. He argued that the size of tax revenues would be the function of GDP, investment, consumption, consumer price, and net export with the explanatory power of 0.995 in R^{square} (Variance) at the 0.05 significance level. However, the GDP indicator has a severe collinearity problem with other predictors and even the outcome variable itself. My field experience tells me that political factors are crucial in explaining fiscal performance at the provincial level. Beijing’s political atmosphere and discretionary policies gave localities signals of what they could do. Institutional changes redirect the level of fiscal efforts. In my preliminary regression analysis, predictor variables are fixed investment, the rate of agricultural output over total output, the amount of actually used foreign capital, state-owned enterprises output values over total output, personnel reshuffling, and institutional award. The intervening variable is the institutional change in 1994. Dependent variables are revenue increase, revenue increase over GDP increase, expenditure increase, and expenditure increase over GDP increase. This analysis can provide information of what variable(s) was meaningful in generating Beijing’s and provincial fiscal performance. However, since this approach does not require extensive contextual research, it may not be powerful enough to explain intergovernmental fiscal relations and the role of the Beijing government in fiscal reforms. For example, since raw resources are calculated as pooled data, it can not trace Beijing’s discretionary policy over certain regions. More importantly, according to my interviews, the personal reshuffling variable is one of major means of Beijing’s control over provinces, but it may not be significant in the regression analysis. Since the Beijing government has selectively applied personnel reshuffling over provinces with varying degrees, the effect of reshuffling is diluted even at the level statistically insignificant. The limit provides why this study should be complemented with extensive contextual research such as historiography and case study.

²⁷ GDP is the gross market value of the goods and services attributable to labor and property. It equals GNP less the net inflow of labor and property income from abroad.

central governments of more developed countries generally have higher percents of revenue control over GDP than do governments of developing countries.²⁸ The average of revenue over GDP by central governments in developed countries has been in excess of 30 percent during the period of 1980-1995; meanwhile, it has been about 20 percent in developing countries. In addition, governments of socialist countries, which generally operate on a planned economy, tend to have higher rates of revenue than governments with market-oriented systems. We found that Beijing's control over fiscal resources was highly decentralized even during the initial period of the reforms. The proportion of Beijing's revenue share over GDP was only 6.3 percent in 1980, which was much less than the approximate 20 percent in other developed and developing countries (Statistical Yearbook of Shandong 1998, 434). The size of government tax revenue as of 1986 in China was much less than other socialist countries as well (see Table 2-4).

Table 2-4: Comparison of Socialist Government Tax Revenues, 1986

(In percent of GDP)

	Bulgaria	CSFR	Hungary	Poland	Romania*	Yugo	USSR	OECD	China
Profit Tax	18.7	25.1	11.1	11.0	13.5	6.4	16.0	3.0	7.6
Income Tax	4.0		0.8	3.8	6.0	8.6	3.9	12.1	(2.3)**
Turn Over Tax	16.5	15.9	16.7	11.6	9.8	6.8	11.5	11.5	10.7 (8.4)
Social Security	9.7	5.9	16.6	10.3	7.2	8.1	3.3	9.3	3.2 (1.7)
Custom duties	0.5	0.7	3.5	2.8	0.9	1.8	7.2	--	1.6 (0.8)
Other	0.2	1.0	3.5	4.1	--	5.0	3.8	2.2	0.0 (0.0)
Total	49.6	48.6	52.5	43.6	37.4	36.7	45.7	38.1	23.2 (13.1)

Sources: V. Tanzi, 1991, 21; World Bank, 1995, 197.

Note: * 1988 and ** Tax Revenue in China in 1993.

Mao Zedong's deliberate policy to check the power of the central bureaucracy and government during the Cultural Revolution was responsible for Beijing's weak fiscal capacity during the early period of the post-Mao reform. However, the weak fiscal position does not necessarily mean that the Beijing government was incapable in the fiscal arena. Before drawing a conclusion on the fiscal extraction level, direction and

²⁸ See Statistical Yearbook of Shandong (1998), 434

contents of strategic policies during the post-Mao reform period, which might have influenced the fiscal extraction level, needed to be checked.

As seen previously in the revenue over GDP and actual revenue over GDP indexes in Table 2-1, the State GDP method reveals that the fiscal position of the Chinese government has gradually weakened from 31.2 percent of revenue over GDP in 1978 to 12.4 percent in 1998, with the lowest point of 10.8 percent occurring in 1996. The size of actual revenue was 38.1 percent over GDP in 1978, decreasing slowly to 27.5 percent in 1992. Then it plunged to 16.7 percent in 1993 with the introduction of the new accounting system that excluded the extra-budgetary revenue remitted from SOEs in 1993. However, it is crucial to note that, as emphasized in the previous section, Beijing's control over fiscal resources was much greater during the reform period than the data suggest.²⁹ After the 1994 fiscal reform, even the downward trend seen in the formal data ceased and the proportion of revenue over GDP started to surge from 1997.

In terms of the state GDP method, Beijing's fiscal control had appeared weakened in the formal data until 1996. A look at patterns of fiscal change on the provincial level, produces a different interpretation of Beijing's capacity, let alone of the extra-budgetary figures. To study provincial patterns, I chose the four years of 1982, 1987, 1991, and 1998 as a proxy of each fiscal reform during the initial period of the post-Mao reforms, the experimental period of the replacement of profit by tax reform, the years of the fiscal contract system, and the years of the tax-sharing system respectively. Then, I got the lists of provinces whose tax burden (the state GDP score) is higher than the national average. The results are shown in Table 2-5.

Table 2-5: High performing Provinces in the State GDP Method

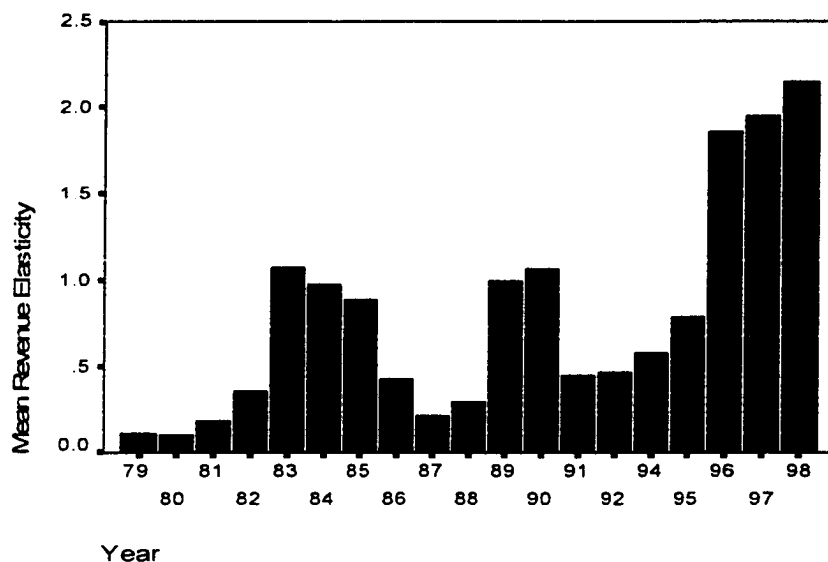
Area	Year	1982	1987	1991	1998
Coastal Area		Shanghai, Tianjin, Beijing, Liaoning, Jiangsu	Shanghai, Tianjin, Beijing, Liaoning	Shanghai, Tianjin, Beijing, Liaoning, Guangxi	Beijing, Shanghai, Guangdong, Tianjin, Liaoning
Central Area				Jilin, Shanxi	Shanxi, Inner Mongolia
Inland Area		Qinghai, Gansu	Qinghai, Yunnan, Gansu	Yunnan, Guizhou, Gansu	Yunnan, Guizhou, Ningxia, Shaanxi

²⁹ In addition to Beijing's control over quasi-fiscal institutions, SOEs also took considerable burdens of social welfare. As Walder (1988) indicated, a broad range of social welfare includes schools, housing, hospitals, and pensions, which governments in many other countries are often responsible for. Therefore, the size of fiscal extraction in China tends to be underestimated compared to those of other governments with different political and social systems.

Note: These provinces scored higher than the mean score. The mean score was 15.787% in 1982, 13.817% in 1987, 11.891% in 1991, and 6.387% in 1998. The order is descending according to the state GDP score.

During the initial period, Beijing's revenue relied heavily on fiscal performance in the coastal area, in particular Shanghai whose revenue burden was 49.8 percent. The fiscal extraction scores of Shanghai, Tianjin, Beijing, and Liaoning continued to be higher than the national average throughout the post-Mao period. Fiscal standardization during the period of 1985-1987, during which taxes replaced profits, effected a marginal change in previous provincial efforts. Jiangsu dropped from the list and Yunnan became a high level of extraction province. However, Table 2-5 shows that, as the reform proceeded, more provinces scored higher than the average and the number of high performers steadily increased, a positive sign for the Beijing government in that it was able to encourage more provinces to contribute revenues for the state budget than the average level. In particular, after the 1994 fiscal reform Guangdong, whose revenue proportion was first in the nation (6.5 percent) followed by Shanghai's 3.9 percent as of 1998, recorded a high fiscal effort score. Its ranking was 16th in 1982 and 17th in 1991, jumping to 4th in 1998.

Figure 2-1: Elasticity Coefficient of Revenue over GDP



Sources: Calculations based on *Difang caizheng* [Local Finance] No. 3 1999: 63; Xue Muqiao (ed.), *Almanac of China's Economy 1985/1986*. Hong Kong: Taidao Publishing Limited, 1986: 7; CFY 1999; and CSY 1999, 58, 111, and 275.

Note: Actual revenue means the sum of the budgetary revenue and the extra-budgetary revenue. The coefficient in 1993 was not counted because of inconsistency problem caused by the criteria change of the extra-budgetary fund and in the process of the introduction of the new fiscal system. If we count the coefficient of the revenue, it is 0.82. In case of the actual revenue coefficient, it is -0.72.

When locally collected central revenues are combined with the provincial revenues, total fiscal efforts in the key provinces improved from the lowest point in 1992 to a considerably higher level in 1998. For example, the average revenue burden of Beijing, Shanghai, and Guangdong in 1992 were 11.5, 15.8, and 9.7 respectively, but in 1998 they reached 17.9, 18.1, and 12.2 respectively (CFY 1999, 393).

These examples reveal that the Beijing government has been successful in encouraging revenue efforts across the provinces and increasing revenue burdens on the major beneficiaries of post-Mao reforms in spite of overall declining state-GDP scores. However, the average proportion of revenues over GDP continued to decrease from 15.8 percent in 1982 to 6.4 percent in 1998. Even if the size of extra-budgetary revenues and off-budgetary funds were added and the proportion would not be as small as it appears to be, it still reveals a weak fiscal capacity in the formal system.

One problem of the state GDP method is that it only exposes the static fiscal position of the GDP over any given period and thus fails to show the revenue changes associated with GDP changes. To supplement the limit, I introduce the revenue elasticity method. The revenue elasticity method provides an answer to the problem in the state GDP method in dividing absolute change in revenue with absolute change in GDP. If the revenue increase margin is equal to the GDP increase margin, the revenue elasticity coefficient is 1. If the revenue increase coefficient is less than 1, the revenue increase rate is less than the GDP increase rate. Beijing's capacity to implement its fiscal policy is more dramatically revealed in the fiscal elasticity method. Chelliah's study (1970) on trends in taxation in 27 developing countries during the periods of 1953-55 to 1966-1968 illustrates that at the stage of economic development, tax revenue tends to grow faster than GNP. During those periods, the mean income elasticity coefficient of total taxes in the countries was 1.4 (Chelliah 1970, 63). In China's case, the revenue elasticity does not show such a tendency, but has instead evinced a different pattern during the period of economic reforms. During the initial period of agricultural reform, 1979-1982, the elasticity coefficient of the budgetary revenue had been less than 1, then almost reaching

the balance during the period from 1983 to 1984. However, as the reforms in urban areas and of replacement of profit by tax were launched in 1985, the coefficient plunged to considerably lower with the exception of 1989-1990 than 1 until the new fiscal reform was implemented in 1994.³⁰ It means that revenue increase rates remained far lower than GDP growth rates.

It was only after 1994 with fiscal reform that the Beijing government was able to reverse the upward trend. Average coefficient during the periods of 1979-1984, 1985-1987, 1988-1992, and 1994-1998 were 0.46, 0.51, 0.64, and 1.46 respectively.³¹ The results are noticeable because the Beijing government was able to mobilize higher fiscal efforts over time in the budgetary arena, in contrast to the popular view of rising local power during the period of economic reforms. However, if extra-budgetary revenues were combined, the coefficients would reveal that the level of tax efforts decreased since 1985 during the period of urban economic reforms. If after combining the extra-budgetary and budgetary revenues the coefficients were calculated, it would be 0.94 for the period of 1979-1984, 0.74 for the period 1985-1987, 0.70 for the period of 1988-1992, and 1.56 for the period of 1994-1996. The actual sizes of revenues and their combined coefficients reveal that the Beijing government was unable to boost its tax efforts along with the economic growth of the 1980s. The declining tax effort in actual revenues was in fact reversed since the 1994 fiscal reform as observed in the area of the budgetary revenue Beijing targeted in the reform.

The existence of certain patterns in revenue elasticity over the four periods reveals that the tax effort had not been a function of economic development. Indeed, it was closely related to major shifts in Beijing's strategic policy priority. When the economic reform started toward the end of the 1970s, the level of the tax effort was quite low. The Chinese government was in a declining fiscal position in terms of the tax effort and the share of revenue to GDP. The weak fiscal position of the Chinese government must have constrained its range of options for reform in a time when Beijing launched the agricultural first over the more costly reforms in urban- and industrial reform. As reform

³⁰ It is the period that the Beijing government sought a tighter control over the economy and society after the Tiananmen Incident. Coincidentally, it is the initial period that the fiscal contract system was implemented. I am not able to separate the effects of the fiscal reform on the increase of the coefficient from those of the Beijing's austerity program.

proceeded, however, Beijing mobilized greater tax effort and was thus able to provide the material base to launch urban economic reforms. I attribute the initial successes in the fiscal arena to the political capacity of the Beijing leaders. In the sixth five-year plan (1981-1985), consensus on the fiscal policy in setting the primary goal was to *maintain a fiscal balance* in spite of the rapid increase of fiscal size in the provinces and delivered the message to locals and functional bureaucracies through the old authoritative socialist mechanism.

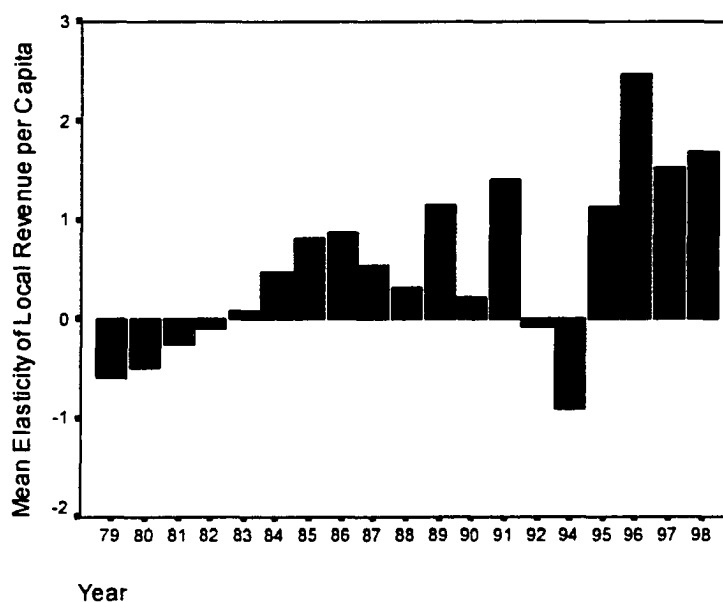
In the seventh five-year plan (1986-1990), Chinese leadership moved its strategic focus to urban sectors beginning in 1985. There was no doubt that without urban and industrial reform, the increases in economic efficiency and productivity would have been impossible. Although the emphasis on budgetary balance continued, the weight of the strategic policy goal shifted to economic development rather than revenue collection (for details, see the next chapter). The Beijing government allotted more resources to localities and enterprises to boost economic development. In particular, a policy priority was obvious in the introduction of the fiscal contract system in 1988. The impact of the shifting policy priority in the fiscal arena was declining tax efforts, which resulted in the declining ratio of revenue to GDP. With changing international security environments, succession crisis, and the alarming level of localism, Beijing political leaders and the revenue-related central administrations sought to reverse the trend to recentralization in the area of revenue, playing, in effect, the role of gatekeeper from the early 1990s. They were eventually able to implement the fiscal reform in 1994 and the attempt appeared to be successful in terms of fiscal elasticity.

Figure 2-2 also reveals the other side of Beijing's ability to command the reforms in the fiscal arena. The local revenue elasticity coefficient per capita shows how local governments were able to mobilize revenues to the GDP. It also reveals a certain pattern. During the initial period of reforms, the Beijing government was unable to encourage local revenue efforts although it was improving modestly the situation. However, in spite of certain fluctuation around the time of the Tiananmen Incident and the introduction of fiscal reforms, revenue effort per capita at the local level increased with fiscal decentralization during the period. What is striking is that the level of revenue effort

³¹ Calculations based on CSY and CFY.

increased after the introduction of the fiscal reform in 1994. Although the fiscal reform aimed to recentralize fiscal power in the area of revenue, it did not end up discouraging local revenue efforts, clearly showing the successful implementation of the new fiscal system. Due to the zero-sum nature of the fiscal reform, overall revenue efforts could have experienced backlash from a decrease in the local effort. Yet the Beijing government was able to find institutional solutions to boost local revenue efforts as well as overall revenue efforts.

Figure 2-2: Elasticity of Local Revenue per Capita over GDP



Source: Calculations based on *Difang caizheng* [Local Finance] No. 3, 1999: 63; and CSY 1999, 58 and 275.

C. Politics of Coordination: A Norm in Policy-Making during the Post-Mao Period

A review of the Chinese fiscal system shows that any assessment of Chinese state capacity in the fiscal arena would be a complicated thing even beyond any number-crunching effect. In the previous section, the extractive capacity of the Beijing government was shown not to be as weak as formal data illustrated when the size of extra/off-budgets were included. The counting-in of the extra-budget also revealed that

Beijing's declining control on the expenditure side was not as dramatic as formal budgetary figures showed. In observing a certain pattern over time in the Chinese fiscal system, the quantitative study raised a fundamental question about the factor composing the state capacity: an intentional aspect in the changes in the fiscal systems. What caused the dramatic changes in the various spheres of the fiscal system over periods? Why did Beijing's leaders do what they did in the fiscal arena? In the same vein, it can be also asked why the localities did what they did.³² I argue that the decision-making norm and structure in the Chinese political system provides a clue to answering these questions. The principle of democratic centralism was reinforced as a main mechanism for decision-making during the post-Mao period. Through the (semi) institutional norm of democratic centralism, a deliberate policy can be visualized from various documents, to reveal the essence of politics relating to a policy. Subordinates can figure out main players, policy priorities, and the degree of enforcement on a certain policy by looking over the entire process. However, the policy was not like a fully institutionalized system as seen in the Western hemisphere. It was, rather, firm in principle but flexible in practice. Such fluidity did not end up merely a personal means to justify a particular leader's preference nor cause chaos in policy-making because it still remained a meaningful mechanism for legitimacy throughout the post-Mao reform period. The Chinese leadership has abided by the *democratic* principle and exhibited its tremendous adaptability to new external challenges within a decision-making structure. In the fiscal area, by observing the rules of the game, China's leaders were able to produce meaningful guidelines, communicate with subordinates, and enforce policies according to its policy priorities.

It is a broadly accepted assumption that individual preferences and choices are made on the basis of reasons. The conventional economic theory of rationality takes actors omniscient with respect to the domains of information and choices. However, in political science, few scholars accept that the standard assumption of the economic rationality theory is realistic. Instead, as Herbert Simon argued, the concept of bounded rationality is broadly accepted on the basic assumption that human cognition is limited

³² I am indebted to Lupia, McCubbins, and Popkin for this argument. See the introduction of Lupia, McCubbins, and Popkin. eds. (2000).

and constrained by several factors.³³ Past experiences, current institutional contexts, external factors, and available resources can all provide reasons why people do what they do. In the following chapters, I use these factors to explain why major political actors behave the way they do under constraints and challenges presented in the fiscal arena, how their choices interact with institutional and structural arrangements, and under what circumstances external factors exert their influences.

For this purpose, constructing an organic approach is necessary to understand the nexus between the roles of the four factors in China's fiscal arena.³⁴ This approach may be seen as retrogressive in view of the contemporary methodological development in political science in general and in Chinese studies in particular, the latter of which more focuses on the economic rationality of individual actors. In Chinese studies, behaviors are often explained in terms of either individual's rational choices based upon relational and material incentives or institutional constraints. However, I assume that China is in the transitional period from socialism to market orientation. During the period of extensive change period, few norms and institutions are fixed. Accordingly, the reasons upon which people's behaviors are based also change. Under this circumstance, the organic approach focusing more on dynamic relations between the parts of a whole is useful at the macro level to understand why people in China do what they do while not necessarily denying the fruits of given individualistic or mid-level approaches.

To begin with, before undertaking a study of why China does what it does in the fiscal arena, a discussion of what has been a theoretical bloc of decision-making rules and what kind of decision-making mechanisms have evolved around fiscal issues in changing political and economic situations would be helpful. The Chinese policy-making process at the top level had for years been considered a black box because of the inaccessibility of the socialist system during the Maoist period. However, due to the current opening-up of the Chinese socialist system, a wealth of materials and anecdotes has come to light to

³³ The concept of the bounded rationality, however, does not necessarily interpret human behaviors as irrational. People are reasonable in that their behaviors are based on reasons, irrespective of what these reasons may be.

³⁴ Although I do not follow a reductionist approach, I also resist identifying my approach as Holism or organicism, which has an assumption that a whole cannot be explained in terms of its parts. Instead, I suggest that a relational and organic explanation of the terms (including parts) of wholes and their properties is necessary beyond focusing on parts. Regarding the debates on Holism and Reductionism, a critical review on Holism, see Phillips (1976).

reveal the inner workings of the Chinese decision-making system.³⁵ For example, *Decision-making in Deng's China* edited by Hamrin and Zhao illustrated details of the decision-making process in various issue areas and on different organizational levels. Barnett, Lieberthal and Oksenberg, and Shirk provided rare issue-specific studies in this area. On the other hand, Chung provided a general review and insightful guidelines on the study of Chinese decision-making in his new article written in Korean. Also encouraging is the fact that Chinese sources on the Chinese decision-making have poured out detailed information. One notable article giving specific information is "How does the Chinese leadership make a decision [*Zhongguolingdaoceng zenyangjuece*]?" by Hu Qiaomu (Wang et al. eds. 2000). Since Hu had been one of China's top policy-makers as a central party committee member in 1978 and a Politburo member in 1982 during the initial period of the post-Maoist reforms, his article as to how to make policy represents a rarity of Chinese authorship. *Great Decisions on Economy in the PRC* (*Gongheguo jingjidajuece*) and *Whole Stories of Great Decisions on Chinese Economy* (*Zhongguojingji zhongdajueceshimo*) are collections covering broad ranges of issue- and incident-based anecdotes of policy-making. In the fiscal area, Liu Zuo (2000) provided strikingly ample details as to how taxation policies have been formulated in his new book, *Fifty years of the Chinese Taxation System (1949-1999)* (*Zhongguo shuizhi wushinian*).³⁶ In addition, Wu Jie (1998)'s *Chinese Government and Institutional Reform* (*Zhongguo Zhengfu Jigou Gaige*) provides detailed information about several cases of decision-making relating to institutional reforms.

³⁵ Carol Lee Hamrin, and Suisheng Zhao, eds. *Decision-Making in Deng's China* (New York: M.E. Sharpe, 1995); A. Doak Barnett, *The Making of Foreign Policy in China* (Boulder: Westview, 1985); Kenneth Lieberthal, and Michel Oksenberg, *Policy Making in China: Leaders, Structures and Processes* (Princeton: Princeton University, 1988); Jaeho. Chung, "Joonggukjeui Jungchaekguajung Yeongu [Study of Chinese Policy-Making Process]." in *Joongguk Jeongchie Yeonguron* [Study of Chinese Politics], edited by Jaeho Chung, (Seoul: Nanam, 2000); Lin Wang, et al. eds. *Gongheguojingjidajuece* [Great decisions on economy in the PRC] (Beijing: Jingji chubanshe, 2000); Liren Shen, et al. eds. *Zhongguojingji zhongdajueceshimo* [The whole stories of great decisions on Chinese economy] (Nanjing: Jiangsurenming chubanshe, 1999); Zuo Liu, *Zhongguo shuizhi wushinian* (1949-1999) [Fifty years of Chinese Taxation System] (Beijing: Zhongguo Shuiwu Chubanshe, 2000).

1. Democratic Centralism as a Basic Decision Rule

Few scholars paid attention to the principle of *democratic centralism* before they turned their eyes to the more visible structural/institutional mechanism in the Chinese decision-making process. I start this discussion by dealing with this principle as a theoretical block of what the Chinese characteristic of decision-making mechanism is. Democratic centralism has two aspects: internal and external. The internal and basic feature is to consider democratic centralism as the fundamental organizing and leading principle of the Chinese communist party and political system. The Party constitution of 1921 and the PRC constitution of 1954 embraced the principle of *democratic centralism*.³⁷ Democratic centralism requires making decisions *by group debates and participation* and not by an individual discretion, meaning that, on all-important issues requiring strict implementation, the rule will be majority rule and the minority will obey the majority (Zhang 1995: 300-301). This so-called democratic principle is utilized in order to invigorate participation and cooperation from lower levels of organization and the masses. It also regulates relations between organizations and the relations within an organization (Cai 1984, 38-42). Unlike the Soviet Union, where the centralizing elements of democratic centralism overwhelmed the democratic elements, the Chinese Communist Party was able to embrace democratic elements more positively in the process of the long civil war lasting until 1949. In theory, *democratic* meant forming majorities and establishing unified views/orientations through criticism, discussion, and persuasion (Mao 1966; Zhang 1980).³⁸ Without *democratic*, no centralism exists because a majority cannot be established.³⁹ Liu Shaoqi even suggested a (majority) electoral system as a democratic mechanism in forming a centrality (Liu 1985, 272). The round-table model and the delegation of consensus model (Shirk 1993) depicted the embedded feature of the Chinese decision-making at various levels of the governing hierarchy. Historical

³⁶ In addition, Shen, Xie et al. (1999), Xiang (1999), Shen (1997), Yu et al. eds. (1998), and Rong, Liu, Gao, eds. (1998).

³⁷ In 1921, when the CPC was born, it was accepted as the organizing principle of the CPC in line with Marxist tradition and later integrated in to the state constitution in 1954.

³⁸ Of course, it is important to note that Mao totally abandoned this in practice during the 1960s and 1970s in the power struggle against the so-called rightists.

³⁹ This view on *democratic* was incarnated in his peasant centered-war strategy during the civil war and also in the theory of the people's democratic dictatorship, instead of the Soviet style of the proletariat-centric dictatorship.

experiences of division and chaos, practical difficulties in controlling multiple groups of population, and an enormously large territory might provide soil for the principle of democratic centralism in China neither merely as an imported Leninist ideology nor rationality of human-made institutional settings. Centralism functions to maintain authority of the upper organization and leaders. The external extension of this principle is often related to the level of power delegation/ decentralization with relative emphasis on either democratic or centralism. The changing rhetoric of key political leaders on either democratic or centralism often signals policy orientation changes.

Mao's exclusive control over power, as seen in the Peng Dehuai's purge and the Cultural Revolution, was imparted to the Chinese decision-making mechanism a very important lesson in general: when the subtle balance between democratic and centralism broke down, what destructive results it could produce! It also reminded the new leadership of the necessity of institutionalizing the principle in a detailed manner. For example, one informal rule broadly accepted among Chinese elites is that of a collective leadership. The famous article written by He Rongfei in the *People's Daily* in February 25, 1979, "*lingxiu shi yigejitian* [a leader is a group]," illustrated this view succinctly and removed the cause of governance by one strong leader from the principle of democratic in the democratic centralism. The principle of collective leadership was formalized in the fifth plenary session of the eleventh CPC Congress in 1979 (Wu, et al. 1998b). When I conducted interviews in Shanghai in 1999 (after the bombing of the Chinese embassy in Yugoslavia by the US fighter), there was a rising speculation in the Western media as to whether Zhu Rongji would step down. At that moment, Zhu was known to be in tense relationship with Jiang Zemin because of Zhu's popularity and rightist stance in economic policies. I asked a high-ranking government officer about this issue, and his answer was confidently negative because removal of Zhu would break an axis of current collective leadership and destabilize the political system. He mentioned that Chinese political elites enjoyed consensus of the collective leadership; throughout the interviews, I observed similar attitudes on this issue. The other legacy was the consensus among leaders on maintaining centralism as a guiding principle at any critical moment. The main feature of the decision-making style during the post-Mao period was to recover the subtle balance between *democratic* and *centralism*, and to prevent placing power to make

arbitrary decisions in the hands of one or a few individuals. Since the overemphasis of centralism and over-centralized power in an individual during the late-Mao period resulted from the destruction of the principle of democratic centralism, how to establish stable rules on the part of democratic element became a prime concern after the collapse of the Maoist regime. The speech of Peng Zhen before the standing committee members of provincial levels of the Party Congress in 1981 described quite detailed rules (Research Board of People's Congress Standing Committee 1992). According to him, the People's Congress is a form of realization of the principle of democratic centralism because the members are *elected* by the people. The final resolution is voting by majority rule. No individual should make decisions on major issues; only the group can make such decisions. When discussing how to reach a decision, Peng Zhen carefully emphasized principles of discussion, consultation, adjustment, and speculation until consensus was reached in cases not requiring urgent decisions. Even though one view may constitute a majority, opposite minority's views should be considered,⁴⁰ and after conducting experiments based on the majority preferences a consensus should be reached in a reexamination process in which the major view if it is proven correct can induce consensus. If not, the minor views should be brought into the discussion and be experimented until consensus builds. Throughout the process, a decision is gradually reached. Therefore, what Peng means by decision-making rules is not a mere majority voting rule but, rather, refers to a long process of consultation, coordination, adjustment, and experimentation to achieve consensus/persuasion among interest parties.

As noted previously, consensus-building became a major mechanism of the democratic principle during the post-Mao period. Consensus building as legitimization of decision-making requires boundless speculations, exchange of ideas, drafts of documents, and negotiations until all interested individuals/organizations reach consensus or attain manifest majority, but although this process often ended in a situation of deadlock because of failure to reach consensus. In practice, what Chinese leaders have had in mind as a criterion of consensus seems to be much tougher than the mere arithmetical majority

⁴⁰ *Guangming ribao* in an article regarding Hu Qiaomu's work style argued that different views, including erroneous views, must be discussed on an equal basis and even added that studying erroneous views can develop correct views because it can serve as counter evidence. See *Guangming ribao*, 9 February 1984.

voting rule. Deng Xiaoping (March 5 1975) indicated the criteria on which a decision should be made after a long and broad range of consultations and discussions. When decision-makers are confident of getting *80% of approval rate* from the people for a policy, they can eventually finalize a decision (National Defense University Board 1993, 989). Although it might be an exaggeration or an inexact criterion on which policy-makers make their decisions, it provides certain guidelines as to how Chinese policy makers should behave. In a politically-torn and -cleaved system, this kind of self-constrained informal rule was likely to have functioned so as at least not worsen the situation and thereby open opportunities for further coordination at the expense of efficiency.

Chinese decision-making structure and bureaucratic arrangements have been designed to satisfy the consensus-building principle. In the eyes of Western rationality and the institutional approach, this kind of mechanism can be seen as a highly unstable system for its lack of institutionalization and written rules. However, the organizing mechanism based on democratic centralism during the post-Mao period was not designed to increase decision-making efficiency, but to increase political stability, avoid direct confrontation, and to ensure smooth policy implementation. The problem of this mechanism is that since it requires consensus-building along the principal-agent continuum, policy-making and implementation are often crippled when consensus building fails to be established. Lieberthal's "fragmented authoritarianism model" succinctly portrays the often-deadlocked moments among vested-interest groups as well as the incessant negotiations and compromise processes in Chinese bureaucratic decision-making process from the angle of Western rationality. Shirk's "delegation by consensus model" (1993) also describes how decision-making at the subordinate level can reach a deadlock when party leadership is divided. She indicated that such situations often occurred during the 1980s (Shirk 1993, 123).

Some may legitimately argue that addition to the principle of consensus-building as a decision-making mechanism during the post-Mao period can be explained by a circumstantial factor. When Deng Xiaoping rose to power, he did not have as much charisma as Mao once enjoyed. Deng's power was based on coalition with other colleagues in the party and the military. Under that circumstance, he could be forced to

comply with other colleagues in making decisions. However, as previously mentioned, the principle of consensus-building was deeply entrenched as informal decision-making rules in bureaucratic organizations and among individuals. When I conducted interviews, I often heard Chinese officials use a specific term “*you daoli*” (in English, “make sense” or “be reasonable”) in explaining their behavior and logic in various negotiations. However, the meaning of the term in Chinese is not only confined to rationality but also extends to the moral area of “should.” By asking whether it is “morally” acceptable, they implicitly raise legitimacy questions on the other side not to force them and induce consensus among vested-interest parties. It is applied at all levels of relations: between the same ranks and between the superior and the inferior in either direction.

During the post-Mao period, China’s policy-making mechanism became more stabilized as a half-formal and half-informal institution. Although no written rules exist in the top ranks regarding policy-making procedures, enormous efforts of consensus building implicit in the principle of democratic centralism became embedded in Chinese politics. First, Deng Xiaoping as a leader patiently practiced the principle most of the time.⁴¹ By doing so, he was able to create balance in a badly-divided political system and to create momentum for further reform. Although he had numerous opponents in various issue areas along with the power to initiate his own policies, he continued to compromise with them or to work on to form a manifest majority on his side. The long cohabitation with Chen Yun is the obvious example. Even when he pushed on toward a certain policy, he deliberately used the principle by amassing support to discourage opponents instead of using power or force. Chen Yizi (Chen 1995, 140) succinctly summarized Deng’s working style as follows: when issues were complex and suffered lack of preparation, “he wanted to be sure that (the issues) were carefully planned and the risks at a minimum.” After amassing the numbers supporting a majority position or getting through a long consultation process, he was able to finalize decisions.

Second, in the top political ranks, various organizations such as *kou*, *small leadership groups (lingdao xiaozu)*, and *xitong* have served consensus-building among

⁴¹ The key exception to this statement will be the role of Deng Xiaoping in the Tiananmen Incident in 1989. However, he still represented consensus of core political leaders on the priority of political stability even in the decision. The southern tour in 1992 might be the other exception. However, I argue that it was not the case. I deal with this issue in Chapter VI.

various political leaders and interest groups in their specialized fields. All these organizations are coordinating and consultative as well as executive organizations in hierarchy at the top level.⁴² The obvious decision rules were to allow full discussion and speculation among members until they reached consensus or at least a compromise. Even before an issue was formally raised, they frequently used preliminary informal meetings and coordination procedures, called *yunniang* [fermentation/deliberation] in Chinese. Although the leader(s) of the organization had the power to finalize a decision, in most cases the leader waited until consensus was established.

In deadlock cases, the leader reported to the top leaders outside the organization in the political hierarchy, chiefly the party secretary, Deng Xiaoping, and maybe sometimes Chen Yun. The more complicated the interests involved in the issue, however, the broader and longer the consultation following, even in the highest rank.⁴³ Informal meetings of the party elders⁴⁴ (which often invited formal organization members) of the 1980s and early 1990s also composed a critical part of the consensus building process and often influenced formal consensus-building process at critical junctures such as a decision in the Tiananmen Incident of 1989. A complicated web was established to maximize consensus and coordination in the badly divided political system by ideological and policy orientations in the transitional period from Maoist rule to the post-Mao political and economic system.

Third, the decision rules at the top level have been entrenched in subordinate organizations in two of their aspects: the vertical and the horizontal. As noted by Shirk (1993), subordinate organizations specified by the principle of division of labor enjoyed a certain power to formulate and execute policies for and give feedbacks on certain policy designs to one higher level of organization in the hierarchy, based on organizational specialization and the advantage of information. In the Chinese bureaucratic structure, government bureaucracies were set up to represent group interests on which their bureaucratic legitimacy relies. Therefore, consensus-building at the lower level of bureaucracy makes policy-making and implementation smoother because Beijing's

⁴² The detail regarding the functions and personal composition of *kou*, small leadership group, *xitong*, see Lieberthal (1995), 192-208.

⁴³ Author's Interviews.

⁴⁴ The elders included Deng Xiaoping, Chen Yun, Ye Jianying, Li Xiannian, and Deng Liqun.

political leaders assure political support from bureaucracies and groups that the bureaucracy represents. The advantages of this “delegation of power” are to reduce overloads of daily administrative work and responsibility from the hands of the Beijing government. The consensus rule also functions as a fire alarm to the Beijing leaders when any subordinate group is not satisfied with a policy (Shirk 1993, 117). Lack of consensus at subordinate levels creates pressure to initiate another round of consensus-building procedure at the higher level, “escalation of coordination (*xietiao*)” as termed by Shirk. However, delegation by the consensus model is not perfect in practice because political elites at the top in Beijing are able to veto any policy they do not like as well as to guide policy orientation in the direction they liked.

In interviews, I noticed that subordinate/local organizational elites carefully looked for clues on policy orientation in Beijing as a guide for their discretionary behavior. Beijing’s leaders have had the discretionary power to decide the temporal and thematic ranges of delegation by consensus as in the case of 1994 fiscal reform.⁴⁵ Another problem arose for subordinate agents when the Beijing leadership was divided because the agents could not find any clues to the range of delegation by consensus. Any political initiative under that circumstance might constitute a political gamble (as was experienced during the Cultural Revolution). The most reasonable strategy for them is likely to wait until everything becomes clear. The political implication of this situation is that policy-making and implementation is likely to be at halt or in disarray because of uncertainty surrounding the preferences or inserted factional politics at the top.

The consensus-building process has been required in decision-making within the subordinate level of bureaucracies as well. Within the same bureaucratic organization, division of labor among sub-units is well defined in the Chinese bureaucratic system although coordination problems exist between sub-units.⁴⁶ When sub-unit members design a draft, they work as a group rather than individually, which requires consensus-building among members. However, the degrees of complication and difficulty in reaching consensus must vary along with the issues and the characters of the organizations. Decision-making on highly redistributive issues or in those organizations,

⁴⁵ I will deal with this issue in Chapter V.

⁴⁶ Again, this organizational feature requires a mechanism of escalation for coordination.

the so-called comprehensive (*zonghe*) organizations,⁴⁷ that deal with such issues, is more likely slow, complicated, and difficult because it requires a long process of coordination, bargaining, and compromise to reach consensus, whose process often ends up in a deadlocked situation.⁴⁸ Following the rationales, decision-making on economic issues takes a longer time and consumes more energy to finalize. Military and foreign policy organizations are more likely insulated from interest-based politics and so produce quicker and easier decisions because of their relative professionalism. However, according to Yang's account regarding foreign policy-making, the operation procedure even in the foreign-policy organization requires "consensus among participants at the basis of frequent discussions and consultations. The consensus thus reached takes the form of a formal report for approval --- that offers the unanimous recommendation ---- (Yang 1995, 95)." The consensus building, as a legitimate form of decision-making, becomes obvious through the documentation process. The document must be cosigned by all parties involved in the decision-making process before it is delivered to top leaders for final decision (Yang 1995, 96).

The principle of democratic centralization has been integrated as a basic rule of decision-making at various organizations and has regulated relations between organizations during the post-Mao period. In theory, *centralism* is based on democratic because the centralism is an expression of democratic.⁴⁹ Without clarifying what majority preferences are, no centralism exists. In practice during the late Maoist period, Mao seemed to consider himself as the incarnation of the majority or at least the protector of it. Consequently, he alone interpreted what a majority preference was. However, during the post-Maoist period, the principle has been applied in a more institutionalized fashion. Certainly, devastating experiences during the Cultural Revolution contributed to subsequent efforts at institutionalization, thus hostile to quick decisions by a few decision-makers. Political leaders detailed how to apply the democratic principle and

⁴⁷ Hamrin and Zhao eds. (1995), xxxvi.

⁴⁸ One example will be the case of the bankruptcy law. The discussion regarding the introduction of bankruptcy law even stirred at the 17th session of the 6th NPC standing committee, whose process was often known as rubber-stamping, in spite of long drafting preparation, consultation, and coordination. Under the situation of disagreement among members, the chairman could not help but hold off on making decision until consensus is built. See more detail in *Gongminribao* (27 September 1986), 3.

⁴⁹ Deng indicated this point succinctly in the preliminary workshop for the third plenum on 13 December 1978. See Central General Office (1990), 77.

sought to institutionalize it in formal and informal forms.⁵⁰ In the eyes of some scholars, the informal form of rules must be seen as highly unstable.⁵¹ However, in respect to the Chinese bureaucratic structures and norms noted above, it can be seen that they have been organized in a way whose principle can be accomplished or entrenched as a working decision-making rule. As noted above in Deng's remark on the criterion, the democratic principle has been applied in a much stricter manner than the mere majority rule. Consequently, (a) overall the Chinese decision-making process tends to be slow and inefficient, (b) their reform processes have been gradual, and (c) the organizational decision culture becomes antagonistic to quick decisions. However, it is designed to promote political stability and effectiveness for policy implementation.

2. Policy-Making in Practice

If policy-making is a process for problem-solving, the problem should be defined. To define the problem, numerous inputs are required. After experiencing the input processing stage, policy-makers would for a certain reason choose an option among many. The policy-making process is not necessarily linear, rational, incremental, or smooth because it will be influenced by numerous factors such as the quality of inputs, given institutional constraints, often accidental external factors, and interaction among actors based on their power and resources. Even leadership character can play a crucial role.⁵² The success of policy implementation may be an independent issue from decision-making, but it is very likely to be interrelated with the quality of the decision-making process and the nature of issues.

⁵⁰ A counter argument is from Su Shaozhi, who was secretary of the party group and director of the institute in the Marxism-Leninism-Mao Zedong Thought Institute until 1987. After reviewing the history of the Marxism-Leninism Institute at CASS, he argued that the Chinese decision-making was non-procedural, unpredictable, and highly personal and political. I fully agree with him in that there was no obvious written and formal procedure of decision-making during the period. However, when we look at the behaviors of political leaders even in Su's article, no leader could make a decision alone, which required consensus building among interested top leaders. If there was no clear line of consensus, the decision had been deferred.

⁵¹ For example, see Su (1995).

⁵² For example, see how the personalities and leadership styles of De Gaulle and Mitterrand in France shaped and changed the power of French president beyond their presumed constitutional power in Mark Kesselman, "France." In *Introduction to Comparative Politics*, edited by Mark Kesselman, (Boston: Houghton Mifflin Company, 2000), 104-114.

In this section, I deal with an input-processing mechanism because the mechanism is an *a priori* condition in determining the quality of information. More foci are placed on the sources from which Chinese policy-makers obtain information for making a decision, who and which institutions are involved, and what institutional mechanism exists in the processing stage. In this respect, *Hu Qiaomu* provides the most valuable and reliable insider source in the top decision-making echelons, and reveals numerous formal and informal details relating to the Chinese top decision-making process.

1) Sources of Information

The simplest characterization of China must be that it is enormous in terms of territory and population and that it is ethnically diverse. These characteristics have caused great difficulties for political elites in controlling the vast territory and people. The size factor drastically increases the monitoring problem for political elites, although the monitoring problem always exists for principals even of industrialized countries. Hence, it is understandable why China has had quite a sophisticated bureaucratic system for quite a long time.

It is not difficult to understand that during the initial period of the PRC the Chinese policy-makers had enormous difficulties in acquiring objective and correct information, given the backward social/economic infrastructures and the damages of long periods of war lasting until 1949. In particular, when ideological and political norms and mobilization are dominant over objective economic efficiency and rationality, the quality of information is highly likely to be rotten. Planning requires a high quality of information. When false reportage problems becomes epidemic, the planning system is destined to fail. The failure of the Great Leap Forward movement is often attributed to the failure of correct information collection.

After the *Lushan* conference of 1959, Mao became more isolated in terms of information-gathering.⁵³ He relied more on smaller numbers of private sources. In general, as a result of relatively backward modernization and institutionalization for

⁵³ To see more detail, Tciwcs (1990).

information gathering,⁵⁴ Chinese leadership experienced difficulties in gathering accurate information at the basic level in spite of the initial success of transition to socialist system. The political and ideological struggles aggravated reliability of information gathered through official channels.⁵⁵ After experiencing times of horrific political struggle, localities had ample reasoning to make false reports to protect themselves from political and ideological criticism and to adjust to the political/ ideological stream. The result was that reports from the formal organizational networks were highly likely to be biased.

Since the Maoist period, one method of information gathering was through regular organizational channels, which mostly came from various local party/ governmental organizations as a form of paperwork (*wenjian*) (Chen 1995; Wu 1995; Chung 2000). These organizations sent reports (*huibao*) on daily matters and situations as well as suggestions. Beijing leaders spent considerable time daily in reading the information supplied (Hu 2000, 1). After reading those documents, political leaders added their views, suggestions, or directives on the document if necessary. Then, the documents were handed over to relevant organizations/ individuals to review and formulate a new draft based on the preferences and suggestions, after which they were again placed in the consensus building process. If necessary, (in) formal meetings were convened to handle the issues. Conceptualized as documentary politics by Wu (1995), this document-circulating process has proven quite common and crucial in the Chinese decision-making because it has become a chief method of building consensus.

Another formal source was news from the various mass media agencies such as Xinhua News Agency,⁵⁶ TV, and People's Daily (Hu 2000). Although these media were more frequently used for top-down propaganda, they also collected local information and delivered some feedback from the bottom. This kind of media provided internal

⁵⁴ Regarding the weakening organizational power of the State Statistical Bureau after the Great Leap Forward campaign, See Huang (1996a), 62-65. Furthermore, the ministry of supervision (*Jiancha bu*) was established but soon abolished in the middle of the Great Leap Forward movement. For most time, party discipline had been intermingled with administrative discipline. Then, it was restored in the effort of strengthening monitoring on administrations during the post-Mao period. See Huang (1995), 836.

⁵⁵ As to this problem, see Yao Yilin, Wen Jiabao, and Li Ruihuan's speeches. Ministry of Personnel, ed. *Renshibumin Bangongshigongzuo Shiyongshouce* [Practical Handbooks regarding Office Affairs of Personnel Departments] (Beijing: Beijinggongyedaxue chubanshe, 1991), 18-19.

⁵⁶ It is specialized with international news although it also dealt with domestic information. See Yang, 94.

publications for political leaders. In particular, sensitive materials were highly classified, with limited access only for relevant leaders depending on their power level.⁵⁷

The third source was reports from specialized organizations and institutes, often called think tanks (*zhinangtuan*) such as the Chinese Academy of Science (CAS) and Development Research Center (DRC).⁵⁸ Reports from the think tank organizations were sent either on regular or impromptu bases. Reports and policy suggestions by scholars and specialists individually and even letters from ordinary people also provided information for political leaders. Because of the volume of this kind of input from the bottom, the inputs were discretionarily selected via a screening process with the screened reports and letters then handed over to leaders. In this context, the roles of secretaries/office members of top political leaders should receive more attention as gate keepers. Chung (2000, 147) even indicates that the roles of secretaries are sometimes almost equivalent to those of their principals in terms of their influence as coordinators.⁵⁹

Direct contacts in the forms of meetings and personal invitations from various people also provided information. Another method was to dispatch investigation and consultation teams on irregular bases whenever necessary. In particular, when a comprehensive and encompassing issue such as fiscal reform was at stake, the frequency of dispatching investigation and consulting teams increased considerably. For example, an interviewee in the MOF recalled that the frequency of dispatches almost doubled during the period of 1991-2 and after summer of 1993, when local information and consultation were required to prepare for the fiscal reform implemented in 1994. The other was that leaders themselves often traveled to various localities to better understand local situations. However, it has yet been to be known when and through what processes political leaders made their decisions for such investigation trips.⁶⁰

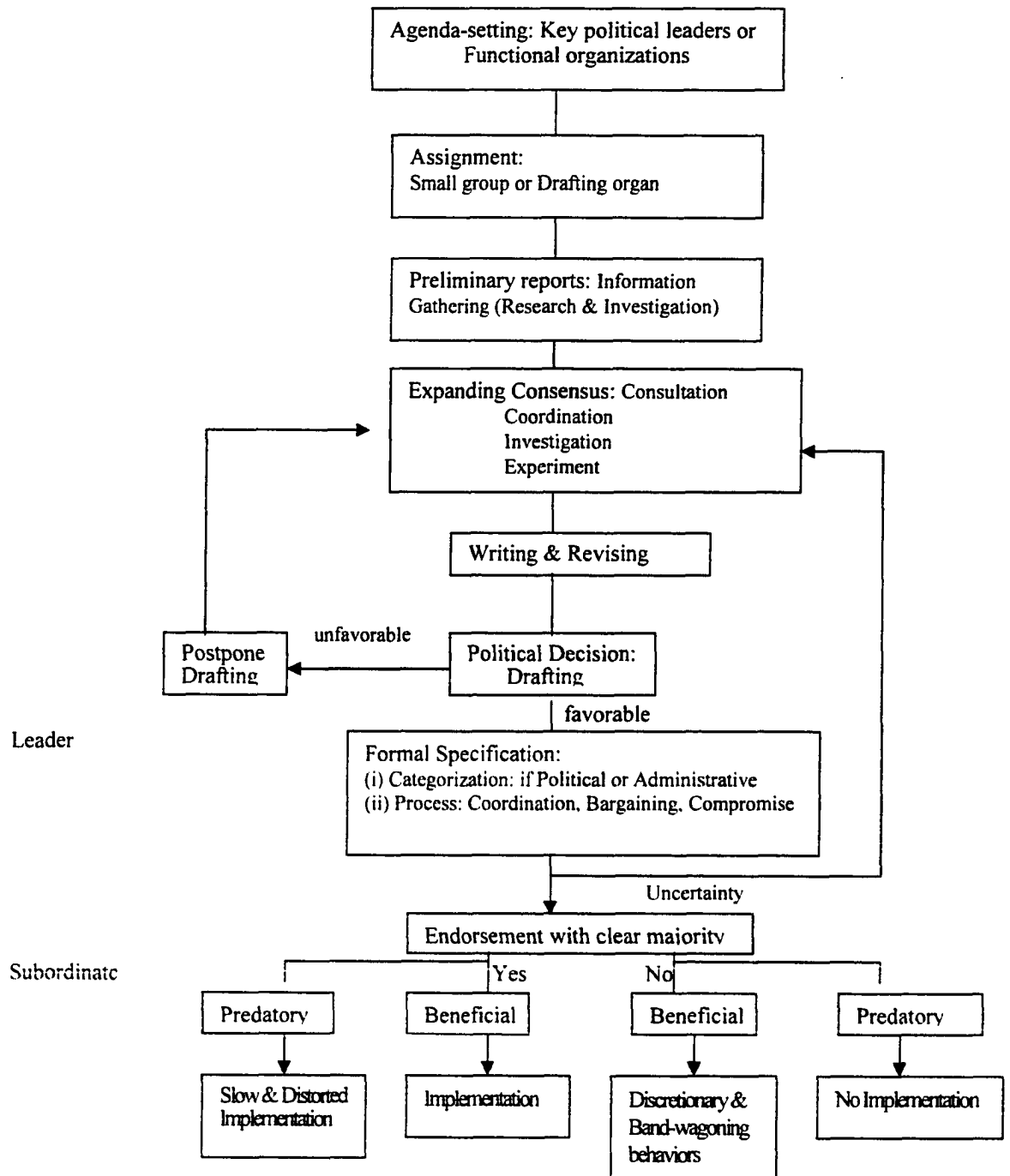
⁵⁷ Ibid. Also see Shaozi Su, "The Structure of the Chinese Academy of Social Sciences and the Two Decisions to Abolish its Marxism-Leninism-Mao Zedong Thought Institute," in Hamrin and Zhao, eds. (1995).

⁵⁸ The Chinese Academy of Social Science (CASS) became established and independent from the CAS in 1977.

⁵⁹ The secretary also can be an important career background. Huang Hua (Zhu De), Song Ping (Zhou Enlai), Liu Huaqing (Deng Xiaoping), and Zeng Qinghong (Jiang Zemin) are the prominent figures with secretary background (Chung 2000, 147).

⁶⁰ An interviewee mentioned that mostly, the trip is designed by current issues and irregularly. However, the decision-rule for such a trip is not yet clear. One of the most well known cases will be the southern tour by Deng Xiaoping to reverse a conservative trend in the party and to show his

Figure 2-3: Policy-Making Structure in China



support for further reform in 1992. Before he left on the trip, there was an articulate effort to amass support for the trip and dramatize the effect. For the detail, see in Chapter V.

When the post-Mao reformers launched reform programs, one of the most problematic deficits they experienced was the lack of accurate information and stable information-collection organizations, which were essential to carrying out their reform programs. Since decentralization measures in various economic areas were done by delegation of power, strengthening the monitoring system became more important in supervising subordinates. Huang's *Administrative Monitoring in China* (1995) well illustrated the enormous efforts required to strengthen monitoring organizations during the post-Mao period as follows: (a) a cadre evaluation system [*ganbu kaohe*] established in 1979 and detailed with procedures and guidelines for performance evaluations of local Party and governmental officials in 1988; (b) the efforts of strengthening and centralizing the State Statistical Bureau [*guojia tongjiju*]; (c) the General Auditing [*shenji*] Administration established in 1983; (d) the record reporting [*beian*] procedures established to facilitate monitoring by the department of central organization in 1984; and (e) the ministry of Supervision reestablished in 1987.

Institutionalization requires time, regularity, and stability. Even after establishing organizations, it takes time to get them operating in full swing. Then, there is the question of how the Chinese leaders got their information during the initial period of the post-Mao reform, that is, during the 1980s under the weak level of institutionalization. Hu's answer was in accord with the traditional ways noted above (Hu 2000, 2). However, a shortage of reliable information from the official organizational channels and lack of institutionalization in the information-gathering area, political leaders were forced to rely more on informal and private networks than on formal channels to get quality information. It is also understandable why specialized functional elite groups (think tanks: *zhinangtuan*) had critical roles during the period, in particular, in the area of decision-making about the economy.⁶¹ The role of the CASS as a think tank for Zhao Ziyang is the well known example.

When more objective rational principles replaced ideological zeal while reliability of information was low, and when political leadership required consensus-building

⁶¹ Chung (2000) indicates that the roles of the "think tanks" were not likely strong in the political area, compared to the economic issue area. Yu, Bin also indicated trivial roles of the think tanks in the area of foreign policy. See Yu, Bin, "The Study of Chinese Foreign Policy." *World Politics*, Vol.46, No.2 (January 1994). As to professionalism of the ministry of foreign policy, see Yang (1995).

instead of individual charisma, the policy-making process is very likely to be incremental and thus slow, the policies more likely moderate, experimental, and evolutionary.

Without detailed and accurate information, political leaders would not have blue-prints or plans for economic reforms. Therefore, most initial reform measures or policies could not help but be vague rather than specific and well-defined. They required information accumulated by piece by piece experimentation to define their policies in detail. After having experienced the previous disasters resulting from massive campaigns, no political leader could dare to bear responsibility for another failure politically.

Since political orientations among leaders were quite different on the various issue areas during the transitional period from the Maoist era to the post-Mao era, any failure could cause recurring political turbulence and upheaval. Under the diversity of political orientations represented by key political leaders, the best strategy was to seek consensus-building or an obvious majority to share the political responsibility; otherwise, a straightforward political struggle for power might develop, which the reformist political leaders had the consensus to avoid. The norm of consensus-building was fortified by sheer necessity. All these situations constrained introduction of the massive and drastic measures and prevented quick and dramatic changes of policies across the economy. The so-called China's gradualist economic strategy, often described in Chinese "crossing the river by groping for the stones," was the outcome under such structural and situational constraints. The Chinese policy-making process illustrates a piecemeal, incremental, and evolutionary feature designed to maximize areas of agreement among various relevant bureaucratic organizations and leaders.

2) Policy-Formulating Process⁶²

As shown in Figure 2-3, Chinese policy-making can in the main be divided by two stages: before formal specification and after. According to Wu (1995, 27-30), there are seven steps in formulating a central document to be formally endorsed by top political leaders and relevant organizations: initiation, selection of drafters, top-down directives, research and drafting, revision, approval, and dissemination. Before a draft is brought under formal discussion and specification, which is at the stage of approval in Wu's

⁶² This argument is mainly based on Wu's seven stage model. See Wu (1995).

terminology a considerable time and energy-consuming process beneath the surface is generally required. At the pre-approval state, informal and formal arrangements are made in “draft-making.” At this stage, since there is no time set, it is highly unpredictable as to when initial ideas can be formed as a draft. The procedure of draft-making often appears informal but is still recognizable. In general, the more comprehensive and complicated the issues are, which are often defined as political issues, the longer it takes and the harder it is.

To begin with, agenda-setting in crucial issues has not typically been a function of the National People’s Congress (NPC) or other social interest groups, contrary to the practice of many Western democratic systems. Top political leaders and relevant state/party organizations appeared to initiate the agenda-setting. The agenda can be categorized as either political or administrative (Hu 2000; Wu 1995). A political agenda refers to issues regarding party lines (*luxian*), principles (*fangzhen*), policies (*zhengce*), and works (*gongzuo*). An administrative agenda refers to issues relating to government administration and policies. In a formal structure, the political agenda should go through a decision-making process in the Politburo standing committee, the Politburo, the Central Work Committee, the Central Committee Conference, the CPC Congress, and the NPC according to the level of its importance. The administrative agenda is subjected to meetings in the State Council General Office, the State Council Standing Committee, and the State Council. If necessary, the Politburo and the State Council convene a joint conference of the provincial governor/party secretary (Hu 2000, 2).

Drafters are selected by leader(s) who are assigned the responsibility of drafting. For a political agenda, the drafting members are often from various organs including party, government, and even local institutions: mostly regular policy-consulting institutions. Members dealing with administrative agendas come from the appropriate administrative department in the party/government (Wu 1995, 28). Each of the formal top policy-making bodies, the Politburo or the State Council, has its own drafting organization(s), but the drafting organization(s) has often been restructured and abolished according to rises and falls in influence accompanying a leader’s political fate (Wu 1995, 28). At the agenda-setting stage, the individual(s) who becomes the leader of the small

drafting group, often triggers battle among competing political groups.⁶³ Although a top leader(s) can initiate policy-making and draft-making requires an exhausting process of coordination and compromise among various related groups and individuals, the leader in the draft-making group can still find room to insert his ideas.⁶⁴

The next step is to communicate with other political leaders to get directives, views, and suggestions. Senior drafters often use “phone calls, circulation of specific information documents, and aides’ attendance at related meetings of leading organs” as means of such communication (Wu 1995, 29). Based upon the directions, the drafting group starts the work of writing. Meanwhile, communications continue between political leaders and drafters. If a political leader has a concern, he or she will often enjoy individual access to the contents and the right to add his/her inputs. Other related organizations are also invited to make their inputs as well. On the other hand, at this stage, investigation and research groups are dispatched to the area of policy subject to gather information. If necessary, a small scale experiment is also conducted by agreement of the top political leaders. The results of investigation, research, and experiments are reported to the top political leaders, and drafters seek more opinions from them before making a draft.⁶⁵

The next step is to revise the previous version, report it back to the top political leaders, and then finalize the draft-making between the small drafting group and the top political leaders. At this drafting stage, although specific group(s) initiate agenda-setting according to their political/economic policy orientations, in the making of the draft they invite broad ranges of related individuals and organizations to get information and to adjust conflicting interests, and seek advice and opinions from the top political leaders. By doing so, they seek to broaden policy coalition and consensus and to become a *recognizable* majority⁶⁶ before the draft is brought under the formal discussion. However,

⁶³ For example, see the competition between Li Xin and Hu Qiaomu for the position of the director of the General Editing Office of Mao Zedong Works in Yu’s memoir (1998). Li represented Hua Guofeng camp as Hu did Deng Xiaoping camp.

⁶⁴ For example, Yu criticized that Hu Qiaomu could insert his own idea in drafting the public report after the third plenary session by distorting Hua Guofeng’s speech from “Resolutely Complete the Nationwide Anti-Gang of Four Mass Campaign” to “Resolutely End Using the Slogan of Class Struggle as a Key Link.” Yu (1998), 85-86.

⁶⁵ Wu regards this stage as the last stage of writing. Wu (1988), 29.

⁶⁶ Remember that the simple arithmetic majority is not a sufficient condition to acquire endorsement from the top authority, the State Council or the Politburo.

since there is no routine procedure and time-schedule written in the form of regulations in the draft-making, no one knows when it can be drafted and endorsed by the central authority.

The drafting groups and its leader(s) should attend to the political tide and the process of consensus-building. To sell their agenda, acquiring endorsement from the key political leaders such as Deng Xiaoping and Chen Yun is crucial. However, the key leaders also exercise a high degree of caution in endorsing most agenda because they do not want to push others to the wall by quickly endorsing it should the others think differently.⁶⁷ All parties should wait until all conditions are mature (*chengshu*).⁶⁸ When surrounding conditions are unfavorable, the best strategy can be to delay agenda-drafting. By nature, the more interest groups and political leaders the issue is related to and the greater influence it would have on their interests, the harder it is to establish consensus. For example, the *replacement of profit by tax* reform required almost four years to formally present to the State Council and the NPC (November 1982) from the stage of the agenda-setting (November 1978).⁶⁹

After its drafting in the small group, the draft is subjected to the formal policy-making procedure. As noted, the draft should be approved by the top policy-making body, the State Council, the Politburo, or the NPC if necessary. Wu emphasizes this stage as key to policy-making in that this is the central and formal stage of building consensus or winning compromise among leaders. Although various interests have already been adjusted during the draft-making process, the draft again is subjected to speculation, discussion, and consensus-building among officials having formal positions and organizational authorities. Some revision is again required. Throughout this extended formal process, a document (policy) eventually gains authority (Wu 1995, 30). After getting such an endorsement, it is publicized internally and formally as a policy. The general rules of publicizing the policy are as follows: “first supervisors, and then

⁶⁷ Of course, it is not necessarily happening at times. They are sometimes confrontational. If it was related to a core principle of his, he bullied against the other by amassing his supporters. Deng's southern tour in 1992 is an example. However, overall, they sought compromise, balance, and mutual respect regardless of their individual relations.

⁶⁸ “Time is ripe (*shiji chengshu*)”/ “Conditions are mature (*tiaojian chengshu*)” will be one of the terms most frequently heard when we conducted interviews in China.

⁶⁹ See Liu (1999), 99 and 124.

subordinates; first within the party, then outside; and first officials, then the masses (Wu 1995, 33).”

In practice, the procedure I described above is not necessarily in exact order. Draft-writing and revising often overlap. Work on varying issues, investigations, researches, experiments, and draft-writing can be painfully repeated. Even after giving their formal endorsement to a new policy, Chinese leaders often proved reluctant to implement it nationwide without having full confidence in it, in which case further experiments are set up. In the process, dissatisfied leaders can still give their inputs. For example, even after the *replacement of profit by tax* reform was endorsed by the State Council and the NPC in 30 November 1982, several experiments were conducted in Shanghai, Tianjin, and Jinan. Zhao Ziyang (Premier) was also required to comply with the fiscal reform principles suggested by Hu Yaobang (General Party Secretary) by embracing them in a revised draft of February 28, 1983, (a) specially by allowing enterprises more incentives, and (b) agreeing that the state should take the largest part, enterprises the middle, and individuals the least (Liu 2000, 149-150) even though the fiscal reform was an administrative agenda in nature. Eventually as of June 1, 1983, the State Council was able to launch nationwide the *replacement of profit by tax* reform.

Wu defines this process as *documentary politics*. The formulation of an endorsed document illustrates the Chinese style of law (policy)-making. As Shirk indicated (Shirk 1993), the level of consensus in the leadership is crucial in shaping the degree of implementation at the subordinate level. The other factor must be the character of the issue in terms of local interests. The juxtaposition of central endorsement and local interest creates four kinds of situations. A situation of the combination of central endorsement with a clear majority and local supports is most crucial in securing the implementation, as in accepting the norm of “seeking truth from facts.”

The format of central endorsement with local reluctance produces a distorted and slow implementation as seen in the *replacement of profit by tax* reform. Without the backing of a strong consensus among the central leaders, a policy can be locally implemented only if the localities embrace it. One case of the former situations, the introduction of the agricultural reform policy in the late 1970s, resulted in discretionary implementation and much bandwagoning behavior in the provinces (Li 1997; Chung

1995). The latter case revealed the failure of implementation such as in Hu Yaobang's political reform in 1987.

Chinese power struggle often surfaces over the issue of selecting an agenda and the leader of the drafting-process. Despite certain abnormalities, the guiding principle in the draft-formulating process was the Chinese version of *democratic* as a consensus-building mechanism. The entire process of formulating a draft and acquiring a formal endorsement is designed to induce consensus, bargaining, and compromise among related groups and leaders as well as to enhance policy legitimacy and eventually to facilitate implementation (Wu 1995, 35). In this sense, the document-producing process is almost the equivalent of the law-making process in Western democratic countries. One feature differing from the Western style is that the roles of informal consultation, adjustment, and small group speculation are often crucial and indeed dominant. However, this kind of informality is considered requisite, and it acquires regularity and predictability by virtue of existence in the policy-making process. In decision-making, majority rule certainly exists but political leaders and draft-makers prefer choosing a conflict-avoidance strategy, in case they cannot reach full consensus, to majority voting. Therefore, documents produced through this kind of politically-painstaking process are highly meaningful to Chinese political life. In particular, resolutions on economic and political reforms, political reports in the Party Congress, and annual/multi-year economic or budget plans prove to be a barometer in understanding the current stream of Chinese politics.

Overall the Chinese policy-making process comprises complicated web of informal and formal rules and activities. From the next chapter, the detailed Chinese policy-making cases in the fiscal arena will be illustrated.

Chapter III

Restructuring Fiscal System after Mao: Toward *Replacement of Profit by Tax Reform*

This chapter will begin with a brief introduction of the legacies of the Chinese fiscal system during the Maoist era. In principle, it was a top-down system under a socialist planned economy. However, an examination of the structure reveals that the Maoist fiscal system had evolved into a considerably more complex one than any other socialist systems. The strong intervention of politics in China's fiscal system resulted in drastic fluctuation in the pendulum of centralization-decentralization and failed institutionalization. Post-Mao reforms in the fiscal system proved to be incessant efforts to overcome such negative legacies. The fiscal preconditions explain a crucial part of the reason why Beijing has focused its enormous energy on establishing standardized fiscal system along with the overall economic reforms.

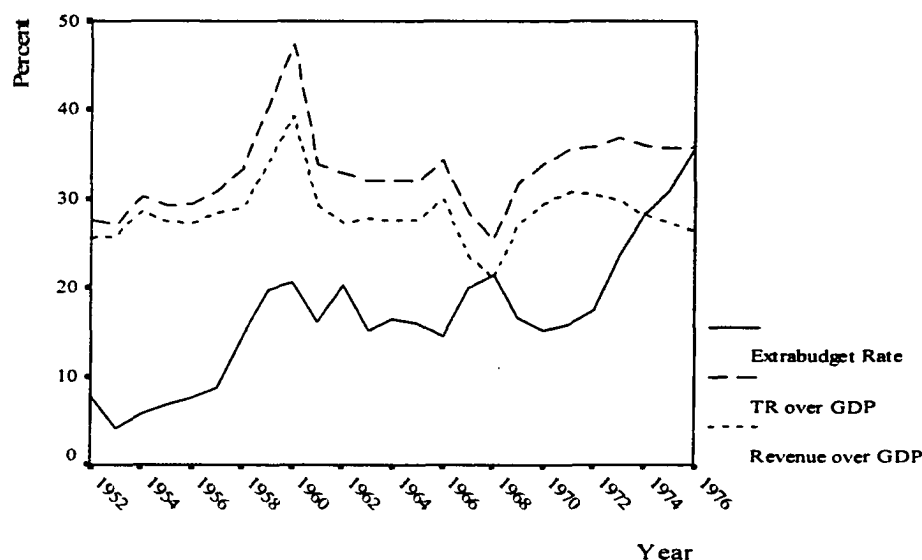
The second half this chapter will explain why and how the first *replacement of profit by tax* reform was introduced and implemented in the midst of efforts toward fiscal standardization and institutionalization as it was during the initial period of economic reforms. The overall policy priority, guiding *democratic* decision-making norms, and external factors outside the fiscal arena determined the timing, degree, and speed of the fiscal reform and implementation.

A. Historical and Institutional Legacies of Chinese Fiscal System under Mao

During the Maoist period, paths of economic development were changed in response to political goals often disregarding economic rationalities, in particular during the periods of the Great Leap Forward and the Cultural Revolution. Although the size of public finance in China changed along with the level of economic development in accord

with the conventional revenue expansion theory of Wagner's Law,¹ China's financial expansion was not linear and incremental due to the political influences. Figure 3-1 shows that during the Maoist era the Chinese socialist state was surprisingly effective in mobilizing fiscal resources society-wide, whose capacity is often measured by the ratio of the government revenue to GDP. The Chinese socialist system was able to extract a fairly high level of the total government revenue (33.1 percent average) in spite of the existence of rather less-sophisticated taxation institutions.²

Figure 3-1: Level of Revenue Extraction during the Maoist period



Source: Calculated from MOF 1992, 13-16, 186-187, and SSP 1997.

Note: 1. Extra-budget Rate refers to the ratio of the extra-budgetary revenues over the budgetary revenues.
2. TR over GDP refers to the proportion of the sum of budgetary and extra-budgetary revenues over GDP.

It was much higher than the average of about 20% characteristic of most developing countries⁴ that failed to effectively extract resources because of the gap between rapidly developing tax bases and lagging taxation institutions. The relatively

¹ Over a hundred years ago, Adolf Wagner claimed that the public economy expands in direct relation to the growth of the national economy (Cited from Jackman 1993, 54).

² The highest point was 47.4 percent in 1960. The total government revenue means the sum of revenue and extra-budgetary revenue. As seen in Figure 4-2, the Great Leap Forward campaign and the Cultural Revolution were the thresholds of skyrocketing increase of the proportion of extra-budgetary revenue over the budgetary revenue.

⁴ See Statistical Yearbook of Shandong (1998), 434.

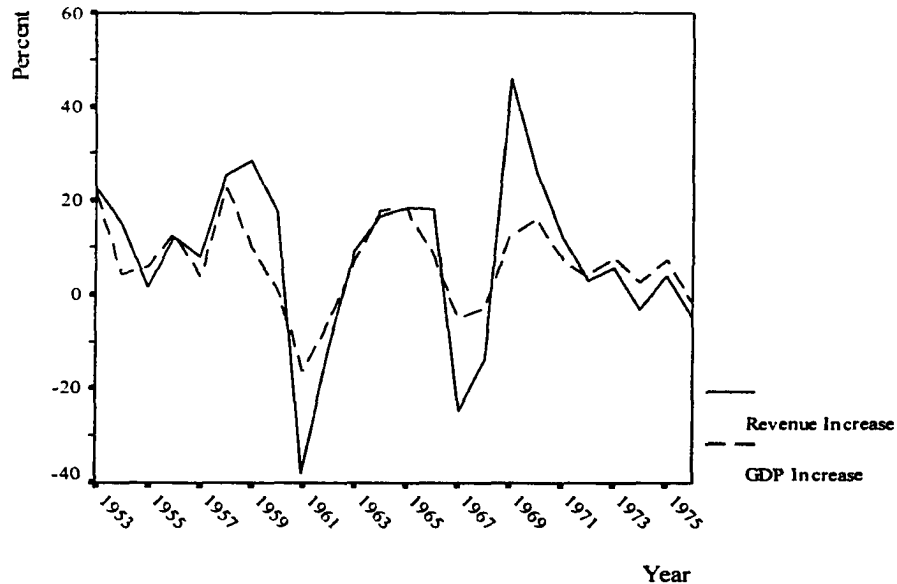
high extraction rate was attributed to the socialist feature of high resource mobilization (see Table 2-5), although the Chinese extraction level was relatively low among socialist countries. During the first five-year economic planning period under Mao (1953-1957), the Beijing government was able to increase volume of taxation in the process of the socialist transformation in spite of its lagging taxation institution. The total revenue (budgetary plus extra-budgetary revenues) proportion reached almost 50 percent of GDP in the midst of the zeal of the Great Leap Forward campaign.

China's socialist system revealed a severe defect, as Kornai (1992) well illustrated in his famous book *the socialist system*, the monitoring problem. The two periods of massive political campaigning under the leadership of Mao Zedong might prove the Maoist answer to the monitoring problem. The ideological causes and power struggles that had twice swept China over a twenty-year period drastically sapped most established institutions in the financial and economic areas. Figure 3-1 reveals patterns that clearly illustrate how destructive were the Great Leap Forward Campaign (1958-1960) and the outbreak of the Cultural Revolution (1966-1976) for the fiscal system. Despite fluctuations, an overall decline in the increase of rates of revenue and GDP was obvious throughout the Maoist period. The Great Leap Forward Campaign (1958-1960) and the outbreak of the Cultural Revolution (1966-1976) tremendously destabilized economic and fiscal systems. As a result, the Chinese state suffered enormous amounts of state deficit and failed to realize its economic potentials during those periods of upheaval in spite of its high extraction levels as compared to those of most developing nations.

A prominent feature in the fiscal system during the Maoist period was that changes in the Chinese fiscal system were linked with political struggle. Political struggle often paralyzed the fiscal system, as seen after the Great Leap Forward and in the early 1970s, and they also brought extreme measures during the Cultural Revolution period. As seen in Figures 3-1 and 3-2, there were clear patterns according to policy changes followed by institutional changes. During the Great Leap Forward and the Cultural Revolution periods, the GDP increase rates sharply dropped and the ratios of extra-budgetary funds to budgetary funds and deficits jumped. In the area of fiscal extraction, both periods recorded extreme trends such as sharp increase during the Great Leap Forward and sharp decrease during the period of the Cultural Revolution. Such politically

motivated changes in fiscal systems were far from economically rational and severely destabilized China's fiscal systems.

Figure 3-2: GDP and Revenue Increase Rates during the Maoist Period



Source: Calculated from MOF 1992, 13-16 and SSP 1997.

Note: Revenue Increase and GDP Increase refer to Annual Revenue Increase Rate and GDP Increase Rate respectively.

Another serious problem, caused by political logic in the area of fiscal policies, was the lack of institutionalization. In the midst of political struggle, fiscal system rules and guidelines were dramatically changed by the political logic of political leaders, which had profound influences on fiscal performance. Even though divisions of authority and responsibility were drawn between Beijing and local governments, the rules had not been able to bind their behaviors as intended. Beyond fiscal sharing arrangements, the Beijing government was able to reclaim more funds from provinces by renegotiating the terms as necessary. Provinces also asked for more funds from the Beijing government, giving various reasons whenever they could not meet basic local spending. During the Maoist period, the tremendous influence of politics on the fiscal system and lack of institutionalization remained strong in the Chinese fiscal arena under the influence of the Maoist legacy with its socialist tradition of “eating from the big pot.”

It is worth noting that Chinese taxation system as an institution was far from a sophisticated and efficient version of a modern fiscal system during the Maoist period. A complex monitoring system was not required under the socialist economic structure. State enterprises were subject only to turnover tax; collectives were subject to an income tax with the same turnover tax. The turnover tax existed only to secure a regular transfer of funds from enterprises to the state. Almost all Chinese businesses were under state control, accounting to the state for their profits. The average proportion of tax revenues to government revenue was just 38.7 percent during the Maoist period (1950-1976), with the lowest point of 29.6 percent in 1960 occurring at the peak of the Great Leap Forward Movement.⁵ Taxation bureaus were for most of the time under control of the MOF, and no central collection and monitoring organizations in the fiscal arena were established.

The political and ideological legacy of the Great Leap Forward and the Cultural Revolution contributed to the Chinese fiscal system's high level of decentralization in terms of revenue collection and management. The devastating effects on the fiscal institutions during the Cultural Revolution were more profound than the Great Leap Forward, as revealed in data on the fiscal extraction level and GDP growth. At the end of the Cultural Revolution, the size of central government revenue was only 12.7 percent of the national revenue size as of 1976, whose amount covered merely 26.2 percent of central expenditure.

The presence of such a weak central finance system, however, should not lead to defining the Chinese fiscal system as a decentralized system on the whole. The Chinese fiscal system was centralized in that both fiscal decentralizations were effected by a combination of political visions, struggles, and the imperatives of Mao Zedong, and the system could be reversed by political decisions of the Beijing leadership as seen during the adjustment period after the failure of the Great Leap Forward Movement. When the leadership issues settled, the Beijing government was still able to wield its fiscal power through socialist planning and other control mechanisms such as the personnel appointment system and party apparatus without confronting any serious resistance from localities.

⁵ Calculation based on SGTB (1997), 3.

As a result of China's two disastrous political campaigns, economic development stagnated and as a result the taxation base could not fully realize its potential size; otherwise, it would be much larger. As Shirk indicated, the Chinese state was trapped in a situation in which "central and local governments were fighting over a smaller and smaller piece of China's economic pie" (Shirk 1993, 152). The post-Mao reforms were efforts to reverse the trend toward stagnation. Along with reforms, the issue of extractive capacity increased in importance at all levels of government because those governments desperately needed expansion of budgets to support economic development and to meet rapidly expanding public spending. When political and ideological factors were no longer dominant guidelines for economic behaviors, the politics of resource distribution among major political actors became intense, and the relationship between the Beijing and local governments evolved in the process of intense struggle.

B. Restructuring Formal Fiscal System during the Early 1980s

1. Formal Policy-Making Organizations in the Fiscal System

Before discussing historical evolution in China's efforts to restructure fiscal systems during the initial period of economic reforms, an explanation of how the formal decision-making system in the fiscal arena worked is in order.

The institutional catastrophe of the Cultural Revolution made restructuring institutions one of China's top priorities in the post-Mao policy. For example, the fifty-two ministry levels of organization under the State Council at the end of 1975 quickly increased to 100 as of December 1981 (Wu Jie ed. 1998, 343-344). The roles of the party and the government have long been inseparable in China's policy-making. The CPC had directed policies by positioning its party members in its overlapped organizations in the government. Since major institutional reshuffling in the relationship between the party and the government started in 1982, however, administrative works have been formally handed over to the government. Since the handing-over, formal state institutions have played much more active roles in drafting fiscal policies. In the formal system, at least six major organizations were involved in policy-making in the fiscal arena: the National People's Congress (NPC), the National People's Congress Standing Committee, the State

Council, the Ministry of Finance, the State General Taxation Bureau, and the Provincial People's Congress and its Standing Committee (Department of Tax Policy 1996, 23-26).⁶

According to the Chinese Constitution, the NPC is the supreme legislative organization in producing basic laws (including tax laws). The NPC's other role is to oversee execution of state administration. For example, an individual income tax law was passed in the third plenary session of the fifth NPC on 10 September 1980. However, since there is no clear explication of what composes the *basics* in the roles of law-making between the NPC and the NPC Standing Committee, the Standing Committee also produces laws which are not handled in the NPC.⁷ The Standing Committee can revise and add to laws during the period of NPC session. The NPC and its Standing Committee established a specialized finance and economy committee to examine tax laws and the execution thereof during the session. The Standing Committee allowed the State Council the power to make regulations and rules regarding the reform of industrial/commercial taxes as well as reforms in the economic system.

In practice, the State Council is the most crucial lawmaker in the fiscal arena. The State Council has drafted most laws and regulations for the NPC or the NPC Standing Committee. With delegation of power from the Standing Committee, in particular, the Council played a crucial role in drafting laws and regulations in the reform of industrial/commercial taxes during the period of 1983-1985. Setting administrative regulations and rules is another role of the State Council according to the laws produced by the NPC and the NPC Standing Committee. Under the State Council, several commissions have played functional roles in policy-making process. The commissions have proven to be organizationally comprehensive than ministerial organizations in the thematic aspect and more *formal* and *standing* in the temporal aspect. The process of establishing, modifying, and abolishing committees was subjected to the permission of

⁶ In addition, there is the State Council Custom Tax Regulation Commission. It is a specialized organization in Custom taxes, which is composed of administration directors from the MOF and other administration relating to Custom tax area, was placed under the *kou* management of the State Economy and Trade Commission, which was established in 1993. It handles Custom tax-related policies, regulations, rules, and detailed guidelines.

⁷ For example, Agricultural Tax Regulation was introduced in the 96th plenary session of the first NPC Standing Committee in June 1958; "Taxation Management Law" in the 27th plenary session of the Seventh NPC Standing Committee in September 4 1992; and "Law on value-added tax, consumer tax, business tax of the foreign investment enterprise and foreign enterprises" in the 5th Plenary Session of the Eighth NPC Standing Committee in 29 December 1993.

the NPC or its Standing Committee. During the early period of the post-Mao reform, the State Planning Commission (SPC), the State Economy Commission (SEC),⁸ and the State Commission for Restructuring the Economy (SCRE) gave inputs in policy-making in the fiscal arena according to their organizational interests. For example, the SPC and the SCRE were proponents of the *replacement of profit by tax* reform; meanwhile, the SEC was an opponent. The Commissions played comprehensive roles in making drafts and giving suggestions after communicating, coordinating, or sometimes conducting research with encompassing ministerial organizations in the same issue area.

One opaque institution is the existence of the *kou* [gateway] system.⁹ According to Wu Jie et al. (1998, 408-412), the *kou* system started in the 1954 institutional reform and as an official organization existed until early in the Cultural Revolution. In September 1954, eight general offices (*bangongting*), an increase over the previous four-committee system under the Political Council (*zhengwuyuan*), were established under the State Council: political and legal, education, heavy industry, light industry, finance and trade, transportation, agriculture, and state capitalism. Each general office retained more than four ministerial levels of organizations in general under its jurisdiction. The general office was called *ban* and its jurisdictional range or line as *kou* in abbreviation. The *kou* played a middle-belt role between the state top leader(s) and subordinate functionary organizations at the ministry level by facilitating coordination, adjustment, inter-organizational cooperation, and even decisions-making. The director of finance and trade *kou* during the period 1954-1958 was Li Xiannian a Vice-Premier as well as Minister of Finance. The establishment, abolishment, and alteration of the *ban* did not require the permission from the NPC or its Standing Committee, which differs from the case of commissions.

The *ban* system was abolished in 1970 although its legacy of categorization remained in practice, and the State Council has sought to directly control ministries and commissions without the *ban*'s middle-belt role in the formal administrative hierarchy. Although the *kou* system no longer exists as a state institution in the formal system, in practice its legacy appears to remain strong in a semi-institutional aspect. Lieberthal

⁸ It was abolished in the 1988 institutional reform.

⁹ In 1958, the foreign affair *ban* (*kou*) was established. After 1959, the change of the *bans* in number and jurisdiction were quite large. For more details, Wu et al. (1999), 410.

(1995, 192-194) illustrated in detail the existence of *kous* as an (informal) power organization during the post-Mao period. An interview also confirmed the existence of (sub) *kou* in the financial and economic area: the interviewee, who was an insider in the financial arena, was able to identify the figures in charge in this arena since the post-Mao reform: Chen Yun, Zhao Ziyang, Yao Yilin, Li Peng, Zhu Rongji, and Li Lanqing. Although comprehensive and powerful *kous* exists, such as party affair *kou* and foreign affair *kou*, their hierarchical positions vary in the government. Since the 1988 institutional reform, most *kou* managements were placed at commission and ministry levels (Wu Jie et al. 418-419). For example, in 1988 the General Taxation Bureau was renamed the State Taxation Bureau, after which it became a vice-ministerial level and was placed under control of the State Council from the jurisdiction of the MOF. However, the state taxation bureau was still categorized as the MOF *kou*.

The *kou* relationship was not one of leader and subordinate. Each organization in the line was independent and placed under direct control of the State Council. An organization within a certain *kou* should submit reports to the State Council or the central leadership via the leader of the *kou*. In the making of important decisions, coordination and revision with the *kou* leader were also required (Wu et al. 1998, 412). The actual jurisdiction of *kou*, however, has often overlapped with those of commissions as well as the small leadership group of the post-Mao period. The role of *kou* remains somewhat vague and often causes role confusion among organizations. During the post-Mao period, the policy-making locus in the fiscal area seemed to move to formal institutions, such as commissions and the small leadership group, from the *kou* management system.

Another noteworthy institution under the State Council is the small leadership group (*lingdaoxiaozu*), which multiplied in an impromptu manner to cover various issue areas on the administrative level. These small groups have played a crucial role in filling a void organizationally in tackling arising issues during transitional period. In character, it is an ad hoc organization to facilitate coordination and to exert leadership, whose organizational status was not legally defined and its existence was not observed in most developing countries. The State Council has the formal power to form these groups whenever necessary because there have been no binding institutional regulations from the NPC regarding establishment and abolishment of the groups. As an organization, the

small leadership group has had no fixed administrative status in the Chinese hierarchical administrative system. For example, the influence of the State Finance and Economy small leadership group established in 1979 could even overshadow the power of the Premier in the field because of the political influence of members such as Chen Yun and Li Xiannian.¹⁰ Meanwhile, the Anti-Corruption small leadership group founded in 1983 and guided by Gu Mu was not as powerful as the State Finance and Economy small leadership group in the Chinese political hierarchy (The Board 1999, 926). Some small leadership groups have a general office under ministerial levels of administration such as the small leadership group on Natural Disaster Rescue under the Ministry of Water Conservancy; the others have their own general offices such as the small leadership group on Economic Development of Underdeveloped Regions (Wu et al. 1998, 414). Remarkably, the number of these groups increased rapidly during the post-Mao reform period and at their peak reached 85 in 1993 (Wu et al. 1998, 414).

In the fiscal arena, the Central Finance and Economy small leadership group (*zhongyang caizheng lingdaoxiaozu*) was established in 1980 (Director, Zhao Ziyang) after the abolishing of the State Finance and Economy small leadership group guided by Chen Yun and Li Xiannian. It played a key role in introducing industrial/commercial taxes in accord with the principle of the *replacement of profit by tax* under the direction of Zhao Ziyang, Premier of the State Council, in the early 1980s. However, the decision-making role in the fiscal arena gradually moved to formal organizations from the relatively less formal small leadership group during the 1990s.

The Ministry of Finance specializes in administering state fiscal policies, revenue and expenditure management, and auditing and surveillance in the financial area. It also formulates and executes fiscal policies, regulations, rules, and other detailed guidelines, and its work includes formulating laws relating to adjustments of tax items, tax rates, tax reductions, and tax exemptions. Commonly the MOF issues its detailed guidelines and rules right after the State Council ratifies a regulation applied at the state level in the fiscal arena. For example, when the State Council issued the Provisional Regulation on

¹⁰ In addition, the leader of the science and technology small leadership group, established in 1982, was Zhao Ziyang, and the leader of the central foreign affair small leadership group was Li Xiannian in 1983. Both were powerful small groups because of leaders in the groups. See Central Policy Research Board (1999), 924-927.

Consumer Tax on 13 December 1993, MOF's release of its detailed guidelines and rules was followed on 25 December 1993. In drafting the *replacement of profit by tax* reform, the MOF played a very active role in promoting the reform as well as the General Taxation Bureau.

Until 1988 the General Taxation Bureau had been a sub-organization of the MOF. As the main administrator of all tax collection and management, its roles are to execute tax policies and State Council directions and to draft laws, regulations, rules, and detailed guidelines relating to taxation for the MOF and the State Council as well as to exercise responsibility in supplying revenue to the state. The Bureau wields line leadership over local taxation organizations. After the third major institutional reform of 1993, the State General Taxation Bureau (the former State Taxation Bureau) strengthened its organizational power over local state taxation bureaus by directly controlling central and shared taxes and making personnel appointments of directors and vice-directors of the provincial state taxation bureaus. It also supervises and guides provincial taxation bureaus, expressing its power to exert its organizational opinions in appointing directors of provincial taxation bureaus (Department of Fiscal Policy 1996, 29).¹¹

The provincial People's Congress and its Standing Committee are additional policy-making organizations in the fiscal area. According to the Constitution and the Organic Law regarding the Local People's Congress and Government, the provincial People's Congress and its Standing Committee can formulate local laws. Under the traditional socialist unified tax policy system, the discretionary power of the local organizations was limited. Under the current tax laws, however, delegation of power is often allowed in the local tax area, though local situations vary and objective monitoring is difficult at the national level. For example, the Provisional Regulation on Urban Land Tax of 1988, the Provisional Regulation on Urban Maintenance and Construction Tax of 1985, the Provisional Regulation on Cultivated Land Occupation Tax of 1987, the Provisional Regulation on House Tax of 1986 allowed local discretion.¹²

The general features of policy-making in the fiscal area during the post-Mao era were the increasing role of formal institutions and efforts of standardization. In particular,

¹¹ As of 1995, the State General Taxation Bureau comprised of about 400 personnel and 13 department levels of administration. See more detail, Department of Fiscal Policy 1996, 30-31.

¹² The examples are extracted by the author from Liu's book (Liu 2000, 580-583).

functionally-specialized organizations such as the MOF and the General Taxation Bureau functioned as the main executive branches in making drafts. Although the roles of the NPC and the local NPCs gradually increased, in the early 1980s the State Council and the small leadership group were delegated the power from the NPC and took most of the responsibility for making fiscal policies. During the period, these bureaucracies assiduously sought standardization of the fiscal system; however, informal politics often hindered the goal from being realized and resulted in only gradual policy change in the fiscal area as a result of compromise among various vested interests and practical consideration among the top political leaders.

2. Efforts for Expansion of Institutional Capacity

The main feature of the Chinese taxation system during the period of a classic socialist economy was that the central government controlled all major economic activities through a central plan except for the periods of the Great Leap Forward and the Cultural Revolution. Market sectors were thoroughly oppressed. Tax revenue from the non-socialist sector covered only 3.7 percent of the total tax revenue (Li 1991, 12).¹³ Taxation was viewed chiefly as an instrument of convenience in controlling revenue flows from state enterprises to the government. However, the Great Leap Forward and the Cultural Revolution almost entirely destroyed the taxation system: the role of taxation was disregarded, taxation bureaus were dismantled, and tax officials were sent to the countryside for reeducation. In 1975 the General Taxation Bureau was reestablished but until 1978 control over revenue by the Beijing government remained remarkably low, at about 15.5 percent of the national revenue.

Policy priorities in the fiscal arena during the early post-Mao reform period (1979-1984) were revealed in the political report given by Hu Yaobang in the twelfth CPC Congress in September 1982 and the sixth five-year (1981-1985) economic plan given by Zhao Ziyang in the fifth plenary session of the fifth NPC in November 1982. In the midst of overall economic adjustment policy, Hu's political report emphasized fiscal

¹³ Enterprise income tax from state enterprises had been a major source of revenue until 1984, whose revenue share of total revenue was 60 percent in 1978, 30.5 percent in 1985, and 21 percent in 1990. As of 1993, it shares 14.1 percent of total revenue. See *China: Macroeconomic Stability in a Decentralized Economy* (The World Bank 1995, 196).

system stabilization, fiscal balance, securing necessary state revenues, and fiscal incentives for localities and enterprises (Hu 1982, 11). Zhao's report provided more details. According to the plan, policy priority is given to fiscal adjustment and balance. The main tasks during this period were to maintain economic stability with a certain pace of economic growth rate and to prepare plans and programs for further economic and social developments. During the period, the average growth rate target for national income was quite moderate, in the range of 4-5 percent. The average revenue growth rate target was 3.3%. The ratio of fiscal revenue over national income was required in the 28-30 percent range provided economic situations were good.¹⁴

In order to stabilize fiscal balance and improve the overall fiscal situation, strengthening of the tax system was crucial. Even before the third plenum of the eleventh CPC Congress in December 1978, political leaders had reached consensus on the urgent need to restructure the tax system (Xiang 1999; Liu 2000; Central Board of Policy Research 1999). Economic reforms increased market influence over the centrally planned economy; under the condition of insufficient functioning of the market (prices) over production, however, a broad consensus existed that the tax system ought to be the main policy mechanism of state control over production, exchange, redistribution, and consumption. In order to generate stable revenues for the Beijing government and to increase the role of macro-economic control, items that were less important in the previous planned economy, the tax system needed to be significantly reformed in both its legal and administrative respects. Since that consensus, the taxation system has experienced several changes with increasing political and economic ramifications.

The most urgent imperative was to strengthen taxation organizations and personnel as indicated at the National Financial Work Conferences in April 1978 and May 1979 (Xiang 1999; Liu 2000).¹⁵ Additionally, to collect more correct information of the tax base the State Council rectified the Notice on Handling Taxation Registration drafted by the General Taxation Bureau on 1 September 1982. According to the notice,

¹⁴ The average target of the ratio during the sixth five-year plan was exactly 27.8% (Cong and Zhang 1999, 990). Compared to the average growth rates during the fifth five-year plan, the basic construction and military expenditure growth rates would be curtailed as high as 10.2% and 2% respectively.

¹⁵ Law-making in the fiscal arena also started as a means to strengthen the fiscal system. For example, two major tax laws were approved in the third plenum of the fifth People's Congress held in September 1980: Law on Income Tax on the Joint-venture Enterprises and Law of Personal Income Tax.

all industrial and commercial business units and individuals were required to register at the taxation bureau in their respective region (Liu 2000, 402-403). The registration became the basis of subsequent taxation statistics and thus further standardization of the tax system.

In April 1978, the MOF issued detailed guidelines on how to organize tax organizations at the National Financial Work conference, as follows (Liu 2000, 524-527): (a) every province and autonomous region should establish a taxation bureau separated from but placed under the finance bureau; (b) unified control by the finance bureau was adopted in Beijing, Tianjin, and Shanghai. However, the MOF did not reintegrate the two bureaus in other regions where the two were already separated; (c) the MOF demanded establishment of a taxation bureau at the county level. The administrative position of the taxation bureau at the municipality and county levels is equivalent to that of the finance bureau; and (d) below the county level, taxation branches should be established along with regional administrative boundaries or within the People's Commune under the control of the county-level taxation bureau. As of 1978, seventeen provincial governments had a taxation bureau, thirteen out of the seventeen taxation bureaus being established that year.

Organizational separation to tighten up Beijing's control in the taxation area seemed to induce fiscal difficulties and consequent complaints from local governments. As a result, via the State Council's Issue Not to Abolish Local Taxation Bureaus of 19 May 1983, the MOF announced that it would not expedite separation of taxation bureaus from finance bureaus in regions where it had not yet done so. However, the principle of separation of taxation bureaus was again confirmed as a policy goal. The State Council issued the so-called 37th Document on 24 August 1983, in it placing emphasis on vertical leadership in terms of cadre management, personnel arrangements, and finance in the fiscal arena. By mid-1984, virtually every provincial government but the three aforementioned municipalities separated their taxation bureaus from their finance bureaus (Liu 2000, 533).

With regard to authority relations in the taxation system, the MOF in January 1981 again confirmed the principle of dual leadership (*Shuangzhong lingdao*) by the one higher level bureau in the same line (vertical) and the same level of local government.

Vertical leadership was given priority.¹⁶ The General Taxation Bureau was under the MOF control. In March 1982, the State Council's notice on strengthening taxation works laid down the rules for personnel control extending to the county level. The appointment of director of a taxation bureau above the county level had to be approved by one higher level of the taxation bureau. In particular, the MOF's approval was required for the appointment of director and vice-director at the provincial level (Yuan and Men 1995, 5). The notice also extended the privilege to the taxation bureau officials to attend government meetings, read documents, correct violations, and interpret laws and regulations relating to taxes. On 11 August 1982, a crucial suggestion from the MOF on cadre management in the fiscal area was circulated; according to its suggestion, *kuai-kuai* leadership would dominate over the *tiao-tiao* leadership in the fiscal area. That is, cadres in the fiscal area above the county level of administration would be mainly under the control of the local party rather than the one level higher fiscal organization (Liu 2000, 532). Although the State Council No. 131 document reassured hierarchical leadership as principle for cadre management and finance, local leadership in the fiscal area was already broadly recognized.

To strengthen the role and position of taxation bureaus at the provincial level, the State Council in April 1982 upgraded provincial-level tax bureaus to a half-level higher than *chu* (office) level,¹⁷ and the taxation bureau was allowed to establish the *chu* under its jurisdiction (Liu 2000, 531; Guo 1996, 71). However, it still remained under the control of the finance bureau at the provincial level.¹⁸ Accordingly, by late 1982 eight provincial levels of government already promoted the position of their taxation bureaus. Finance bureau's party branches in thirteen provincial governments suggested taxation bureaus to be promoted to the half-level higher one. By mid-1984, the promotion of taxation bureaus and separation of taxation bureaus from finance bureaus were

¹⁶ The State Council issued the dual leadership as a control mechanism over the taxation bureaus in December 1983 (Yuan & Men 1995, 5).

¹⁷ The taxation bureau at the provincial level of administration previously seemed to be at *chu* although it was called *ju* [bureau]. It was Yao Yilin who suggested raising the organizational status on 26 March 1982 (Liu 2000, 530-531).

¹⁸ In addition, with increasing importance according to the new economic policy, the General Seashore Tariff Bureau was located under direct control of the State Council, which was previously controlled by the Ministry of Foreign Trade since 1961. When the General Seashore Tariff Bureau was established in 1949, it belonged to the Ministry of Finance.

accomplished at the provincial level except for the three municipalities (Liu 2000, 531, 533).

On 19 May 1983 the State Council notice placed a special emphasis on strengthening fiscal organs at the township level (Liu 2000, 532). In August 1983, the leadership over the county-level taxation bureau by provincial-level taxation bureau was manifestly enforced in an emergency State Council Notice on the fiscal balance along with the information on the introduction of the first stage of the *replacement of profit by tax* reform. The provincial taxation bureaus were to allow provincial governments to control personnel appointments, personnel arrangements, and taxation bureau expenditures on the county level.

The devastating decentralization and destruction of fiscal institutions during the Cultural Revolution aggravated the traditional socialist monitoring problem. In 1980, to monitor more effectively in the fiscal area, the State Council issued a notice regarding strengthening surveillance work in the finance area. In the notice, the Council urged establishment of a surveillance mechanism within every finance organization up to the county level.¹⁹ Further, the Beijing government organized an investigation team almost every year, though it proved to be inherently an anecdotal, partial, and provisional mechanism because it was not regularized. On 5 September 1981, the State Council issued a MOF notice to the provincial governments and ministerial organizations to assign a tax auditing agent to large and mid-size enterprises to intensify fiscal surveillance (Liu 2000, 397-398). Beijing's efforts like these to strengthen taxation organizations and to regulate their behaviors did not, however, assuage the existing monitoring problem. A fundamental difficulty was that both enterprises and local cadres had insufficient experiences with the modern accounting under the market-oriented system.

Outcomes of poor accounting were most obvious in taxation. On the government side, Beijing focused more on the establishment of *local* fiscal administrations and encouraged strengthening local initiatives according to the principle of *Suiting Measures to Local Conditions* (*yindizhiyi*). Such prioritization contributed to the other problem that there existed no independent surveillance organization for the finance bureaus. This

¹⁹ For detail, see *Caijing* No. 8 (1980): 1-2.

meant that no specialized mechanism for investigation and surveillance existed on the standing national level. Therefore, the Beijing government would have to rely on monitoring the self-investigation of *local* financial bureaus and non-standing and anecdotal dispatch teams. Examination of the results of anecdotal investigations done by the Beijing government revealed the widespread moral hazard problem in the taxation arena even during the early 1980s. According to a 1981 nationwide investigation, for example, tax evasion was prevalent regardless of the type of enterprise: more than 50 percent of enterprises appeared to be in violation of the Beijing government's taxation policy (Department of Fiscal Policy 1996, 400). In one province, the sheer size of the tax evasion (about 1.3 billion yuan) exceeded the size of tax collection (about 1 billion yuan) (Guo 1997, 71).²⁰ It was only in August 1985 that the State Council decided to formalize a surveillance mechanism on an annual basis (Liu 2000, 402). This mechanism was called the Great Inspection of Taxation, Finance, and Price Affairs (*shuiwu caiwu wujia dajiancha*).²¹ Furthermore, regulations and rules in the tax collection area were not in detail been institutionalized. Local tax bureaus therefore broadly exercised their discretionary power by setting up their own rules during the initial period of reforms. Accordingly, a national tax collection work conference was organized for the first time in 1985 to strengthen regulations in the area of tax collection during the post-Mao period. During the early 1980s, it was inevitable that the Beijing government depended on the cooperation of local governments in detecting local tax evasion, avoidance, and exemption against Beijing government regulations.

As indicated by Yao Yilin in 1981, another practical solution to weak monitoring in the taxation area was to increase the number of personnel in the arena without shaking up the given institutional arrangements (Liu 2000, 527). As of late 1979, the total number of personnel in the taxation area reached 178,680, a figure that outnumbered the highest level achieved before the Cultural Revolution. The *Chengdu* conference in May 1979 declared the issue of recruiting and educating tax agents as a historical task. Hu Yaobang

²⁰ Report on Tax Evasion Situation and Establishment of Tax Collection System, Department of Finance, February 1982. (Extracted in Guo 1997, 71).

²¹ It was abolished with settlement of the tax-sharing system in 1998.

also paid attention to the problem of insufficient number of taxation personnel.²² In April 1981 the MOF reported a plan to the State Council to add 80,000 tax agents to the current 200,000 agents over the next two years. The number of personnel in the taxation area was 285,895 at the end of 1982, as planned. In 1984 and 1985, 40,000 more tax agents were recruited and total numbers exceeded 320,000 after the state council reemphasized recruiting tax agents and strengthening the taxation organization at the bottom level given that the *replacement of profit by tax* reform implementation of August 1983 was dramatically increasing the complexity of the financial task (Guo 1997, 71; Liu 2000, 532-533). The number increased to 500,000 in 1989 with the addition of 60,000 assistants. As of 1993, the total number of tax agents including assistants had already passed the 700,000 mark (Yuan & Men 1995, 5). As a result, the average increase rate of personnel exceeded 12 percent during the period 1980-1993, which was higher than all economic growth rates during the same period.

The Beijing government continued to increase its organizational capacity in the fiscal arena and to support fiscal institutionalization during the early 1980s. With increasing emphasis on taxation, it promoted the organizational status of the taxation bureau up to the level of the finance bureau. Remarkably during this period, the Beijing government was able to reach institutionally even below the county level of government in the taxation area for the first time since the devastating effects of the Cultural Revolution swept away institutional capacity in this area. Although separation of taxation bureaus was not yet completed at the county level, it had been achieved at the provincial level by the end of 1984. However, the Beijing government still suffered from lack of central monitoring and collection systems during the early 1980s in spite of enormous

²² After he read an article of Lu Chenhua regarding problems of taxation works (*Renmin Ribao*, May 15 1982), Hu Yaobang demanded the Minister of Finance, Wang Bingqian, to look into this issue. Accordingly, Wang wrote a report to Hu on the issue regarding the strengthening of the taxation organization and increasing the number of personnel. However, the report also indicated that the measures would be gradually implemented because of a financial problem.

²⁴ One example was to allow enterprises and organizations to possess from 5 percent up to 15 percent of discretionary funds out of the total budget, instead of taking all profits from enterprises and all revenue income from localities, depending on the economic sectors (Xiang 1999, 304-305). The policy was ratified in November 1978 by the State Council. In July 1979, the State Council also set detailed rules and regulations on profit calculation and management. For example, innovation funds must be 1-2 percent of the total profit; welfare funds 11 percent of the total wage; bonus funds 10-12 percent of the total wage; and enterprise funds not to exceed 5 percent of the total wage (Xiang 1999, 304-305).

efforts to rebuild taxation organizations. The government certainly allowed localities increased discretionary powers and thus moral hazards in the fiscal arena.

The question is why the Beijing government did not install a strong monitoring system in the fiscal area in spite of its obvious necessity. One answer can be found in the weak institutional capacity of the Beijing government during the transitional period. A more fundamental reason is to be found in the policy priorities of the Beijing government. In the fiscal arena, acquiring stable revenue collection for the state was the primary goal, but it was subjected to national priorities of economic reforms and development. Increasing surveillance and monitoring could hamper vigorous initiatives on the local level, whose initiatives were essential for economic development as well as revenue enhancement. Although the weak monitoring system proved a practical constraint in the full introduction of the *replacement of profit by tax* reform, the Beijing government did not strenuously seek to strengthen monitoring systems despite its rhetoric during the early 1980s. The policy priority was to provide incentives and regulate fiscal works rather than to monitor them.

3. Initial Experiments in the Fiscal Management System

(A) Jiangsu Model

During the early post-Mao period it became a common norm that initial experiments should be conducted before any national or major policy was introduced. Beneath the formal organizational level, various informal exchanges of views and experiments were essential. New experiments in the fiscal area began based on the preconditions of decrepit fiscal institutions and escalating fiscal deficit problems at the end of Mao's period. To encourage fiscal effort and readjust the institutional problem at every level of government, soon after Mao's death and the end of the Cultural Revolution in 1976, several revenue-sharing experimental plans were proposed from both top and bottom to boost fiscal efforts.²⁴ Among them, *Jiangsu's* proposed, the Fixed Rate Responsibility (*gudingbilibaogan*) budget management system, a version of the Sharing Total Revenue (*zongshou fencheng*) arrangement, was accepted in December 1976 under permission of the State Council. The main feature of this experiment allowed Jiangsu province to have greater latitude in fiscal management under guidance of the state plan.

The system had three characteristics: (a) it was a contract system, (b) after fixing the ratio of remittance to the central government, provincial expenditure was linked with revenue efforts (*shouzhiguagou*), meaning that the more revenue collection the more expenditure, (c) instead of annual adjustments, the sharing rate was fixed for a period of four years beginning in 1977. Except for special cases such as natural catastrophes, the fixed rate would not be rearranged.²⁵ Therefore, the Jiangsu system allowed provincial governments to enjoy more latitude in revenue/expenditure managements.

In the Sharing Total Revenue system based on the contract, total revenue from enterprise profits and industrial/commercial taxes were pooled and shared with the central government at a single negotiated rate. After Jiangsu remitted a fixed proportion of its total revenue to the central government, it could determine the spending levels for specific expenditure categories under an overall expenditure ceiling. According to the contract, the revenue sharing rate between the Beijing government and Jiangsu was 58 percent and 42 percent respectively in 1977, and then 57 percent and 43 percent from 1978 to 1980. However, the ratio was adjusted again to 61 percent vs. 39 percent in favor of the Beijing government in 1979. After 1981, the dividing rule became more complicated by applying the Clarifying Revenue and Expenditure, Level by Level Responsibility (*huafenshouzhi fenjibaogan*) system (Xiang 1999, 319; Yu 1993, 213). The overall result of the experiment was initially quite successful. In 1980 the volumes of total industrial production output and revenues of Jiangsu increased by 80.2 percent and 38.1 percent respectively as compared in 1976. Jiangsu's revenue remittance to the central government increased by 47.5 percent, while provincial revenues also increased by 25.9 percent (Oksenberg and Tong 1991, 15; Yu 1993, 201).

The *Jiangsu* system was a first step in separating local and central fiscal managements, that is, the Level by Level Fiscal Managements (*fenji guanli*) during the post-Mao period. Under circumstances in which the Beijing government could not identify revenue bases in detail, this system still allowed it a stable revenue supply from the localities. The system simply divided all pooled fiscal revenues at a fixed rate. In return, provincial governments received more latitude in fiscal management under the

²⁵ However, in January 1978, the fixed rate was changed in favor of the central government at the national plan meeting. After the arrangement, the rate between the central government and Jiangsu was 61 percent and 39 percent respectively. Yu, Guoguang (ed). 1993, 201.

fixed contract. Localities favored the system over any other attempt at fiscal centralization or at thorough fiscal decentralization giving greater fiscal freedom to enterprises.

The major problem of this system was that the sharing system was basically based on negotiations between the central and provincial governments. The provincial governments negotiated various revenue sharing schemes with the central government, after which the rates were fixed for a certain period as negotiated. Under the influence of the Cultural Revolution during late Maoist period, no strictly assigned responsibility of revenue sources exist, and as a result, large loopholes for arbitrary power involvement and soft-rule constraints remained in the relations between the central and provincial governments. Although the *Jiangsu* system might have not reflected exact fiscal bases in various regions, it was a convenient, efficient, and effective tool for the Beijing government to use penetrating local fiscal bases by means of handing the responsibility for gathering information and monitoring enterprise activities over to the local governments under the circumstances that Beijing did not yet have sufficient information and institutional monitoring mechanisms over local fiscal activities. Meanwhile, a more advanced fiscal management system such as the tax assignment fiscal system required identifying fiscal bases in each region and then a monitoring system to provide information of degrees of implementation. In this respect, it is understandable why both the MOF and the localities were able to agree to implement the Jiangsu style of fiscal management system to meet the exigencies of a particular period. However, any central fiscal organization such as the MOF would prefer a more standardized system when strengthening its central monitoring and bureaucratic ability to control local information.

(B) Another Experiment

A modification of the Sharing Total Revenue arrangement, Sharing Revenue Increase, Linking Expenditure with Revenue (*zongshoufenceng, shouzhiguagou*) budget management system, was suggested by the MOF and implemented in ten provinces and cities in 1978: Shaanxi, Zhejiang, Hunan, Beijing, Gansu, Jiangxi, Fujian, Shanxi, Jilin, and Heilongjiang. This system was also designed to provide incentives in local revenue collection. Under this system, the ten provinces could retain discretionary funds (*jidong*

caili) only when they increased their volume of local revenue compared to the previous year. Beijing and local governments divided the revenue increments based on a negotiated sharing rate fixed for three years. However, the targets of local revenues and expenditures and the proportion of sharing total revenues were still subject to annual adjustment (Oksenberg and Tong 1991, 16; Yu 1993, 203).

In 1978 at the provincial level, economic and fiscal situations coupled with continued economic expansion and investment showed improvement, with the provinces gaining a total surplus of six billion *yuan* of provincial revenue or an increase of 64 percent over 1977. In contrast, large-scale constructions drained Beijing's budget, and the Beijing government suffered a budget deficit. However, the provinces were unlikely to contribute to the central budget in 1979, as the new economic policies of lowering the overall growth rate, reducing agricultural taxes, arranging for wage and employment, and increasing purchase prices for farmers would doubtlessly diminish their income. Anticipating no increase in revenue, provincial governments did not expect to collect reserve funds under the Sharing Revenue Increase System of 1978. The system was terminated to encourage revenue efforts at the provincial levels; as a result, this experiment only lasted for one year. However, these experiments were still under the influence of the Maoist fiscal system, such as the eating in a big pot, the sharing total revenue, and lack of division of authority and responsibility between the central and local governments. As seen in the political report of the eleventh CPC Congress address in August 1977, the Maoist class struggle line was still a guiding party principle.²⁶ For more fundamental fiscal reforms, more pragmatic and incentive-oriented guidelines were required.

The political victory by Deng Xiaoping and his allies over the Hua Guofeng group, the so-called Maoist followers, in the third plenary session of the eleventh Congress of the CPC at the end of 1978 opened the window for further change in the Chinese fiscal system. The new political leadership identified the problems of the Maoist system as overemphasis on political/ ideological factors in economic (fiscal) managements, overinvestment in the heavy industrial sector, incentive problems, and lack

²⁶ To see Hua Guofeng's political report in the eleventh Party Congress held in August 1977, *Hongqi* No.9 (1977): 3-31.

of managerial responsibility (Liu 1999, 95-96; Han et. al. 1989, 58-61; Central Policy Research Board 1999, 1918-1928; Cong 1999, 983-985). The economic reforms with market-oriented elements also proclaimed the Maoist taxation system as outmoded, where only a few taxes existed and the bulk of government revenues were handed over in the form of remittance by state-owned enterprises.²⁷ Without fundamental changes in the fiscal system, it was impossible for the state to implement new economic reforms. Consequently, a more fundamental reform in the fiscal arena was formally requested by the vice president of the CPC, Li Xiannian, at the Central party workshop in April 1979 (Liu 1999, 100).²⁸ Following guidelines from the new leadership, the MOF set up a special structural reform group in order to examine several plans on the basis of the *Jiangsu* experiment (Xiang 1989). As well, some goals and policies for the fiscal reform were introduced at the national tax administration conference held in Chengdu in April 1979.

- (a) Respect for economic laws was emphasized. Institutionalization in the taxation area was urgently requested. In the taxation area, no laws existed, only tentative regulations. In addition, most categories of taxes were outmoded 1950's. According to the new plan, a total of 17 items of taxes would be applied instead of the current 8 items of taxes.²⁹
- (b) The principle of increasing roles of taxes in revenue and in macro-economic control was taken for granted.
- (c) Necessary expenditures of the central government must be guaranteed. To do so, tax bases should be broadened along with changes of economic environments.³⁰
- (d) Increasing management power and responsibility of enterprises was recommended to overcome the incentive problem. New fiscal reform must help bring into full play the enthusiasm of each level of government and enterprise.
- (e) Special treatments in tax burdens on the agricultural sector were given to encourage economic development in rural areas and to keep balance among industries.

²⁷ In addition, to deal with new economic actors, such as foreign-owned, small, and individually-owned enterprises, the taxation system had to be adjusted.

²⁸ Zhang Jinfu the minister of the MOF stressed that the taxation system should serve for the tasks of the new era, adapt to the demands from economic basis, and facilitate economic development. Liu (1999), 98.

²⁹ According to the plan, stamp tax (1988) and special consumer tax (1991) were re-introduced. State-owned enterprises income tax (1983), state-owned enterprise fixed asset utility tax, natural resource tax (1984), loan and interest income taxes, and license tax would be introduced.

³⁰ For example, a study group was formed in the MOF to introduce state-owned enterprise and individual income taxes and foreign taxes to help the opening-up policy during the period from the late 1978 to the early 1979. The two taxes were introduced in 1980.

Maoist legacies in the fiscal system quickly lost their rationales, but replacing them with a new fiscal system would not be an easy task. Localities and most ministries, which had enjoyed their power over resources under the traditional system, had good reasons to be reluctant to introduce a more transparent and regulatory fiscal system. In particular, as for a highly redistributive and political issue in character, the new Chinese decision-making style required prolonged coordination and multiple compromises among various interest groups and political leaders to ensure its legitimacy for national implementation. Due to lack of sufficient information, monitoring mechanisms, and institutional arrangements, the process would inevitably prove gradual and incremental. No single political leader would dare to take a political risk to be a sole patron of a nation-wide fiscal reform. As a result, until various built-in interest parties reached consensus with and among the top political leaders, the fiscal reform policy could not be finalized and implemented at the national level. To implement the new fiscal management system, policies had to be able to provide a win-win situation for all involved parties. This kind of norm, as well as other environmental conditions, later gave very strong impetus to maintain the fiscal contract system for more than a decade in spite of its several perceived problems. As a result, when a new fiscal system was implemented, it often appeared far from the original MOF ideas, which sought to regulate and centralize taxes by assigning them to level-by-level administrations.

(C) *Sichuan Model*

After repeated study and coordination, consensus was reached among the MOF and provincial delegates at the National Tax Administration work conference for fiscal reform held in October 1979 to launch the "Classifying Revenue and Expenditure, Level by Level Responsibility" (*huafenshouzhi, fenjibaogan*) budgetary management system (called Sichuan model) from the beginning of 1980 (Yu 1993; Zhang 1999). The new system was more sophisticated in characteristic in that it identified the regional responsibility of revenue and expenditure management based on previous experiences and natural conditions of each region as well as fiscal management power between the Beijing and provincial governments. It required a much more complex method than did the Jiangsu system in addition to an intense process of clarification and negotiations to

finalize *base figures* for provincial revenue and expenditure. Intense discussion and debates between the provincial delegates and the MOF officers had transpired, based on the previous data of each province at the first round. Any further issue was dealt with between the top provincial leaders and Beijing's leader at the second round during the national plan conference in late 1979 (author's interview).³¹ For smooth implementation, the MOF and the State Council conceded to the localities to subtract more than three billion *yuan* from the base figure set forth from the original plan in the conference at expense of the central coffers (Xiang 1989). The political implication of this system was to change the main fiscal control mechanism from the *tiaotiao* (departmental control) to the *kuaikuai* (regional control) system. It is the major departure for the Cooking in a Separate Kitchen (*fenzaochifan*) as well. Under this system, central ministries would no longer plan the expenditures of local projects nor would they issue mandatory fiscal targets, although they could still issue reference targets.

The change entailed in the fiscal reform could have had profound impacts on given organizational and power relations, so the reform's nature was basically political. Implementation was not an easy task and often met with backlash. In the early 1980s, a hot political battle was waged over increasing the role of taxes over profits. Increasing the role of taxes would provide tighter control by Beijing over fiscal resources by standardizing tax bases even under the contract system, which would eventually replace the fiscal contract system with a more unified and standardized tax-based system. During the post-Mao period up to 1983, political debates had proven fierce on the issue of introducing the *replacement of profit by tax* system as well as several experiments already begun in 1979 with strong input from the MOF.

The *Sichuan* model was a variant of the Assigned Revenue System of 1951-58 in that revenues were divided into three types and assigned fiscal (both revenue and expenditure) management responsibility to respective governments: (a) central/provincial governmental fixed incomes, (b) shared income at a fixed rate, and (c) shared income at negotiated, adjustable rates (Oksenberg and Tong 1991, 17-18). The base

³¹ Provincial delegates mostly included director of the financial bureau and a vice-governor level of leader (sometimes, governor). In the MOF, one or more provinces were assigned to an officer at the division level, who continues to monitor the province(s) previously assigned to him and is very well equipped with the knowledge of fiscal situations of the assigned province(s).

figures fixed for revenue and expenditure were calculated on the basis of those figures of 1979. With the existing system under the twin pressures of lagging revenue collection and increasing fiscal deficit, the Beijing government aimed to provide better incentives to local governments and enterprises for revenue mobilization while ensuring an adequate amount of revenue to finance the Beijing governmental programs during the sixth five-year economic plan period (Zong 1986, 18; Wong April 1992, 207).³² In principle, the fixed and sharing rates were set for five years, to give more fiscal power to localities and to encourage local fiscal efforts. Expenditure sizes were linked with revenue efforts: more revenue, more expenditure. In addition, although the Sichuan system maintained the essence of the fiscal contract system, it further accommodated demands from the General Taxation Bureau and the MOF to create a stable and predictable fiscal management mechanism by categorizing the sources of revenues. These two tasks seemed to be compatible because it was impossible to ensure the adequate revenue for the central government without providing localities and enterprises with enough incentives.

In February 1980, the State Council promulgated a Regulation of Implementing the Dividing Revenue System. Sichuan province started implementing it, and two dozen other provincial governments soon took it up (Yu 1993, 207 and Li et al. 1992, 19). It was not a pure and unitary tax-sharing system, however, but a combination of profits and taxes. Instead of imposing a uniform fiscal system on various regions, the system combined several sub-fiscal systems and elements of a fiscal contract system. Except for this main system, three other types of fiscal arrangements coexisted at that moment (Zong 1986). First, special fiscal favors were given to Guangdong and Fujian. Guangdong was allowed to remit a fixed amount to the Beijing government, and Fujian got fiscal support for five years with a fixed amount from the Beijing government. Under this system, called the Great Responsibility System (*dabaogan*), both provinces could enjoy much more flexible fiscal management power over other provinces (author's interview). Second, five minority regions (Xizang, Xinjiang, Guangxi, Inner Mongolia, and Ningxia) and three poor provinces (Yunnan, Guizhou, Qinghai) acquired the subsidy of a 10 percent annual increase for five years provided their fixed and adjustment incomes could

³² Regarding the sixth-year economic plan, see Hu Yanbang's report in the twelfth CPC Congress in 1982 (Wu, et al. 1998b, 1956-1980).

not cover expenditure. Third, the Beijing government declined to loosen its control over Beijing, Tianjin and Shanghai in revenue and expenditure management because their fiscal positions in the nation were so crucial; their fiscal revenue income was 25 percent of the national revenue income and their expenditure about 6 percent (Han and Zhao 1982).³³ The Beijing government continued to apply to the three the old Total Revenue Sharing system and annual adjustment method.

The introduction of the Sichuan model and various other measures expanded the fiscal power of most provinces, in particular, provinces with rapidly developing economies. Provincial governments would enjoy greater expenditure if they collected more revenue. Provincial governments could now structure their budgets on a stable basis, as the Sichuan system fixed the rates of revenue sharing and subsidies for five years. However, it was not necessarily welcomed by all provinces. As Oksenberg and Tong observed, some incentives were given to some provinces for smooth implementation of the fiscal contract system (Oksenberg and Tong 1991, 23-25).³⁴ The new mechanism helped establish local finances. It is noteworthy that the Beijing government lengthened its tentacles in the fiscal arena to the county/city levels (Li et al. 1992, 19). The county level of finance started to function as an independent unit during this period. In the system, local enterprise profits and commercial/industrial taxes were two major revenue sources for local governments. If the major source of revenue shifted from enterprise profits to commercial and industrial taxes, provinces had to offset reduced enterprise profits by increasing tax revenues from the industrial/commercial sectors. Although industrial/commercial taxes were a rapidly increasing revenue source, they did not necessarily evenly provide benefits for all provinces.

Some provinces with backward economies were under heavy pressure from their fiscal instability due to small revenue bases and low revenue growths. Under these circumstances, the legacy of the tacit social contracts of the socialist system and the norm

³³ As of 1980, those municipalities were crucial in the Chinese fiscal system because of the wealth in terms of GDP per capita and contribution of revenue to the Beijing government. They ranked No 2, No 3, and No 1 respectively.

³⁴ To see an argument against this, Yu, 208. According to Yu, since the industrial and commercial tax was also in the directory of the local revenue, there was no incentive for provinces to change to the revenue-sharing system. The change of revenue-sharing system, then, can be seen as the strength of the central government. Therefore, the point of the debate becomes as to how much local governments were under pressure of fiscal instability, a choice of either freedom or stability.

of consensus constrained the Beijing government from implementing thorough standardization and regularization in the fiscal system. Beijing had to pay attention to each region according to its own situation and set up standards as acceptable for both sides. The Beijing government poured a considerable amount of its own finances into impoverished areas, peasants, and uncompetitive enterprises and workers, to help them keep the national pace.

The fiscal contract system was flexible in nature, so the Beijing government could flexibly apply different contracts over various regions while inserting its own preferences into the mechanism. In the contract system, for example, the Beijing government could take advantage of the imbalance in negotiation powers to readjust rates as seen in the case of Jiangsu in 1979 in spite of the four-year prefixed rate. It retrieved provincial revenues for the central coffers by drastically increasing the share of industrial/commercial taxes in revenue, whose volume (41.5 percent) eventually became larger in the 1985 national revenue than the volume of profits (30.7 percent).³⁵ The other example comes from Shanghai. During the fiscal deficit of 1980-81, the Beijing government borrowed money from local governments, 7 billion yuan in 1981 and 4 billion yuan in 1982 (CASS 1987, 17), Shanghai being the largest loaner. In the 1982 negotiations with Shanghai, after fixing the retention rate at 31.2 percent the Beijing government simply changed Shanghai's retention rate to 28.5 percent by confining Beijing's debt equivalent to 2.8 percent of the retention rate (Cui and Zhao 1983, 38; author's interview).

Throughout the history of People's Republic of China, whenever the Beijing government experienced difficulties in garnering sufficient revenues from localities, it had a tendency to favor a more arbitrary contract system to guarantee its stable share in the national revenue. In this respect, supporting the fiscal contract system would not necessarily help an ambitious political leader, such as Hu Yaobang, increase his local popularity, contrary to what Shirk argues. The final figure base was in *most cases* decided by more practical negotiators in the MOF and provincial governments at the end of the year at the basis of an already-defined criterion.

³⁵ The World Bank, *China: Macroeconomic Stability in a Decentralized Economy* (The World Bank, 1995), 196.

It is also evident in the early 1980s that there was a strong need for consensus-building, for stabilizing politics, and for expanding reform support as well. The remark of Xiang Huaicheng, Vice-Minister of the MOF as of 1989, illustrates in his retrospection on the Chinese fiscal system the reasoning for coordination (Xiang 1989, 25-26).

The standards for the distribution of fiscal resources should be made as rational as possible so that differences among the regions will not become excessively great. ----- Our economy consists of various interests. We must recognize and respect economic interests of enterprises and localities, and coordinate these interests.

As a result, negotiations for the fiscal contract often ended up giving more resources to localities than originally planned by the MOF. All these discretionary policies helped drain the coffers of the Beijing government in the early 1980s.

In response to these situations, the Beijing government practiced many institutional powers over localities to circumscribe new fiscal powers of the provinces allowed by the new fiscal regime if necessary. As mentioned previously, the Beijing government still exercised a tight grip over the finance of three municipalities. The MOF and the State Council still possessed the power to approve provincial budgets. In principle, provincial expenditures would not exceed revenues. Provincial governments would abide by state regulations on taxation, prices, wages and bonuses, enterprise finances, drawings upon special funds, and unit spending norms. Provinces had to fulfill central government plans to deliver materials and commodities, and provide funds for certain national and regional enterprises and services (Oksenberg and Tong 1991, 18-19). In an effort at fiscal centralization during the period, the Beijing government regained control over the three expenditure items of science and technology, and funds for tapping into the technological transformation of existing enterprises. These items were no longer subjected to the budget contract of the local government, but were instead appropriated into special items by the Beijing government.³⁶ In addition, Beijing was still able to adjust the contracts when necessary, although the original contract was fixed for five years. For example, when the introduction of the first stage of the *replacement of profit*

³⁶ The three main sources of the fund are local surcharges collected and dispensed by financial departments of the local governments, various fees collected and dispensed by local basic units and funds retained by enterprises and their corresponding ministerial and local owners. See *Collection of 1981 Financial Regulations and Systems* (Yijiu Bayinian Caizheng Guizhang Zhidu Xuanbian) Vol.1 (Beijing: Zhongguo Caizheng Jingji Chubanshe, 1985), 12-17.

by tax reform changed given interests, the Beijing government renegotiated with various provinces and autonomous regions to adjust to the new conditions (Xiang 1989).

The Sichuan system expired after the second *replacement of profit by tax* reform introduced in 1984.³⁷ As fiscal reforms were related to redistribution of resources, in the processes of policy-making and policy revision every organization and region affected by the reforms sought to give inputs according to its own interest. Consequently, fiscal institutionalization was influenced by changing balances, met various obstacles, and was slowly and non-linearly implemented. The average life span of a taxation system during the period of 1978 to 1994 was less than four years; meanwhile, it had been about eight years during the period of 1950 through 1973. The case of the *replacement of profit by tax* reform provides a good example of how Chinese political leaders, organizations, and localities shaped fiscal reform in the early reform stage. The case also reveals how the Chinese conflict resolution (consensus-building) mechanism operates through coordination, compromise, bargaining, and personalized intervention.

C. Toward the *Replacement of Profit by Tax* Reform

In the evolution leading up to the *replacement of profit by tax* reform, let alone the initial conditions, three other factors were crucial in explaining the timing, degree, and speed of fiscal reform and implementation: the overall policy priority, the guiding principle of being democratic,³⁸ that is, the need to build consensus among key political leaders and related interest parties, as well as factors external to the fiscal arena. The absence of a charismatic leader, the fiasco caused by individualized decision-making during the late-Mao period, and the lack of sufficient information at the basic administrative levels practically emphasized the importance of consensus-building in the post-Mao decision-making. The competition between Zhao and Hu for succeeding Deng delayed consensus-building and policy formulation for the *replacement of profit by tax*

³⁷ The conflicts within Chinese leadership are often visualized according to their policy stances. Susan Shirk's work also claimed that their stances on fiscal reforms were closely related to the succession conflict between Hu Yaobang and Zhao Zhiyang.

³⁸ It refers to the *democratic* in democratic centralism.

reform due to the deadlock situation between the two.³⁹ External factors also have to be taken into account; although they have not been determinants in fiscal reforms, they certainly provided momentums and reasons to delay or to precipitate fiscal reforms. The economic instability following fiscal deficit and inflation delayed the *replacement of profit by tax* fiscal reform in the early 1980s; on the other hand, the Gulf War and the changing international security environment during the early 1990s played positive roles in introducing the fiscal reform by providing the reasoning to continue building military expenditures, and thus in worsening the Beijing's financial capability, eventually forcing various interest parties to reach consensus to introduce the fiscal reform much earlier than scheduled.

As indicated previously, the *replacement of profit by tax* system reform was initiated much earlier than anticipated by many scholars.⁴⁰ It was late 1978 when the MOF revealed the idea of the *replacement of profit by tax* reform in a preliminary draft on reform of industrial/commercial taxes (Shen et al. eds. 1999. 534). As of 1979, the share of taxes in revenues began to outnumber profit remittance (Xiang 1999, 305). During the Maoist period, profit remittance from profit-making state-owned enterprises was a major source of the government budget; the share of taxes continued to be less than 50 percent of the revenue. In addition, remittance from enterprises was mostly controlled by related ministries and local governments. With the existence of few regulations on profit remittance and the lack of strict supervisory institution, enterprise remittance was often subjected to discretionary consideration and negotiations between collectors and payees (Shao and Ding 1983, 37). In the view of the MOF as well as the General Taxation Bureau,⁴¹ such deregulation and decentralization of financial resources needed to be adjusted and made more centralized to supply sufficient funds for the central government. In addition, the traditional method of funding state finance was no longer an efficient and effective way because it was too crude to cover various sources of fiscal bases as new market elements were introduced.

³⁹ Meanwhile, the unstable position of Jiang Zemin as a leader during the early 1990s facilitated the fiscal reform to garner support from the military.

⁴⁰ For example, Shirk (1995, 226) finds its origin from the 1980 SEC document authorizing various types of experiments. In 1982, the issue of the replacement of profit by tax reform draft was formally floated to the surface. However, the Chinese decision-making procedure requires considerable time and energy for *yunniang* and draft-making to reach consensus before an issue comes to the surface.

⁴¹ The General Taxation Bureau was under control of the MOF.

(A) Organizational and Individual Preferences

Based on organizational and individual interests, proponents and opponents to the fiscal reform found themselves divided. The powerful central bureaucracies under the traditional plan system, such as the State Planning Commission (SPC),⁴² the MOF and the MOF's General Taxation Bureau, were obvious proponents. The State Commission for Restructuring the Economy (SCRE) joined the proponent group under the guidance of Zhao Ziyang. Given the characteristics of the General Taxation Bureau and the MOF, they became natural proponents of bringing more control of taxes and revenue resources under their authorities. The SPC also had an organizational interest in ensuring funds for the Beijing government to fund for key energy and transportation projects, which was under control of Yao Yilin (Chen Yun's protégé) since August 1980. The SPC's functional responsibilities often overlapped with the State Economic Commission's (SEC) and competed with the SEC for influence in micro-economic and enterprise managements (Wu Jie et al. 1998, 395). The SCRE was established in the wake of institutional reform in February 1982 and placed under the State Council.⁴³ The key role of the SCRE when Zhao Ziyang was director was to design and facilitate economic reform programs under the guidance of the State Council. The SCRE had a potential of institutional conflicts with the SPC over the control of macro-economic design, but both maintained coalition for the *replacement of profit by tax* reform with Zhao's cooperation with Chen Yun during the period.⁴⁴ The SCRE also often worked together with the MOF in making drafts for the fiscal reform.

On the other hand, the State Economic Commission (SEC),⁴⁵ Institute of Industrial Economics of the Chinese Academy of Social Science (IIE),⁴⁶ Industrial Ministries, and localities were reluctant to support the *replacement of profit by tax* system

⁴² In 1988, the tasks of the SPC were reassigned only for macro-economic control and comprehensive economic management after it combined both the SEC and the original SPC.

⁴³ Its institutional hierarchy in the State Council was sixth right behind the SEC out of 61 ministerial organizations in 1982.

⁴⁴ Fewsmith explained that Zhao became a proponent of the "replacement of profit by tax" reform to garner support from the powerful central ministries such as the MOF and central leaders such as Chen Yun and Deng Xiaoping. Fewsmith (1994), 135-136.

⁴⁵ Its institutional hierarchy in the State Council was fifth right behind the SPC, but ahead of the SCRE.

⁴⁶ Jiang Yiwci was a director.

(Shirk 1996, Ch.11). Hu Yaobang as a General Secretary appeared to be supportive of the fiscal contract system (Shirk 1996, Ch.11),⁴⁷ but his position on this issue was not surprising, given that Rural Development Research Center (Du Runsheng, director), which had such great success in introducing the household responsibility contract system in rural areas, was under the control of the Central Secretariat. The SEC, which was in charge of the microeconomic area as well as the IIE, was a well-known supporter of managerial and financial autonomy for enterprises. Originally, the SEC, under Yuan Baohua who was appointed as head in February 1981 proved less powerful than the SPC in spite of its right-behind position with the SPC in the organizational hierarchy. However, the SEC was strengthened by integrating eleven functional organizations, including the state finance and trade small leadership group and the state agricultural commission, in the institutional reform of 1982.⁴⁸ During the period, Hu appeared to be actively seeking to exert influence on economic issues and so strengthened the SEC as the main institutional means of inserting his policy. The CASS in general appeared to be a strong institutional backer for enterprise autonomy throughout the post-Mao period.⁴⁹ Industrial ministries and localities favored the contract system based on profit remittance, in which rapidly developing industries and localities were likely to retain more fiscal resources; meanwhile, less-profitable enterprises (mainly heavy industries) and less developed areas could expect more subsidies from the Beijing government. A uniform tax system based on tax assignment was less likely to provide more resources to enterprises (as well as their supervising ministries) and localities.

However, equating local and industrial preferences with the contract system often overlooked the fact that all these benefits relied on favorable negotiations and the policy priority of Beijing leaders. By negotiating with provinces, the Beijing government could

⁴⁷ Shirk indicated that Hu's support on the fiscal contract system was motivated by his ambition to succeed in Deng Xiaoping and competition with Zhao Ziyang. She argued that he leaned toward the fiscal contract system to garner more support from localities because the fiscal contract system was popular among local leaders and would provide chances with pork-barreling politics. However, it is not certain of the motivation whether it was a problem-solving and temporal approach to the rising deficit of the Beijing government or a pork-barreling politics as described by Shirk. What became obvious was that he soon became a minority position on the issue among key political leaders.

⁴⁸ Its institutional hierarchy in the State Council was fourth just behind the General Office, Ministry of Foreign Affairs and Ministry of Defense. After series of institutional conflicts with the SPC, it was integrated into the newly reorganized SPC in 1988.

⁴⁹ It appears to have had a general tendency to be sympathetic and representative to interests of localities and enterprises because it has had extensive regional branches and members.

ensure its short-term policy goal with greater certainty than in the tax-sharing system. Under uncertain economic and fiscal situations, the Beijing government often adopted this short-term measure to secure and stabilize central revenues. This fiscal contract method also conduced to creating win-win situations because the Beijing government allowed localities much discretionary power in local finance therein. However, the fiscal contract system certainly proved detrimental to fiscal institutionalization and standardization, both of which would provide more secure fiscal bases and modernized, efficient fiscal management in the long-run. Therefore, the choice between the profit remittance-based contract system and the tax-based assignment system was not necessarily related to pork-barreling politics in garnering more support from provinces.

The functional roles of each political leader, Zhao as an administrator and Hu as a national leader, were likely to support their preferences at certain political junctures. Zhao's role was basically an administrator, and he tended to be less flexible toward policies that exceeded his administrative vision. Meanwhile, Hu's role as a political leader in nature gave him greater flexibility beyond organizational constraints. When fiscal deficit problems overwhelmed Beijing's leaders, Hu supported the expansion of the flexible contract system during the period from 1982 to 1983.

In 1982, ten of fifteen provinces originally under the tax-sharing system returned to the contract system and all provinces except the three municipalities plus Guangdong and Fujian were on the system by 1983 (Oksenberg and Tong 1991; Wong 1990; Shirk 1993). The rather rigid Sichuan system was replaced with the more flexible sharing total revenue (*zonghe fencheng*) system. During the period, the tax collection fulfillment rate averaged 107.6 percent, which was better than the 104.5 percent of the previous two years (SGTB 1997, 4). In addition, the ratio of tax revenue to total product value increased to 6.3 percent and 6.2 percent in 1982 and in 1983 respectively, compared to 6.0 percent in 1981. The increase rates of tax revenue also outnumbered those of total product value in both years.

The central finance and economy small leadership group was the key institutional locus for coordinating between proponents and opponents of the fiscal reforms in key leadership. In July 1979, a finance and economy commission under the State Council was formed thanks to the strong support from Deng Xiaoping. Chen Yun and Li Xiannian

were director and vice-director respectively. The commission was abolished in March 1980 and transformed into the Central Finance and Economy small leadership group that became the single most powerful institution in dealing with China's economic and financial affairs, with Zhao Ziyang who was appointed as head.⁵⁰ In the organizational hierarchy, the small leadership group was under the Central Secretariats of which Hu Yaobang was General Secretary. The key party leaders could insert their own ideas in the group activities, and Deng eventually gave Zhao his support in taking charge of economics in spite of Hu's reluctance to embrace the *replacement of profit by tax* reform (Shirk 1993, 240). When a clear majority formed, Hu Yaobang retreated from his position and endorsed the *replacement of profit by tax* reform. Zhao actively utilized his position in this group to promote the *replacement of profit by tax* reform, cooperating with old party leaders such as Chen and Li (author's interview; Central Policy-Making Research Board 1999, 922-923). The role of Deng Xiaoping was known to be supportive but could be seen as ambivalent. Shirk indicates that Deng's position on the *replacement of profit by tax* issue could have been merely strategic to avoid alienating his old colleagues such as Chen Yun and Li Xiannian (Shirk 1993, 251-252). Deng certainly showed his respect to Chen's views on economic issues. However, Deng had been a steadfast proponent for stabilizing and institutionalizing the state organizations, as was Chen Yun in spite of his flexibility in action.

Indeed, one need not necessarily agree with the view explaining the *replacement of profit by tax* reform in terms of power struggle between the conservatives and the reformers. There are no clear, logical, and practical ramifications for policy orientations on the matter between the so-called economic conservatives such as Chen Yun and Li Xiannian and the economic reformists such as Zhao Ziyang, Hu Yaobang, and Deng Xiaoping. On the contrary, as of 1979 the direction in principle toward the *replacement of profit by tax* reform seemed to meet little challenge as a goal (author's interview). With the rising demand for regulation of administrative system practices and the necessity of more stable revenue collection for the state, there was few dispute among reformers in Beijing. Increasing the role of taxes and replacing profit with taxes fitted well with such a

⁵⁰ Later, Hu Qili (June 1983), Li Peng and Tian Jiyun (April) became members of the small group. See Central Policy-Making Research Board 1999, 926-927.

policy trend. In addition, a more standardized tax system would provide the state with more stable revenue sources in practice. The *replacement of profit by tax* policy as a goal was gaining more support due to the stable growth of tax remittance, compared to fluctuating profit remittance's downward trend during the early 1980s (Shao and Ding 1983, 38).

(B) Forming a Fiscal Policy and its Evolution

The issues were on how quickly and how thoroughly Beijing would implement the tax system under specific circumstances. In spite of such consensus favoring introduction of the *replacement of profit by tax* system and, in the long run, a tax-based system, the question is why the profit-based and contract-based system survived so long. The Sichuan system implemented in 1980 was an eclectic half-contract system combining tax with profit remittance. The court politics between Zhao and Hu caused the fiscal system to fluctuate between the contract-based and the tax-based systems because of their different positions under the situation of economic instability and increasing deficit during the early 1980s. However, both and elder political leaders evinced no discord on policy priorities to ensure state revenue stability and a balanced budget. Changing the fiscal situations of the Beijing government and adjusting interests could influence the speed of implementation but not the fundamental direction. Deng Xiaoping reserved his final words, and, in less degree, so did Chen Yun and Li Xiannian although these two eventually expressed a desire to finalize the overall implementation when time became ripe. However, due to bifurcated organizational interests in the *replacement of profit by tax* reform, a lengthy-consensus building process was required until in April 1983 the State Council finally ratified implementation at the national level the first stage of the *replacement of profit by tax* reform.

With a changing a political tide in favor of the reformists, the MOF initiated studies of taxation system reforms and several times avowed the necessity of taxation reform. The General Taxation Bureau of the MOF sent its outlines of the reform to the MOF party organ in its Report on Industrial/Commercial Taxes on 15 November 1978 in which it suggested increasing both the role of taxes in the fiscal arena and macro-economic control. To respond to the demand, the MOF party organ decided to establish a

small group under the guidance of the general taxation bureau, inviting the participation of other bureaus. An investigation team with more than 100 individuals working in the fiscal area proceeded to Jiangxi to investigate issues surrounding industrial/commercial taxes and the SOE's profits in February-March 1979. Then the first national financial work conference held in Chengdu in May 1979 after the third plenary session reached a consensus that some experiments for the *replacement of profit by tax* reform should start up in 1979 and be more comprehensively expanded by late 1980. Xue Muqiao, a prominent economist and key member of Zhao Ziyang's think tank, in 1979 also suggested the introduction of the *replacement of profit by tax* reform beyond the contract-based Jiangsu fiscal system (*Hongqi* 1979, No 8).⁵¹ These initiatives garnered support from some key Beijing political leaders, such as Chen Yun and Li Xiannian.⁵²

In early 1979, the central finance/economy commission (*zhongyang caijing weiyuanhui*) recommended the introduction of the *replacement of profit by tax* reform in the preliminary draft on the Reforms of Economic Management system (Liu 2000, 110-111). Accordingly, the minister of the MOF, Zhang Jingfu, submitted to the second plenary session of the fifth People's Congress in 21 June 1979, a plan to work for the reform after further investigation and experimentation (Liu 2000, 111). It was Hubei's finance bureau that finally initiated the experiment in May 1979 with the agreement of the MOF and the provincial leaders, followed by Shanghai and Sichuan in January 1980. In March 1980, an investigation team composed of about 100 members from the General Taxation Bureau and regional taxation bureaus was dispatched to Liu Zhou city in Guangxi Province. By the end of 1980, Beijing, Tianjin, Guangdong, Heilongjiang, Henan, Shaanxi, and Gansu had launched experiments in some enterprises. Eighteen provincial levels of government joined the experiment by the end of 1981 (Zhang 1998, 535). The initial result of the experiments was considered quite successful. For example,

⁵¹ Since 1980 Zhao was in charge of daily works of the economy as Premier of the State Council, director of finance/economy small leadership group under the guidance of the Central Secretariats. Xue became a director of economic research center under the State Council that was established in July 1980 and co-director with Ma Hong of the research center of price, established in July 1981. The other two research centers under the State Council were the research center on technology and economy (director Ma Hong, May 1981) and the research center on economic laws and regulations (director Gu Ming, July 1981). All four comprised Zhao's think tanks.

⁵² With the full support of Deng Xiaoping, Beijing leadership decided on March 14, 1979 that the Central Finance/Economy Commission (*zhongyang caijing weiyuanhui*) be established under the State Council. Chen Yun was appointed director; Li Xiannian vice-director. See Yu et al. (1993), 45.

in 1980 the profit increase enjoyed by participating enterprises compared to that of 1979 was 23.7 percent, and the remittance increase to the Beijing government 15.9 percent (Liu 2000, 114; Naughton 1985, 231).⁵³

During the same period, meanwhile, the share of fiscal revenue to national income continued to lose 1.8 billion yuan in 1979 and 3.9 billion yuan in 1980 although the national income increased 33 billion yuan and 28 billion yuan in 1980 (Xu 1982, 27). In the face of declining fiscal control by the state, the *replacement of profit by tax* reform could be a viable alternative given its the initial success on the experimental level. In listening to the report of the Central Finance and Economy small leadership group drafted by the MOF, Zhao Ziyang declared on 26 August 1980, that the main target of the fiscal reform would be the *replacement of profit by tax* reform.⁵⁴

The road to the *replacement of profit by tax* reform was not as smooth as the MOF originally planned. Because the Beijing government recorded large budget deficits in 1979 (17 billion yuan) and 1980 (12.7 billion yuan) consecutively, key political leaders paid more attention to stabilizing high inflation and maintaining the budget balance between the revenues and expenditures than to the fiscal reform itself.⁵⁵ However, one of the main reasons for the deficits was certain political and discretionary decisions. To facilitate agricultural reforms during the period 1979-1981, the Beijing government allowed tax redemptions and supported raising prices in the agricultural sector equivalent to 52 billion yuan; to support employment and raise salaries and incentives on the village level of enterprise, it also provided 40.5 billion yuan. These policies were costly and exceeded by 54 percent its original cost estimation 60 billion yuan (Wu, et al. 1998b, 1942).

The other factor was the government's inability to maintain the pace of revenue collection along with the economic growth. From the end of 1980, readjustment and austerity policies were introduced to stabilize inflation and to improve budgetary deficits. No political leader could precipitate the *replacement of profit by tax* fiscal reform since

⁵³ In 1981 the profit increase rate dropped to 9.7 percent and remittance rate decreased to 5.4 percent.

⁵⁴ He was Politburo Standing Committee member, Premier of the State Council, and Director of the central finance/economy small leadership group as of June 1980

⁵⁵ Chen Yun, in particular, was extremely cautious in implementing comprehensive economic reforms. He placed his emphasis on various experiments first before comprehensive implementation although he agreed with the reform in principle. Such an attitude was also seen in his speech regarding "special economic zone" in 1981. See Wu, et al. (1998b), 1871-72.

leaders were not still convinced of the results that could be produced by the reform under a worsening macro-economic situation. A legacy of the Maoist period had been the fiscal collection system's decentralization. No central fiscal inspection mechanism had been installed until 1985. Hence, Beijing's leaders needed information and cooperation from localities plus more experiments to assure smooth implementation and positive results for the economy and finances.

The political atmosphere in which collective leadership was emphasized and democratic centralism publicly revived in the fifth plenary session of the eleventh CPC Congress held during the period from February 23 to 29 in 1980 (Wu, et al. 1998b, 1828-29, 1835) provided a space in which various interest parties could dare to exert their own ideas regarding fiscal reform. This led to a situation of deadlock when, during the period of November and December 1980, a conference of provincial governors and a national plan conference were convened to deal with the issue of the industrial/commercial taxes, whose issue was submitted by the MOF and the General office of the SCESR. Yet no decision was reported from either conference (Liu 2000, 115). Furthermore, reflecting to the difficulty of reaching consensus, Yao Yilin appeared passive on the topic of the *replacement of profit by tax* reform in his speech at the national taxation bureau workshop on 27 January 1981, stating only that the reform would be the right direction in the long run and that it should be gradually implemented (Liu 2000, 115-116). Considering that Chen Yun was a key protégé of Yao, it was a major set-back for the *replacement of profit by tax* reform.

In efforts to reinforce fiscal reform, Zhao convened China's leaders in economic organizations on 23 March 1981 to discuss how best to facilitate reforms during the period of economic adjustment. In the meeting, he emphasized getting rid of the current contracting method by replacing profits with taxes. His other concern was over central government finances which were worsening even as local finances were flourishing (Liu 2000, 116). By increasing the role of taxes and expanding the range of the tax base, he sought to overcome the Beijing government's financial difficulties. In addition, the fiscal reform was considered a breakthrough for Zhao's comprehensive economic reforms. In the circumstance in which price reform was not imminent because of technical difficulties and the threat of inflation, fiscal reform had to be implemented to adjust

enterprise behaviors according to objective economic principles. Accordingly, Tian Jiyun, Zhao's protégé later promoted to vice-secretary of the State Council in 1983, drafted a report on the fiscal reform plan in April 1981. Based on the draft, the Central Finance and Economy small leadership group and the general office of the State Council demanded to conduct further research on the fiscal reform.

On 31 July 1981, Zhao called together the Central Finance and Economy small leadership group to listen to the report on the comprehensive plan of the fiscal reform delivered by Wang Bingqian, Minister of the MOF. The guidelines suggested in the meeting were as follows: (a) the purposes of fiscal reform were to increase state revenue and adjust incomes between the central and local governments as well as between the functional bureaucratic organizations and business; (b) tax reform should not lead to inflation. The problems relating to fiscal reform, compared to price reform, was relatively light, so fiscal reform should be implemented ahead of the price reform; (c) fiscal reform should be adjusted to give incentives to international trade and coastal regions. However, experiments should be conducted in advance of implementation; (d) the division of fiscal management between the central and local governments should be clarified; and (e) the State Council agreed to circulate in localities the Draft on the Industrial/Commercial Tax Reform under the aegis of the State Council.

After the MOF once more revised the report based on the guidelines, a draft providing the blueprint for reform on the industrial/commercial tax system was submitted to the State Council on 14 August 1981. The basic ideas of the draft were to increase the role of taxes and guarantee stability of the state revenue. Detailed policies of the draft were as follows (Liu 2000, 117-119): (a) given the complexity of forms of economy, tax items should be incrementally recovered and increased; (b) to increase management responsibility, profits should be incrementally replaced with taxes; (c) taxes should actively be utilized to increase their roles in macro-economic control and to invite foreign capital and technologies; (d) fiscal reform should not lead to inflation and increase the burden on the people; (e) guarantees should be given to the state revenue first and special attention paid to adjustment of interests among localities, functional organizations, and enterprises to encourage their participation; and (f) industrial/commercial taxes should be divided into central taxes, local taxes, and sharing taxes.

Under this system, both the central and local governments would possess financial and tax revenue management power. New local taxes, such as estate taxes and urban construction taxes, would be introduced. Formally-abolished local taxes such as the urban real estate tax, vehicle license tax, market transaction tax, special consumer tax, and stamp tax would also be restored. The State Council would set up items of taxes, principles of collection, and high-ceilinged tax rate but allow discretionary power to provincial governments to collect, stop, reduce, and exempt taxes according to their situations (Liu 2000, 119). On the other hand, the new fiscal system should increase the amount of tax revenue up to 20 billion yuan more than in the current system. In particular, the amount of taxes transferred from enterprise interests would be 19 billion yuan. The proportion of the industrial/commercial tax to the national revenue would increase from about 50 percent up to about 70 percent.

The draft even set the time schedule for accomplishing the tasks mentioned above within a five-year period. It also strongly recommended strengthening fiscal institutions and inspection capacity in the fiscal arena. According to the plan, schools and departments specializing in taxation would be established to provide a stable supply of personnel in this field in the long-run. The state would establish a taxation inspection team in large enterprises and station a taxation cadre in mid-size enterprises. Furthermore, the plan indicated that the reform would create a standardized and regulated system. The draft certainly allowed localities and enterprises legitimate ground for controlling their own fiscal resources and a rather long-term schedule for considering various local situations. The main idea of the fiscal reform was obvious: to strengthen Beijing's control over China's fiscal system and to standardize fiscal activities in a more transparent manner. Not unexpectedly, opposition to the *replacement of profit by tax* reform flared up among localities, enterprise managers, and functional organizations, or precisely those which would lose their discretionary control over fiscal resources if new unitary taxation systems were implemented.

The impacts of the 1981 readjustment policies were to restrain local and enterprise finance, although the policies did help the central budget balance and market price stabilization. Meanwhile, the MOF continued to issue warnings about declining state financial ability and deficits while complaining that most fiscal resources went into

the hands of non-financial organizations and enterprises (Wang 1981; Zhang 1981; Zhang 1982; Han and Zhao 1982). However, during 1980-1981 inflation, alarming fiscal deficits resulting in the Beijing government's fiscal austerity program, and the possibility of social unrest and political risk forced the *replacement of profit by tax* proponents to compromise with their opponents. As a result, the draft adopted a gradual and experimental approach for the fiscal reform and set up a quite moderate five-year time schedule for full implementation.

On 5 September 1981, when the State Council had finally sent to provincial governments a circular (Joint Report) regarding the draft, the circular indicated that new experiments for the *replacement of profit by tax* would not expand beyond the level already attained. It also encouraged provincial governments to provide their own inputs to the MOF after having conducted their own research and sessions of discussion and revision. It recommended that the MOF needed to do more experiments before it promulgated the draft officially. Increasing conflicts over enterprise and fiscal reforms among bureaucratic organizations as well as academic worlds were obvious during this period (Shirk 1993, Chapter 11). The SEC, industrial ministries, the Institute of Industrial Economics of the Chinese Academy of Social Science⁵⁶ promoted the re-extension of the fiscal contract system during the period. Under the conditions of economic uncertainty, this contract system could be utilized to secure state revenue at a steady growth rate as well as provide enterprises with incentives. Hu Yaobang, General Secretary of the Party, was known to have intensified his support for reinforcing the fiscal contract system during Zhao's visit to Africa.⁵⁷

During the period 1982-1983, the fiscal contract system as previously mentioned was quickly extended to most provinces in five different types of contract.⁵⁸ When Hu addressed the report at the twelfth CPC Congress in September 1982, he urged that localities and enterprises provide fiscal resources for central projects rather than make pork-barreling gestures and demanded that local development slow down to guarantee

⁵⁶ Jiang Yiwei became the head of the institute after 1982, and a well-known supporter of enterprise autonomy.

⁵⁷ Zhao Ziyang, who was supposed to take care of daily government works as Premier and competed for political successor of Deng Xiaoping, was furious of Hu's move (Shirk 1993, 240).

⁵⁸ Regarding the different types of fiscal contract systems, see Oksenberg and Tong 1991; Han and Zhao 1982.

financing of the central projects.⁵⁹ Hu's institutional solution to the financial problem of the Beijing government was to encourage broad expansion of the fiscal contract system. By adjusting the contracts according to local situations and central demands, he intended to secure the stability of central finances while making allowances in local situations (Han and Zhao 1982).

Under the system, the four given fiscal arrangements expanded to five. The previous three arrangements remained intact but the Clarifying Revenues and Expenditures and Dividing Responsibility system with its five-year fixed rates was divided into two. Henan, Shanxi, Jilin, Heilongjiang, and Jiangxi remained under the system; these provinces were able to spend more according to fixed formulae if they could increase their revenues from fixed and adjustment tax sources. Liaoning, Jiangsu, Hebei, Zhejiang, Anhui, Shandong, Hubei, Hunan, Sichuan, Shaanxi, and Gansu, whose divided rate of adjustment income was low or whose increase in adjustment income could not cover decrease in fixed income adopted the *Jiangsu* system again to divide their total revenue with the Beijing government and secure a certain level of expenditure with five-year fixed rates.

The Institute of Industrial Economics of the CASS along with the SEC actively promoted the fiscal contract system. The experiment in profit-contracting at the Capital Iron and Steel Company in Beijing was a well-known case promoted by the two institutes (Shirk 1993, 232). In the prominent journal *Economic Management [Jingji Guanli]*, Mo Huilin and Zhu Chongguang (1983) argued that the fiscal contract system was thought to leave greater fiscal resources in the hands of enterprises than did the uniform tax system. Accordingly, the experiments for the *replacement of profit by tax* reform at Xiangtan Iron and Steel Company and Yueyang Chemical Company in Hunan proved that there was no difference between the *replacement of profit by tax* reform and the traditional profit remittance method. They argued that, to the contrary, the *replacement of profit by tax* system worsened the financial situation of the steel company by taxing too much.

As for local officials, the fiscal contract system still appeared attractive because bargaining during times of economic uncertainties could diffuse their fiscal responsibilities. In practice, the Beijing government was successful in forcing provincial

⁵⁹ As to Hu's report, see Wu, et al. (1998b), 1948-1949, 1956-1980.

governments to reduce their expenditure by 10 percent in negotiations over contract terms. However, provincial governments could get several billion yuan of subsidies more than the Beijing government originally planned, which left unsolved the fiscal problem of the Beijing government even after reforms to the fiscal contract system (Zhu 1983; Xing 1984). Consequently, financial difficulties even under the fiscal contract system brought criticism from the MOF. The fiscal contract system was too complicated to broadly implement and needed time for preparation (Zhu 1983); meanwhile, experiments for the *replacement of profit by tax* were celebrated as successful (Editorial of *Caizheng* 1983).

Despite Hu's support of the fiscal contract system in the report, Zhao was able to draw a decision to precipitate the *replacement of profit by tax* reform in the standing committee of the State Council on 30 November 1982, and asked to submit a detailed implementation plan to the MOF and the SCRE. The four guidelines issued by Zhao were (Liu 2000, 124): (a) remove the current situation of *eating from a big pot*; (b) do not make the rules too complicated in the primary stage and keep in mind that the main principle should be to stabilize state revenue income; (c) guarantee given interests of enterprises while still encouraging competitiveness; and (d) provide equal treatment for small scale of enterprises regardless of sectors. The same day, Zhao also gave an address on the plan to introduce the fiscal reform in the Report on the Sixth Five-Year Plan in the fifth plenary session of the fifth National People's Congress, which should be approved by the Politburo (Shirk 1993; Liu 2000; Zhang 1999).

In the latter report, Zhao evaluated experiments of the *replacement of profit by tax* fiscal reform as successful and affirmed that the fiscal reform playing a major economic adjustment mechanism would be precipitated within three years. The three-year term was a much bolder approach than the five-year one drafted by the MOF in August 1981. Without the full support of Deng Xiaoping and Chen Yun, Zhao dared not to address such a report, whose address required the approval of the Politburo Standing Committee (Shirk 1993, Chapter 12; Liu 2000, Chapter 2). However, a look into the content of the report reveals that Zhao compromised with Hu by integrating contract elements into the *replacement of profit by tax* reform. Given that little price reform had been implemented, profits and taxes would be allowed to co-exist during the first step of implementation, which was supposed to be completed before 1985. That is, enterprise profits would be

taxed in the forms of income tax and local taxes, after which the remaining profits would be divided between the state and enterprises according to various pre-fixed contracts. According to the original plan, the after-tax profits would be adjusted at a uniform rate. However, the after-tax profits were left intact. This policy was the product of compromise with opponents to the *replacement of profit by tax* reform.

Practical difficulties in implementing a full scale fiscal reform thoroughly replacing profits with taxes as well forced Zhao to compromise with the opponents. Although Zhao reported that the fiscal experiments had proved successful, Tian Jiyun, vice-premier in charge of fiscal issues, implied that the experimentation in more than 400 enterprises during the period 1979-1982 had encountered certain challenges (Tian 1983, 9-10). The existence of considerably different levels of profits among enterprises and industries mainly due to state-guided policies and price system worked to prevent thorough implementation of a standardized taxation. Until price reform was implemented, the coexistence of taxes and profits was inevitable. As a result, Zhao predicted pessimistically that the next stage of reform would not be possible within the next two years (Tian 1983, 10).

After the decision in the Standing Committee of the State Council in November 1982, Zhao convened the State Council Standing Committee several times to examine reports from the MOF concerning fiscal reform. In the meetings, Zhao mentioned that criticism that the fiscal reform was failing to give enterprises sufficient incentives but gave assurances that taxation would in fact encourage enterprise competitiveness. He emphasized again that the profit contract system was not the right direction for China. As Tian pointed out, a broad consensus already existed among political leaders and scholars in favor of the *replacement of profit by tax* reform (Tian 1983, 9). Hu also finally agreed on implementing the reform comprehensively during the last half of the year. His suggestions were to encourage enthusiasm of enterprises and to allow the state the most benefits, enterprises mid-level benefits, and individuals the lowest-level benefits (Liu 2000, 149). Zhao quickly embraced Hu's suggestions. Therefore, in late 1982 the political conditions with which to launch the *replacement of profit by tax* reform became rife.

The final work was to add the details that would facilitate smooth implementation. Several investigations and additional researches had been conducted in Shanghai, Tianjin, and Jinan from late 1982 to early 1983 (Wu 1985). At this point, the draft on the implementation methods of the *replacement of profit by tax* reform in the SOEs was submitted to the State Council by the MOF on 25 February 1983. On 28 February 1983 the State Council forwarded the draft to provincial governments for further opinions. Finally, on 2 March 1983, the public was informed of the fiscal reform that went under the title, Implementing the *Replacement of Profit by Tax Reform is Crucial Reform (shixingligaishui shi yixiangzhongdagaige)*” in the *People’s Daily*. Subsequently, a national work conference on the *replacement of profit by tax* reform was set by the MOF for 17-29 March 1983. This conference provided yet another opportunity for various bureaucratic groups to exchange their points of view as well as to do a final tune-up before comprehensive implementation.⁶⁰ Later in his report to Zhao Ziyang, Wang Bingqian, Minister of the MOF, expressed his satisfaction with a wide-ranging discussion on the subject at the conference (Liu 2000, 154).

According to the original plan, the new fiscal reform was supposed to be implemented from 1 April 1983 on, but the MOF again revised its draft after the work conference and only submitted it to the State Council on April 12 1983 (Liu 2000, 155). The revised version was more flexible, for one thing allowing some enterprises to use the current profit-contract system until 1984. The basic outline of the revised version was as follows: (a) mid- and large-scale of state-owned enterprises would be taxed at the 55 percent rate of income tax. After tax, the remaining profits would be divided between the state and enterprises in various ways, such as with incremental remittances, fixed rate remittances, adjustment taxes, or fixed amount of remittances. This relatively high rate was designed to guarantee the fiscal stability of the central government, which satisfied Hu Yaobang’s demand that the state should get the largest share.⁶¹ During the previous drafting process, various ideas about taxes were suggested at 40-60 percent rates that were still lower than the general profit remittance rates of 70-80 percent of large SOEs under the previous traditional socialist system (Kuo 1996, 41). Tian wanted the state to

⁶⁰ The other opportunity must be at the national taxation work conference, which is held at the end of every year (author’s interview).

⁶¹ It also supported the interest of the MOF.

secure at least 50 percent (Tian 1983, 10). The high 55 percent of tax rate was certainly met the policy priorities of the Beijing leadership of securing the central budget even as it alienated a part of the ruling bloc of China's political system, large state-owned enterprises, and local officials. In return, the large state-enterprises were allowed to retain certain levels of discretionary funds. Furthermore, as remittance in the form of taxes was more transparent and institutionalized, localities could develop their own budget plans on a more stable basis. In practice, however, as profit-after-tax was subjected to the old method of contract both sides still preserved leeway for further negotiation and compromise.

(b) Small profit-making state-owned enterprises and small enterprises above the county level were subjected to eight levels of progressive income tax. Small enterprises would take all responsibility for their after-tax loss, which was supposed to apply for mid- and large-sizes of state enterprises in the original plan as well but left out in the final version because of protests from ministries and provinces operating large-scale enterprises (Shirk 1993, 249). (c) The income tax from state-owned enterprises would be divided between central and local finance according to designated subordinate relations. In addition, local taxes were introduced, and every enterprise would pay local taxes (in the range 10-15 percent of profits) to guarantee local expenditure, depending on the local situation. This policy weakened dominance of ministries and local governments over enterprises in localities.

However, the new system did not adhere to the principle of hard-rule constraints. First, the items of local taxes were not given to localities as originally planned. As of 1985, only three items were allotted as local taxes. In addition, the Beijing government allowed state enterprises to pay interests before tax to adjust contracts on funds, and to retain the given contract system until 1984 with MOF permission. In terms of institutionalization, the new system was more advanced than the previous profit contract system although it was far from being a stable institution. On 24 April 1983, the State Council ratified the MOF draft and sent a directive on the *replacement of profit by tax* to provincial governments and administrative organizations under the State Council. In the directive, the State Council again emphasized the principle that the state would take the largest share. On 29 April 1983, the MOF finally publicized A Tentative Regulation on

Collection of Income Tax from State-Owned Enterprises, gradually beginning to be implemented nationwide on July 1 and applied regressively from 1 January 1983.

The overall result was more successful than expected, though there were reports of resistance from people and enterprises that had benefited from the previous profit contracting system (FBIS, July 11 1984, PRC National Affair, K4; FBIS, August 9, 1984, PRC Regional Affair, P1). Political leaders and financial officers grew more optimistic about their financial situation, which provided the fiscal environment for Zhao to precipitate the second stage of the *replacement of profit by tax* reform in 1984 ahead of its original schedule.⁶² The *People's Daily* (10 September 1984) reported results proving that the *replacement of profit by tax* system was more advantageous than previous profit retention contract systems. Xing Hua (1984, 13-15) in an article in *Finance (Caizheng)*, the best-known periodical that represented the MOF, further suggested that the proportion of revenue over national income should reach around 28-30 percent and the proportion of central revenue over national revenue could increase up to 60-70 percent.⁶³ As of 1983, in fact, the former had already achieved about 29 percent, but the ratio of central revenue to national revenue was only about 36 percent, still far behind Xing's suggestion. Interestingly, the idea of the 60-70 percent ratio for central revenue survived and became a policy target in the reform of the tax-sharing system during the early 1990s.

By late 1983, the implementation rate in profit-making state-owned enterprises reached 92.7 percent. The final account of industrial/commercial taxes was 7 percent higher than originally planned (SGTB 1997, 4). In addition, for the first time in the PRC history the proportion of tax in revenue reached over 80 percent, much higher than the original target of 70 percent, compared to 51 percent in 1982. Realized profits in 1983 increased 11.1 percent, compared to that in 1982. In the profits, the increase of realized profits from industrial enterprises was 9.7 percent, of which the state took 61.8 percent and the enterprises 38.2 percent; the increase in commercial enterprises was 8.9 percent, of which the state 65.3 percent and the enterprises 34.7 percent (Liu 2000, 158-159). The proportion of revenue over GDP improved to 23.0 percent (28.8 percent over National

⁶² That was planned to be implemented by the end of 1986 according to the document drafted by the MOF in August 1981. See Liu (2000), 117-120.

⁶³ This article was the last one of a series of 11 articles regarding the evolution of the Chinese financial system reform.

Income) from 22.9 percent in 1982, which was the first reversal of the downward trend in the proportion since the inception of reform measures in 1978. The revenue increase rate (12.8 percent) also exceeded the GDP increase rate (12.1 percent). During the previous four years, the average revenue increase rate was 1.7 percent; with reform, the average GDP increase rate was about 10 percent, which could be counted a great success. Based on this success, the Beijing leadership could be much bolder in implementing the second stage of the *replacement of profit by tax* reform, which was in fact implemented nationwide from October 1984.

D. Politics of the *Replacement of Profit by Tax* Reform

The formal stage of the draft on the industrial/commercial tax reform in August 1981 came almost three years after the MOF revealed the idea of *Replacement of Profit by Tax* reform in a primary draft for that aspect of reform in late 1978. Then it took more than four and half years to implement nationwide the first stage of the *replacement of profit by tax* reform and almost six years to affect the second stage of the *replacement of profit by tax* reform. When the first stage of the *replacement of profit by tax* reform launched after lengthy preparations, however, it was implemented successfully, with a 92 percent of implementation rate nationwide in a year.

What factors contributed to such success? Common historical experiences provided a basis for consensus in the fiscal arena among key political leaders: the necessity of fiscal institutionalization and reduction of political influence in fiscal matters. Legacies of the Cultural Revolution allowed the Chinese leadership to achieve consensus on rebuilding state institutions to work in a regular and predictable way. The evolution from the Jiangsu to the Sichuan fiscal management system, in which the scope of revenue and expenditure was defined for the central and local governments, illustrates the direction of fiscal institutionalization. Accordingly, an increase in the role of taxes and a guarantee of state revenue became the two pillars of the fiscal arena. Decentralization measures and more flexible contract systems could continue to be subjected to these principles. In this respect, the *replacement of profit by tax* system enjoyed more legitimacy than the profit-contracting system. Few had doubts as to the

direction that the *replacement of profit by tax* system would ultimately take as a policy target.

In addition, the principle of democratic centralism as a procedural norm in decision-making was broadly accepted, with emphasis of the “democratic” principle, among key political leaders during this period. If an issue was considered as *political* and could influence broad vested-interests in the Chinese power structure, it was assumed to take time and energy to conduct investigations and to adjust interests sufficiently to garner a clear majority and even full consensus on the issue. The Beijing leadership was divided as to how and when to implement the *replacement of profit by tax* reform though consensus existed on its implementation in the long run. Given that the price system might cause unacceptable inflation and a major shift of interest structures within the traditional economic management system, which the old political leaders such as Chen Yun and Li Xiannian as well as the traditionally powerful bureaucracies such as the SPC and the MOF feared, the profit-contract system emerged as an alternative to the *replacement of profit by tax* system at the transitional stage because it could be more flexible in adjusting the distorted (re)distributive mechanism caused by state intervention.

Hu Yaobang supported the contract method. However, when he recognized that Deng and other key leaders clearly preferred the *replacement of profit by tax* reform, he quickly backed down. On the other hand, Zhao as a key proponent of the *replacement of profit by tax* reform also compromised and integrated the interests of the profit contract system in the process of draft-making. The outcome was far from the original plan and eventually divided the implementation into two stages in the last drafting stage. The first stage of the *replacement of profit by tax* reform did not aim at thorough replacement of profits with taxes as originally sought by its supporters. However, supporters of the reform were still able to impose key policy priorities: to guarantee a stable fiscal supply for the Beijing government while providing incentives to localities and enterprises, which were still subjected to this primary goal at that moment. Although fiscal decentralization was the more vocal slogan, fiscal centralization and decentralization were issues of choice in assuring stable finances for the Beijing government.

On the other hand, proponents of the profit contract system who were large enterprise managers and localities were able to maintain the contract mechanism after tax

and even allowed a few exceptions before tax in exchange of support for the *replacement of profit by tax* system. Only profits were taxed and the portion above quota was still left to the contract system. Repayment for loans was allowed before taxation. The remittance burden of the mid- and large-size SOEs under the new fiscal system was formally reduced to 55 percent in the form of an enterprise income tax, with the Beijing government still preserving its discretionary power to tax further in the name of the adjustment tax. Under the previous profit remittance system, enterprises generally remitted more than 70 percent of their profits after which about 10 percent of profits remained. Under the new system, a higher profit retention rate could be expected even in enterprises' final accounting along with profit increase. Overall, though the first stage of the *replacement of profit by tax* reform had never been the ideal type for either side, but it was a saddle point⁶⁴ for both sides under given constraints. Under these circumstances, either proponents or opponents could claim victory. The result was quick and successful implementation and the Beijing government achieved its goal.

With the inception of the economic reforms, the Beijing government sought to dilute the traditional *tiao-tiao* and *kuai-kuai* control over lower levels of government and enterprise. The Local Organic Law in 1979 had weakened the administrative ability of the next-higher level of local government to interfere in sub-local government.⁶⁵ From 1981, a city-centered economic development strategy became publicly apparent.⁶⁶ The core cities (*zhongxin chengshi*) were supposed to function as centers of economic activity. Administratively, the county level of administration in rural areas had been gradually abolished, placed under or integrated into an urban-style larger city.⁶⁷ Ma Hong, who was a key brain in the early Chinese economic reforms, was not reluctant to reveal an important aspect of the city-centered strategy in an interview: to need to tackle

⁶⁴ In mathematics, it refers to a point at which a function of two variables has partial derivatives equal to zero but at which the function has neither a maximum nor a minimum value (see *Random House Webster's Unabridged Dictionary*, 2nd edition (New York: Random House, 1997): 1690. In this paper, it refers to a situation that different interests of two parties meet at a point but the balance of interests is not stable.

⁶⁵ See Unger (1987), 31. The original source is from *Beijing Review* 51 (21 December 1979): 17-20.

⁶⁶ Regarding the summary of a conference with representatives from 15 provinces and cities on this issue, "youguan zhongxin chengshide jigewenti [Some issues regarding central cities]," *Jingjiyanjiu cankaoziliao* 27 (17 February 1982): 2-10.

⁶⁷ As of 1987, the rate of control of county-level governments by the cities was 33.1% (Lin 1998, 330).

the *kuai-kuai* problem.⁶⁸ The hidden assumption was that the city-centered strategy would also function to check the rising fiscal power and localism of provincial governments. The 1983 introduction of the *planned city (jihua danlie shi)* system was the typical case. By 1988, Chongqing, Wuhan, Shenyang, Dalian, Guangzhou, Xian, Haerbin, Qingdao, and Ningbo were designated as the planned cities.⁶⁹ These planned cities were placed under Beijing's direct control in the economic plan and resources distribution system but under provincial governments placed in its administrative hierarchy. Although its official purpose was to make the cities play centers of economic activities to facilitate economic development in the area, it certainly weakened provincial control over its jurisdiction. In particular, as the Beijing government encouraged a horizontal cooperation of the planned cities with surrounding regions (Tian, Zhu, and Cao 1988), the planned city and provincial government often conflicted over plan targets, resources, and administrative powers because no formal rules existed on the relationship.

A deliberately skewed price system also helped to strengthen the fiscal power of sub-provincial governments in the early 80s. The Chinese price system allowed higher profits to light industries, which were chiefly owned by counties or low levels of government.⁷⁰ According to Unger, those sub-provincial governments were beneficiaries of the early reforms (Unger 1987, 31). The Beijing and provincial governments owned the bulk of heavy industries, which suffered from relatively low profits and high tax rates. The fiscal implication of such a skewed price system was that provincial governments suffered the most in earning sufficient self-revenues. The Beijing government also

⁶⁸ Hong Ma, "Renzhen kaizhan duijingjizhongxin wentide yanjiu [Arduously proceed the research about the economic center issue]." *Jingjiyanjiu cankaoziliao* 27 (17 February 1982): 10-13.

⁶⁹ Chongqing, Wuhan, Shenyang, Dalian, Guangzhou, Xian, and Haerbin had already been the planned cities or under the direct control by the Beijing government during the 1950s and 1960s. Only Qingdao Ningbo had never had such status but they were rectified along with the increasing importance of the coastal cities in 1987 and 1988 respectively. During the 1980s when the planned city system was reintroduced, Chongqing of Sichuan became the first planned city in 1983. A task team from the finance department of Chongqing complained of the heavy financial burden of the city to Beijing in its internal report in 1987. The city remitted 40.2% to the Beijing government, 22.3% to Sichuan, and only 37.5% of its revenue was left for its own expenses according to the total revenue sharing system introduced in 1984. As of 1987, the task team supported the introduction of the tax-sharing system to encourage activities for local tax collection and to alleviate the problem. Task force, "Danlieshi caizhengtizhi libi yu jinyibu gaigede shexiang [Strengths and problems of financial system of the planned city and a tentative idea for further reform]." *Jingjiyanjiu cankaoziliao* 90 (10 June 1987): 32-40. The report by Tian, Zhu, Cao (1988) implied that Chongqing should be allowed to get the status of municipality such as Beijing in the future.

⁷⁰ The profits of light industries decreased steadily during the last half 80s (*Jingjiguanli* July 1987, 4-6).

experienced a similar fate with the provincial governments, but it still had an enormous administrative power, as seen in the fiscal reforms, to change the rules.

However, as economic and fiscal decentralization were implemented, conflicts among various levels of government became apparent. The inception of the fiscal policy of *Separating Kitchens from a Big Pot* certainly encouraged each level of government to pursue its own interests. In particular, local protectionism arose along with the further reforms focusing on the urban sectors. Urban sector reform and adoption of the coastal development strategy again changed the power relationship among various levels of governments. As indicated in Wagner's law, expenditures on every level of government dramatically expanded along with rapid economic development. The self-reliance index illustrates that in general, the fiscal situation of the Beijing and local governments had been worsened since the inception of the economic reforms. In specific, however, the Beijing government, provincial governments, and county governments suffered deficit problems while city and township governments enjoyed expanding revenues as well as surpluses.

Importantly, the Beijing government could not and did not use the other institutional means at its disposal during the period, means such as creating central monitoring and personnel appointment systems to insure implementation of the *replacement of profit by tax* reform at the local level during the period. When correlation is measured and regression is run between personnel reshuffling of provincial governors and party secretaries, and regions (coastal, central, and inland region), no significant pattern appeared.⁷¹ Considering the inner logic of the Beijing government to appoint more insiders in the strategic regions so as to boost regional economies, the result illustrates that the Beijing government did not use the personnel appointment system actively to induce regional commitment favoring the Beijing government during the period 1979-1984. However, when Beijing, Tianjin, Shanghai, and Guangdong are focused on, the Beijing government appeared to exert a tight control of these provinces by appointing outsiders as party secretaries and governors. Every province had at least one outsider; Tianjin and Guangdong had all outsiders. It was a kind of minimalist

⁷¹ To see the method, refer to Chapter II.

strategy, which discretionarily tightly controlled a few key target regions to ensure the central government policy, then allowing the other areas more flexibility.

Another noteworthy is Deng's role. At the stage of introducing the *replacement of profit by tax* system, his preference was unknown. However, he certainly showed his respect for the functional division of leadership. He did not challenge the preferences of Chen Yun and Li Xiannian, who had specialized in the economic and finance areas for years and supported Zhao Ziyang, who was in charge of economic and administrative matters, over Hu Yaobang on this respect (Shirk 1993, 251). His well-known support for bold economic reform and decentralization does not fit with his support for strengthening Beijing's fiscal control. Shirk depicted his support as passive on this issue, to appease his old colleagues. However, these ideas about Deng underestimate the fact that he had been a centralist as along with Mao Zedong in that he never considered giving genuine power to localities in economy and politics. What made him different from his colleagues was the flexibility with which he adopted decentralization measures as means.

The other notable feature of Chinese leadership in decision-making during the early stage of reforms was respect paid to objective conditions to avoid the risk of poor or impromptu decisions on political issues. External factors, such as worsening fiscal condition for the Beijing government and high inflation during the early 1980s, had never been a determinant for fiscal reform, rather providing a momentum for postponing the introduction of fiscal reform and providing an opportunity for proponents of the fiscal contract system to introduce their views into the political power structure. Old party leaders did not prevent or subvert various fiscal experiments in the economic and financial arenas though they did have their own preferences for the *replacement of profit by tax* policy. In particular, their flexibility proved to be practical under the circumstances that no regular central fiscal inspection mechanism existed and most information and implementation hinged on local cooperation. As seen in the decision-making leading up to the *replacement of profit by tax* reform, the democratic principle of democratic centralism had been applied in the leadership to enforce centralism beyond the mere face-saving level. The practice certainly ensured political stability, which had potential to be extremely fragile during a period of power transition. Additionally, it ensured policy implementation by allowing all interest groups to share the fruits of reform. Still, the

entire process that produced the *replacement of profit by tax* reform was not in the nature of linear evolution.

Chapter IV

Aborted Mission for Fiscal Institutionalization

A. Evolving Institutional Interests and Fiscal Standardization

In October 1984, when the third plenary session of the twelfth CPC central committee formally adopted the landmark *Decision on Economic Structural Reform*, the focus of China's economic reform moved from the agricultural to the urban sector. The new initiative was possible because the major goals of the sixth five-year plan had been successfully implemented: steady economic growth, fiscal stability, and inflation control (Wu, et al. 1998b, 2022). The impact of the shift would be enormous because the urban reform was fundamental and comprehensive in character, including reforms on prices, taxes, banks, SOEs, and property rights in the long run. It would fundamentally change given interests and power relationship in Chinese society. After the reform launched in 1985, therefore, different orientations on economic policies among reformers and various economic bureaucracies became apparent.

Widening differences were observed in economic policies of Deng Xiaoping and Chen Yun. As discussed in the previous chapter, during the late 1970s and early 1980s Deng Xiaoping had been patient with views different from his own, respected his old colleagues like Chen Yun who specialized in economic affairs, and gave considerable efforts to building consensus. However, according to Fewsmith (1994, 143) Deng was convinced by 1983-84 that Chen's economic views were too conservative to generate economic development and maintain political legitimacy by means of the economic development. Zhao also appeared to have more confidence in handling economic affairs after he successfully launched the first stage of the *replacement of profit by tax* reform in 1983 (Shirk 1993, Chapter 12).

The main issues of debate among reformers were whether the reform had to move into the microeconomic area, such as into price and property reforms as the key to economic reform or focus on macroeconomic control. A group of young scholars in the

reformist camp with the support of Deng and Zhao began to take the issue of inflation more positively, which was a departure from the moderate reformers. As for them, rapid growth and inflation were inevitable in the process of economic transformation. Rapid economic development rather than steady economic development under conditions of stability were regarded as the source of political stability and legitimacy. Such views certainly brought conflicts not only among reformers but also with traditional economic bureaucrats of the SPC and the MOF (Fewsmith 1994, 143-144).

In the fiscal area, a major shift also occurred. Along with urban reform, the second stage of *replacement of profit by tax* reform was introduced in 1984 to replace profits with taxes. Although it was successfully introduced much earlier than originally planned, the overall implementation process at the second stage of the fiscal reform was precarious.¹ The introduction of a taxation system and fiscal standardization brought fear that those reforms might enhance Beijing's tight grip over the fiscal area. Under the traditional socialist system, administratively-set prices allowed processing industries, which were mostly concentrated in the coastal area, the advantage obtained by setting higher profit rates. A high product tax rate would certainly increase the burden of finance in the coastal area. The agricultural sector also enjoyed special considerations and privileges in the areas of taxes, subsidies, and special funds during the late 1970s and early 1980s.² Therefore, the Beijing government confronted severe resistance from industrial enterprises, the agricultural sector, and the coastal provinces even in the drafting stage.

Consequently, the fiscal policy turned out to be moderate as Chinese decision-making norms forced players to compromise and to acquire detailed consensus while ensuring implementation of the policy priority. The standardized tax system and high tax rates in the original plan were not fully introduced. An element of the profit contract

¹ Originally, Zhao and his advisors planned to introduce the second stage of taxation reform after the implementation of price reform. However, the price reform was too complicated to simply adjust in a short time. In addition, as it also could influence vast whole peoples' livelihood as well as bureaucratic interests in depth, it met the "irreconcilability" of broad interests. In particular, manufacturing industries and the coastal area, which had enjoyed benefits from the discretionary price system under the traditional plan system, were natural main opponents. See more in Shirk (1993), 264-67.

² For example, circulation funds to support agriculture in the budget had been provided for free until the urban reform started. The Beijing government ordered every provincial government to provide circulation funds to support agriculture from 1981 on (*JingjiRibao* 15 July 1986). As indicated in the previous chapter, the tax rate in agricultural sector was very low as well.

system remained in the form of an adjustment tax.³ At the second stage of the replacement of profit by tax reform, the state allowed enterprises to wield more discretionary power over profits after tax than in the first stage, although the state was still able to tax excessive profits for adjustment.⁴

According to statistics, after implementation of the replacement of profit by tax reform, the state enterprises were able to enjoy a 12.2 percent increase in profits in 1984 (Liu 2000, 182). Taxes became the dominant means of revenue collection as the second stage of the replacement of profit by tax reform was successfully introduced. The ratio of taxes over the total revenue reached 65.2 percent in 1985, the highest in the history of the PRC (SGTB 1997, 14). In 1984 and 1985, the increase rates of industrial and commercial taxes outnumbered those of both national income and total values of industrial products (SGTB 1997, 12-13). The fulfillment rates of industrial and commercial tax collection of 1984 and 1985 recorded the highest rates in two consecutive years in the PRC history, 114.3 percent and 121.7 percent respectively (SGTB 1997, 4). As a result, Jin Xin, the director of the General Taxation Bureau, was able to speak with satisfaction of the progress of implementation in the second stage of the replacement of profit by tax reform at the National Taxation Work Conference in 1985 (Liu 2000, 183). Stabilization of state revenues during this period certainly provided Zhao and young scholars with a buffer zone from which to jump to the next stage of reform. As indicated in the *People's Daily* (September 19, 1984), the replacement of profit by tax reform paved the way to urban reform.

1. Initial Efforts for Fiscal Standardization

Reforms always induce conflicts and uncertainty. Therefore, it was not strange that during *the sixth five-year plan period* (1981-85), the fiscal goals were to guarantee a stable increase in state revenues and to maintain a fiscal balance. Because the main fiscal concern was to secure revenues at the national level, the state's revenue increase had been much more emphasized than Beijing's revenue increase during the period

³ For more detail, see Shirk (1993), 266-279; Liu (2000), 159-183.

⁴ The adjustment tax rates varied according to the circumstances of enterprises. However, to prevent arbitrary taxation, the 1983's figure was provided as a base ones and then, fixed rates of adjustment tax were applied on the profit and fixed for seven years. See more, Liu (2000), 166.

(Zhao1988a). In the report at the first plenary session of the sixth NPC under the guidance of Zhao Ziyang on 6 June 1983, a comprehensive economic reform schedule during *the seventh five-year plan period* (1986-90) was presented. During the seventh five-year plan period, coastal areas would be given priority according to the *three-region development strategy* drafted by the SPC (Lu and Xue et al. 1997, 9). Sound economic and fiscal environments were required as a precondition for overall reforms. During the seventh five-year plan period, the draft suggested that standardization in taxation should be implemented and tax collection gradually increase. Political leaders agreed that during the period, the economic growth rate would be higher than during the sixth five-year plan period. Originally it was set as 7 percent but was allowed to be higher during the process of implementation (Wu et al. 1998b, 2037). It was Deng Xiaoping who supported such economic growth. However, Chen voiced his opposition to an excessively high growth rate in the total industrial outputs of 22.8 percent as seen in the early 1985 (Wu et al. 1998b, 2039).

After the informal draft-making process over almost two years, Zhao took the issue of the seventh five-year plan to the CPC Congress on 18 September 1985 (Zhao 1988b). According to his explanation in the Congress, as of 1985 the economic and fiscal situations were positive. However, the most important task was still to maintain favorable economic and social environments, whose interpretation in the fiscal arena would be to maintain stable fiscal and economic growth and a fiscal balance. According to the plan, the seventh five-year plan period would be divided into two parts. In the first two years, policy priorities were focused on creating a favorable environment for major reforms and an adjustment in the economic growth rate; the last three years would focus on reforms of the price, tax, and banking systems. During the five-year period, the major tasks in the fiscal arena were still to guarantee stable fiscal revenues for the state and strengthen the standardization of a tax system (the tax-sharing system).

The rapid growth of economic development and inflation since 1984 had already shaken the reformers' consensus on fiscal balance and adjustment policies as targeted in the sixth five-year plan. In fact, the national income growth rate already outnumbered the target of 4-5 percent in 1982 and sharply increased in 1984-1985. However, the fiscal target in terms of the ratio of state revenue over national income still maintained the level

of 28-30 percent until 1985 as recommended in the plan.⁵ Now, the issue of whether or not the Beijing government would maintain the fiscal target while keeping the economic growth rate at a much lower level than the current one came to the fore in various debates.

The General Taxation Bureau and the MOF assiduously promoted standardization of the taxation system, as in the introduction of the second stage of the *replacement of profit by tax* reform. As indicated in the *Renminribao* on 25 January 1983, the position of fiscal sectors was that fiscal system's direction should be the thorough implementation of the tax system, instead of the current mix of tax and profit remittance system. Furthermore, revenues should be appropriate to various levels of government according to the source of taxes. Therefore, from 1984 many tax laws and regulations were implemented.⁶ Efforts for standardization gradually expanded. The collective enterprise income tax was introduced on 11 April 1985, the individual enterprise income tax at the village level on 7 January 1986, the individual income adjustment tax on 25 September 1986, and individual income adjustment tax for private enterprise investors and private enterprise income tax on 25 June 1988.

In the middle of the standardization efforts, a young scholar under the CASS, He Zhenyi, took a bold step by urging the introduction of the *fenshuizhi* [tax-sharing system]. He argued in an editorial in *People's Daily (Renminribao)* 30 November 1983 in 1983 and in an internal document in 1984 (He 1984) that introduction of a tax-sharing system would be a key to the urban reform. It would standardize tax rates and increase the responsibility of economic and governmental units for their financial management. His articles are significant in that their main contents were eventually introduced in the 1994 fiscal reform although it took a long time to implement them. In the short report (He 1984), he criticized a contradiction of the current fiscal system wherein the ratio of Beijing's revenue over state revenue was about 20 percent while its expenditure was higher than 55 percent. Along with criticizing the increasing extra-budgetary funds, he raised the issue of the current revenue-sharing system according to administrative

⁵ It was 28.5 percent in 1982 and 28.3 percent in 1985 (CSY 1999; SGTB 1997).

⁶ For example, in the form of draft, regulations on product tax, value-added tax, salt tax, business tax, natural resource tax, and enterprise adjustment tax were implemented as of 1 October 1984. See Liu 2000, 177.

jurisdiction, which would result inevitably in strong local protectionism. The current fiscal system would weaken Beijing's fiscal position and eventually lose its control over local finances.

His solution was to introduce the *fenshuizhi* wherein the Beijing and local governments would collect revenues in the form of taxes and *share* them between the Beijing and local governments regardless of jurisdiction of the enterprises. He also suggested increasing the proportion of Beijing's revenue by trimming local revenues to the degree that the local government could support its expenditure. Local government would rely on its own fixed revenue and central subsidies in order to meet its own expenditure.⁷ His article was circulated in the form of an internal document in 1984 and part of it was embraced in the 1985 fiscal system. As he suggested, the proportion of the *sharing-revenues* in the state revenue was emphasized, and fixed Beijing's and local revenues were about 40 percent in 1985 under the new system (Department of Budget in the MOF 1985, 11).⁸

On 21 March 1985, the State Council promulgated the new fiscal management system of "assigning different categories of taxes, determining revenue and expenditure, and fixing contracts of the local governments (*Huafenshuizhong, Gedingshouzhi, Fenjibaogan*).” It implemented in 1985 with the success of the first stage of the *replacement of profit by tax* reform and in a sound fiscal condition. The second round of the *replacement of profit by tax* reform planned thoroughly to replace enterprise profits with a series of taxes. However, the base figures for revenue and expenditure among governments and enterprises were still subjected to contracts. Under the system, an enterprise income tax and an adjustment tax replaced profits, but the base figures for the revenue were negotiated based on the sum of the enterprise income tax and the adjustment tax. Then too, the revenue base figure was compared with the expenditure base figure. Based on the difference, it would be determined whether a provincial government should get subsidies or should remit to the Beijing government. This system would allow fixed local taxes to increase the fiscal autonomy of local governments, which would further serve standardization of the fiscal system.

⁷ He already strongly supported in 1983 the introduction of a sharing system in the tax system to restrain localism between the central and provincial governments (He 1983).

In implementing the system, the Beijing government persuaded the local governments that they would enjoy more stable revenues from their own revenue sources. The Beijing government also released its policy of tight fiscal control over Beijing, Tianjin, and Shanghai. Under this new fiscal system,⁹ these cities were no longer subjected to the sharing total revenue system or an annual negotiation for the remittance rate (MOF Budgetary Department 1985, 11). For example, in the case of Shanghai in 1985, the Beijing government increased its base figure of expenditure from about 2.1 billion *yuan* to 3.6 billion *yuan*. In addition, the remittance rate of revenue was also slightly decreased to 76.8 percent (Chen 1999, 19; author's interview). As a result, during the three years 1985-87 the amount of revenue Shanghai actually controlled increased 2.8 times (16.8 billion *yuan*) from the 5.6 billion *yuan* of 1984.¹⁰ However, the overall fiscal burden in the coastal area was still higher than the national average, so the heavy burden was later criticized as a defect that discouraged local enthusiasm for increasing tax efforts.

On the other hand, the new system was designed to check state intervention and arbitrary conscription of enterprises by regulating tax-items and assigning management responsibility (Yu 1993, 217-18). Tax revenues were divided into three categories: fixed central government revenues, fixed local government revenues, and shared revenues.¹¹ In the original notice of the State Council, local fixed revenue sources included the industrial and commercial taxes, the income tax on joint venture enterprises, the income and adjustment taxes on locally owned SOEs and collective enterprises, the agricultural income taxes, the rural market trading tax, the housing tax, and the vehicle utilization tax.¹² However, in practice, the fixed local revenue was limited to only one item, other

⁸ As mentioned previously, in practice, a few tax items were assigned as local taxes.

⁹ Previously, the Beijing government controlled almost 90 percent of revenue and expenditure of Shanghai during the period 1949-84. Chen (1999), 38-39.

¹⁰ The figure included sharing local income, earmarked subsidies, price subsidies, and other self-raised funds. Chen (1999), 53.

¹¹ The revenues that belonged to the central government were as follows: income and adjustment taxes on all central government enterprises; the business tax on railroads; bank headquarters and insurance company headquarters; the profit remittances of all enterprises owned by the military; the special tax on fuel oil; the income taxes; sales taxes and royalties from offshore oil activities of foreign companies and joint ventures; income from finance bonds; the surcharge for the energy and transportation fund; and all the taxes and duties levied at customs. Only the customs taxes are collected directly by the central government. The rest are collected by local tax authorities and then turned over to the central government.

¹² See the notice in *Caizheng* (April 1985): 10-11.

industrial and commercial taxes, in 1984, and increased to three in 1985: the local part of the urban maintenance and construction tax, the pollution fee, and the urban water resource fee.¹³ The amount was minuscule. The bulk of revenue sources were assigned as sharing taxes.¹⁴ After 1985, original fixed local revenue sources were pooled into the part of revenue-sharing. In this system, the Beijing government still possessed an enormous power as the definition of the rates and bases for these taxes were not under local government control (The World Bank 1995, 108).

In the original *replacement of profit by tax* reform plan, taxes on profits would thoroughly replace confiscation of all profits and enterprises would enjoy fiscal autonomy after taxes. As it was implemented without prior price reform, a progressive tax system was initially considered to reduce different profit rates among regions and enterprise segments. Yet the plan was beyond its institutional capacity to handle a complex tax system. Therefore, the enterprise income tax was set below the average profit rate. Then, to adjust still-existing differences of profit levels, an adjustment tax was introduced. The Beijing government argued that the revenue burden under the current system became much lighter than under the previous profit arrangement. According to the calculation by the MOF, the profit rate left to state enterprises was 7.9 percent in 1979 but 38.7 percent in 1985 (General Office for Financial Reform in the MOF 1987, 1). However, after mid-and large-size state enterprises in practice paid 55 percent income tax and about 10 percent adjustment tax, they were still subject to a 10-15 percent level of taxation for construction funds and various fees (Wang 1988). After payment, then, only 20-25 percent of profit was left in the hands of enterprises. The rate was still higher than that of 1979, but the high rate of fiscal burden was later criticized by proponents of the fiscal contract system as an obstacle to invigorating enterprises and a main cause of fiscal deficit due to the lack of incentives for enterprises.

¹³ To compare the changes between 1984 and 1986, see Yonghua Hu, "1985 *nian zhongyang yu difangyusuanshoulujice huafen wenti* [the issue of dividing budgetary revenues between the central and local governments in 1985]." *Caizheng* 4 (April 1985): 23-25; Si Qian, "1986 *nian zhongyang yu difangyusuanshoulujice huafen wenti* [the issue of dividing budgetary revenues between the central and local governments in 1986]." *Caizheng* 4 (April 1986): 10-11.

¹⁴ These sources are as follows: all sales taxes (value added, business and product), natural resource taxes, the construction tax, the salt tax, the individual income tax, the wage bonus tax.

The Beijing government also continued to allow various types of fiscal contract systems in uncertain and less-standardized economic environments. Five dividing methods were adopted as follows: (Ning and Zhang 1994, 507-508; Yu 1993, 207).

- (a) Division from the total amount: applied to whose revenues were greater than expenditures.
- (b) Fixed remittance: Heilongjiang (except for Haerbin city).
- (c) Fixed subsidies to localities: Jilin, Jiangxi, Shaanxi, Gansu. On the other hand, unfixed subsidies to localities were applied to Hubei and Sichuan whose amounts depended on remittance to the center from each province's planned city (*Jihuadanlie Shi*).
- (d) Subsidies for autonomous regions
- (e) Great management responsibility system for Guangdong and Fujian.

The fiscal management system of 1985 as well as of 1980 still possessed the basic feature of the "big pot" fiscal system because its fiscal responsibility in expenditure was not clearly designated. The Beijing government still wielded its discretionary power over provincial finances, and divisions between vertical and horizontal leadership were not yet fully clarified in the bureaucratic structure of the Chinese fiscal system. The situation provided enterprise managers and local governments with soft-budget constraints under the dual economic system. Without clear lines of responsibility in fiscal management, the responsibility of tax collection according to the original formula was often left to parochial interests at the local level. Another problem of this system was that it allowed *loan payment to the banks before paying taxes (shuiqian huandai)* to mollify opposition from large state-enterprises (Liu 2000, 249). The annual amount was higher than 10 billion *yuan*, which was equivalent to almost a tenth of the total industrial and commercial taxes in 1985 (Xiang 1989, 28; SGTB 1997, 14). Moreover, the number of pretax items had steadily increased.

The results were a decrease in income deliverable to the state and rapid expansion of investment. The burden of the state finance worsened. In addition, since no environment for fair competition and evaluation over different economic sectors and regions had been established, the Beijing government adopted a one-to-one negotiation method in fixing the remittance rate, in consideration of regional specific interests and situations (Kuo 1996, 42-43). It required an enormously extensive series of negotiation

meetings to settle the rates. The MOF, the responsible bureaucracy, was overwhelmed with work (author's interview).

The effort for fiscal standardization encountered a backlash in 1985-86 under pressure from high inflation and an incomplete price reform. In particular, implementation of the comprehensive price reform as a prerequisite for a fair-competition environment was much tougher than originally thought. In the report of the third plenary session of the sixth NPC, the State Council indicated that the policy priority of 1985 would be to start reforms of the price and wage system (Policy Research Board 1999, 167). Accordingly, from 1985 on, prices of five industrial items and most agricultural products except for a few crucial items were open to market prices (Zhang, Huang, Li eds. 1998, 113; *Wenhuibao*, 2 January 1985).¹⁵ In China, in practice, liberalization of prices of agricultural products was short-lived in most cities in 1985 because local governments feared discontent of residents and social unrest due to the price rises (Shirk 1993, 302). As indicated by Richard Goode, an IMF advisor on tax reforms in developing countries, a systemic price reform was especially unlikely to be accepted and implemented because of the vested-interests affected in the society.¹⁶ While tax reform brought the costs to targeted groups, price reform would defuse the costs by influencing broad interests of society. The top leaders would be most likely to choose the path of least resistance, that is, tax reform. The choice between tax and price reforms was a political decision.¹⁷

It was difficult for various types of enterprises with various kinds of ownership to engage in fair competition under the distorted price system. The complexity in adjusting the distorted price system by means of taxes became a major obstacle to fiscal standardization. In addition, high inflation and the introduction of partial price reform in 1985 destabilized the given relationship between the state and enterprises as well as between the Beijing and local governments. Accordingly, an adjustment was required in the fiscal arena. In 1985-1986, the fixed revenue for the Beijing government was still

¹⁵ According to them, it was only 1988 that the ratio of state fixed prices of social products and labor decreased to around 50 percent.

¹⁶ As for the impacts of price reform among vested interests, see Shirk 1996, 301.

¹⁷ Richard Goode, "Obstacle to Tax Reform in Developing Countries," in Richard Bird and Oliver Oldman, eds., *Taxation in Developing Countries* (Baltimore: Johns Hopkins University Press, 1990), 124.

untouched, but the fixed revenue for localities and shared revenue as a whole were combined and rearranged according to local expenditure to adjust the relationship.

Revenue sharing formulae differed across regions as in the past. The jurisdiction and the scope of revenues defined the size of expenditures. The formulae had one common guiding principle, that local governments should retain enough revenue to cover a basic level of services¹⁸ and should turn the remainder over to the Beijing government. If the size of revenues is greater than expenditures, a part of surplus will be handed over to the Beijing government according to a fixed ratio as negotiated. All autonomous regions and others in which regular revenues did not meet expenditure demands could not only retain all the revenues, but also received an additional subsidy from the Beijing government (Oksenberg and Tong 1991, 24; Yu 1993, 209, 217; The World Bank 1995, 108). The ratios of revenue remittance and subsidies would be fixed and remain unchanged for five years. The local governments could spend more or less according to how much they would mobilize revenues beyond the contracts. However, it was a retreat from the idea of thorough standardization of the fiscal system. The new system could stabilize Beijing's revenues by forcing a major part of shared revenue sources to be assigned to the Beijing government, while still guaranteeing local interests that their revenues would not fall below the level of previous expenditures.

As of 1986, this new attempt at fiscal standardization appeared to lose grounds in accomplishing its goals in the adjustments of 1986 and the overall reintroduction of a fiscal contract system beginning in 1987.¹⁹ However, fiscal standardization remained as an organizational policy goal for the MOF and the General Taxation Bureau. Jin Xin, the GTB director, avowed efforts for fiscal standardization as his goal in the national taxation

18. The basic level of services means education and health, price subsidies, administration, agricultural expenses, social welfare, and operating expenses for industries, transportation and communication. See Wong (1991), 703.

¹⁹ Xiang Huaicheng (Xiang 1989, 24-25), vice-Minister of the MOF, succinctly summarized contributions of the 1985 divided tax system at various levels as follows:

"First, the attempt to define different categories of taxes with accumulated experiences to prepare for the introduction of a more thorough going tax distribution system in the future. Second, adherence to the principle of the "allowing the central and local authorities to fix their own responsibility and maintain the fixed ratios of revenue sharing and subsidization for five years" has encouraged the enthusiasm of the local governments to tap new fiscal resources, increase revenues, and economize on expenditure and ensured further revenue growth. Third, improvement making the basic norms of expenditure fixed. Instead of using expenditures from a certain year in the past as the base figure, the basic norms were set in accordance with

work conference on 23 July 1985. The Suggestion on the Seventh Five-Year Plan for the National Economic and Social Development, drafted in the CPC Congress on 23 September 1985, assured that the tax assignments would be in full play during the seventh five-year plan: 1986-1990 (Liu 2000, 247). Policy priorities in the fiscal area were still enjoying stable fiscal supply and balance rather than encouraging aggressive fiscal efforts. Zhao echoed his support of the fiscal standardization in the fourth plenary session of the sixth NPC on 25 March 1986, and his support for fiscal standardization continued even after he became provisional Party General Secretary, replacing Hu Yaobang. In the report of the thirteenth CPC Congress on 25 October 1987, Zhao introduced the term tax-sharing system (*fenshuizhi*), the policy goal for the fiscal standardization, for the first time in his formal report to the Congress (Zhao 1987, 14). Zhao's support of this issue continued steadily until he finally embraced the fiscal contract system as a provisional measure in 1988 upon becoming a party general secretary.

2. Evolving Bureaucratic Interests

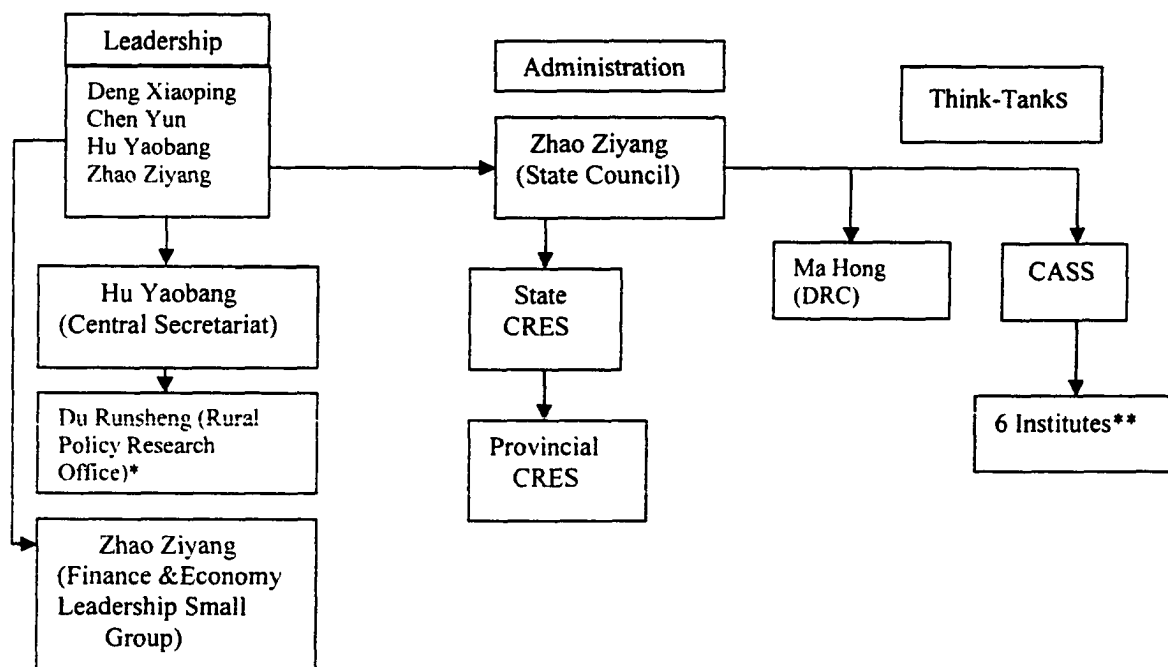
As discussed in the previous chapter, the two broad coalitions were formed according to their bureaucratic affiliations as to the choice between the *replacement of profit by tax* reform and the *contract on profit* system. Proponents for the replacement of profit by tax reform became a manifest majority, and they were able to implement the two stages of the replacement of profit by tax reform. During the initial period after the introduction of that system, China's overall economic and financial situations were evaluated as stable in the third plenary session of the twelfth CPC CC in October 1984. However, as the economy grew at an excessively high rate during 1984-1985, debates and conflicts relating to the reform strategy were intensified. A thorough standardization of the fiscal system and stable revenue growth would rely on comprehensive reforms in other areas. Reforms in the areas of the price system, the enterprise contract system, and property rights, and the influence of certain ideological legacies could be constraints on the pace and degree of reforms in the fiscal area. In particular, the situation became more

the revenues defined in the 1983 final accounts and the ratio of revenue sharing fixed in the existing fiscal system.”

complicated with the urban reform, for with the introduction of the urban reform, political realignments were formed according to organizational and leader-oriented interests.

What was remarkable was the increasing input from sources beyond the bureaucracies in a decision-making process. As of 1985, two major axes of the think tanks (*zhinangtuan*) were composed of scholars working in centers under the State Council and the institutes in the CASS. In the drafting process of “Decision on Economic Structural Reform” and its aftermath, Zhao Ziyang gradually increased his reliance on young economists. He had previously worked with traditionally powerful economic bureaucracies such as the SPC and the MOF and the newly-established SCRE (*guojiajingji tizhi gaige weiyuanhui*) in the pursuit of the replacement of profit by tax reform. Under the State Council, the Economic Research Center had been established in 1980 with Xue Muqiao as director, and the Technology and Economy Research Center in 1981 under Ma Hong. Both were allies in the reform.²⁰

Figure 4-1: Formal Leadership over Think-Tanks in the Economic Reform as of 1985²¹



²⁰ In addition, there were two more research centers relating to economic reforms under the State Council in the early 1980s: Research Center on Economic Law, established in July 1981, directed by Gu Ming, and Research Center on Price, established in July 1981, directed by Xue, Muqiao and Ma, Hong.

Note: 1. DRC refers to Development Research Center. It was formed in 1985 to strengthen its function as the think tank under the State Council through the merging of the former Economic Research Center, Technical Economic Research Center, and Price Research Center under the State Council. Later in 1990, part of functions and staffs of the former Rural Development Research Center were incorporated into DRC.

2. * It should not be confused with Rural Development Research Center under the State Council, established in 1982.
3. ** Six Institutes refer to Economy Research Institute (Liu, Guoguang), Industry and Economy Research Institute (Zhang, Yiwei), Agriculture and Economy Research Institute (Zhan, Wu), Finance and Trade Resources Research Institute (Liu, Mingfu), Quantitative Economy and Technical Economy Research Institute (Wu, Jiawei), and World Economy and Politics Research Institute (Pu Shan). In 1985, Hu Shengren was appointed as director of the CASS. Previously, Ma Hong had been the director since 1982. After the establishment of the Development Research Center to strengthen policy-related research function under the State Council in 1985, he was appointed as director of the DRC.

However, the organizations and personnel were under strong influence of Chen Yun and Li Xiannian. Zhao could neither command nor dominate them except for the SCRE, although he was in command on economic issues in the governmental hierarchy. In the wake of institutional reform in 1982, the SCRE was established to guide comprehensive matters of reform and placed under the direct control of the Premier, Zhao Ziyang. Bao Tong, the chief of staff for the premier's office, and He Guanghui, a protégé of Zhao, were vice-directors of the SCRE as of 1985. It was Zhao who seriously recruited young scholars into his camp (Chen 1995; Fewsmith 1994). It seemed inevitable that Zhao expand his ideas of reform as well as his power base within the Chinese political system. Established scholars were mostly linked with Chen Yun and Li Xiannian and their relatively conservative ideas on economy. According to Fewsmith, Zhao turned to Chen Yizi, the organizer of the Rural Development Research Center, to organize the institute for Chinese Economic Structural Reform (*Tigaisuo*) under the SCRE (Fewsmith 1994, 136). In many aspects, Zhao relied on the SCRE and its *Tigaisuo* and provincial *tigaisuo* rather than on the traditional bureaucracies. For example, scholars under the State Council institutes, such as Wu Jinglian, Zhou Xiaochun, Liu Liqun, She Xiaomin, Li Jiange, and Lou Jiwei, began to more aggressively report their suggestions on fiscal reform through the SCRE from 1986-87.²² Their suggestions related to promoting the tax-sharing system and to establish a local fiscal management system. The fiscal contract

²¹ I am indebted for the ideas for this table from Chen 1985.

²² To see their collection, Jinglian Wu, and Xiaochuan Zhou, eds. *Zhongguo Jingji Gaige de Zhengtishenji* [The Integrated Design of China's Economic Reform] (Beijing: Zhongguo Xinhua Chubanshe, 1988).

system was criticized by them as an administrative management controlling enterprises by relating administrative units. In particular, Liu and She argued that to implement the contract system required further bureaucratization for dealing one-to-one with enterprises. Chen Yizi also organized a group of young economists into the Beijing Association of Young Economists, whose director was Bao Tong, and published a journal, the *Forum of Young Economists (Zhongguo zhongqingnian jingji luntan)* (Fewsmith 1994, 136).

Many young economists were from various institutes in the CASS. Since Ma Hong, an early theorist for economic reform and proponent of commodity economy, was appointed as director of the CASS in 1982, it had become more active and provided theoretical bases for further reforms.²³ After the twelfth CPC Congress in 1984, six research institutes in the CASS were the main locus of young scholars²⁴ In localities, a local economy research institute had been established under the local academy of social science. Young scholars in the CASS became more and more independent of previous conservative views. They were not as apprehensive of the impacts of rapid growth, fiscal deficit, and some inflation as the rather conservative leaders, Zhao Ziyang, Chen Yun, Li Xiannian, Xue Muqiao, Ma Hong, and other conservative bureaucracies (the SPC and the MOF).²⁵ All these conservative reformers had earlier supported the introduction of the fiscal decentralization to local governments and enterprises, but they had put a higher priority on budget balance and economic stability. The young scholars contrarily viewed the positive roles of rapid economic growth and deficits for providing room for further reforms.

One of the most vehement opponents of the fiscal standardization came from the heavy industrial sector. Previously, industrialists already suffered from low profits because of a price system skewed in favor of light industries (Unger 1987). The new

²³ He was in charge of the *technology and economy center* and also of *price research center* with Xue Muqiao under the State Council in 1981. The governmental centers and academic institutes became two pillars of further reforms.

²⁴ The economy research institute (Liu, Guoguang), industry and economy research institute (Zhang, Yiwei), agriculture and economy research institute (Zhan, Wu), finance and trade resources research institute (Liu, Mingfu), quantitative economy and technical economy research institute (Wu, Jiawei), and world economy and politics research institute (Pu, Shan), Chen (1985), 26-28.

²⁵ Other leading economists included Liu Guoguang, Dong Furen, Wu Jianguan, and Dai Yuanchen. All of these scholars worried about the ability of the macro-economic control by the Beijing government as the fiscal decentralization went on. See Yang (1994), 78.

fiscal institutionalization, that is, a thorough introduction of tax system, would likely impose on them a higher burden, lower profit retention rate, and fiscal centralization. In the bureaucratic structure, the SEC competed with the SPC for control over funds and development of large enterprises and continued to promote the profit contract method with the support of Hu Yaobang and heavy-industry related ministries.²⁶ The implementation of the second replacement of profit by tax reform was considered unfavorable for large state enterprises because the system would likely take more profits out of their hands through the imposition of a high tax rate. According to the new system, the large state enterprises would pay 55 percent of net income for industrial and commercial taxes. Then, after the tax, the adjustment tax should be paid in 5-25 percent profits. After paying taxes and various fees to the central and local governments, they could possess merely around 20 percent of the profits (Shirk 1993, 289-290).²⁷ In particular, the adjustment tax was odious to them although the Beijing government guaranteed a less arbitrary application.

The SEC backed a campaign from late 1984 which would allow more leeway for mid- and large-size state enterprises to retain more funds for upgrading their equipment. As a result, the rates of adjustment tax for some enterprises were gradually reduced in 1985 (Shirk 1993, 292). During the period, the role of the SPC over enterprises often overlapped with the SEC. Although it won the battle in a campaign to invigorate enterprises in 1985, the SEC was eventually integrated into the SPC in the 1988 government institutional reform (Wu et al. 1998, 395).²⁸ The irony is that the SEC, which fervently promoted the fiscal contracting system, was abolished in the same year when the contraction system was implemented nationwide upon the demise of Hu Yaobang.

²⁶ For example, ministry of petroleum, ministry of electricity, General Petroleum and Chemistry Co., and General Color Metallurgy Co. would lose to local governments their control over 30 percent of industrial and commercial taxes from subordinate enterprises by the new fiscal system (*Mingbao*, April 24, 1985). See also the SEC's conflicts with the SPC over funds of technical renovation projects between the 1985 and 1987 in Shirk (1993), 291.

²⁷ Shirk indicated that the range would be 5-20 percent. It seemed to be overestimated in general, considering my interviews and other Chinese statements. However, it was quite evident that the burden was considerably high and choked finance of enterprises as well as local governments under pressure from rapidly increasing expenditures.

²⁸ The overlapped roles were mentioned as a major reason for the integration. See more in Wu et al. (1998), 395-396.

The agricultural sector was also stirred by the standardized taxation system. Traditionally, the agricultural sectors had enjoyed special treatment in the tax rates. Except for the adjustment period during the early 1960s, their tax burden was less than 1 percent of gross agricultural output value (SGTB 1997, 27). Along with the post-Mao agricultural reform, the rate increased up to 1.8 percent in 1983. However, given the more than 13 percent annual increase rate in gross agricultural output value, as compared to around 6.7 percent in heavy industry and 10.5 percent in light industry during the period 1979-1983, the burden of the agricultural sector was still quite low.²⁹ In addition, enterprises in rural areas had annually received 0.3 billion *yuan* in subsidies since 1979 (*Caizheng*, February 1985, 21). Originally, the subsidies were to be cancelled in 1983, but severe resistance forced Tian Jiyuan, Vice-Premier, to declare that the government would delay the cancellation for a while (*Xingdaoribao*, 9 January 1984).

Along with the introduction of a standardized tax system and urban reform, the subsidies were canceled by 1984 and replaced with a lending (*youchang bokuan*) method in 1985.³⁰ Apprehension and resistance to the new fiscal system in the agricultural sector then grew. In response, the MOF convened a conference on the subject of fiscal issues in rural state enterprises in December 1984 (*Caizheng*, February 1985, 20-21). In the conference, the MOF and delegates agreed that the previous profit contract system allowed preferential policies to the agricultural sector but nonetheless the standardized taxation system was an irreversible trend. However, under the pressure from the agricultural sector the MOF and the State Council agreed that they would continue to apply the fiscal contract system in the agricultural sector during the seventh five-year plan period (1986-90). In practice, however, the tax rate over the gross agricultural output value increased to the 3 percent level and never dropped lower during the 1980s (SGTB 1997, 27). Accordingly, demands for fiscal support in the agricultural sector grew, as seen in Jiang's article in the *Caizheng*.³¹

Although it was not necessarily to link policy preference over the standardization of taxation system with institutional affiliation during the mid-80s, in general scholars in

²⁹ Author's calculation from SGTB (1997), 27.

³⁰ In 1985, the amount of the allocated funds for agriculture was 1 billion *yuan* but in the final account was 1.6 billion *yuan*. See more in *Jingjiribao*, 15 July 1986.

CASS appeared relatively more favorable to the fiscal contracting system than in the centers under State Council. Both organizations played important roles for Zhao Ziyang as a think tank. When contracting methods were considered more reformative and the CASS was relatively free from the direct control of the State Council, scholars in the CASS could be more liberal and flexible than was the official position of the government. In addition, CASS was more likely to represent regional interests by including local members (provincial academy of social science) as its units. *Jingji Yanjiu* [Economic Research], the well-known journal of CASS, continued to publish articles in favor of fiscal decentralization and the fiscal contract system. These emphasized diversity (Tian 1984), limits of the role of taxes (Li and Rong 1985), criticism of fiscal balancism (Zhang and Jie 1986), and support of further fiscal decentralization (CASS Economic Research Institute 1987; Dai and He 1987).³²

Yet the official position of the CASS as an institute under the State Council still appeared favorable to fiscal management by the Beijing government as seen in the report of the Study Group of Economic Construction and Reform of CASS in 1987.³³ In particular, the article written by Dai Yuanchen, a member of the Economic Research Center in CASS, is worthy of note in that he dealt straightforwardly with the issue of decreasing revenue over national income. According to him, contrary to the popular view at that moment the proportion of state revenue over the national income was not as low as others had originally thought if they considered the rapidly-increasing extra-budgetary revenues. Compared to other countries, many organizations such as factories, schools, and armies played considerable fiscal roles in the Chinese system by supporting health

³¹ Lemin Jiang, "Renzhenguanche Zhongyanglehao Wenjian [Wholeheartedly Implement the No. 1 Central Document]." *Caizheng* 6 (June 1986): 26-28.

³² Yinong Tian, "Caizhengtizhide Gaige Tongjihuaingji de Guanxi [Relationship between Finance System Reform and Planned Economy]." *Jingjiyanjiu* 5 (May 1984): 16-20. Yet, his overall argument as a bureaucrat of the MOF still focused on macro-control over finance. For others, see Hongfeng Li, and Zhaozi Long, "Duishoushui Daiti Jiege Hongganzuoyongde Zhuyue Yinsude Tantaoshu [Study of Restraining Factors on Replacing Price with Taxes]." *Jingji yanjiu* 6 (June 1985): 76-77; Chenwu Zhang, and Xuezhi Jie, "Jingjitizhigagezhong de Caizhengzhuangui [Financial Transformation in the Economic Reform]." *Jingjiyanjiu* 1 (January 1986): 53-57; CASS Economic Research Institute, "Jianchi Shidu Fenquanfangxiang Chongsu Guojiaguanligeju [Maintain the direction of appropriate decentralization and re-mould the state management structure]." *Jingjiyanjiu* 6 (June 1987): 16-25; Yuanchen Dai, and Suoheng He, "Zaicaizhengkunnanshi Suomianlinde Hongguanzhengce Xuanze [Imminent Macro-policy choices in the period of financial difficulty]." *Jingjiyanjiu* 5 (May 1987): 26-32.

care, housing, insurance, and so on. The level of fiscal extraction would be higher than 40 percent over national income, which was much higher than the 30 percent level which Bo Yibo projected as an ideal (Dai 1986). Advocates for fiscal and economic retrenchment were straightforwardly rebuffed in this argument. However, it is also noteworthy that a number of articles were published in favor of strengthening fiscal management by the Beijing government, in the same journal during the period.

The localities constituted another strong proponent group for the contract system (Chen 1985; *Mingbao* July 8, 1985; Finance Bureau in Hunan 1986; *Wenhuibao* February 19, 1986; Dai and He 1987; *Guangmingribao* 27 January 1988). As argued by the director of the finance bureau in Heirongjiang, Chen Jingxin, the new fiscal system with more standardized taxes appeared to place most provincial governments under tightened pressure in securing sufficient revenues.³⁴ The fiscal situations of provincial governments began to deteriorate (Chen 1985). Although different interests existed over regions, in general localities preferred a more flexible contract system to the standardized taxation system. Around the issue of urban reform, there were still differing views on redistribution of fiscal resources. The poor central and inland areas, supporting an inverse step (*nitidu*) development strategy, requested subsidization of the poor by means of taking from the rich (*choufeibushou*) to the MOF (Dai and He 1987, 28-29). The fiscal contract system would likely provide more subsidies for these disadvantaged areas than the standardized taxation system because they would have greater chances of being favored in negotiations.

On the other hand, for the coastal provinces the fiscal contract system could be a devil or an angel, depending on the will of the Beijing government in negotiations. However, since in practice most industrial enterprises were located in the coastal areas, they suffered more from high tax rates. In addition, their recognition of Beijing's policy priorities also made them more favorable to the contract system because the Beijing government would not seek over-centralization as seen in the previous negotiations for the introduction of the replacement of profit by tax reforms. The overall economic

³³ Study Group of Economic Construction and Reform, "Duijinianlai Jingjijianshe yu Jingjigaigede Fansi [Reflection on Economic Construction and Economic Reform in Recent Years]." *Jingjiyanjiu* 3 (March 1987): 3-10.

development strategy of the Beijing government and key political leaders leaned further toward decentralization and invigorating enterprises during the seventh five-year plan, although viewpoints conflicted over degree and speed since the inception of economic reforms in 1978. Voices of local interests became more apparent in various areas (An Qihong 1985, K10; Zhang and Jie 1986; Dai and He 1987, 28-29; Shirk 1993, Ch.13).

Zhang and Jie, young scholars from Northeast (*dongbei*) Finance School, dared to criticize the supporters of fiscal stability in their article in the *Jingjiyanjiu*, written in 1985. According to them, all reforms would require increased expenditures and induce fiscal unbalance. They conceived of fiscal deficit as a normal and inevitable situation during the reform period. Their solution was to reduce the tax burden, to further decentralize fiscal resources to the localities, and to give more autonomy to enterprises, thus increasing revenues in the long run (Zhang and Jie 1986). Dai Yuanchen in the Economy Research Institute of the CASS and He Suheng in the Zhejiang Metallurgy and Economy Professional School (1987) also supported Zhang and Jie's views regarding the current fiscal decentralization program as irreversible and the deficit problem as normal during the reform period. Jiangsu Financial Bureau praised the fiscal contract system as the reason for its fiscal success for the previous 35 years (Jiangsu Finance Bureau 1984). The fiscal contract system could benefit local governments by expanding control of its enterprises and resources while decreasing administrative intervention by the Beijing government (Wang 1988).

In practice, as the Beijing government allowed a few marginal taxes as the fixed local revenues in the more standard tax system in 1985, the new system appeared less favorable than local governments would have wished. In addition, if only income taxes had been applied as a pure form of tax standardization, rapidly developing regions would receive more benefits from the system because they would wield more control over the surplus beyond the contracted quota. Instead, the Beijing government conscripted a considerable portion of after-tax profits in the name of an *adjustment tax*. Almost 98 percent of Shanghai's mid- and large-size state enterprises were subjected to the adjustment taxes, and the amount of adjustment taxes conscripted from Shanghai was one

³⁴ Chen implicitly criticized the heavy pressure under the new fiscal system by referring to an old idiom, "*Yangjiishendan* (Raise Chickens for laying Eggs)," which urges Beijing to reduce the burden.

quarter of the total amount of adjustment taxes in the nation (Xu, Du, and Zhao 1985). As a result, Shanghai was one of the most visible opponents to the standardized taxation system. In the city finance cadre conference, the director of the Shanghai Finance Bureau, Bao Youde, publicly demanded that the adjustment tax be lowered for the mid- and large size state enterprises in 1986 (*Wenhuibao* February 19, 1986). The Shanghai party committee and government became much bolder in the early 1988 by informing the Beijing government that the fiscal contract system must be mainstreamed and should be implemented (*Guangmingribao* 27 January 1988).

The MOF traditionally favored fiscal stability and balanced budgets. Ye Zhenpeng from the Finance and Science Research Center at the MOF predicted that fiscal stability would worsen along with price reform because price reform would require enormous amounts of wage adjustment payments and subsidies. Hence, Ye argued against price reform without fiscal stability (Ye 1986). The *finance (caizheng)*, the most authoritative journal under the influence of the MOF, published many articles in support of fiscal balance and stable fiscal development (Department of Budget in the MOF 1985; Sun 1985; General Office for Finance and Taxation Reform in the MOF, 1987; Zhang 1988), standardized tax system and increasing the role of taxes (Li 1986; Liu 1986; General Office for Finance and Taxation Reform in the MOF, 1987), and increasing the role of Beijing's fiscal management (Zhu 1983; Editorial 1983; Zi 1983; Ji 1984; Zhu, Wang, Wang, and Liu 1984; Zhu and Wu 1985; Wang 1988).³⁵

³⁵ See the examples. Fulin Zhu, "Duijinjinian Woguocaizhengtizhigaigede Jidiankanfa [Some Opinions about Recent Finance System Reform in China]." *Caizheng* 2 (February 1983): 16-17; Editorial Board, "Gaige Yaobaozheng Guojia Caizheng Shoulu Zengjia [Reform Should Guarantee State Revenue Increase]." *Caizheng* 4 (April 1983): 5; Mengfei Ji, "Tongyi Lingdao Fenjiguanli shi Yusuanguanlide Zhongyao Yuanze [Unified Leadership and Divided Management are a Crucial Principle of Budgetary Management]." *Caizheng* 4 (April 84): 19-22; Pingyang Zhu, Jiwei Wang, Jian Wang, and Xiaping Liu, "Tigaogongyezhengzhizhong Guojia Suodebizhongde Jigewenti [Some Issues in Increasing the Ratio of State Revenue over Gross Industrial Output Values]." *Caizheng* 4 (April 84): 23-24; Fulin Zhu, and Lihua Wu, "Jiaqiang Duihongguanjingjiwentide Yanjiugongzuo [Strengthen the Study of Macroeconomic Issues]." *Caizheng* 2 (February 1985): 1-4; Yunsu Sun, "Caizheng Shouzhi Pingheng shi Caizhengzhuangkuang Genbenhaozhuande Zhuyaobiaozhi [Fiscal Balance is a Major Sign of Turning the Fiscal Situation Better]." *Caizheng* 6 (June 1985): 31-32; Fuyu Li, "Caishuitizhigaige shi Jingjitizhi Quanmian Gaigede Guanjianhuanjie [Fiscal Reform is a Key link for Comprehensive Economic Reform]." *Caizheng* 7 (July 1986): 6-7; Rongcang Liu, "Caishuitizhi Gaigezhongde Jizhong yu Fensan Wenti [Problem of Centralization and Decentralization during the Financial Reform]." *Caizheng* 12 (December 1986): 25-26; Shaofei Wang, "Mingque Caizhengtizhi Gaigede Congti Mubiao Jiakuai he Shenhua Caizhengtizhigaige [A Clear Goal of the Financial Reform Facilitates and Deepens Financial Reform]." *Caizheng* 2 (February 1988): 6; Zhuoyuan Zhang, "Caizheng Zhengce yao Weijingjide Wending he

As seen in the MOF article from the department of budget about the new fiscal management system (1985), however, the institutional priority of the MOF was not necessarily rigorously supporting the increasing role of taxes. Although the General Taxation Bureau was under the MOF, the MOF had reasons not to be pleased with the rise in institutional hierarchy of the General Taxation Bureau. Increasing the role of taxes and the expansion of jurisdiction by the General Taxation Bureau over other tax policy areas would certainly reduce the power of the MOF. The MOF's concern was the stable increase of state revenues rather than fiscal management methods. The SPC also shared with MOF similar institutional interests with the MOF for fiscal balance and a stable increase of the state revenues for maintaining macro-economic stability (Finance Bureau in the SPC 1985; 12-13). During the period, the General Taxation Bureau continued to promote the standardized tax system as seen in the July 1985 speech of Jin Xin, Director of the General Taxation Bureau. His speech's primary position was that the state revenue stability in the form of taxes needed guaranteeing, to give enterprises incentives to increase the tax base (Liu 2000, 183). He also vigorously sought to institutionalize tax regulations and laws, as previously described in detail. Vice-Premier Tian Jiyun, a protégé of Zhao Ziyang, was an avid promoter of the standardized tax system and in favor of promoting the institutional status of the General Taxation Bureau (author's interview).

A noticeable change of the position in the SCRE was observed. The SCRE as a strong supporter of the replacement of profit by tax reform worked closely with the MOF in the mid-1980s. Its position in the urban reform was in favor of further decentralization and strengthening incentives as seen in the 1986 report of the inspection team on the urban economic reform. Young SCRE scholars appeared dissatisfied with stability-focused policy during the 1985-86 (Hua, He, Zhang, Luo, Bian, and Du 1987; Research Group on Urban Economic Reform in the SCRE 1986). They argued that current fiscal difficulties and the existence of the old system would not hamper further reforms and attributed the current financial difficulties to just such adjustment policies. Their prescription was to allow rapid economic reform and further delegation of fiscal power to

Xiezhou Fazhanfuwu [Fiscal Policy must serve Economic Stability and Cooperative Development].” *Caizheng* 2 (February 1988): 7-8.

enterprises and localities. Since the current tax system was blamed for the weakened enthusiasm of enterprises and localities, their positions naturally led to preference for the fiscal contract system as an alternative allowing enterprises greater autonomy.

Zhao's position in favor of a more standardized tax system over a fiscal contract system continued even in the thirteenth CPC Congress in 1987 and in spite of advice from young scholars. Zhao's preference for the standardized tax system was noticeable in the Suggestion on the Seventh Five-Year Plan on 23 September 1985, the Report on the Seventh Five-Year Plan in the fourth plenary session of the sixth NPC on 25 March 1986, and Report on the Thirteenth CPC Congress on 25 October 1987. According to Shirk, Zhao supported the standardized tax system in his competition with Hu Yaobang and the necessity for a coalition with old cadres and strong bureaucracies such as the SPC and the MOF (Shirk 1993, Chapter 13). Shirk's explanation is persuasive in that consensus-building and coordination among top political leaders still worked even after mid-1985 although Deng had grown much more aggressive about furthering reform and the nature of urban reform made it more conducive to conflicts among key political leaders as well as other interest groups. Zhao had enjoyed Deng's support in his works in the administration and economy, and he could secure support from the elders by positioning himself in a more conservative stance relative to Hu Yaobang.

However, his preference was more related to the role of a government leader. According to Chen Yizi, Zhao's close protégé, it was Zhao who seriously sought to diminish the party's role and to establish the government's authority (Chen 1995, 148). Even after party elders at the *enlarged (kuoda)* politburo meeting nominated him as a provisional party general secretary in January 1987, he was still reluctant to accept the position and favored the Premier work. As an administrator, planner, and government leader, his preference remained the more standardized fiscal system, that is, the tax-sharing system. As seen in the political report of the 1987 CPC Congress, Zhao continued to support fiscal standardization by urging the introduction of the tax-sharing system. Therefore, his support for fiscal standardization seemed more established in his thinking than would be a mere political tactic to garner anti-Hu support from elders and conservative groups, as is conventionally suggested.

It was well known that Hu and the State Economic Commission (SEC) continued to promote the contract system (Shirk 1993). The director of the SEC, Lu Dong, in the national conference on productivity and frugality, rigorously promoted the fiscal contract system in July 1987. According to him, the fundamental purpose of the fiscal contract system was to guarantee a *long-term* stable increase of revenue as well as to invigorate enterprises (*Jingjiribao* 20 July 1987). He shrewdly criticized the argument of proponents for the tax-sharing system by indicating that the current system would in the short run be favorable to stability in revenue increase but in the long-run detrimental.³⁶

On the other hand, the positions of Chen Yun and Li Xiannian on the fiscal issue are well known. They were not mere fiscal centralists; Rather, they supported the delegation of fiscal power to localities and enterprises. Their fear was of losing control, and so they were ardent supporters of fiscal stability, balance, and management, and apparently favored standardization of the fiscal system. As long as the fiscal contract system could provide stable revenue growth and relatively stable economic growth to the Beijing government, they would be supportive of the system. However, in their view the overall situation of economic growth rate during the late 1980s was not ideal.³⁷ Therefore, they took a stand against the fiscal contract system. Deng's role was not clear in this fiscal issue after the mid-1980s, but according to Chen Yizi, he was supportive of Zhao's work throughout 1980s. From 1986 on, however, he grew bolder in behalf of further political and economic reforms than did Zhao. Although his preference for fiscal management systems was not known, he seemed more than receptive to the fiscal contract system as long as it could promote incentives to enterprises and localities, and as long as economic development was in the guidelines for the political reform (Chen 1995).

When conservative elders and bureaucracies were dominant and guided the retrenchment policy as in 1985, it was always wisest to be on their side. From 1986 on, however, the overall political and economic atmosphere changed. As debates on the mechanisms of economic reform among scholars and bureaucrats became fierce in 1985-86, views that boldly went beyond conventional stability-focused policy gradually gained

³⁶ Wang (1988) also argued that the addiction to a short-term stability of revenue (under the current tax-based system) was the main obstacle to the fiscal contract system and further reform.

³⁷ The summaries of views on economy and finance by Deng Xiaoping, Chen Yun, and Li Xiannian are in Xiang's *Fifty Year's Chinese Finance* (1999), 424-448.

momentum. Conflicts of interest among various groups appeared.³⁸ In the early 1986, Hu Yaobang was already effectively purged.³⁹ Deng Xiaoping stepped up for political reform by assigning Zhao Ziyang to organize the design of political reform at the work reporting session of the Central Finance and Economy Leading Small Group on 13 September 1986 (Chen 1995, 140-41). Considering political decision-making tradition in China, the move by Deng was extraordinary because the sphere of politics was in the hand of Hu Yaobang. It certainly showed that Deng favored Zhao over Hu. Deng set up the guidelines, which suggested decentralizing power, motivating local incentives, raising efficiency, and getting rid of bureaucratic defects (Chen 1995, 141). The reform-minded young scholars regarded the less flexible and more standardized tax system as an obstacle to further reform. After a fierce debate and political speculation, enterprise reform became the prime agenda of the whole reform program when the State Council issued *Some Decisions on Deepening Enterprise Reform and Strengthening Enterprise Enthusiasm* on 5 December 1986 (Li 1999, 111).⁴⁰ Therefore, until the end of 1986 bolder reforms in both the economic and political arenas gradually became dominant and peaked with the adoption of the primary stage of socialism and planned-commodity economy theory at the thirteenth CPC congress in 1987. However, Zhao still favored the tax-sharing system even though the enterprise contract system was broadly introduced that year.

³⁸ In early 1985, Chen Yizi, the director of the Economic Reform Institute, conducted investigation over ten counties and reported the results to Hu Yaobang and Deng Xiaoping. The conclusion was the necessity of political reform to clear the way for economic reform. See Chen (1995), 140.

³⁹ I am indebted to Lieberthal on this point.

⁴⁰ To see summaries of the debates, *Jingjiyanjiu* 11 (November 1985), 72-76; *Jingjiyanjiu* 2 (February 1987), 3-14. Obviously, the CASS appeared an avid promoter for enterprises reforms. Hu and Dai (1984); Study Research Group on Urban Economic Reform in the SCRE (1986); Zhao (1987); Dai (1987); Task Force in Economy Research Institute at the CASS (1987). In Contrary, already established scholars such as Wu, Jinglian (1987), Ma Hong, Xue Muqiao (1987), Li Yining (1986), Liu Guoguang (1999) and Agriculture Development Research Center in the State Council (*Jingjiyanjiu* June 1987, 15-16) were much more cautious of a rapid and bold reform. For others, see Muqiao Xue, "Woguoshengchan ziliao Suoyouzhide Yanbian [Change of Property System on Means of Production in China]." *Jingjiyanjiu* 2 (February 1987); Jinglian Wu, "Guanyu Gaige Zhanlue Xuanzede Luogan Sikao [On some Thoughts of Choice of Reform Strategy]." *Jingjiyanjiu* 2 (February 1987); Yining Li, "Jingjitaizigaigezhong Jidaiyanjiude Jigelilunwenti [Some Theoretical Problems Required Urgent Study during the Economic Reform]." *Jingjifazhan and tizegaige* [Economic Development and Structural Refrom] 5 (May 1986); and Guoguang Liu, *Zhongguojingji Tizhigaigede Moshiyanjiu* [Study of Patterns on Economic Reform in China] (Guangdong: Guangdong Jingji Chubanshe, 1999).

B. Efforts to Strengthen the Monitoring Mechanism and Institutionalization

So far, I explained how policy preference in the fiscal arena had been diversified in China's bureaucratic power structure. Its decision-making rules certainly required both political supports from key leaders and consensus-building efforts from participants. However, in understanding why they did what they did, it is still necessary to look at Chinese institutional capacity to implement fiscal reforms. In particular, the existence of a reliable monitoring mechanism is crucial when local interests are not consistent with those of the Beijing government on a certain policy. The institutional capacity to enforce Beijing's policies limits the Beijing government's policy options. In addition, the way Beijing wields given institutional means in enforcing its policy also provides localities with a cue for behavioral standards. In particular, an understanding of the chain of action-reaction between the Beijing government and local governments became more important when economic reforms allowed localities to increase their inputs in the policy-making process.

Since the 1980 introduction of the divided fiscal-management system, the financial stability of local governments was linked with the economic performance of local enterprises. Hence, local governments had strong incentives to help local enterprises access more resources for running enterprises and to reduce the amount of remittance to the Beijing government. As a result, reports on the level of tax evasion, tax avoidance, tax reduction, and tax holidays were prevalent through the nation.⁴¹ The Beijing government and central financial bureaucracies were fully aware of and were duly alarmed by the situation as seen in the Report on the 1986 State Revenue Account and the Draft of 1987 State Revenue by Wang Bingqian, minister of the MOF, on 26 March 1987. Subsequently, the State Council issued the Decision on Tightening Taxation Rules and Strengthening of the Taxation Work on 8 April 1987. It was the first decision made

⁴¹ Regarding the results of self-inspection in seven provinces (Hebei, Hubei, Shanghai, Gansu, Guangdong, Tianjin, and Shandong, see *Jingjiribao*, 17 October 1985. In general, higher than 60 percent of enterprises among the inspected violated the laws and regulations. When we consider that it is the result of self-inspection, in practice, it must be much higher.

by the State Council on the specific taxation-related rules since the Decision on Unified Taxation issued by the political council (*Zhengwuyuan*) in 1950 (Liu 2000, 415).

In the decision, it is noteworthy that the State Council still preferred the more standardized fiscal system over the fiscal contract system, proving this preference by urging local governments to collect taxes according to the rules and not to adopt contract methods in taxation even if they implemented various contract systems. During the mid-1980s, the Beijing government had increased its efforts to institutionalize the fiscal system and to strengthen an inspection mechanism to a greater degree than the previous years. Yet policy priorities and insufficient institutional capacity constrained the Beijing government from placing tougher measures against localities. Of note is the fact the State Council made considerable efforts, to institutionalize its fiscal system and to establish a more systematic inspection mechanism during this period.

As previously mentioned, the State Council approved the Report on Launching a Great Inspection in Tax and Finance Management drafted by the MOF and established an annual inspection system called the *great inspection on tax, finance, and price* (*shuishou caiwu wujia dajiancha*) in 1985.⁴² In May 1985, the General Taxation Bureau convened the first national taxation work conference and later drafted the “Provisional Regulations on Tax Collection Management” after the national tax work conference held in June-July in 1985. The draft was officially adopted by the State Council on 21 April 1986, after surviving a long process of consultation and consensus-building, and became the basis of all subsequent tax collection-related rules and principles (Liu 2000, 408).

It was from 1985 on that some provinces such as Jilin and Liaoning established a taxation inspection team (*shuiwu jichadui*) down on the level of the county finance bureau with encouragement from the General Taxation Bureau. However, until the end of 1987, only three provinces (Jilin, Hebei, Hubei) and one city (Wuhan) were proving relatively cooperative in implementing the inspection mechanism (Liu 2000, 476). Furthermore, in order to strengthen the capacity of supervision over state-enterprises, the State Council in 1986 made a decision to establish a supervision organ, which was directly controlled by the MOF in eighteen provinces where a large number of mid- and large-size state enterprises existed and the levels of profits and deficits were high

⁴² It was cancelled in 1998.

(*Jingjiribao*, 15 October 1986).⁴³ The State Council eventually expanded direct control to the poor inland provinces: Hunan, Shanxi, Guangxi, Qinghai, Ningxia, Xinjiang, Guizhou, Neimenggu, Yunnan, and Jiangxi in 1987 (*Renminribao*, 27 January 1987).

Administratively, taxation branches had been established at the township level along with the first stage of the replacement of profit by tax system since 1983. As of 1986, around 80 percent of townships had established taxation organs. In particular, Jiangsu, Hebei, Shanxi, Liaoning, Jilin, Zhejiang, Hunan, and Jiangxi reached the 90 percent level (*Jingjiribao*, 10 June 1987). Another change was apparent in the efforts to strengthen the more centralized financial statistics system (Wang 1985). Along with implementation of the decentralized fiscal management system, a more centralized line of authority in the area of fiscal statistics was emphasized, which was mainly under MOF control. Establishment of the department of fiscal statistics in the finance bureau at the provincial level was recommended. The “Synopsis of State Finance Statistics” published by the MOF set up standardized rules for statistical indexes and items and increased the volume of comparison data of provinces. A mutual exchange of information was also encouraged. However, I was told that the MOF and political leaders had extreme difficulties in getting correct and standardized information during the 1980s. It was only in the early 1990s that the visible outcome of the government effort appeared relatively reliable (author’s interview) although a severe underreporting problem at the township level was recognized by the State Statistics Bureau (Wang and Hu 1999, 84-86). To correct the underreported figures, general research and sampling methods were frequently used. The publicized figures were the products after adjustment of the State Statistics Bureau. Similar procedures have been applied to all the publicized figures including the figures in provincial statistical yearbooks (Wang and Hu 1999, 85). Detailed intra-provincial fiscal data and statistics were then sharable among members in this field as a form of internal reference as well as in the Chinese Statistical Yearbook (author’s interview).⁴⁴ The organizational status of the State Statistics Bureau was raised to the

⁴³ They were Beijing, Tianjin, Shanghai, Hebei, Liaoning, Jilin, Heilongjiang, Jiangsu, Zhejiang, Anhui, Fujian, Shandong, Henan, Hubei, Guangdong, Sichuan, Shaanxi, and Gansu.

⁴⁴ The increasing acknowledgement by the political leaders on the pivotal role of acquiring correct data in the economy and the austerity atmosphere in the early 1990s seemed to exert the central power in this area to improve the quality of data, let alone with the improving institutional capacity in the data processing area.

level of ministry under the State Council by Notice No. 25 of the State Council. It was approved in the first session of the eighth NPC in 1993 (Secretary Bureau of the State Council General Office et al (ed) 1995, 328-333).

Along with the increase in the role of taxes in the state revenue, the organizational position of the taxation bureau continued to rise. In particular, the July 1985 national taxation work conference (*quanguo shuishou gongzuo huiyi*) paved the way for the rise of the role of the taxation organs. It urged that provinces abide by the decision of No. 131 document of 1983, which dictated that the taxation bureau at the provincial level should be promoted to higher than the *chu* [office] level and the taxation bureau should be separated from a finance bureau at the county level. The conference also suggested that the taxation branch at the basic level should be established according to the economic region. To avoid the intervention of the township level of governments and to guarantee tax collection, the suggestions in the conference prohibited the branches from being controlled by the township government. In addition, Zhao Ziyang agreed to increase by 100,000 the number of agents in the taxation area in three years to reach a total number of 463,120 in 1988 (Liu 2000, 536).

Subsequently, detailed measures to promote the taxation bureau were implemented. Tian Jiyun, Vice-Premier, suggested on 6 August 1985 that institutional reform would be a key to strengthening the fiscal system (Liu 2000, 536-37). He provided the basic scheme of the separation of local taxation bureaus from the state taxation bureaus. According to his suggestion, the local bureau would be in charge of local taxes and legislation on local taxes. The fixed central taxes and sharing taxes would be under a centralized control. The institutional status of the General Taxation Bureau should be promoted but placed under the *kou* management of the MOF. The status of the taxation bureau had to be equal to that of the finance bureau at the provincial level while in charge of the local taxes. On 30 December 1985, Tian proposed that the taxation branch at the township level should be established according to economic region and placed under direct control of the taxation bureau of the county government in terms of personnel arrangements, costs, and cadre management. He also strongly warned against the tendency of rich rural townships to establish their own taxation branches in their administrative regions.

Hu Yaobang also involved institutional reform in the taxation system, paying attention to a suggestion from the ex-director of the taxation bureau of Yunnan that the General Taxation Bureau be promoted to the MOF level and that the taxation bureau at the provincial level be promoted to the office (*zhengting*) level (Liu 2000, 537). On 7 April 1986, he publicized his concerns on this issue by inviting Jin Xin, director of the General Taxation Bureau, to address issues relating to taxation works in the central secretariat meeting.⁴⁵ In the seventh article of the “Decision on strengthening taxation rules and intensifying taxation work” issued by the State Council on 8 April 1987, the establishment of the taxation branch corresponding to economic regions was adapted. However, Hu’s involvement in this issue (government works in general) was not as previously noted welcomed by Deng and Zhao (Shirk 1993; Chen 1995). In particular, after Hu refused to reprimand the student demonstration and liberalization movement in 1986, Deng and the Party elders reached a consensus to remove Hu from his post and to replace him with Zhao (Chen 1995, 146-148).⁴⁶

The MOF was also unhappy with the idea of raising the institutional status of the General Taxation Bureau equivalent to that of the MOF. However, what is evident was that there was little disagreement in the general direction of strengthening the taxation organs among political leaders and bureaucracies. The issue of raising the status of the General Taxation Bureau was resolved in the form of a compromise accompanying the second major institutional reform in 1988 during the post-Mao period.⁴⁷ The General Taxation Bureau was renamed the State Taxation Bureau and placed under the State Council of the MOF although it was still under the *kou* management of the MOF.⁴⁸ The State Taxation Bureau was upgraded to a vice-ministerial level of administration and became more independent from the MOF control. It was in 1993 that the State General Taxation Bureau eventually became a ministerial level of administration under the State Council with the new name of the State Taxation Bureau and thus acquired a full

⁴⁵ According to Liu, it was the first time for the party leader to directly handle the taxation issues in the meeting. See Liu (2000), 537.

⁴⁶ Hu was removed from the General Secretary as of January 1987.

⁴⁷ The first major institutional reform occurred in 1982. The number of (semi) ministerial organizations under the State Council decreased to 61 from 100.

⁴⁸ About the *kou* system, refer to Chapter IV.

independence from the *kou* management of the MOF (MOF, Department of Fiscal Policy 1996, 29).

During the period 1984-1987, the Beijing government made considerable effort to introduce various tax-related regulations and laws, strengthen taxation organs, standardize fiscal data, institutionalize inspection mechanism, and penetrate to the township level in taxation. In spite of the principle of slimming down government institutions in the first and second institutional reforms, the Beijing government continued to expand the capacity of its fiscal organs and personnel. However, no capacity was sufficient to prevent the fiscal deficit and financial difficulties of the Beijing government. When policies from Beijing conflicted with local interests, the implementation at the local level was sluggish as evidenced in the establishment of inspection teams at the provincial level. As the Beijing government did not have its own inspection teams, it was forced to rely on reluctant provincial inspection teams to investigate local fiscal affairs. In addition, the will of the Beijing government was in question in the area of inspection. Although Beijing finally managed to regularize the great inspection (*dajiancha*), my interviewee indicated that it was not as threatening as it was supposed to be. For example, a provincial government in the coastal area was able to hide its discretionary funds in its sub-administrative region, but the Beijing government never investigated that level. However, he was quite sure that the Beijing government was aware of the practice (author's interview).

The MOF also established an incentive mechanism for local taxation bureaus by bestowing awards annually for its achievement in a final settlement of account of the respective provinces from 1985.⁴⁹ It is certain that leaders of awarded bureaus garnered certain advantages by adding points for their promotion (author's interview). However, the bureaucratic decision-making feature under dual leadership did not provide sufficient incentives for those individuals to go beyond their organizational interests. Although MOF had the power to control the appointment of a finance bureau director at the provincial level, it required informal consultation with provincial leaders. If provincial leaders strongly opposed the appointment, it was not highly likely to be imposed and vice

⁴⁹ For the contents, see Table 4-3.

versa. The MOF did not want to make any trouble, and then there was the reality that it relied almost totally on the cooperation of provinces in its revenue collection effort.

However, the main problem of encouraging regional fiscal efforts was that the fiscal performance of each province had not been reflected in the negotiations between Beijing and the provinces. In making rules for remittance to Beijing under the new fiscal contract system in 1988, those provinces whose fiscal effort scores were high did not in fact derive benefits from their awards; those provinces, on the contrary, experienced disadvantages in the next round of negotiations. On the other hand, those provinces with a record of no award and low revenue increase rates in the past few years received favorable treatment. This practice, in sum, certainly was unfavorable for the fiscal efforts of local governments. An interviewee frankly told me that it would be bothersome if a locality achieved higher than its target since it could cause considerable disagreement between it and MOF in the next round of negotiations setting the remittance base (author's interview).

Surprisingly, the Beijing government did not actively utilize the inspection or award mechanisms to encourage local fiscal efforts. It is understandable why localities resisted the establishment of the inspection mechanism. The question then becomes why the Beijing government did not vigorously strengthen inspection activities in the face of its financial difficulties. The key reason comes from its policy priority. As seen in the draft for the seventh five-year plan, the policy focus was moving toward deepening economic reforms from adjustment and stability. As urban reform advanced, the policy priorities of the Beijing government had gradually moved on to bolder reform measures such as rapid economic development and acceptance of fiscal imbalance to invigorate enthusiasm from localities and their enterprises. In addition, Deng's preference for much bolder reform than that of any other conservatives became obvious when he supported further political reform in 1986 and opposed expanding the anti-bourgeois campaign in the early 1987 (Chen 1995).

The changing emphasis on autonomy in local governments and enterprises in the overall policy-making society was quickly embraced by localities. It certainly weakened the position of conservatives seeking greater control of finances. The State Council sought to strengthen its extractive capacity by means of fiscal institutionalization and

standardization. However, various political constraints made the mechanism of inspection and rewards far from the appropriate responses to fiscal efforts, as local governments found the political leeway to resist measures to strengthen fiscal inspection and standardize tax system. In particular, Zhao and the General Taxation Bureau were unable to force localities into further tax standardization when key political leaders could not reach consensus and louder voices were being heard from the localities.

Another reason came from Beijing's lack of institutional capacity in implementing a more complicated fiscal system. After introducing a more standardized tax-based system in 1985, Chinese fiscal organizations still suffered from a lack of personnel and methods to deal with a complicated tax system in the urban reform environment. For political reasons, price reform was not fully introduced during the period. Without reasonable adjustment of prices, which had been distorted under the socialist economic system, Beijing could not command optimum tax rates. Setting tax rates was complicated, and Chinese leaders and bureaucrats had limited experience. In addition, tax collection would become much more complicated with the introduction of such complicated tax rates. It is obvious that most agents in the fiscal arena, personnel hired and trained in a few years without accumulated experience at the organizational level, were simply not up to handling such complicated taxation systems. Hence, a main cause of fiscal deficit and financial difficulty was attributed to insufficient institutional capacity in the fiscal area (Wang 1988).

Observedly the Beijing government had systematically utilized its power of personnel appointment to deliver its will (see Chapter VI). Looking at the insider/outsider index, it had appointed more insiders as governors who were familiar with local situations better during the post-Mao reform era. However, it also sought to check localism by designating more outsiders as party secretaries in the same period. In the context, this period 1985-1987 proved a turning point. When it launched bold economic reforms and promoted local economic developments, Beijing dramatically increased the proportion of insiders in party secretary positions as well as governorships from 1985 onward. This was a strong sign of Beijing's support of the principle of *yindizhiyi* [adopting measures in the lights of realities of specific regions]. Accordingly, during this period localities experienced a burst of decentralization featuring a composition of

insiders and outsiders. The Beijing government emphasized consensus-building and negotiations among interest-related parties to encourage tax collection in the localities, instead of utilizing the punishment mechanism or administrative directives (Liu 2000, 542). Beijing's personnel reshuffling also encouraged localities to be bolder in the pursuit of their interests.

Overall, the Beijing government had exerted incessant effort to establish a more standardized fiscal system and institutionalization in various fiscal areas during the period 1985-1987, its efforts proving both comprehensive and constant. In spite of a tide of slimming-down in the number of personnel working in the government in administrative reform during the mid-1980s, the number of personnel in the taxation area continued to grow at quite a rapid speed. However, penetration into localities was not as smooth as Beijing wished, as evidenced in the sluggish implementation of the inspection mechanism on the township level. During the mid-1980s, this implementation was far short of complete. In particular, with the lack of price reform new standardized tax system placed enormous burdens on fiscal institutions, whose burden often exceeded beyond institutional capacity. As seen in the next section, the situation certainly restrained the policy options for policy makers in the midst of fiscal difficulties. During the period, the Beijing government had also been reluctant to wield its various powers to increase fiscal efforts at the local level on account of its differing policy priorities. The cost included frustration of a thorough-going standardization of taxation and a declining proportion of the state revenues. A standardized fiscal system was in effect left behind as a future goal in the fiscal arena when the fiscal contract system was introduced.

C. Revival of Fiscal Contract System

The Chinese economy took a disastrous downward turn from 1986 onward. In 1985, the increase rate in the national income had been 13.5 percent, and that of industrial and commercial taxation was 48.0 percent after the introduction of the *replacement of profit by tax* policy. The State revenue increase rate was 25.2 percent. However, in 1986 these figures dropped 7.7 percent, 6.7 percent, and 18.9 percent respectively (SGTB 1997, 12-14), and the prospects of those were much less optimistic in 1987. One reason

for the economic downturn was the austerity measures adopted by Beijing to calm the rapid economic development and inflation. Some scholars strongly condemned the 1985 decision to enact a retrenchment policy as a highly erroneous policy, which was based on the old idea, in that the retrenchment policy hampered further reforms and the speed of economic development (Wu 1987, 11).⁵⁰ However, a more fundamental reason was the lack of incentives and enthusiasm from enterprises under the current fiscal system (Wu 1987; Liu 2000, 189). The tax burden was too heavy on mid- and large-size state enterprises, which were mostly concentrated in the coastal area. Provinces in the coastal area expressed unhappiness with the current system because the fiscal burden removed the benefits of a rapid economic development that they would enjoy.

On the other hand, state finances also suffered under the current fiscal system. The increased rate of industrial and commercial taxes (6.7 percent) dropped to a point lower than that of the total industrial output values (11.7 percent) as well as under the national income (7.7 percent) in 1986. The proportion of state revenues to national income was steadily on the decrease. The fiscal target rates of 28-30 percent in terms of the proportion of state revenue over national income as set during the sixth five-year plan collapsed in 1986, dropping to about 25 percent (MOF, Fiscal Reform General Office 1987, 2).⁵¹ In addition, the practice wherein the state allowed enterprises to pay loans back before paying income taxes considerably reduced the proportion of redistribution by the state, which was equivalent to approximately a tenth of industrial and commercial taxes in 1985.

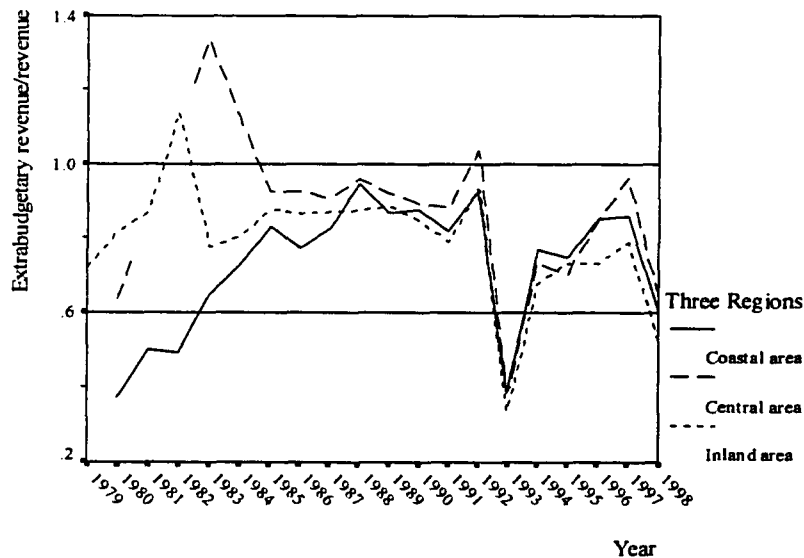
Until 1985, regional gaps in terms of national income per capita and proportion of GDP had almost achieved equilibrium over regions, but the situations changed after that. For example, in 1980 the proportion of GDP in coastal areas was 52.3 percent in national GDP, 31.2 percent in central areas, and 16.5 percent in inland areas. The 1985 proportion

⁵⁰ Regarding the introduction of conflicting ideas on this issue, see Liu, Guoguang and Zhao, Renwei. "Dangqian zhongguojingjitizhigaige yudaode jige nanti [Some Problems met by Current Economic Reforms]." *Jingjixue zhoubao*. 22 September 1985.

⁵¹ The guide line that Bo Yibo suggested was 30 percent. Dai (1986), 25.

merely changed to 52.9 percent, 31.1 percent, and 16.5 percent respectively (Lu and Xue et al. 1997, 107).⁵² However, after 1985 the gaps started to widen.⁵³

Figure 4-2: Ratio of Extra-budgetary Revenue over Budgetary Revenue



Source: Calculated from CFY and Provincial Statistical Yearbook, respective year.

Note: The drop in 1993 resulted from Beijing's decision to remove state-owned enterprise funds from the extra-budgetary item in its accounting.

As seen in Figure 4-2, the ratio of extra-budgetary revenues over budgetary revenues in poor areas had been much higher than in coastal areas until the introduction of the fiscal contract system. That meant that tax collection in poor areas was less standardized as well as that the practice of collecting fees and funds was much more prevalent in poor areas to meet their expenditures.⁵⁴ The figure reveals that the introduction of the standardized tax system in 1985 contributed to reducing the size of the extra-budgetary revenue ratio in every region although coastal areas quickly increased the ratio during the urban reform. However, overall ratios of extra-budgetary revenues across the regions were maintained at fairly high levels during the 1980s. Each local government

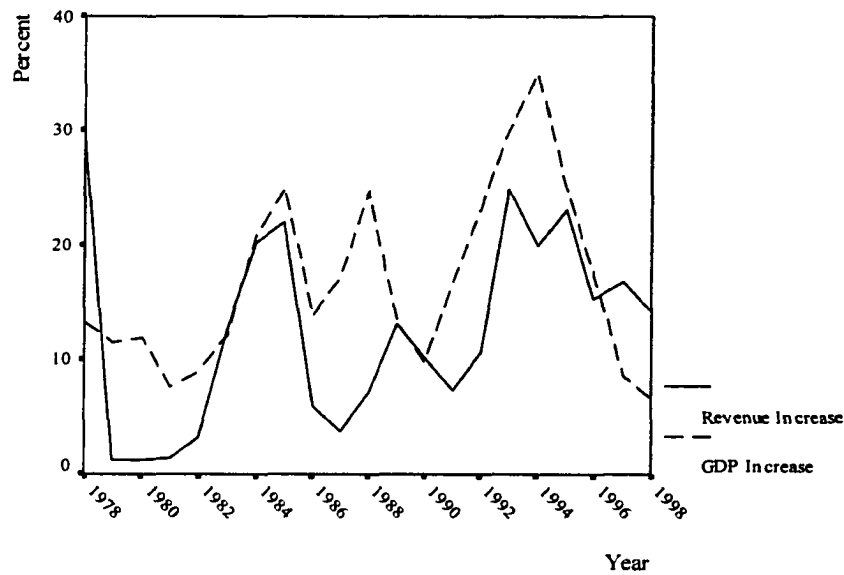
⁵² The proportions over the national average in the national income per capita in the coastal, central, and inland regions were 135 percent, 86 percent, and 70 percent in 1978 respectively; they were merely changed to 137 percent, 86 percent, and 68 percent in 1985.

⁵³ The proportion of the coastal area increased to 53.5 percent in 1990 and 58.4 percent in 1994.

⁵⁴ Of course, in terms of absolute terms, the amount in the coastal area must be much higher than in the other areas because of the size of economy.

strove to fund its expenditures and economic development by indiscriminately tapping local funds without regard for standardized regulations. With the fiscal difficulties of 1987, coastal areas appeared to increase their proportion of extra-budgetary funds. After the relative relaxation of the fiscal burden on localities by the Beijing government with the introduction of the fiscal contract system in 1988, the ratios slightly decreased and the gap between ratios among regions was also decreased to a narrow margin.⁵⁵

Figure 4-3: Revenue Increase Rate over GDP Increase Rate during the Reform Era



Source: Calculated from CFY 1999, 448.

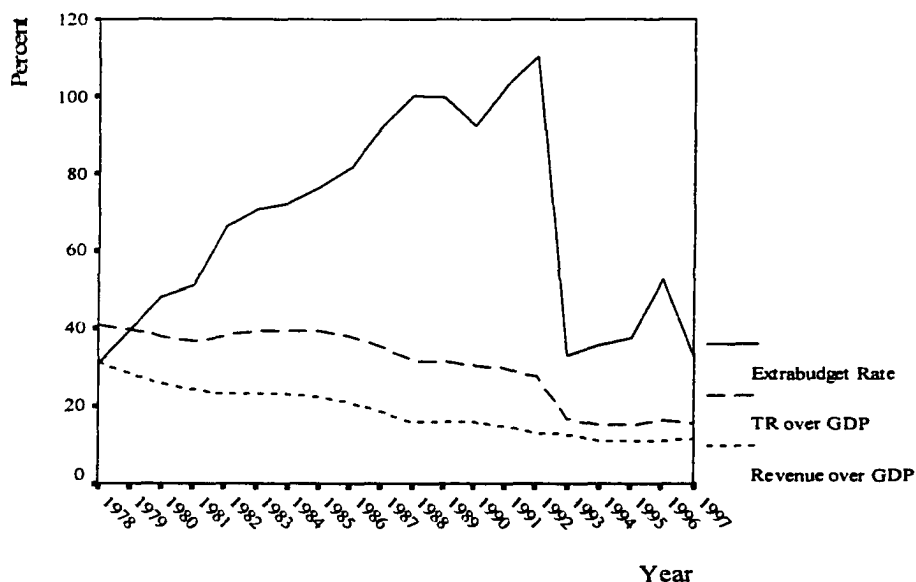
Note: Revenue Increase and GDP Increase refer to Annual Revenue Increase Rate and GDP Increase Rate respectively.

Figures 4-3, 4-4, and 4-5 illustrate the worsening fiscal situation in the period of 1986-1987. In Figure 4-3, the gap between revenue and GDP increase rates dramatically widened during the period. It was from 1985 onward that the gap increased, peaking in 1988 when the fiscal contract system was introduced. Figure 4-4 illustrates that the ratio of revenue over GDP steadily declined after reaching its peak in 1985. Meanwhile, the increase in extra-budgetary funds was skyrocketing, the proportion of extra-budgetary

⁵⁵ Its implication was a widening gap of availability of fiscal resources among regions afterward.

revenues over budgetary revenues passing the 80 percent level in 1985 and becoming almost identical to each other in 1988.

Figure 4-4: Fiscal Situations during the Reform Era



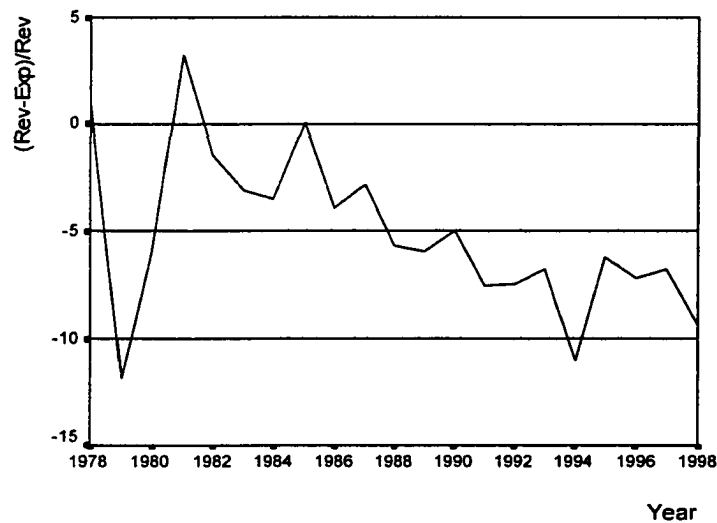
Source: CFY 1999, 448-449, 476.

- Note:
1. Extra-budget Rate refers to the ratio of the extra-budgetary revenues over the budgetary revenues.
 2. TR over GDP refers to the ratio of the sum of budgetary and extra-budgetary revenues over GDP.
 3. The rapid drop of the extra-budgetary fund rate in 1993 was due to Beijing's decision to remove the state-enterprise funds from the accounting item, which was higher than 70% of the total extra-budgetary funds. In 1997, the Beijing government also removed the intra-budgetary government fund (fee) from the extra-budgetary fund. Both of the items removed in the low times of adjustment were mainly under the control of the Beijing government. Therefore, such adjustments dramatically reduced the proportion of the extra-budgetary fund size of the Beijing government in the official figure.

The problem of the deficit problem is illustrated in Figure 4-5. It was from 1985 onward that the deficit problem became obviously apparent. Overall, the fiscal situation of the Chinese government quickly deteriorated with the advent of the urban reforms in 1985. Certain patterns of change in the fiscal situations can be observed according to the change of one fiscal system to another. The figures illustrate that the fiscal system during the period 1985-1987 had a negative correlation with the downturn. The impacts of fiscal reform in 1988 brought certain improvements in the initial period as they pertained to state fiscal stability, but it quickly brought state fiscal deterioration after 1990;

meanwhile, the Chinese economy grew rapidly during the period. The tendency in GDP and revenue increase rates was reversed only after the introduction of the tax-sharing system (*fenshuizhi*), and the revenue increase rate exceeded the GDP increase rate from 1996 onward, when the tax-sharing system came into full play.

Figure 4-5: Level of Deficit during the Reform Era (percent).



Source: Calculated from CFY 1999, 449, 452.

Note: (Rev-Exp)/Rev refers to (Revenue-Expenditure)/ Revenue*100.

As the fiscal situation became worse during the period 1986-1987, the fiscal contract system gradually gained momentum as a breakthrough for the fiscal difficulties at the time. It became obvious that the previously-attempted standardized tax system would not inspire either enthusiasm among enterprises or stabilized product values without thorough price reform. Consequently, the fiscal contract system seemed to be a promising alternative, one which was already proven successful in the agricultural sector. It was praised as having been the main mechanism responsible for creating local economic success and fiscal stability in particular in Guangdong (*Jingjiribao* January 7, 1988). The insufficient institutional capacity of the Beijing government to monitor enterprise behaviors also favored the fiscal contract system. Beijing did not have sufficient experience, personnel, and institutional mechanisms for handling more complex tax rates and collection during the initial period of urban reform. The relatively heavy revenue burden in the coastal areas under the current system also discouraged

enthusiastic tax collection and caused a serious drop in the revenue increase rate in the area. Revenue increase rates in the industrial and commercial taxes in most coastal provinces recorded remarkably low figures during the period 1986-1987. In particular, the situation in Shanghai and Tianjin was alarming.⁵⁶ Shanghai first recorded 2.9 percent in 1986 and then -1.4 percent in 1987; Tianjin 3.7 percent in 1986 and -2.0 in 1987; and Jiangsu 6.6 percent in 1986 and 4.8 percent in 1987. In addition, remittance increase rates to the Beijing government from industrial and commercial taxes consecutively recorded negatively during the same period, -15.6 percent in 1986 and -13.4 percent in 1987 (SGTB, 37-38). As a result, the Beijing government had to borrow about 9.3 billion *yuan* from localities in 1987 for the first time since the borrowing of the period of 1981 and 1982 (*Jingji yanjiu cankao* No. 1, 1994, 37).

Regardless of the state enterprises and Beijing-local government relationships, the fiscal contract system had some strengths over the standardized tax system. To begin, it had flexibility. According to the situation of an individual enterprise, the state could adapt a different contract to give itself room to set what it wanted. Xiang Huaicheng succinctly summarized that point in his article (Xiang 1989, 29):

Along with price reform, the wage system will also have to be redistributed. During the period, it will be extremely difficult to stabilize the fiscal system at any given point. This requires the institution of a highly *adaptable and flexible* system, a *transitional* system that can take into account the interests of both the central authorities, the localities and is acceptable to both sides.

Another strength of the fiscal contract system was transparency of responsibility. The contract manifestly indicated its terms. Therefore, enterprises must remit a certain amount of profit to the state according to the contract. The contract typically specified a minimum amount of taxes to be paid each year to the state, according to base figures and rates already fixed in previous negotiations, and it covered a period ranging from 1 to 5 years. Thus the Beijing government would be provided a stable revenue growth. On the

⁵⁶ The State Council and the central finance and economy small leadership group noticed Shanghai's significance in economic development in the process of the urban reform in 1985. In February 1985, the development strategy of Shanghai was the main issue in the State Council and various suggestions were reported to the State Council (see *Jingji xuexi cankao ziliao* No. 122 (12 August 1985): 2-23). A main recommendation was further economic and fiscal decentralization, opening up to the outside world during the seventh five-year plan period. It also preferred a fiscal contract system. However, due to a political reason Shanghai as a reserve base was kept in giving the consideration of provided economic reforms would fail. Thus, Shanghai was placed under tight fiscal control by the Beijing government until the 1988 fiscal reform.

other hand, enterprises and local governments could retain the part that exceeded the contract's demands, so deriving incentives for greater efforts.

The other strength of the fiscal contract system was its simplicity. It did not require an extensive monitoring mechanism, which anyway was lacking in the Beijing government at that time. The responsibility for meeting the target was placed in the hands of the enterprises and local governments. These strengths were appealing at that time if only because no other alternative appeared better. As a result, from 1987 onward, the fiscal contract system was widely implemented in state enterprises. In the following year, it was extended to the provincial governments in their relationship with Beijing.

However, opponents to the fiscal contract system were reluctant to apply it to the relationship between Beijing and the provinces. Its strength also meant weakness to its opponents. Since it was based upon one-to-one negotiations, it would inevitably lead to a series of negotiations to calculate and adjust the base figures in revenue and expenditure that would result in the nullification of the base figure (*baosijishu*). It exactly apposed all the efforts most traditional financial bureaucracies and Zhao Ziyang sought to overcome (Liu 2000, 189). Other problems of the fiscal contract system were worsening soft-budget and moral hazard problems, called *baoying bubaokui* [taking profits but not being responsible for loss] in Chinese. It was contradictory to the situation that proponents of the contract system should argue from a position of strength. Under the contract system, those who had already accomplished the contract target could control after-contract profits at their discretion, but those who could not meet the target were forced to make various excuses by taking the influences of uncontrollable economic and social environments such as price changes and unemployment problem. As local government revenues hinged on various kinds of remittances by local enterprises under the fiscal system that linked revenues with expenditures, local governments were also willing to allow such enterprises a reduction of taxes; otherwise, they would be remitted to the central coffers. In addition, many enterprises did not allot funds for depreciable costs of fixed assets out of their profits, whose owner was in principle the state itself. The amounts supplementing out of their own profits for the depreciable funds among enterprises were only 22.2 percent in 1988 and 20.2 percent in 1989 in Shanxi and 4.7 percent in Jiangxi during the period 1987-1989 (Wang 1999, 518-519).

The other problem was short-term profit-making activities. As most contract terms ran for two-three years, those enterprises pursued short-term and quick benefits rather than investing funds for technological renovation and long-term development, and local governments also instigated such activities to garner more revenues. As a result, the problem of potential loss was serious even if enterprises appeared to make profits on the surface. Short-term profit-making would in the long run worsen productivity and cause serious loss of the enterprises. According to a 1990 investigation by the Industrial and Commercial Bank of more than 180 state enterprises, the ratio of obvious loss-making enterprises was 28 percent and that of potentially loss-making enterprises was 53 percent. Another investigation in the late 1990 revealed that the situation had grown even worse, considering that the ratio of enterprises with potential losses was 78.6 percent (Wang 1999, 520). Although this situation previously existed, it was obvious that the proportion of enterprises with potential losses dramatically increased after the fiscal contract system was introduced (Wang 1999, 519). The system would eventually hamper the stability of local and central finance alike.

As already indicated by some scholars, the new drive for further reform resulted only in worsening the financial situation, in particular, in the Beijing government. A look at the contents of the fiscal contract system, for example, shows that the World Bank found that the contract system tended to undermine the Beijing government's tax collection by the relatively generous terms set by Beijing and the rapid growth of the economy during the contract period. The fiscal contract system also reduced the Beijing government's flexibility to introduce new tax policies in the future as well as encouraging rampant localism. Table 4-1 illustrates the contract effects, eventually proving to decrease tax rates when a fiscal contract method was adapted, called the CMRS, which was used by the majority of mid- and large-size state enterprises.⁵⁷ Following the

⁵⁷ "A Contract Management Responsibility System (CMRS) is in use for about 60-70 percent of all medium- and large-scale enterprises. It operates on the principle of target tax remittance rather than target profits. In one variant, the enterprise manager contracts to remit a certain tax quota to the government supervisory unit, which is increased annually, usually by 7 percent. In another variant, the enterprise hands over a fixed direct and indirect tax quota each year, with the above quota profits accruing to the enterprise. An Enterprise Management Responsibility System (EMRS) applies to medium- and large-scale state enterprises and calls for the enterprise manager to meet an agreed profit target for a special number for years. The first year profit target is set at the same level of profits earned in the year prior to the implementation of the system, ensuring that the Government's tax revenues (55 percent of the agreed target profit) do not fall short of the level attained before the system was instituted." See World Bank 1990, 11.

contract's formulae, the effective tax rates would end up at 28 percent in 1990, which was much lower than the original rate 55 percent.

Table 4-1: Tax Contracts: Estimation of Effective Tax Rates

Year	Profits (Billion Y)	Total Taxes (Billion Y)	Effective Average Tax Rates (percent)
1986	10.6	5.8	55.0
1987	12.7	5.86	46.1
1988	15.2	5.94	39.0
1989	18.3	6.03	32.9
1990	21.9	6.14	28.0

Source: World Bank 1990, 11.

"The enterprise's 1986 profits were Y 10.6 billion and its contract stipulates a minimum of Y 10.6 billion in profits after 1986 to be taxed at 55 percent. This guarantees income tax revenue to the government of Y 5.8 billion. Any excess of profit over Y 10.6 billion will be taxed at the rate of 27.5 percent. Assuming profit growth of 20 percent per year, the effective average tax rate is 46 percent in 1987, 39 percent in 1988, 33 percent in 1989, and 28 percent in 1990."

Zhao Ziyang brought the issue of China's declining fiscal health to the fore in the report in the fifth plenary session of the sixth NPC on 25 March 1987. For the first time, fiscal problems in the ratio of central revenue over national revenue as well as the ratio of revenue over national income (the two fiscal ratios) were mentioned with the emphasis on the ratio of the central revenue (Zhao 1988c, 1320-1321). The problems of decentralization of fiscal resources, the extensive increase of expenditure, and fiscal deficit were reported serious partly for reasons of the international oil price collapse and succeeding decrease in export income. The prospect of the fiscal situation for the following years was not optimistic. However, Zhao was still reluctant to endorse the fiscal contract system, instead, suggesting tightening expenditures and utilizing extra-budgetary funds for basic construction.

On the other hand, Zhao Ziyang did not dare to introduce a bold fiscal reform for further standardization because of imminent fiscal problems as well as rising opposition to the bold fiscal reform for further standardization. Reluctantly, Zhao Ziyang also turned to favoring the contract system in 1988.⁵⁸ In the institutional contexts of

⁵⁸ Shirk indicated that because of political incentives and choice rules structured by Chinese political institutions, Zhao immediately switched positions to advocated contracting and abandon standardization. However, previously indicated, he appeared to be in favor of the standardization even in the report at the thirteenth CPC congress in October 1987 even after he became a provisional General Secretary. He was

consensus/absolute majority rule, which required at least a visible majority of approval among related bureaucracies and political leaders for adopting a policy, conditions favoring the contracting system arose in early 1988. As usual, the policy-making did not end up a zero-sum game. It was certainly, however, a product of compromise reflecting various preferences among bureaucracies, scholars, and political leaders. For example, the efforts for fiscal standardization were not discarded. The given practice of paying loans on fixed capital investment before paying taxes would be cancelled, which would necessarily tighten fiscal constraints on enterprises.⁵⁹ In addition, all profits would not be pooled and placed as objects of contracts. Profits were still subjected to tax payment. Only after taxes, various contracts on profits with extraction rates lower than in the previous system would be imposed. On the other hand, one guiding idea for the newly-rising problem of economic cutbacks was to provide more incentives for localities and to implement further fiscal decentralization (Xiang 1989, 28-29). As Shirk indicated, the contracting system would revive pork-barrel politics because its nature required one-to-one negotiations at various levels.

The strengths of the fiscal contract system, that is, clarity of responsibility, impromptu, and flexibility of application drew attention as instant solutions to fiscal problems under conditions of insufficiency for introducing the tax-sharing system. Nonetheless, the worsening fiscal problem did not cause another round of economic retrenchment policy as in the past. In political discourse, a bold drive for reforms became a dominant issue as benefits of previous reforms had been spread to all levels of society. Reform-minded scholars were vocal in many influential journals such as *Jingji yanjiu* [Economic Review], *Caizheng* [Finance], *Zhongguo shehuikexue* [Chinese Social Science], *Jingji yanjiu cankao* [Reference on Economic Research: internal document], *Gaige neican* [Inside Information on Economic Reform: internal document], *Jingji guanli* [Economic Management], *Guanli shijie* [Management World], and *Jingji xuexi cankao ziliao* [Reference materials for Economic Study: internal document]. The previous fiscal reform for standardization was criticized as an *administrative* delegation of power (Yang

not active to support contracting system as Shirk described. Rather, his support was due to the absolute majority rule and the current fiscal difficulties. As for Shirk's argument, see Shirk (1993), 281.

1986; Lou 1986; Zhao 1987).⁶⁰ A more aggressive delegation of power in the economic and fiscal arena was strongly recommended, to give more fiscal and management autonomy to enterprises.⁶¹ The fiscal contract system would allow enterprises to wield a broad range of discretionary power after contract. Although some scholars already warned that it would hamper state revenue efforts in the long-run and fiscal standardization efforts in the present, the majority seemed to be overwhelmed by the dismal fiscal situation and lack of institutional capacity to handle such a problem. Policy-makers could not wait until the price reform was implemented and fiscal monitoring system was updated.

The DRC, the CASS, the MOF, the SCRE, the SEC, and the SPC all agreed on introducing the fiscal contract system, but with varying degrees of support (author's interview). Shanghai, Hubei, and Shaanxi local financial bureaus publicized their support for the fiscal contract system in the *Caizheng* [Finance] after the thirteenth CPC congress.⁶² Wang Shaofei and Zhang Zhuoyuan in the Finance, Trade Goods, and Materials Research Center at CASS also wrote articles supporting more enterprise autonomy in the fiscal system.⁶³ Even Xue Muqiao, who always prioritized economic

⁵⁹ However, this practice was not removed. Jin Xin, director of the State Taxation Bureau, indicated its extensive existence in the suggestion on "comprehensive reform of industrial and commercial taxes during the eighth five-year plan period" in 1988. See more in Liu (2000), 253.

⁶⁰ Qixian Yang, "Guanyu Woguo jingjitizhi Gaige Mubiao Moshi Yanjiu [On the Study of Goals and Means for Economic Reform in China]." *Zhongguo Jingji Tizhi Gaige* 5 (May 1986). Excerpt from Hongguang Wu, ed. *Zhongguo 20nian Jingjitizhi Gaige Lunwen Jingxuan* [Collection of Articles concerning Economic Reforms during the last Twenty Years], 411-429 (Beijing: Jingjixue Chubanshe, 1998); Jiwei Rou, "Xiqu Nansilafu Jingyan, Bimian Qianghuadifang Fenquan [Absorb Yugoslavia's Experience, Avoid Strengthening Decentralization]." *Jingjishenhuitizhi Bijiao* No 1 (January 1986); Renwei Zhao, "Jingji Tizhi Gaige Zhanlue Taolun [Discussion on Economic Reform Strategy]." *Jingjiyanjiu* 4 (April 1987).

⁶¹ Bird and Chen suggested distinguishing three varieties of decentralization, each of which represents a certain degree of independent decision making at the local level. According to them, "decentralization is the dispersion of responsibility within a central government to regional branch offices or local administrative units. Delegation refers to a situation in which local governments act as agents for the central government, executing certain functions on its behalf. Devolution refers to a situation in which not only implementation but also the authority to decide what is done is in the hands of local governments." See Bird and Chen (1998), 124.

⁶² See, Youde Bao, "Anzhaoshisanda de Luxian Shenhuacaishuigaige [Deepen Fiscal Reform according to the Principle of the Thirteenth CPC Congress]." *Caizheng* 2 (February 1988): 1-2; Tao Ge, "Yaochulihao Caizhengfenpeizhong de Jigeguanxi [Handle Some Relations well in Fiscal Distribution]." *Caizheng* 2 (February 1988): 4-5; Fulin He, "Shixing Fenshuizhi Xuyao Chuangzhao Tiaojian [To Implement the Tax-sharing system Requires of Creating Conditions]." *Caizheng* 2 (February 1988): 5.

⁶³ Shaofei Wang, "Mingquecaizheng Tizhi Gaigede Zongti Mubiao Jiakuai he Shenhua Caizhengtizhi Gaige [Clarify the Comprehensive Goals of Fiscal Reform, Speed up and Deepen Fiscal Reform]." *Caizheng* 2 (February 1988): 6; Zhuoyuan Zhang, "Caizhengzhengci Yaoweijingjide Wending he Xiezhou

stability and fiscal balance and was a leading figure in the Economic Research Center (later in the DRC) under the State Council, appeared tolerant of China's macroeconomic difficulties (Xue 1992, 36, 65-67). Meanwhile, MOF still had reservations regarding full support for the contract system, although it did recognize that the fiscal contract system would be a provisional policy goal under the circumstances that conditions for the tax-sharing system were not rife (MOF, General Office for Fiscal Reform 1988). An editorial in *Caizheng* tried to prove that the *replacement of profit by tax* system was compatible with the fiscal contract system.⁶⁴

As seen in the report of the thirteenth CPC Congress in 1987, economic reform and development became an irreversible trend and the main source of party legitimacy. The official introduction of the *primary stage theory of socialism* also provided ideological legitimacy for more market-oriented reforms. That is, the theory ended debates on whether the period of market-oriented economic elements existed in a transitory period, leading to socialism or in a primary stage of the actual socialist period.⁶⁵ Serious attention should be paid to its political implication because the theory would provide a stable ideological legitimacy for further reforms as well as achievements. The theory would also appraise localities of Beijing's policy priorities and preferences.

About 1988, the MOF's position appeared to be moving in the direction of adopting the fiscal contract system. The general office for fiscal reform in the MOF expressed its public support on the fiscal contract system in an article in *Jingjiguanli* [Economic Management]⁶⁶ in October 1988 (MOF General Office for Fiscal Reform 1988, 36-37, 39). The argument for a more standardized tax system could no longer be seen in the article by Wang Bingqian, minister of the MOF (Wang 1988). Since the MOF's foremost institutional concern was to secure a stable revenue increase, it did not assiduously promote the standardized tax system as a priority when the two goals appeared to be in conflict with each other. In the article, he declared that 1988's primary

Fazhanfuwu [Fiscal Policy Must Serve for Economic Stability and Corporate Development]." *Caizheng* 2 (February 1988): 7-8.

⁶⁴ Editorial, "Chengbao Jingying Zerenzhi shi Ligaishui Gaigede Shenhua [The Fiscal Contract System is Deepening of the Replacement of Profit by Tax Reform]." *Caizheng* 2 (February 1988): 9.

⁶⁵ For detail, see Kim (1996).

task should be to deepen reforms of the enterprise contract system and various fiscal (contract) systems to ensure increase of the *two ratios*.⁶⁷ However, the MOF accepted the contract system as a provisional means to move toward the tax-sharing system. After a series of debates, imminent goals in the fiscal arena were set as *separating taxes from profits, paying loans after taxes, honoring contracts after taxes (shuilifenliu, shuihouhuandai, shuihouchengbao)* which possessed both elements of the fiscal contract and fiscal standardization.

Provisional Premier Li Peng confirmed that the fiscal system would move toward the tax-sharing system based on the enterprise contract system in a political report to the first plenary session of the seventh NPC on 25 March 1988. According to Li, the goals of fiscal policy in the next five years would be to gradually complete the taxation system and to create the conditions to move to the tax-sharing system and payment of loans after taxes, which implied that the fiscal contract system would be a transitional means. With efforts to strengthen its fiscal institution, the State Council renamed the General Taxation Bureau to the State Taxation Bureau (STB) (*guojia shuiwuju*) and promoted its institutional status a half-level up, to vice-ministry level, in May 1988. However, the STB was not yet able to accomplish its institutional goal as a fiscal organ independent from the control of the MOF. It was still placed under *kou* management in the MOF. As revealed in remarks made in a meeting with regional taxation bureau directors on 5 December 1987, the General Taxation Bureau continued to promote a more standardized tax system because it regarded the fiscal contract system as a transitional means only (Liu 2000, 248).

However, a vested majority of bureaucracies appeared to be in favor of the fiscal contract system. Accordingly, the MOF and the SCRE prepared the draft to introduce fiscal contracts, which would be fixed for three years (Liu 2000, 189-190). The General Office for Fiscal Reform of the MOF accordingly emphasized the strength of the fiscal contract system. The fiscal contract system would bring a certain degree of transparency in fiscal distribution between Beijing and local governments. The fixed remittance rate

⁶⁶ In terms of the publication number of economic journals in circulation, it enjoyed the largest. It was published under the co-control of 10 research centers and bureaucracies including the CASS and the SPC.

⁶⁷ The two ratios refer to the ratio of state revenue over national income or GDP and the ratio of the central revenue over the state revenue.

would encourage local initiatives because the local governments would possess fiscal resources above the quota. Another merit of the fiscal contract system was that it could be flexibly applied according to local situations. In addition, the Beijing government would be assured of a stable revenue growth (MOF, General Office for Fiscal Reform 1988, 36).

Table 4-2: Fiscal Contracts between the Center and Provinces

Province	% of total collection retained by provinces			Subsidies from The center (100 mil)			Remittance to The center (100 mil)			Basic sharing With growth 88-92		Basic sharing rate 88-92 (%)	Fixed quota (100 mil) with growth 88-92		Fixed quota to the center (100 mil), 88-92	Fixed quota Subsidy (100 mil), 88-92
	85	86	87	85	86	87	85	86	87	Basic rate	CRI (%)		Initial amount	CA (%)		
Beijing	48.2	49.6	49.6							50.0	4.0					
Tianjin	39.5	39.5	39.6									46.5				
Hebei	69.0	72.0	72.0							70.0	4.5					
Liaoning	51.1	52.7	52.7							58.25	3.5					
Shanghai	26.0	23.5	23.5												105.0	
Jiangsu	39.0	41.0	41.0							41.0	5.0					
Zhejiang*	57.0	57.0	62.7							61.47	6.5					
Fujian				2.4	2.4	2.4										0.5*
Shandong	59.0	77.5	75.0													2.89
Guangdong							7.8	7.8	7.8				14.1	9.0		
Guangsi				7.2	7.9	8.3										6.08
Shanxi	97.5	97.5	97.5									87.55				
Inner Mongolia				17.9	19.6	20.6										18.42
Jilin				4.0	4.0	4.0										1.07
Heilongjiang	96.0	96.0	96.0												2.99	
Anhui	80.1	80.1	80.1									77.5				
Jiangxi				2.4	2.4	2.4										0.45
Henan	81.0	81.0	87.1							80.0	5.0					
Hubei	66.5	100	100													**
Hunan	88.0	88.0	88.0										8.0	7.0		
Sichuan	89.0	100	100													**
Guizhou				7.3*	8.2	8.6										7.42
Yunnan				6.4*	9.3	9.7										6.73
Tibet				7.5*	8.3	8.7										8.98
Shaanxi				2.7	2.7	2.7										1.2
Gansu				2.5	2.5	2.5										1.25
Qinghai				6.1*	6.7	7.1										6.56
Ningxia				4.9*	5.4	5.7										5.33
Xinjiang				14.5	16.0	16.8										15.29

Sources: *Jingjiyanjiu cankao* No. 1 (1994), 38-39; Christine Wong (1995), 89 and 92-93; Zhengfu Jian (1998), 137-38.

Note: 1. I do not have the data for Zhejiang for the period from 1985 to 1987, so based on data from Wong, CSY, and CFY, I retrogressively calculated them.

2. * it started from 1989. **Hubei and Sichuan Provinces turned to provinces getting subsidies after Wuhan and Chongqing acquired "Planned city" status (Wong, 1995: 91). Wuhan and Chongqing also remitted a part of its revenues to respective province, which was 4.78 percent and 10.7 percent respectively. See in *Jingjiyanjiu cankao* No 1 (1994): 39.

3. CRI: Contracted Rate of Increase; CA: Contracted Annual Rate Increase

4. X^a: Subsidies were to increase by 10 percent year after 1985. Bahlard Wallich (1992), 13.

5. I omit the method of "sharing the total amount of revenues as well as sharing increased revenues [*zongfencheng jia zengzhangfencheng*]" for the period 1988-1992 because it was applied to three planned cities: Dalian, Qingdao, and Wuhan.

Method (percent)	City	Dalian	Qingdao	Wuhan
Sharing the total revenue		27.74	16.00	17.00
Sharing increased revenue		27.26	34.00	25.00

The State Council Standing Committee promulgated an introduction to the fiscal contract system on 7 July 1988 and implemented it during the period of 1988-1990. The chief tasks for the new fiscal system were to insure stable growth of Beijing's revenues as well as to encourage local economic development. According to this system, all provinces except Guangdong and Shaanxi, autonomous regions, and all the experimental cities except Guangzhou and Xian were subject to changing to various contract systems. Each government was minimally allowed to retain revenues sufficient to cover its 1987 level of expenditures. In addition, each government would retain a proportion of the incremental revenues above the 1987 level according to a pre-negotiated contract with the center (World Bank 1990, 108). There were six different types of contracts across various regions (Xiang 1989, 30-31; *Jingjiyanjiu cankao* 1 1994, 38-39):

- (a) *Basic sharing ratio with progressive revenue increases (Shoulu dizeng baogan)*: The prescribed progressive increase rates of revenues on the base figures of revenues were set up in advance. The calculation was based upon actual annual revenues in 1987 and expenditures of each region with reference to the increase in revenues of provinces in the past few years. Local governments were allowed to retain everything in excess of the progressive increase rate. If a province could not meet the contract target, the provincial government should make up the affected part with fiscal resources at its own disposal. This system was implemented in ten regions: Beijing, Hebei, Liaoning (except Shenyang and Dalian), Shenyang, Haerbin, Jiangsu, Zhejiang (except Ningpo), Ningpo, and Henan and Chongqing.
- (b) *Basic sharing ratio (zonghe fencheng)*: Based upon the evaluation of revenue conditions in two recent years, the revenue sharing ratio on the total amount of the revenues between the Beijing and local governments was decided. This system was applied to Tianjin, Shanxi, and Anhui.
- (c) *Sharing the total amount of revenues as well as sharing increased revenues (zonghefencheng jia zengzhangfencheng)*: To begin with, the actual revenues were divided according to the fixed ratios. Then, the increased revenues compared to that of the previous year were divided according to fixed ratios at the basis of the sharing of local revenues with the Beijing government. This method was applied to Dalian, Qingdao, and Wuhan.
- (d) *Fixed quota with progressive growth (Shangjiejie dizeng baogan)*: With the standard of the 1987 level of revenues, the amount of remittance to the Beijing government was fixed, and it increased at progressive rates of increase. Guangdong and Hunan were the cases. The rate of Guangdong was 9 percent and Hunan was 8 percent.

(e) *Fixed quota (Ding shangjie)*: Shanghai, Shandong, and Heilongjiang remitted fixed amount of revenues to the Beijing government.

(f) *Fixed amount of subsidy (Ding buzhu)*: The Beijing government delivered a fixed amount of subsidies to cover local expenditures that exceeded the revenue base figures set according to a prefixed norm of revenue and expenditure. This contract was applied to 16 regions: Jilin, Jiangsi, Gansu, Shaanxi, Fujian, Neimenggu, Guangxi, Xizang, Ningxia, Xinjiang, Guizhou, Yunnan, Qinghai and Hainan, Hubei, and Sichuan except Wuhan and Zhongqing. These regions suffered from large expenditures compared to their revenue.

With the implementation of the fiscal contract system, the Beijing government was able to secure a stable increase of revenues at the same time as encouraging provinces to actively contribute to revenue increases. After the minimal revenue increase of 3.6 percent coupled with the large deficit in 1987, the Beijing government was able to bounce back to a more than 7 percent revenue increase under the new fiscal system. Originally, the economic growth rate was set as 7 percent during the seventh five-year plan, and to maintain fiscal stability the revenue increase rate had to keep up with the level. The Beijing government was able to maintain the level by revising the rules of the fiscal management system in the middle of the seventh five-year plan period, whose average increase rate for the five years achieved 6.7 percent (Cong and Zhang et al. 1999, 996). The average of the national income growth rate recorded 7.5 percent (7.9 percent in GDP), which was close to the original plan.

The fiscal system was an apex of the popular idea summarized as *bangquanyangli* [giving more autonomy and allowing more interests]. This system allowed not only fiscal responsibility but also incentives for revenue-collection from each local government by means of adjusting the contracts close to local situations. Table 4-2 illustrates that the Beijing government did not intend to substantially increase the remittance burden of provinces under the new fiscal contract system. Certainly the amount of subsidies for the provinces previously receiving subsidies would be decreased and fixed. The poor provinces were required to increase their own tax efforts. As for most provinces that previously showed a high remittance rate, basic sharing with the progressive revenue increase system was applied to encourage their tax efforts. Instead of fixing the retaining rate as was done in the previous system, Beijing gave the provinces an incentive by setting an annual revenue increase rate and allowing them to retain the portion in excess

of the contract. Considering the overall revenue growth rate in provinces during the period, the terms were quite lenient to provinces. The highest was 6.5 percent for Zhejiang, which was still much lower than the revenue growth rates of industrial and commercial taxes for the past several years. Zhejiang's worst growth rate for industrial and commercial taxes was 7.9 percent in 1987. Guangdong seemed to have had a relatively high burden with the annual 9 percent increase in revenue remittance. However, except for 1986's negative growth of -2.9 percent, its revenue growth rate of industrial and commercial taxes had never been lower than 10 percent for the last seven years. Although the contract terms for Guangdong, as compared to the previous one, was worse under the new fiscal system, compared to the remittance rates of other major provinces such as Shanghai, Jiangsu, and Tianjin, it still received favoritism. Guangdong only paid around 15 percent of the amount of industrial and commercial taxes in 1988.

As seen in Table 4-3, provinces that were awarded for their good practices in the final settlement of accounts each year during the period 1985-1987, remarkably did not get any benefits in the negotiation. On the contrary, they enjoyed disadvantages.⁶⁸ Shanxi, Yunnan, and Anhui were the typical examples; Shanghai, Tianjin, and Shandong were on the opposite extreme. In the award index Shanxi, Anhui, and Yunnan registered very high scores, which meant high compliance with the Beijing government in fiscal accounting. However, Shanxi and Anhui did not receive such favorable terms as most coastal provinces could acquire, and their sharing rates were reduced. The amount of subsidies of Jilin, Jiangxi, and Yunnan were considerably curtailed.⁶⁹

On the contrary, Shanghai, Tianjin, Shandong, and Heilongjiang did not register good scores in the award index, but they acquired favorable treatment in the new fiscal system. The greatest beneficiary of the new system was Shanghai, whose fixed amount of remittance in 1988 was 10.5 billion *yuan*, which was equivalent of about 76 percent of its industrial and commercial taxes for the year. Shanghai's remittance rate was nearly

⁶⁸ Guangdong can be an exceptional case. Its award score was relatively high among coastal provinces. It means that contrary to conventional impression, Guangdong worked hard to meet Beijing's standard in fiscal contribution in return of the special favoritism in the area for economic development.

⁶⁹ Guangdong's compliance level was high in the index. However, its case was different from the other high compliance provinces because it had already enjoyed a preferential policy from the Beijing government.

identical, in fact, to that of previous year. However, once the remittance amount was fixed for several years, Shanghai could expect to retain considerable amounts of

Table 4-3: Awarded Provincial Finance Bureau for Final Settlement of Account

Province	85	86	87	88	89	90	91	92	93	94	95	96	97	SUM
Beijing												1	1	2
Tianjin				2				1						3
Hebei				2	1	3	2	3	3	3	3	3	2	25
Liaoning				2	1			1	1	2	1	1	1	10
Shanghai						1								1
Jiangsu		1					1			1		1	1	5
Zejiang												1	1	2
Fujian					1	1								2
Shandong				2		2	3	2	2		2	3	3	19
Guangdong	2	1	2		2				1		1		1	10
Guangsi					2		1	1						4
Shanxi	2	2	1	2	3	2		1	1	2	2	1	2	21
Inner Mongolia		1	2	2	1	1	1				1			9
Jilin	2	2		2			1	1	1	1	2	2	2	16
Heilongjiang		2			1	1	1	1	1	1	3	3	3	17
Anhui	2	2	2	2	2	1	3	1	1	3	1	2	2	24
Jiangxi	2	1	1	2	1	3	1	2	3	2	1	2	1	22
Henan			1	2			2	3	2	1	1	1		13
Hubei		1			1	1	1	2	2	1	3	1	1	14
Hunan		1	2	2	3	2	1		1					12
Sichuan		2	2	2	2	1		2	3	1				15
Guizhou		1			1							1		3
Yunnan	2	2	2		1	1				1				9
Tibet													1	1
Shaanxi						1	1			1	1	1	1	6
Gansu			1		3	2	2	1						9
Qinghai									1	2				3
Ningxia							3	3	2	3	2	2	3	18
Xinjiang	2	2		2										6
Chongqing								2	2	2	2	2		10

Source: Department of Finance Budget in the MOF, *Difang Caizheng Juesuan Wenjian Ziliao* [The final settlement of account of local finance in 1998] (1999, Beijing): 227-236.

1. The award mechanism was standardized from 1989. Before 1989, two different formats were applied in different years. If there were two levels of awards (1986 & 1987), awarded institutions were scored 1 and 2 according to the awarded level; if there was only one level of award (1985 & 1988), they got the score 2. This counting method underestimates the relative significance of those previous years, which largely underestimates the scores of the central region. Since 1989, I counted the scores as follows: 3=First Award; 2=Second Award; 1=Third Award.

2. The average score of coastal region = 7.55

The average score of central region = 16.44

The average score of inland region = 7.78 (excluding Chongqing)

revenues in coming years. For example, the remittance rate was reduced to about 63 percent in 1989.⁷⁰ Tianjin also gained preferential treatment after suffering a heavy fiscal burden in previous years. Its retention rate increased from 39.6 percent to 46.5 percent. As with Shanghai, a fixed quota system was applied to Shandong and Heilongjiang. In particular, Shandong was able to acquire enormous favor. Its previous remittance ratio was 25 percent of industrial and commercial taxes in 1987. Under the new system, the amount of fixed quota was equivalent to 2.9 percent in 1988.⁷¹ Considering the economic development and tax increase in coming years, it is understandable that Shandong acquired a substantial favoritism.

There is no doubt that the fiscal contract system was quickly implemented since it was in accordance with the interests of many major provinces. Although the new system introduced a mechanism to encourage greater fiscal efforts by the provinces, the greatest benefits would go back to the provinces themselves as seen in the formulae. The new fiscal system would certainly cost the fiscal control of the Beijing government over the localities. For example, the average increase rate of revenue remittance in the basic sharing system with progressive revenue was 6.5 percent in 1988, while inflation rates were 18.5 percent in 1988 and 17.8 percent in 1989 (Yu 1993, 220). The revenue increase rate of the Beijing government was 3.3 percent in 1988 and 4.8 percent in 1989. The greatest benefits of revenue increase went back to the provinces as designed. As a result, Beijing's share in total tax revenues had declined more sharply since 1988.

⁷⁰ The author calculated these figures based on SGTB data (SGTB 1997, 34-36). My interviewees in Shanghai still loudly complaint on the formula in that it gave too much burden to Shanghai, compared to that of Guangdong.

⁷¹ One of my interviewees told some interesting stories why Shandong got favoritism. According to him, Shandong was the most active province to cultivate personal relationship. Since it was more visible to use formalized personal relationship such as academic and regional connections, it systematically sent "*baomu*: (baby sitter & house keeper)" to key political figures and bureaucrats in the Beijing government. By using the personal connection in the domestic area, they could take some advantages. He cynically called it "*baomu*" politics. Since it is quite private, it is hard to prove how extensively it was used. Yet, it still reveals a practice how significant personal relationship and informal politics in China have been although he also indicated that using visible personal relationship for favoritism were most likely to fail. It could be echoed quickly from other interest parties and be placed under public criticism. In the case of Heilongjiang, it was 4.0 percent in 1987. The fixed remittance quota of 1988 was equivalent to 4.1 percent. However, when we consider that the quota was fixed for three years, it is obvious that the ratios would be rapidly reduced as increase of the taxes and economic development.

In practice, the Beijing government appeared more capable of revising the rules of the game than seen in the formal fiscal contract system. The power of revising the rules was done in quite a discretionary fashion but not necessarily meant in a predatory one. Profit-making provinces were forced to remit much more than the amount they contracted. However, poor provinces were able to attain subsidies from the Beijing government more than contracted. Such fiscal transfers by the Beijing government were often justified as, in the common cause, *making sense (youdaoli)* as well as socialist in its egalitarian ideal. The logic of such a transfer was political, but it differed from pork-barrel politics among political contenders. One interviewee indicated that the Beijing government also informally encouraged horizontal fiscal and technological transfers from rich areas to poor areas during the period, which differed from the conventional idea that the Beijing government strictly controlled the development of horizontal relations among localities. Of course, the funds were locally financed. Encouragement was redoubled for the horizontal transfer, and it was formalized after the fiscal reform in 1994 (author's interview).

In negotiations, the Beijing government was still able to take advantage of the unbalanced power that evinced itself. As in the early 1980s, the Beijing government simply subtracted the amount of debt, which it had borrowed from localities in 1987, from the base figures of local expenditures without paying it in the negotiations of 1988. In return, however, the Beijing government increased the number of fixed local taxes which had originally been assigned as sharing taxes in previous years. For example, in 1987 the fixed local taxes were only the following four in practice: urban maintenance and construction tax, vehicle license tax, collective enterprise bonus tax, and local land appropriation tax.⁷² Sharing taxes occupied the largest part of revenues under the current system (*Jingjiyanjiu cankao* No. 1 1994, 36). However, in 1988 the number of fixed local taxes increased dramatically to 19 (see in detail, Huang and Xu 1988, 17-19).

The move toward strengthening local tax bases was taken for granted because proponents for the tax-sharing system considered it a help for the tax-sharing system in the future, whose system would be based on separation of taxes according to

administrative responsibilities. In addition, the enterprise income tax rates were also lowered from 10 percent to 35 percent in 1988, instead of from the previous 55 percent. The MOF and the SCRE prepared the draft to introduce fiscal contracts, which would be fixed for three years (Liu 2000, 189-190). The General Office for Fiscal Reform of the MOF advanced the fiscal contract system's strength as being its certain degree of transparency in the fiscal distribution between the Beijing and local governments according to the contracts. As the remittance rate was fixed, it would encourage local initiatives because local governments would possess fiscal resources above the quota. Another merit of the fiscal contract system was that it could be flexibly applied according to the local situation. In addition, the Beijing government could acquire stable revenue growth to a certainty (MOF, General Office for Fiscal Reform 1988, 36).

Table 4-4: Fiscal Relationship between the Center and Heilongjiang (100 mil.)

Heilongjiang	78	80	85	86	87	88	89	90
Formal Contract			3.1	3.4	1.4	3.0	3.0	3.0
Actual Amount of Transfer	31.51	0.51	3.49	3.85	3.65	7.01	6.71	8.46

Source: Economic Statistical Yearbook of Heilongjiang 1990, 515 and 1991, 598.
For the data of Formal contract, Wong 1995, 92.

In Heilongjiang's case as seen in Table 4-4, the remittance rate to the Beijing government was twice as high as the original amount of the contract after the fiscal contract system's introduction. It is noteworthy that the extraction level increased considerably more than before after the fiscal contract system was implemented. In 1987 the Beijing government allowed a certain amount of remittance reduction under conditions of economic and fiscal difficulty that struck the nation that year. A report on Guangdong revealed a similar story. As seen in Table 4-2, Guangdong was subjected to a fixed amount (about 7.8 million *yuan*) of remittance to the Beijing government during the period from 1985 to 1987. However, it had to contribute energy and transportation funds, extra remittances after reducing expenditures, a part of the industrial and commercial taxes collected by Guangdong for customs offices, and so on. The result was a 14 percent annual increase in revenue remittance to the Beijing government although it had an

⁷² The list only indicated the formal one categorized in the *Caizheng*. Therefore, it did not necessarily refer to all local taxes. Local governments were able to collect various small taxes and fees in their convenience. In particular, Guangdong was often referred to such practices in my interviews.

existing contract with Guangdong to fix the amount of remittance during the period, which outnumbered annual revenue increase rate (13.2 percent) of Guangdong (*Jingjiribao* January 7, 1988).

Ningxia represented the opposite case. Ningxia has been a poor ethnic-minority region that relied on subsidies from Beijing to meet its expenditures. The contracted amount of subsidies was about 4.9 million *yuan* in 1985, 5.4 million *yuan* in 1986, and 5.7 million *yuan* in 1987 respectively. Under the new contract system, the amount of subsidies was negotiated at the 5.33 million *yuan* level from 1988, a figure less than that of the previous two years. However, a look at the provincial data in Table 4-5 reveals that in practice Ningxia was able to garner much more than the contracted amounts consecutively. The sources of extra-funds would be composed of earmarked subsidies, price subsidies, and other impromptu subsidies from the Beijing government. Although the amounts after 1988 were slightly reduced, they continued to outnumber the fixed amount of subsidies originally set by the contracts.

Table 4-5: Fiscal Relationship between the Center and Ningxia (100 mil.)

	78	80	83	84	85	86	87	88	89	90	91	92	93	94	95	96
Revenue	3.16	2.04	1.78	2.31	2.91	3.66	4.11	5.09	6.33	6.23	6.81	7.73	10.85	7.17	8.98	12.68
Central Subsidy	2.71	3.78	5.46	6.37	7.37	8.24	8.93	8.38	8.34	8.22	8.45	8.58	8.85	8.72	8.51	15.44

Source: The Statistical Yearbook of Ningxia, 1994, p. 171; 1997, p. 97, 2000, p.99.

The figures of 1994-96 do not include tax returns from the Center.

A look at the anecdotal cases and interviews enables concluding that in spite of the implementation of the new fiscal contract system the Beijing government paid more to poor regions and conscripted more from rich ones than the contracts originally specified with the respective provinces. Therefore, poor regions were likely to be able to utilize considerably more funds than formally appeared and channel them for their own local development. This assessment is supportive of the argument made by Hu Angang in his report (internal document) on national policy when it says that the regional economic gap was not widened but narrowed during the 1980s.

D. Incomplete Mission

It would be unfair to dogmatically argue that the Chinese reform strategy was an incremental and gradual one. Under the leadership of Zhao Ziyang, the Beijing government attempted a bold and dramatic reform for the standardized tax system along with urban reforms during the period from 1985 to 1987. In its very conception, it was quite revolutionary because it promised to root out the previous socialist profit-remittance system and rearrange the relationship between Beijing and the local governments in the area of resource redistribution. The idea of a bold fiscal reform was possible because previous reforms in the fiscal area had proven successful and provided a stable fiscal base for further reforms. Although there were disagreements among political leaders and bureaucracies on the new fiscal reform plan, the general consensus for establishing a standardized modern economic system provided a favorable environment for the more standardized tax system over the negotiation-based contract system.

The experiments during the period certainly paved a way for the introduction of the tax-sharing system in 1994. However, the more standardized tax system was not favored by localities and reform-minded parties because of the belief that the system would discourage local enthusiasm for economic development and even for fiscal efforts. For the opponents, the introduction of the more standardized tax system meant recentralization of the tax system. Local governments were more actively able to count on their inputs while taking advantage of the worsening economic and fiscal situations in 1986 and 1987. Insufficient institutional mechanisms to enforce Beijing's policies in the fiscal area also placed a constraint on Beijing's options. On the one hand, Zhao Ziyang's effort to introduce the standardized tax system failed in that the tax-based fiscal system was eventually replaced with the fiscal contract system in 1988. On the other hand, it was partially successful in that a considerable degree of laws, regulations, and inspection and award mechanisms were introduced and organizational capacity in the fiscal arena were also strengthened although far from completion.

It would be unfair to mention that Chinese reforms did not have a blue print for reforms. No country could have a clear blue print in the process of such a massive transition at the structural level. In a moderate sense, however, policy guidelines for economic development existed according to the five-year plan, whose plan was to take

bolder steps for economic development during the seventh five-year plan. Standardization and institutionalization have been tenaciously pursued. Under the Chinese decision-making norms, however, zero-sum games seldom occurred. The politics in the Beijing government induced coordination and compromise rather than mere top-down command. Each interest party was allowed to insert its organizational interests. China's historical experience during the Maoist period and leadership style did not allow one dominant group to take entire responsibility for a policy and its potential success or failure. The introduction of the fiscal contract system in 1988 was the case as well. In the process of drafting, various interest parties were allowed to give their inputs. According to *democratic* principle, various ideas, suggestions, and alternatives were taken into consideration. In the mean time, policy priorities emerged from the leadership and were documented in the formal meetings. The documented policy priorities certainly exercised an authority over the nation. However, when situations did not necessarily develop as planned, a cleavage of alternatives became apparent among the interest parties. Changing preferences were observed among scholars and government policy priorities on fiscal management systems according to fiscal and economic situations during the period from 1985 to 1988.

In the formal system, the Beijing government still enjoyed a highly unbalanced power over localities. The most formidable power was the control over the personnel appointment system. Beijing was able to use party control to appoint and remove provincial leaders. In the past, whenever there was a political change in Beijing, provincial leaders would be purged and recruited to smooth Beijing's new political direction.⁷³ In spite of the stated aim of the post-Mao leadership to separate the party from the state, retention of the principle of dual authorities remains a feature of provincial politics in China. The division of power between party secretary and governor at the provincial level is also a key mechanism in controlling provincial leaders because the Beijing leaders can mobilize one against the other if a provincial leader proves being obstructive (Breslin 1996,17). In cadre promotion criteria, fiscal performance constitutes a category although its score proportion was minuscule. The wide-ranging provincial

73 Teiwes (1972) notes purges of twelve provincial leaders from late 1957 to 1959 as the impact of Gao-Rao rightist deviation case.

leadership had been changed between 1983 and 1985 (Mills 1985, 26-27; Breslin 1996, 14). However, it is not clear whether the reshuffling can be linked with fiscal reforms and individual performance in the fiscal arena. The insider/outsider index indicates that the Beijing government slightly increased its control over localities during the late 1980 period.

In the fiscal area, the straightforward powers of the Beijing government were control over fiscal policy, authority over budgets, negotiations for various fiscal management systems, and some extraordinary fiscal powers over local revenues and expenditures, all of those as constrained by central policy. Using largely administrative regulation rather than market intervention, it performed the task of macro-economic stabilization, balancing rates of growth in production with those of employment and inflation (Oksenberg and Tong 1991, 4; Wong 1992, 706-707). In addition, it assigned the scope of taxation, tax rates, revenue-sharing rates, and the division of fiscal responsibility. Local governments were given no authority to levy taxes except for the few fixed local ones.⁷⁴

The central leadership even altered the administrative control relationship between the central government and other administrative units. For example, the Beijing government placed 14 crucial cities directly under its control in economic planning and resource allocation beginning in 1984 and continuing until 1997 (author's interview). The direct control of planning cities was another mechanism to check provincial power, allowing as it did the separation of major cities from their direct control. In early 1983, the status of provincial-level economic management jurisdiction was granted seven core cities— Chongqing, Wuhan, Shenyang, Dalian, Canton, Haerbin, and Xian.⁷⁵ The economic function of these cities was to encourage local economic development and permit these cities more active roles in the process. However, its political implications were to check the expansionist interests of provincial governments and to circumvent

⁷⁴ The other means are as follows: (a) the Beijing government stipulated the level of local expenditure in periods of economic retrenchment by issuing mandatory targets that set spending levels for each major expenditure category by issuing non-binding directive (*zhidao xing*) or reference (*chankao xing*) targets. (b) It can regulate provincial receipts and spending through revenue collection and spending schedules, financial operations and accounting procedures. (c) It can enact extraordinary fiscal measures such as requisitioning provincial surpluses by forced borrowing and purchase of finance bonds, and freezing local bank accounts.

⁷⁵ As of 1987, Qingdao and Ningbo were granted the same status. See Jonathan Unger (1987).

provincial barriers set by them although the relationship between respective provincial government and those cities had varied (Jonathan Unger 1987; author's interview). As seen in Sichuan and Hubei, the policy altered provincial fiscal relations with the Beijing government from a self-reliant to a subsidy province.

The voices of localities became louder as they accumulated economic resources subject to discretionary disposal. Localities became increasingly bold and capable of resisting Beijing's attempts to take resources away from them and in ways that they did not directly challenge the central authority politically. When Beijing leadership reached obvious consensus on policy priorities over certain issues, it would be risky (and unwise) for provincial leaders to oppose them either through formal or informal channels. It is natural that in the formal and informal negotiations for an adjustment in the division of revenues and responsibilities, the provinces should seek a more favorable revenue-sharing ratio, a bigger subsidy, or a reduction in expenditure responsibilities. It would be difficult to obtain favoritism in most cases, though, given China's overall fiscal decline and persistent budgetary problems at all levels (author's interviews).

One interview reveals that there are two stages of policy-making in the fiscal arena between the central and provincial governments. Although there was a consulting process, the Beijing government was dominant in setting long-term targets, in general three to five years, which had been finalized at the vice-premier or premier levels. The target worked as a main frame of fiscal relations during the binding years and the main frame was seldom changed. The second stage occurred yearly to adjust the frame between the MOF and the provincial governments. In this stage provincial delegates could place inputs for their own favor while providing the good reasons for them. However, the degree of flexibility at the second stage was restricted within the frame. In addition, as already discussed, most favoritism went by policy to poor areas. Therefore, I was told that little favoritism was allowed for rich provinces after the contracts were settled.

Under institutional and practical limits, most localities turned their focus to tapping their own resources by promoting expansion of the local tax base and supporting local economic growth. Therefore, local governments had the dual functions of a predator

and a protector. In an interview by Wong in 1988,⁷⁶ cadres in Jiangsu province estimated that the province needed an annual revenue growth of 20 percent to cover increasing expenditure requirements. As a result, localism flourished even as it adroitly avoided giving a direct challenge to Beijing's authority. Their predatory tactics with respect to local resources were focused on profit areas after payment of the fixed central taxes and not a direct challenge to Beijing authority.

In particular, the poor provinces tapped their fiscal resources outside the budget process, the extra-budgetary funds. In addition, local governments sometimes found the off-budget sources in enterprises. Many local governments conscripted funds from enterprises by imposing various levies and by shifting various costs to the enterprises, such as those of road-building and environmental protection. I was told in an interview in Shanghai that whenever a central inspection occurred, Shanghai dispersed its own funds at the district level of financial accounts under the jurisdiction of the city. By doing so, it reduced the actual size of its available funds. Otherwise, it might be tapped by the Beijing government. However, the interviewee did say that Beijing's inspection teams had never investigated below the city level. These practices were clearly against Beijing's policy because they negatively impacted on Beijing's finances. Nonetheless, as previously discussed, the Beijing government was quite tolerant during the period.

Of interest is the question why Beijing had in the first place ever adopted contracts unfavorable to the Beijing government in the face of its aggravating deficit problem prior to the years introducing the fiscal contract system. Was it a sign of declining power of the Beijing government? I observed that although localities became more active in this period, the local power were not determinants. There were still certain incentives for the Beijing government to do what it did. To begin with, it was possible that the plunge in revenue collection in 1987 shook the traditional bureaucracies in Beijing and drew concessions from localities to guarantee stable revenue growth without the expectation of high economic growth rate. The overall revenue growth rate was negotiated at around 7 percent to meet the target of economic growth in terms of the GDP target during the draft-making process for the seventh five-year plan. However, this view still needs to explain why the contract system survived for so many years.

76. Wong's interview. See Wong (1992), 708.

As Shirk suggested, political incentives of succession contenders to play to the provinces and provincial preferences might have been the factor (Shirk 1993). In particular, political succession contenders might have sought to broaden their base of political support, or at least not to make enemies by allowing particularistic contracts to the provinces. Considering the decision-making rule in China, policy-launchers must gain the absolute majority. After they proved successful in formalizing their policy preferences, they could be in the position to set policy guidelines. However, this argument leaves blank the complicated bureaucratic processes of negotiation and consensus-building. The detailed deals of the fiscal contract had settled down in the bureaucratic process between the MOF bureaucrats and delegates of each province. In addition, the argument fails to explain why the unsettled succession issue was not capable of preventing the strong drive toward more standardized fiscal reform in 1993.

A second reason would take account of Beijing's policy priorities, which focused on economic development as a national task through provision of greater fiscal resources and autonomy to localities and enterprises. The seventh five-year plan already indicated that speedier and more comprehensive economic development would be implemented during the latter part of the plan period. The political report of the thirteenth CPC congress explicitly revealed its policy preferences for more market-oriented economic reforms and development. Economic performance gradually replaced ideology as a source of legitimacy for the CPC. In particular, when the fiscal contract system appeared in accordance with local interests, it gained support from localities quickly. According to Yang Dali (Yang 1994, 74-76), conservative central leaders such as Chen Yun and Yao Yilin were seriously concerned about the growing deficit and challenged the particularistic fiscal contracting system in 1987. However, their challenges quickly became marginal.

With respect to the contracts, it can be observed that the Beijing government certainly sought to provide incentives for the coastal regions by allowing more control of fiscal resources as the regions increased their fiscal efforts along with the coastal development strategy. It also intended to place more pressure on poor provinces by cutting the amount of subsidies and fixing figures for several years. The intention was to reduce rent-seeking behaviors and to convert the energy to increasing productive efforts

in the fiscal area. However, in practice, the fiscal contract system turned out to encourage further localism and rent-seeking behaviors as some scholars had already warned. The Beijing government also revealed its socialist traits, that is, its egalitarian and paternalistic attitudes which were far from conducive to any incentive or efficiency scheme. Beijing was tolerant to unsound behaviors in extra-budgetary revenue collection in the poor regions and allowed much greater subsidies to poor areas than the contracts allowed.⁷⁷ Reversely, it extracted more revenues from rich provinces than contractually permissible. The tasks of standardization and institutionalization in the fiscal area were perforce subjected to political necessity and discretionary forces. Beijing's policy priorities and behaviors heavily influenced local performance in the fiscal areas: rampant localism and the ballooning of extra-budgetary and off-budget funds.

⁷⁷ I do not deny that the Beijing government took this issue seriously and sent inspection teams several times. However, its policy priority was not to tighten the fiscal control. In addition, the insufficient monitoring mechanism restrained a thorough control over unsound local behaviors in the fiscal arena.

Chapter V

Fiscal Contract System and Politics toward Realization of *Tax-Sharing System*

A. Impetus for Fiscal Institutionalization in the Early 1990s

The State Council assigned a research project to various bureaucracies and academic institutions, one requesting them to submit a report regarding fiscal reform during the period of 1988-1995.¹ The State Taxation Bureau also launched its own research project on the tax-sharing system along with the implementation of the fiscal contract system in 1988 (*Jingjiyanjiu cankao* 1 January 1994, 41; Liu 2000, 249). All affirmed that a better solution would bring about a standardized tax system and incorporate the contract systems into the standardized tax system. However, the introduction of the fiscal contract system was perceived as inevitable because of the worsening fiscal situation and other immature conditions in the area of prices, enterprise reforms, monitoring processes, and inspection mechanisms.

The fiscal contract system aimed at encouraging local economic development and strengthening local finances, in particular, in the coastal areas given that the Beijing government did not have an adequate monitoring mechanism to enforce a more standardized tax system. This was in accord with the state's primary policy during the last half the seventh five-year-plan period to promote economic developments in the coastal areas. During the eighth five-year plan period, the policy did not fundamentally change in spite of the conservative drive after the Tiananmen Incident. For example, the Beijing government continued to prioritize placing a considerable amount of fiscal resources in the hands of state-owned enterprises. In 1991-1992, the size of extra-budgetary funds in state-owned enterprises was equivalent to 75 percent of total extra-

¹ They were from the SCRE, the SPC, the DRC, the CASS, the Central Party School, *Beijing* and *Renmin Universities*. See the details in *Chinese Economic Studies* Vol. 24, No.1. (Fall 1990): 76-96.

budgetary funds and about 73 percent of budgetary funds.² The fiscal priority was to provide more resources for local economic development than to extract them for the Beijing government.

To implement such preferential policy, several measures were adopted. The most important one was obviously the contracts with most coastal provinces in the *basic sharing ratio with progressive revenue increase* system and other favorable treatments for coastal provinces (see the table 4-7). While securing about 7 percent of the overall revenue growth as planned in the seventh five-year plan, the Beijing government *deliberately* allowed coastal provinces considerable latitude for their finances and relatively lenient terms. Second, in fixing local remittance rates the Beijing government guaranteed the level of local expenditures defined by their expenditure bases (Wang 1999, 546). When it divided the administrative responsibility of finance, the Beijing government took responsibility for subsidizing the costs of price adjustments and state enterprise losses in its expenditures, to release local governments from financial burden. Third, Beijing's taxation policy continued to reduce the tax burden in localities, which allowed a broad range of tax exemption by local governments. To allow more profits, the practice of the *paying loans before tax* in enterprises was permitted to continue.³ Consequently, the growth rates of national income and gross industrial output value in 1988 recorded 11.3 percent and 20.8 percent respectively (SGTB 1997, 12-13). Although due to a new form of tax collection at the end of the 1980s,⁴ the overall revenue growth rate increased from 3.6 percent in 1987 to 10.0 percent in 1988.

Yet the discussion in the 12th State Council Executive meeting chaired by Premier Li Peng clearly illustrated that the Beijing government fully anticipated side effects of the fiscal contract system (*Xinhua* 12 July 1988; Cong and Zhang et al. 1999, 997). A project research team from Beijing University also warned that the fiscal difficulties of the Beijing government might increase and the gap between rich and poor regions grow even wider in implementing the fiscal contract system within a three-year period (Project

² Calculated from Liu (2000), 69 and Statistical Survey of China 1996, 41. Since 1993, the item of extra-budgetary funds in state-owned enterprises has been removed in the accounting of extra-budgetary revenue.

³ See more details in Liu (2000), 66-70.

⁴ Such preferential policy brought an economic heat from 1988 and also lured a shadow of financial problems in the Beijing government. The Beijing government sought to quell the economic heat and collect more revenues by taxing "the national budget adjustment funds." See in Liu 2000, 68.

⁵ In particular, the increase of the industrial/commercial taxes was 14.7 percent in 1988 (SGTB 1997, 14).

research Team, Beijing University 1990, 87). Wu Jinglian, from the DRC of the State Council, also stressed the problems of the fiscal contract system. He succinctly summed up the strengths and weaknesses of the fiscal contract system as follows (Wu 1988, 4-5):

It would increase management power of enterprises, encourage production at a certain degree, and help the governments meet a fiscal target under the condition of the immature market mechanism. However, it would encourage localism and be detrimental to the national interests. This system could obviously not sustain for a long time, but be utilized for a relatively short-term efficacy.

Accordingly, the Beijing government and other research project teams regarded the fiscal contract system as an interim 3-year measure. As suggested by the SCRE and Beijing University, a more standardized tax-sharing system would be introduced during the period of 1991-1995 (SCRE, 76-81; Beijing University, 85-88). However, when exactly it would be introduced depended on various factors such as the degree of consensus, number of reforms, economic situations, and other political factors. The project team from *Renmin* University anticipated that introduction would be impossible, at least until 1993 unless all other preconditions for the fiscal reform were ripe (*Renmin* University, 91-92). Accordingly, fiscal reform required simultaneous reforms in enterprise, prices, and banking systems.

The State Taxation Bureau had already submitted its scheme for fiscal reform in the eighth five-year period at the national taxation work conference on 2 July 1988. Its long-term goal was obviously to introduce the tax-sharing system (Liu 2000, 252-253). In the national taxation work conference in August 1989 it formulated a Comprehensive Tentative Plan for the Industrial/Commercial Tax Reform for the Next Ten Years.⁶ The scheme aimed at improving the proportion of revenue over national income, adjusting current tax items and rates according to the national industrial policies and preparing for the introduction of the tax-sharing system. Currently, although tax rates were high, their practical rates recorded at a much lower register because of various tax evasions and holidays in the localities (Liu 2000, 253). The soft-fiscal management problems could be curtailed by clarifying the fiscal responsibility and strengthening the control of tax exemption and avoidance. The scheme urged an increase in the proportion of tax revenues in the national income and the role of taxes for the macro-economic control should increase. It also suggested expanding the size of local tax revenues, establishing

⁶ *Renminribao* published Zhang Zhenbin's article on the fiscal reform on 18 March 1988 and suggested the tax-sharing system as a direction of the fiscal reform.

local tax systems, and allowing greater fiscal power to localities in preparing for the tax-sharing system.

The scheme was composed of three periods of implementation. The first period 1989-1992 would emphasize putting the fiscal system in order. The Beijing government would strengthen the fiscal management system, prepare for reforms on the value-added and circulation taxes, experiment with the separation of profits from taxes, and search for a new relationship between the state and enterprises upon the end of the fiscal contract system. The second period 1993-1995 would emphasize deepening reforms of major taxes and rearranging the relationship between the state and enterprises. The separation of taxes from profits and a unified enterprise income tax system would be implemented after the fiscal contract system ended. Other taxes such as the value-added tax, product tax, business tax, resource tax, and social insurance tax would be introduced or reformed comprehensively. In particular, a local tax system would be established by increasing the size of local tax revenues. The third phase from 1996 to 2000 would complete the standardized and scientific tax system. Taxes would be simplified and their number of taxes reduced. The scheme also indicated that the tax collection system would be reformed.

Looking at the contents of the scheme, I was convinced that thorough implementation of the tax-sharing system would more likely happen during the ninth five-year plan period, although the Beijing government and the State Taxation Bureau could not nail down when they would comprehensively introduce the tax management system as much as other project teams could not. The reforms of the fiscal management and collection systems would not be implemented as a bundle. The tentative plan suggested establishing a Commission for the Reform of the Tax System under the State Council to guide all the fiscal reforms under strong leadership. As indicated by Jin Xin, director of the State Taxation Bureau, since the fiscal reform would require massive adjustment of given interests, severe resistance might well be encountered in making the draft. He stated that the characteristic of the reform was basically political and would require keeping pace with reforms in other areas (Liu 2000, 253). In Chinese decision-making norms, a *political* issue in character required a comprehensive consultative and negotiation process. Therefore, it was not certain when the more standardized tax-sharing

system would be introduced until negotiations at various levels were completed and political leaders reached a consensus. The tentative plan was endorsed by Wang Bingqian, Minister of the MOF, on 2 April 1990. The contents were integrated in the Suggestions of the Ten-Year Plan for the National Economy and Social Development and the Eighth Five-Year Plan in the seventh full session of the thirteenth CPC Central committee on 30 December 1990 and in Li Peng's Report on the Summaries of the Ten-Year Plan for the National Economy, Social Development and the Eighth Five-Year Plan in the fourth plenary session of the seventh NPC on 25 March 1991.⁷

The State Taxation Bureau revised its fiscal reform plan after a series of consultations and discussions in the national taxation work conference in July 1991. The State Council eventually formally endorsed the plan in the document the Guidelines of the Ten-Year and the Eighth Five-Year Plans for Taxation Work issued on 25 February 1992. During the period of the eighth five-year plan, the Beijing government would launch reforms on circulation taxes, income taxes, resource taxes, and investment/consumption-related taxes. It also planned to experiment with the tax-sharing system and increase the size of local taxes. Under circumstances of high inflation and subsequent political austerity after the Tiananmen Incident in 1989, the priority of the eighth five-year plan was on economic stability although it still emphasized increasing economic efficiency and development. The average economic growth rate was set at 6 percent during the period. Accordingly, the revenue increase target was also set at 6.1 percent and the expenditure target at 5.7 percent. The targets were lower than during the seventh five-year plan; during the seventh five-year plan, revenue and expenditure increase rates were set at 6.7 percent and left room for a faster increase at a later stage.

Contrary to the conventional view, the target in the seventh five-year plan was not likely to be the victory of political conservatives. Rather, it was determined by unstable domestic and international situations and the preset goal of ten years ago to quadruple the GNP by the end of the twentieth century. A majority of scholars including the CASS supported the mid-range of growth strategy, given unstable domestic and international

⁷ As for the contents, Jinhua Chen, *Dibage wunian jihuaqi zhongguojingji he shehui fazhan baogao* [Report on the National Economy and Social Development during the Period of the Eighth Five-Year Plan] (Beijing: Zhongguo Wujia Chubanshe, June 1996); MOF, *Zhongguo Caizheng Nianjian 1992* [China's Yearbook of Finance 1992] (Beijing: Caizheng Zazhishe, 1992).

security environments (Shen et al. eds. 1999, 472-476; *Renminribao* 3 April 1991). The outline of the ten-year and eighth five-year plan, which was passed in the fourth session of the seventh NPC on 9 April 1991, indicated that if circumstances changed, the target would be entirely reexamined. From 1992, there were signs that the Beijing government's views on the international security environment were becoming more optimistic. The domestic situation was far more stable under the leadership of Jiang Zemin. In this respect, it was not strange that the Beijing government upgraded its growth target in 1993. If such a change could be entirely attributed to Deng's initiative in 1992, an important part of the changes within the Chinese government and academic world might be underestimated. In the process, in spite of the mid-range of economic/ fiscal development policy, one noticeable change was that military expenditure acquired a certain priority in the expenditure.⁸ The relative emphasis on the military was related to the changing international security environment and the domestic necessity for the new political leadership to gain support from the military after the Tiananmen Incident in 1989. The changing priority certainly derived from political reasoning rather than from economic reasoning.

As a short-term remedy, the fiscal contract system was implemented, but it caused intergovernmental relations to fluctuate along with changing central policy priorities. Introduction of the fiscal contract system proved not as problematic to Beijing's finances as once conventionally thought. On the contrary, the Beijing government acquired stable increase in revenue growth in the contracts and, as a result, increased its self-reliance ability as calculated by the proportion of revenues over expenditures of the respective government. Plentiful evidences backed up claims that the new fiscal reform well served its end. The growth rate of revenues became stably high, as planned: the rate in 1986 and 1987 was 5.8 percent and 3.6 percent respectively, but it increased to 7.2 percent in 1988, 13.1 percent in 1989, and 10.2 percent in 1990 respectively (Chinese Statistical Yearbook 1999, 265). The growth rate of the industrial/commercial taxes also increased from 6.7 percent in 1987 and 7.8 percent in 1988, to 14.7 percent in 1989 and 19.1 percent in 1990 (SGTB 1997, 13). This fiscal rejuvenation certainly allowed room for the Beijing

⁸ During the seventh five-year plan, it was assigned to maintain the average of 9.1 percent in total expenditure, which decreased to 3.8 percent from the previous period. See Cong and Zhang et al. (1999), 996.

government to take a breath after two consecutive years of low rates of revenue growth, in spite of the fact that some part of the achievement might be attributed to the high inflation rates during the years of 1988 -1989, which were higher than 15 percent.⁹

Table 5-1: Self-reliance Index of Various Levels of Governments

	Center	Local	Province	Region*	County	Township
1975-79	0.30	1.61	-	-	-	-
1980-85	0.65	1.32	-	-	-	-
1987	0.87	1.03	0.73	1.61	0.78	1.50
1988	0.92	0.96	0.50	1.54	0.77	1.40
1989	0.93	0.95	0.52	1.45	0.73	1.35
1990	0.99	0.94	0.56	1.38	0.72	1.33
1991	0.86	0.96	0.59	1.36	0.73	1.30
1992	0.83	0.97	0.61	1.32	0.71	1.35
1993	0.73	1.02	0.68	1.36	0.78	1.40
1994	1.66	0.57	-	-	-	-
1995	1.63	0.62	0.47	0.72	0.48	0.95
1996	1.70	0.65	0.54	0.73	0.49	1.00
1997	1.67	0.66	0.54	0.73	0.50	1.00

Source: *Difang caizheng* [Local Finance] 4 (1999), 9-10.

Note: 1. The self-reliance index refers to the ratio of revenues over expenditures in the respective administration.

1. Expenditures do not include the amount of fiscal transfer to a subordinate government.
2. Region (*di*)* refers to an administration between the province and the county-level administration. In general, it indicates mid to large size cities whose population is more than 300,000. It included three kinds of city: capital city of a province, the planned city (*jihuadanlieshi*), and normal mid-size cities.

The self-reliance ability of the Beijing government also improved for the first three years as seen in Table 5-1. The reliance index shows that the Beijing government increased its self-reliance ability from 87 percent in 1987 to 92 percent in 1988; meanwhile, that of provinces dropped sharply from 73 percent in 1987 to 50 percent in 1988.

Table 5-2: Proportion of the Beijing government in Revenues and Expenditures (percent)

	1986	1987	1988	1989	1990	1991	1992
Revenue*	40.6	38.2	39.8	37.5	41.3	38.8	39.7
Revenue	36.6	33.4	32.8	31.2	33.7	29.3	28.1
Expenditure	41.3	42.1	39.2	36.4	39.8	39.8	41.4

Source: Kou 1996, 156.

⁹ In response, the Beijing government adopted anti-inflationary measures from 1988. The inflation was stabilized in 1990, which was brought down to less than 5 percent. The austerity measures resulted in consecutive declines in the years 1989 and 1990 in Industrial Output Growth in all sectors. See more in CIA (1992), 3.

Revenue* included domestic and international debts.

Table 5-3: Amounts of Local Remittance (1985-1990), 100 million yuan

	1985	1986	1987	1988	1989	1990
Remittance	396.2	389.6	350.4	336.0	346.4	351.7
Local Revenue	1158.5	1343.6	1463.3	1582.5	1842.4	1944.7
Remittance Rate	34.2	29.0	23.9	21.2	18.8	18.1

Source: Kou 1996, 156.

Yet it is crucial to understand that, as discussed previously, the fiscal contract system did not aim to centralize fiscal power in the hands of the Beijing government. Rather, it was designed to encourage initiatives by localities and enterprises. As a result, the size of local revenues increased considerably after an initial drop during the contract period, but the amount of remittance to the Beijing government contrarily decreased and faltered. Tables 5-2 and 5-3 illustrate the mechanism explaining why Beijing's fiscal situation was worsening. The rate of local remittance to the Beijing government over local revenues sharply dropped since the urban reform began in 1985. Since local remittance had been a major part of the central revenues under the contract, a decline in the proportion of central revenue over the national revenue was inevitable.¹⁰

Right after deciding to implement the fiscal contract system, the sixth plenary session of the thirteenth CPC CC on 26 September 1988 signaled to localities that the Beijing government had changed to a more positive view of local interests in government management. Although decentralization of economic power to the localities had already been the central policy during the 1980s, a strong sign of the change could be seen in the adoption of such concepts as *zunzhong* [respect] and *liyi* [interest] in describing the relationship between the Beijing and local government in a document in the session. Traditionally, the Beijing government used *geiyu* [grant] and *yunxu* [allow] rather than *zunzhong*, and also emphasized local's specific conditions as an outlier of the broad national interest. However, it recognized that the relationship between the Beijing and local governments was basically interest relations (Zhu 1997, 371-372). The fiscal contract system provided rich soil for fiscal localism although the Beijing government forced them to guarantee a certain level of revenue remittance under the terms of fiscal

¹⁰ Economic retrenchment policies, which were implemented in 1988, also helped to prevent further deterioration of the fiscal situation of Beijing.

destitution. The local governments fully recognized the implication of the change and duly absorbed the central policy priority for their own sake. Accordingly, Beijing became a loser after 1990. Provincial governments continued to increase their self-reliance ability from 50 percent in 1988 to 68 percent in 1993. The overall local self-reliance ability slightly increased from 96 percent in 1988 to 102 percent in 1993; meanwhile, the Beijing government ability was declining, up to 73 percent as of 1993.

As warned by the report from Beijing University, the fiscal contract system proved detrimental in the long run to the fiscal situation of the Beijing government. The side effects seemed severer than the Beijing government could have anticipated. First, the proportion of revenues over GDP quickly dropped from 18.4 percent in 1987 to 15.8 percent in 1988 immediately after the introduction of the contract system. After 1990, the trend toward decline became even more obvious. The growth rate of revenues could not keep pace with that of GDP. In particular, the growth rate of industrial/commercial taxes had lagged far behind the GDP growth rate. A severe deficit problem and the declining ratio of revenue to national income operated from 1990. During the period 1991-1993, the average growth rate of industrial/ commercial taxes was 7.4 percent, but the GDP growth rate was 12.3 percent (SGTB 1997, 13; GDPC 1997, 33). The proportion of revenues of the Beijing government in total revenues became less than 30 percent in 1991. The remittance rates of the local revenues continued to decrease, and the self-reliance fiscal ability of the Beijing government dropped from 99 percent in 1990 to 86 percent in 1991. The size of extra-budgetary funds became virtually equivalent to that of the budgetary revenue; the ratio recorded 111 percent in 1992, the highest in PRC history. One noticeable feature was that the Beijing government had tapped a much higher share of extra-budgetary funds compared to budgetary revenues than the local governments. The average rate of extra-budgetary funds to budgetary revenues in the Beijing government was 134.4 percent during the period of 1988-1992; meanwhile, that of local governments was 86.4 percent (author's calculation from respective CSY).¹¹ That is, the Beijing government shored up its worsening revenue situation by tapping more extra-budgetary funds during the fiscal contract period.

¹¹ According to Ma, the ratio of the revised revenues to GDP, which added extra-budgetary funds on formal budgetary revenues, would be 33 percent in 1990 (Ma 1992, 133).

Another obvious problem was a rampant local protectionism that prevented the formation of a unified national market although the rise of the local protectionism was related to the introduction of the fiscal system in 1980, which allowed more fiscal autonomy to localities and linked local revenue to collections with expenditures. Since local government budgets were closely related to the financial health of local enterprises, each local government sought to increase productivity and protect local enterprises. According to Oi, localities became independent fiscal entities that had both the responsibility for local expenditures and the unprecedented right to use the retained revenue (Oi 1992, 103). This shift gave local governments a large share of the more stable and fast-growing revenues (Wong 1992, 213). Local governments manifestly focused on projects which guaranteed quick return in terms of revenue-collection; they did this by artificially boosting investments and enterprise activities at the expense of long-term developmental and social needs. As a policy of Beijing on agricultural product prices was to keep them considerably low as compared to prices of industrial products, every province exerted great effort to promote local secondary industries that would produce more tax revenues and blocked free trade with other provinces to protect its own industries.¹² The trend was obviously detrimental to the formation of a national market.

The fiscal contract system also intensified tax evasion and avoidance problems. The fiscal contract system encouraged local fiscal efforts for their own sakes and allowed discretionary use of their own fiscal resources. Along with economic development, every level of government also formed itself starved for funds. A major part of the funds for local economic development had to rely on localities' ability to raise funds. In addition, Beijing's reliance on local governments in tax collection, the virtual non-existence of a reward system for tax efforts, and a weak monitoring system combined to keep fiscal resources within local jurisdiction, instead of in Central coffers. According to an SCRE estimate, the resulting actual tax collection rate was much lower than the nominal tax

¹² The consequence of localism also distorted redistribution of the fiscal resources. The liberalization of the banking system, which was accelerated with the urban reforms in 1985, provided localities with financial assets. Under the dual leadership, the state banking system was pressured from both levels of governments: the Beijing government and provincial governments. However, with the policy priority of economic developments, provincial governments rampantly exploited every chance to acquire fiscal resources for their own local developments from the bank system. The result was a high inflation. To check the inflation, the Beijing government adopted austerity measures in September 1988 such as mandatory credit ceilings and tight control over central bank lending (Agarwala 1999, 32).

rate. For example, the average tax rate of circulation taxes should have been 11 percent but in practice was only 8 percent. The 55 percent SOE income tax rate was collected less than at a 30 percent rate (Lu 1993, 19).

The other fundamental problem was that the fiscal contract system was a kind of negation of previous efforts to regulate and standardize the fiscal system. As the contract base was determined by one-to-one negotiations when considering the specific conditions of each enterprise and locality, it was often subject to discretionary power and so was far from standardized. Certainly under the fiscal contract system, negotiations every year existed at all levels of the state. The use of non-economic methods in the fiscal contract system was often criticized by reason of “replacing the old distortion with a new distortion and adding disorder to disorder (*luanshang jialuan*)” (Wu 1988, 6). An insufficient market system and the arbitrary use of political power accelerated the problem of *soft-budget constraint* at all levels. The tax rate of 55 percent on the SOEs was too high for most to pay, and after taxing on profits the state often took more profits off the SOEs in the name of the adjustment tax. Under the soft-budget constraint, a rational choice would be to cultivate good relationships (*guanxi*) with government officers and leaders as well as negotiating taxes and remittance rates than to pursue collection. The level of revenue-sharing could be a mere function of the negotiations and policies of the Beijing government rather than of tax collection efforts. The fiscal contract system also forced the Beijing government to adopt non-standard means when it experienced fiscal difficulties. Nonetheless the Beijing government utilized its unbalanced power to compensate its deficits by borrowing and confiscating funds, issuing bonds (*Zhongshiribao* January 8, 1988; *Qingnianribao* February 4, 1988), forcing 10 percent reductions of administrative expenses (*Wenhuibao* February 25, 1988), and retrieving a part of its fiscal power from localities (Kou 1996, 156).

However, it is also noteworthy that in the academic world that a certain degree of exaggeration existed with respect to this matter.¹³ My interviewee told me that it was never easy to acquire such special favor in negotiations between the Beijing and provincial governments, given the China’s bureaucratic working mechanism: the MOF assigned an officer to each or a few provinces for the negotiations. Since the officer had

¹³ It is more likely to be true in the relationship between the governments and enterprises.

long experience in the assigned provinces and was quite familiar with their situations, it was difficult to curry special favor by providing special reasons for it. Nor was bribing easy because the contents of a contract could be compared with previous contracts. Publicized relations also restrained preferential treatment. Bribery occurred at higher levels for political reasons or by virtue of changing policy priorities. At any rate, it was difficult overall for an individual province to acquire special favor by its own doing.

The deficit problem of the Beijing government continued to increase. It reached 7.86 billion *yuan* in 1988, 9.23 billion *yuan* in 1989, and 13.97 billion *yuan* in 1990 (Cong and Zhang 1999, 1000). Although the sizes were only about 3 percent of national revenue, it alarmed the conservative leaders and bureaucracies who traditionally favored fiscal balance. Before the 1994 fiscal reform, Beijing mainly depended on its administrative power to solve the worsening fiscal situation such as in readjusting the base figure of remittance, forcing loans to maintain certain levels of revenue proportion, and ordering all levels of government to reduce their expenditure to target figures. However, these measures were fundamentally contradictory to the *modus vivendi* that the Beijing government had sought to establish, that is, indirect control of the economic system and institutionalization.

The State Council and its leadership relentlessly promoted fiscal institutionalization throughout the post-Mao reforms. Even at the moment that the decision was made for the implementation of the fiscal contract system, Beijing was preparing for the tax-sharing system. For example, Provisional Premier Li Peng already declared in his report to the first plenary session of the seventh NPC on 25 March 1988 that the Beijing government would move toward the tax-sharing system and loan-after-tax system in the next five years (Liu 2000, 249). This fiscal policy was consistent with the report of Zhao Ziyang in the thirteenth CPC congress on 25 October 1987 even though Li Peng had replaced Zhao by that time. In particular, an extended meeting of the Communist Party Central Committee in June 1989 immediately after the Tiananmen Incident certainly favored greater political, social control and economic plans (CIA 1989, iii). However, the attempt of Premier Li Peng to gain more control of the revenues failed in the face of strong opposition from localities and other proponents of the contract system. For example, the a United States CIA report indicated that resistance was

especially strong in the wealthy southern provinces, where economic reforms and opening-up to western business had yielded significant economic benefits (CIA 1989, 5).¹⁴ According to the report, those prosperous provinces resumed some of the construction projects that the Beijing government canceled early in 1989 as well as increased existing barriers to trade with other provinces in order to protect their own industries. The similar resistance also happened in the debates over the substance of the Eighth Five Year Plan in 1990 (Breslin, 26). As Shirk indicated of the political logic, under conditions of strong resistance from provincial leaders Li Peng might be reluctant to antagonize as a contender for political leadership. Given the Chinese political-decision practice, support from Deng Xiaoping would be crucial. However, no sign of support appeared from Deng on the implementation of the tax-sharing system. On the contrary, Deng was leaning toward speeding up the reforms (CIA 1992, 15). Thus, Li Peng was forced to back down as seen in the report regarding the ten-year economic/social restructuring reform and the eighth five-year plan.¹⁵

According to Yang (Yang 1994), the budget deficit issue became a pressing problem in 1990. The number of articles on fiscal problems in *Jingji Yanjiu* [Economic Research], China's leading monthly journal of economics, increased to five, compared to one in 1988 and two in 1989 (Yang 1994, 79). The debate over the two declining ratios, that is, the ratio of central revenues over local revenues and the ratio of revenue over national income, also intensified in 1989 and 1990.¹⁶ A strong sense of crisis in Beijing, caused by the Tiananmen Incident and the demise outside China of the socialist bloc encouraged instituting austerity programs,¹⁷ though beneficiaries of the previous reforms and some political leaders like Deng Xiaoping sought to overcome the crisis by encouraging rapid economic development.

¹⁴ According to the *Far Eastern Review* (4 April 1991), a coalition of provincial governors and other senior figures from coastal provinces comprised a strong veto power.

¹⁵ Yang also indicated this point (Yang 1994, 75). The Report on Suggestions of the Plan was presented by Li Peng in the seventh plenary session of the thirteenth CPC on 25 December 1990. Its final report was rectified in the fourth session of the seventh NPC in March 1991. For detail, see the report in Central Document Research Office 1991.

¹⁶ The debate was related to the drafting of the eighth five-year plan. The draft containing the abolishment of the fiscal contract system, was circulated among central and provincial leaders and became a focus of feud at a series of conferences in 1990. See more in *Far Eastern Economic Review*, 4 April 1991.

¹⁷ Writing by Chen Yuan, son of Chen Yun and the vice-director of the Bank of China, in *China Youth News* revealed the sense of the crisis. He claimed that restoration of the stronger central power is necessary to avoid social and political disintegration of China (*Zhongguoqingnianbao*, 2 January 1991).

The ten-year economic/social restructuring reform and the eighth five-year plan were products of compromise between the two different groups. To begin with, the economic growth rate was set at a moderate 6 percent for the previous ten years, considering the unstable domestic and international situations. In his report, Li Peng indicated that parochial localism in the fiscal contract system was a serious problem and that the tax-sharing system experiment would be launched during the eighth five-year plan. However, the plan affirmed that the fiscal contract system would be continuously applied during the eighth five-year plan period (1991-1995) to encourage local economic development. The final report of the plan obviously indicated China's policy of restraining revenue growths of the central and national governments (Central Document Research Office 1991, 1495). It meant that policy priorities were still being placed on stabilizing and perfecting the fiscal contract system (Central Document Research Office 1991; MOF 1994, 14; Cong and Zhang et al. 1004). The current policy priority of encouraging local initiatives for growing the economy survived (CIA 1992, 15). The rapid economic growth strategy of encouraging local initiatives was reaffirmed and gained appreciably by Deng Xiaoping's southern tour in early 1992. In the fourteenth CPC Congress held in October 1992, the CPC threw open the door for the faster economic growth and market-oriented economic activities by drastically reducing the old ideological shackles. The concept of the market socialism was introduced and the theory of the primary state of socialism introduced by Zhao Ziyang in the thirteenth CPC Congress in 1987 justified introducing market elements into socialism and was reaffirmed as the contemporary stage of Chinese socialism (Central Research Board of Policy-Making, 512).

In the two years 1990-1991, China averaged about 6 percent growth as planned. However, it became obvious that the planned target could not be maintained in 1992. In the central planners' view, the 1992 economic boom had been a disaster. It almost entirely destroyed the original eighth five-year economic and financial plan. The GDP growth rate recorded double digits, that is, 14.1 percent in 1992, and the inflation rate sky-rocketed to 13.2 percent in the following year (CSY 1999, 57 and 294). These double digit increases in the GDP growth and inflation were more than the central planners could absorb in their plan. Accordingly, the second session of the fourteenth CPC made

decisions to adjust the eighth five-year economic plan and to start the drafting process for the ninth five-year plan in the second plenary session of the fourteenth CPC in March 1993.¹⁸ The economic growth rate was upgraded to 8-9 percent from the original 6 percent. In the fiscal area, although the schedule was not indicated, intensification of experiments with the tax-sharing system was urged. Notably, a strengthened military sector had been emphasized in all documents relating to the eighth five-year plan.

In the efforts to create a more market-oriented economy as well as to control overheating in the economy, the Beijing government made the decision to experiment with the tax-sharing system in nine cities and provinces from 1992 according to a scheme submitted by MOF in 1990 as well as the eighth five-year plan. It had four basic features: (1) it encourages the two sides (Beijing and localities) to undertake initiatives (*liangge jijixing*), (2) it improved the rate of the central revenue over the national revenue so as to assure Beijing's control of the redistribution of fiscal resources, (3) it enlarged the range of local fixed revenue to help the localities to establish their own taxation system, and (4) it considered local interests in an appropriate manner. According to those principles, the rules of the experimental fiscal reform were set up. First, all taxes were divided into the central fixed, local fixed, and sharing taxes. The sharing-taxes would be divided by the previously-contracted sharing rates, that is, to 50-50 percent for most areas and to 80-20 percent in favor of minority areas with the Beijing government. Since most of the sharing taxes (basically, circulation taxes) were allotted at the local government level under the fiscal contract system, the new measure would improve the central fiscal position while restraining localism. However, the localities would still be responsible for tax collection because there was no centrally-controlled tax collection system. Second, the experimental system still had components of the fiscal contract system within it to restrain a dramatic change in given interests and the redistribution mechanism. The Beijing government would subsidize those provinces that suffered deficits even after taking its fixed revenue and a part of the sharing taxes. Those provinces having surpluses were contracted to provide an annual 5 percent increase in its remittance to the Beijing government based on

¹⁸ For more detail, see the suggestion and Jiang Zemin's speech in the session in Central Document Research Office (1996), 99-154.

the 1989 base figure.¹⁹ Third, to enlarge the local tax base the number of local fixed taxes increased from 13 to 15 including agricultural taxes and local state-owned, collective, and other joint-enterprise income taxes.

However, the MOF plan did not fix the timing of the comprehensive introduction of the tax-sharing system, leaving it as a goal merely. No consensus seemed to be reached on the timing of the implementation of the tax-sharing system in Beijing until at least after 1992.²⁰ In the annual government report of 1993, adoption of the tax-sharing system was still referred to as a target of the fiscal reform. Time schedule for implementation of fiscal reform was broadly perceived as coming early in the ninth five-year plan (1996-2000) period.²¹ The remaining question was what factors drove the Beijing government to change its original stance on the implementation schedule much ahead of time. After the summer of 1993, the then Beijing leaders appeared to have already determined to implement the tax-sharing system from 1 January 1994 in spite of enormous resistance from coastal areas and even Deng Xiaoping's reluctance. The policy priority shifted from given emphasis on local initiatives to more control of revenues in the fiscal arena. A rising macro-economic control problem coupled with enormous financial pressure from the military expenditure build-up provided the momentum. However, the rules of the new system were determined within the given decision-making norm of democratic centralism. As a result, the outcomes were quite different from the tax-sharing system as originally planned. Elements of the fiscal contract system coexisted with the new system, and conciliatory policies were introduced at many points as a result of negotiation and compromise.

¹⁹ In addition, various extra-budgetary funds such as budgetary adjustment funds and core energy/transportation construction funds would not be in the range of the tax-sharing system. The Beijing and local governments would be responsible for the refunds for export products at the rate 80:20. See more in the MOF (1994), 42-43.

²⁰ Zhong Pengrong from the general research office of the CPC illustrated this atmosphere in his article in *Jingjiribao*, 7 March 1992. He pointed out that the introduction of the tax assignment was not timely under the circumstance that the roles of governments and enterprises were not separated.

²¹ For more details, see an internal document of the MOF (1994a), 14.

B. Evolving Web of Interests

Introduction of the tax-sharing system would dramatically alter given interests, in particular, the relationship between Beijing and the local governments if it were implemented as planned. Accordingly, tension and conflicts among relating parties were fierce as all strove to determine in determining when and how the new system would be implemented. One feature in the politics of the fiscal reform in that period was that conflicting ideas among political leaders and bureaucracies in Beijing grew less crucial in light of the broad consensus among political leaders on implementation already in fact existed as a normative requirement for further reforms. Instead, the conflicting interests between the Beijing government and the localities became more crucial as localities garnered more resources and developed more comprehensive webs of vested-interests along with the decentralization of economic and fiscal power of the previous years. Local leaders, in particular in coastal areas, were able to object more loudly against the Beijing government and its leaders than in previous years. In the Political bureau of the CPC, the number of local leaders increased considerably. For example, at the 12th national party congress no local leaders were in charge. However, at the 14th national party congress in 1992, Chen Xitong in Beijing, Wu Bangguo in Shanghai, Tan Shaowen in Tianjin, Jiang Chunyun in Shandong, and Xie Fei in Guangdong served as the members of the powerful Political Bureau.²² In the point of view of the Beijing government, it was a kind of co-optation process that recognized the importance of local leaders and allowed them opportunities to express their interest at the highest levels of power.

Since the new fiscal reform evinced the strong character of recentralization of fiscal power (i.e., zero-sum game nature) particularly in the revenue area, resistance from localities proved intense, with a tug of war preventing introduction of the new fiscal system. The Beijing government nurtured the power of local administrations and helped them penetrate deeper into society for more efficient and effective control of the same during the post-Mao reform period, which can not merely be measured by the level of revenue collection. No doubt existed that the Beijing government was capable of enforcing what it wanted to do if it made a decision at all costs. However, enforcement

²² Xiao Yang in Sichuan was supported by Deng Xiaoping and according to the original plan, he would be the member. However, he was voted out by the central committee. Regarding this, see FBIS-CHI-96-238 (14 November 1996).

would ruin all the efforts of the Beijing government to build an efficient economic/political system during the post-Mao reform period. The given decision-making norms and practical demand for cooperation from localities in making further reforms required the creation of a win-win formula for the Beijing and local governments. However, creating the win-win situation was not an easy task because the character of the new fiscal reform was basically a zero-sum game. Fiscal reform needed a momentum by leadership, help from external factors, and specialized strategies, to mobilize the principle of democratic centralism.

1. *Tiaotiao* Interests

It has already been observed that organizational positions on fiscal reform varied, depending on organizational interests and political connections.²³ Under the principle of democratic centralism, each major organization was allowed to express its own interests in the process of draft-making and documentation. Although a decision to implement the fiscal contract system in the thirteen provinces and cities was made in the twelfth standing committee session of the State Council on 12 July 1988, it was assumed to be but transitional.²⁴ The tax-sharing system was recognized as a better system in the long-run (*Renminribao*, 13 July 1988; Liu 2000, 260),²⁵ but no consensus had yet been reached as to when and how it would be implemented.

The worsening financial situation of the Beijing government coupled with the lax economic/financial initiatives at local levels in 1986 and 1987 called for the fiscal contract system as a quick remedy, in which the Beijing government would basically depend on its administrative power in setting base figures. The Beijing government could swiftly adjust its imminent financial problems by *administrative* means. Because the contract system provided localities with incentives to acquire more financial resources for

²³ Regarding the organizational conflicts on debt control between the MOF and the people's bank of China, *International Herald Tribune*, 13 April 1988; *Wenhuibao*, 2 June 1988.

²⁴ The thirteen provinces and cities were Hebei, Liaoning, Shenyang, Haerbin, Jiangsu, Ningpo, Chongqing, Beijing, Dalian, Qingdao, Wuhan, and Tianjin (*Jingjiribao*, 14 July 1988)

²⁵ In auditing the government's accounting and 1989 plan, Chen Muhua, chair of the finance/economy committee of the seventh NPC, strongly warned the loss of macro-economic control by the Beijing government (*Mingbao*, 31 March 1989). However, in his six suggestions, the position was not established as a support of introduction of the tax-sharing system. Instead, he focused on initiating fiscal adjustment policies, strengthening surveillance, and reducing extravagancy (*Renminribao*, 31 March 1989).

their own sake, localities welcomed it, and it was quickly implemented. The Beijing leaders and bureaucracies agreed to implement the fiscal contract system under the pressure. The implementation of the fiscal contract system was against the incessant efforts to make the fiscal system transparent and more institutionalized by Zhao Ziyang and other major central bureaus in the planning and finance area. Therefore, it was considered transitory and debates on the fiscal reform did not abate with the implementation of the fiscal contract system. *People's Daily (renminribao)*, the government's official daily newspaper, continued to produce editorials supporting the tax-sharing system in early 1988 although the system was losing ground at that moment.²⁶ Then, an editorial by Chen Yao revealed the reversed trend of thinking in the Beijing government in favor of the fiscal contract system. He urged that Beijing adjust the base figures of revenue remittance to increase its ability to maintain macro-economic control in 1989 (*Jingjiriabo*, 17 November 1989).

One obvious feature of the debates was that the subjects of the battle gradually moved from bureaucratic politics in Beijing to the intergovernmental relationship. However, bureaucratic politics in Beijing were still crucial until the leadership reached consensus on implementing the tax-sharing system. In the government, the traditionally strong bureaucracies such as the MOF, the SPC, and the State Taxation Bureau were major supporters of the tax-sharing system. The SPC and the SCRE, which had previously worked under Zhao Ziyang for the introduction of the tax-sharing system, were placed under the control of relatively conservative political figures such as Yao Yilin and Li Peng upon the fiscal contract system's introduction in 1988. However, the organizational status in practice of the SPC and the SCRE had changed. In the 1988 institutional reform the SPC integrated with its organizational competitor the SEC, which was an institutional supporter for the fiscal contract system under Hu Yaobang's influence. After Jiang Zemin became a party general secretary, the SPC and the SCRE directors were replaced by Zou Jiahua in 1989 and Chen Jinhua in 1990 respectively, whose backgrounds related to Shanghai.²⁷ What was remarkable was the weakening

²⁶ For example, *Renminribao*, 18 March 1988; *Renminribao*, 1 July 1988.

²⁷ Zou Jiahua, born in Shanghai, was taken care of Zhou Enlai and his career was in the Beijing bureaucracy. Chen Jinhua's career background was in Shanghai.

position of the SCRE after the demise of Zhao Ziyang. The new director Chen Jinhua was a considerably more lightweight figure as compared to previous directors.

Of note was the fact that Jiang Zemin, General Party Secretary, was not in the beginning an ardent supporter of the tax-sharing system. On the contrary, he emphasized the importance of implementing the fiscal contract system in his first major public speech in the fifth plenary session of the fifteenth CPC CC on 9 November 1989.²⁸ As a previous Shanghai Municipality mayor, he surely had a personal preference for the fiscal contract system. In the face of the national crisis of disintegration in 1989, the necessity of garnering support from local leaders might have led him to favor the fiscal contract system over the tax-sharing system. Although it was imperative that he as a national leader had to embrace central bureaucracies that preferred tax-sharing in general, he could not have been as enthusiastic about it as were other central leaders such as Li Peng and Zhu Rongji.²⁹ It was only in late April 1993 that he held three meetings of the Central Finance and Economy Small Leadership group and became more actively involved in fiscal reform. Accordingly, the SCRE was no longer active in promoting the tax-sharing system although it expressed its support for introducing the tax-sharing system in 1993 in its own organizational journal, *Jingjitizhi gaige* [restructuring of economic system].³⁰ Meanwhile, Li Peng and Zhu Rongji proved steadfast supporters for the introduction of the tax-sharing system.³¹ They did not play to the provinces as potential leadership contenders, but they likely did more as central bureaucrats in the fiscal and economic arena.

²⁸ To see the content, Wu, et al. (1998b), 2170-2173.

²⁹ As an administrator responsible for economic development and stability, Zhu was not positive of placing more resources on military as Jiang. His attitude was conflicting with the PLA. It was reported that Zhu and the PLA clashed on the issue of increase of military expenditures (*Zhongyangribao*, 2 September 1999). As planned, Zhu wanted to increase 10 percent with fear that a military tension might be the cause of driving international investors away, but the PLA continued to place pressure on Zhu to increase military expenditure 15 percent. Regarding Jiang's incessant efforts to control and to acquire support from the PLA returned with allegiance from the PLA when Deng Xiaoping passed away. Regarding the control over the PLA by Jiang, see *Zhongguoshibao*, 22 September 1997; the editorial by Steven Mufson in the *International Herald Tribune*, 29 September 1997.

³⁰ See the articles by Wang Shaozuo and Lu Ximing in *Jingjitizhi gaige* No 15, 1993.

³¹ Li Peng's strong support to the tax-sharing system was well revealed in the finance work conference in December 1992. In the early 1993, he indicated again the seriousness of the financial situation. To make matters worse, local governments contested each other to attract foreign investment for local developments by allowing various tax breaks. It further drained the potential state revenue sources (*The Japan Times*, 21 March 1993).

The MOF appeared less active in behalf of introducing the introduction of the tax-sharing system in the late 1980s (author's interview), but it still sought to more thoroughly institutionalize the fiscal system. It worked closely with the SPC in drafting the report to the State Council regarding the annual fiscal situation and plan. Both bureaucracies urged financial and fiscal reforms in their reports in the first plenary session of the eighth NPC in March 1993. The organizational goal of the MOF in the fiscal arena was to keep the revenue growth rate up to the GDP growth rate. The MOF experienced conflicts with the rapid expenditure increase policy of the military as it confronted enormous pressure in obtaining fiscal resources to support the military buildup under the fiscal contract system. Even after the introduction of the tax-sharing system, it favored as a reasonable action keeping the increase rate of military expenditure below the level of revenue increase.³² Reform of the fiscal system was the MOF solution for releasing the burden of the increase in military expenditure. The fiscal burden naturally led the MOF to favor among other macro-economic imperatives much swifter reform of the given fiscal contract system. When proponents of the fiscal contract system launched a highly active campaign to sell the system after Deng's southern tour in 1992, the MOF countered them by strongly urging implementation of the tax-sharing system in the summer 1992 taxation work conference and finance work conference. It also held a promotional conference on fiscal reform in December 1992 (*Guangmingribao*, 26 December 1992).

The State Taxation Bureau was naturally the most active proponent for the tax-sharing system because tax-sharing would rapidly expand its control over taxation and thus its organizational power. When the fiscal contract proponents attempted to expand the range of fiscal contracts over the circulation taxes, the State Taxation Bureau resolutely opposed the idea of expansion because it would destroy the bureau's efforts to keep the pace of tax collection synchronized with the economic growth rate. In addition, expansion would severely damage the institutionalization efforts in the fiscal area (*Jingjiribao*, 9 December 1992). In the debates on the fiscal reform in 1992 and 1993, the

³² See the criterion in the interview with Liu Zhongli by *Lianhebao*, 3 March 1997.

State Taxation Bureau arduously promoted the tax-sharing system in various ways.³³ In particular, at the national taxation bureau director workshop in the summer of 1993, all regional taxation bureau directors announced their support for the tax-sharing system (*Renminribao*, 21 August 1993).

During the post-Mao period, there was no doubt that CASS has been a major think tank under the State Council. The formation of the DRC in 1985 created the other major powerful think tank after it merged in 1985 with the former Economic Research Center, Technical Economic Research Center, and Price Research Center of the State Council.³⁴ In general, the DRC appeared to work more closely with governmental organizations (author's interview). The CASS has, for instance, been more sympathetic toward economic decentralization. However, regarding the issue of the tax-sharing system, no strong consistency could be observed in those two organizations. The members in the two organizations were relatively flexible in expressing various views as individuals. Contrary to the initial image of the organizations, for example, Yang Peixin of the DRC became one of the major proponents of the fiscal contract system.³⁵ Meanwhile, He Zhenyi of the CASS was one of the most ardent supporters of the tax-sharing system (He Zhenyi 1983 and 1984). A small task group of the CASS urged the introduction of the tax-sharing system as written before the Tiananmen Incident.³⁶ However, on the issue of tax-sharing, the CASS seemed not as enthusiastic as in the previous fiscal reform and was even critical of it although recognizing the necessity of the system.³⁷ The reason for this can be found in the facts that it represented nation-wide regions rather than just the Beijing government and that it has been a theoretical bulwark of economic decentralization and privatization. Contrary to other most journals and

³³ For example, the national tax theory discussion conference in 1992 held in Sichuan (*Renminribao*, 26 February 1993); an article by the fiscal system reform office of the STB in *Jingjiribao*, 16 March 1993 and an article of Jin Xin, director of the STB in the People's Daily (*Renminribao*, 21 June 1993); a discussion session with *Jingjiribao*, 2 March 1993, Jin Xin's (Director of the STB) article to urge the fiscal reform in *Renminribao*, 21 June 1993 and so on.

³⁴ In 1990, part of functions and staffs of the former Research Center for Rural Development of the State Council were also incorporated.

³⁵ See his article in *Zhanlue yu Guanli* [Strategy and Management], No 1 (1994) and also see Wu 1988.

³⁶ See *Jingjiyanjiu* no. 10, 1990, 11-20.

³⁷ It is noteworthy that He Jianzhang on the CASS was one of the initial supporters of the tax-sharing system. The above preferential position of the CASS was not necessarily to be its official organizational position. The CASS also officially supported the introduction of the tax-sharing system. However, relatively diverse opinions were revealed in the various sources of the CASS.

people, paying little attention to the tax-sharing system in *Jingjiyanjiu*, a major economic periodical under the CASS, is the example. At the very moment starting implementation of the tax-sharing system, a report from the CASS even warned that potentially the greatest social instability in 1994 would probably come from the introduction of the tax-sharing system (*Xingdaoribao*, 3 November 1993).

Foreign organizations such as the World Bank and the IMF played quite positive roles in the introduction of the tax-sharing system, and the Beijing's leaders appeared to be quite attentive to their advice. In the early stage of the fiscal contract system, the World Bank assuaged the fear of the Beijing government by indicating in the Beijing conference of January 1989 that an appropriate level of fiscal deficit could facilitate economic development and that the current level of Chinese debt was not as serious as Beijing thought (*Jingjiribao*, 20 January 1989).³⁸ However, the World Bank and IMF surprisingly supported fiscal centralization in the face of fiscal crisis in the Beijing government and so worked toward introduction of the tax-sharing system by advising the Beijing leaders to tighten up local finances for achieving macro-economic control (World Bank 1991 and 1995; *Wenhuibao*, 31 October 1993). IMF also actively participated in drafting *a strategy of development of tax collection* in February 1993 in an effort to strengthen tax collection and the draft was directly reported to Ziang Zemin in the Central Finance/Economy Small Leadership meeting in April 1993.³⁹

During the period, remarkably, the PLA voiced its organizational interests more loudly than usual in the financial area and their influence soon became apparent.⁴⁰ The

³⁸ This view was not new in the Chinese academy. As seen in the previous chapter, some of the CASS scholars made a similar argument. However, in the wake of the retrenchment policy, this view was quickly rebuffed by Huang, Jubo (*Renminribao*, 3 March 1989; 20 December 1989) and Kuo, Daimo (*Jingjiribao*, 23 August 1989).

³⁹ See Liu (2000), 487. The state taxation bureau previously made the effort to strengthen the tax surveillance system in its suggestions (*yijian*) presented on 18 December 1989 (Liu 2000, 482-485). The overall goal was to make the taxation collection area more transparent and standardize. A major policy was to separate tax collection function and its surveillance function in the taxation bureau. Previously, the incompatible roles were handled by the same personnel. According to the suggestion, the functional separation would be implemented during the period 1992-1993 after some experiments were conducted. As of August 1990, completion rate of the functional separation was 56.3 percent at the county level (Liu 2000, 483). By 1992, the separation work was completed ahead of the schedule. However, the organizational change appeared not to be worked as planned since its superior local government and local taxation bureau more arduously promoted local interests under the current fiscal contract system.

⁴⁰ The typical example of the increasing influence of the PLA in the Chinese politics was the increase of PLA personnel in the CPC CC. In the twelfth CPC in 1982, the PLA personnel occupied 16 percent of the CPC CC members. In the thirteenth CPC in 1987, the number decreased to 27, which was equivalent to 13

PLA was surely involved in the drafting process of the fiscal reform in various ways, having expressed its preference of the tax-sharing system over the fiscal contract system because in large part it would be a main beneficiary of the reform. One organizational interest of the PLA was to increase military expenditures. As is well-known, the PLA suffered from waning financial support in the 1980s due to the policy priorities of the Beijing government. Due to its organizational norm not to get involved in domestic policies and its negative image resulting from interfering in both the Cultural Revolution and the Tiananmen Incident in 1989, the PLA quite sensibly restrained from publicly interfering with domestic policies.⁴¹

Several leaks out of the PLA, however, clearly showed that it fastidiously demanded an increase in military expenditures to the new Beijing leadership whenever it had the chance. For example, it was publicly revealed that a military representative had been included in a major project of fiscal reform in 1991 (The Task Force 1997), whose results were reported to the State Council in 1993 with the recommendation of maintaining 2 percent of military expenditure over GNP. The Beijing leadership responded to the demand positively. From 1989 on, military expenditures reached at least 10 percent growth rates in spite of the widespread financial problems experienced during the period. Furthermore, Chen Zhangshou, Zhang Zhichen, and Dai Zhongyi in the general logistics department of the PLA insisted on increasing military expenditure up to a level between 2.5-3 percent of GNP, which was 1978's level, although the three were fully aware of financial difficulties of the Beijing government.⁴² If the plan had been

percent, but it increased to 39 in the fourteenth CPC in 1992, which was equivalent to 22 percent of the CPC CC members in the fifteenth CPC in 1997, the number again increased to 42, which was equivalent to 27.1 percent (*Qingnianribao*, 20 October 1992; *Zhongguoshibao*, 16 December 1992; Tian and Zhu eds. 2000, 50-51).

⁴¹ An economic link with domestic politics of the PLA was related to its participation in business. The PLA enterprises enjoyed various privileges such as resources supply, tax reduction, and tax holidays. It often appeared conflicting with local interests. See about the relationship between the military and localities in *Zhongyangribao*, 12 February 1995. However, the fear of chaos due to power struggle in Beijing prevented local governments from being in the position of conflicting with local armies. By supporting local armies, local leaders (in the rich areas) expected that local armies would take steps to protect a power struggle in Beijing from spilling over into their regions. See on this view, in an article by Willy Wo-Lap Lam in *South China Morning Post*, 20 February 1995.

⁴² See Chen Zhangshou, Zhang Zhichen, and Dai Zhongyi, "Guofangfei zengzhang jizhilun [Improving Mechanism of Defense Expenditures]." *Junshi Jingji Yanjiu* 8 (1994): 44-47. They also indicated that there was no imminent threat to China. However, they argued that since a gap between the economic growth and the spillover of its effects to the military existed, the readiness of war by the military would require such increase in military expenditures.

implemented,⁴³ the ratio of military expenditure over the government revenue would have been around 22 percent in 1994 rather than 10.6 percent in practice. The PLA was eventually guaranteed at least a 10 percent level of annual expenditure increase during the 1990s at a 1992 Central Military Commission meeting in spite of increasing deficit problems, and the decision was duly reflected in the eighth five-year plan (*South China Morning Post*, 15 March 1993). Such budgetary pressure from the military had the effect of forcing the Beijing government to restrain spending in some vital sectors such as agriculture and social services, as seen in the provisional 1993 budget report to the NPC by the MOF. Prior to overall implementation of the tax-sharing system, the *Liberation Army Daily* expressed its full support for the new fiscal measures which it believed would allow the Beijing government to strengthen its fiscal position (*Jiefang junbao*, 14 December 1993).

In the Chinese fiscal system, the share of taxes from the agricultural area was not large enough to merit much attention. Previous tax rates on agricultural sectors had been relatively low for the reasons that rural regions were too poor to tax and that agricultural sectors sustained higher than 70 percent of the Chinese population as of 1990. However, agricultural sectors all became alarmed at the prospect of the tax-sharing system becoming a reality because it would tremendously increase the tax burden on village and township enterprises as seen in Table 5-1.⁴⁴ The new fiscal system also forced local governments to cancel tax reductions on village and township enterprises and until 1995 allowed tax holidays on village and township enterprises in central and inland areas only. Therefore, the Ministry of Agriculture sought to give leeway to village and township enterprises from the drafts-making stages.⁴⁵ As of 1993, the total number of employees in these enterprises reached more than 110 million, with 6 million more jobs created in just one year. In addition, a 60 percent increase in income for peasants was derived from these enterprises (*Mingbao*, 15 January 1994). However, the Ministry of Agriculture lobby was not very effective, as the Beijing government allowed only a partial tax return by local governments after collection of taxes in accordance with regulations. As seen in Table 5-4, an investigative report revealed that the tax burden of village and township

⁴³ It is calculated at 2.5 percent level.

⁴⁴ See interviews on this matter in *Mingbao* 15 January 1994

⁴⁵ Arthur's interview.

enterprises of the old tax-sharing system increased almost twofold under the new fiscal contract system. Coincidentally, agricultural areas are concentrated in central and inland areas; thus, the increasing burden of the agricultural sector became closely related to the *kuai-kuai* (horizontal) relationships and worsening regional disparity. *Report on Traces of Social Stability Situation* submitted by a task force of the State Planning Commission indicated that the increasing burden on the agricultural sector was one of five major factors that could lead to destabilization of the Chinese state-society (*Mingbao*, 15 January 1994).

Table 5-4: Comparison of Tax Burdens on Village & Township Enterprises under Two Fiscal Systems in Jiangsu Province (billion)

	Under TSS	Under FCS	Differences
Tax Burden in 1994	25	16.9	8.1 (+48 percent)
Tax Exemption	1.5	4.0	2.5 (-62 percent)
Real Tax Burden	23.5	12.9	10.6 (82 percent)

Source: *Mingbao*, 15 January 1994

The nature of the 1994 fiscal reform was not to distribute *cakes* over local actors crucial to implementing it. Instead, it was to retrieve what was already distributed among them. In the previous fiscal reform, the main idea was how to give incentives to locals and thus mobilize their potential for economic development. The main contradiction accordingly occurred between the conservative and reformative forces. The former had strong bases in the central bureaucracies, acquired benefits from the previously-centralized system in terms of disposal of resources, and hoped to continue enjoying a tight grip over China's economic management. The relics of previous centralized system, however, needed to be dissolved. Since the purpose of reform was to allow locals more powers of economic management, it was easy to mobilize support from them. In addition, because the necessity of economic decentralization was gaining momentum, the introduction of the fiscal contract system was not severely challenged either for legitimacy or ideological validity.

However, the introduction of the tax-sharing system was not one of those cases. Various horizontal and vertical interests converged around the reform. Therefore, the introduction of the tax-sharing system was not an easy task and required various tactics in the long process of gaining enough support from various actors to implement it.

Throughout the CPC's history, as contrasted to previous centralized political and economic systems, a decentralized economic system with political guidance from the central government has been the political choice of China's new leadership under Deng Xiaoping.

2. *Kuaikuai* Interests

The policy priority was to allow local governments and enterprises more control of resources during the seventh five-year plan period. When the Chinese economy experienced rapid inflation in 1988, a major response from the Beijing government was to reduce administrative expenditures rather than to centralize fiscal resources. For example, the Beijing government in 1988 emphasized governmental frugality and ordered a 20 percent reduction in administrative expenses at all levels of government, compared to 1987 (*Renminribao*, 24 March 1988). However, the worsening fiscal position of the Beijing government coupled with the political instability in 1989 shook Beijing's priorities and allowed the issue of the tax-sharing system to reemerge. Two rounds of major battle were exchanged in intergovernmental fiscal relations: immediately after the Tiananmen Incident in 1989 and after the summer of 1993.

In general, localities favored the fiscal contract system more than the tax-sharing system by reason of the fact that the former was favorably arranged for local initiatives. In particular, provinces in the coastal areas received the most benefits of the previous fiscal contract system and the central discretionary policy and so strongly opposed the introduction of tax-sharing. Meanwhile, the central and inland areas were generally more accepting of the tax-sharing system with the expectation that it would increase their coffers' size. Guangdong, Jiangsu, and Hainan had a long history of favoring a pro-contract system and were thus strong opponents of the tax-sharing system since they were beneficiaries of the fiscal contract system and various preferential central policies.⁴⁶ In particular, Guangdong's opposition was fierce. Lin Ruo, the first party secretary of Guangdong province, publicly promoted a thorough implementation of the fiscal contract system as a solution to China's fiscal difficulties (*Renminribao*, 21 March 1988). Ye Xuanping, Guangdong's governor, was the most vociferous opponent of the tax-sharing

⁴⁶ Author's Interview.

system. When Li Peng sought to introduce the tax-sharing system in 1989 after the Tiananmen Incident, coastal provinces vehemently resisted the attempt. The fifth plenum of the thirteenth CPC CC during the period of 6-9 November 1989 became a battle field between proponents and opponents of the tax-sharing system. Then, opponents of the tax-sharing system intensified their criticisms of Li Peng and of proponents of the tax-sharing system as conservatives or anti-reformists (*Xingdao Ribao*, 16 August 1993). For the opponents, the fiscal contract system had been a fruit of Deng's reforms, as initiated by Zhao Ziyang in 1980. Its effectiveness was already proven in the process of the reform. The very positive role it had played had not yet been exhausted in providing material incentives, in particular in its encouraging of local participation, for economic development. To opponents of the tax-sharing system, the introduction of it must have seemed a conspiracy by conservatives to reverse the trend toward economic decentralization. Such an ideologically publicized attack on the Beijing authority was not to be tolerated. As a result, Ye Xuanping, the loudest speaker of the opponents, was removed from the position of Guangdong governor. However, Li Peng and proponents of the tax-sharing system could not also break the resistance because Li Peng was himself vulnerable to ideological criticism.⁴⁷ Such a mobilization for ideological attack as that of anti-reformists was a deep blow against the proponents of the tax-sharing system in Beijing.

Jiangsu was in the coastal area, but it was not able to enjoy the same preferential policies as Guangdong and Fujian.⁴⁸ Therefore, it too shared Shanghai's unease with central policy. Jiangsu Governor Chen Huanyou cautiously complained that Jiangsu's burden of fiscal transfer to the center was already been too high, for as of 1991 Jiangsu had transferred 61 percent of its revenue (7 billion *yuan*) to the center and even increased that amount at a fixed rate. Under such a burden, he argued, Jiangsu and its county governments had to rely on bank loans to continue developing its local economy

⁴⁷ In this point, it appeared not persuasive that Li Peng backed down to play to provinces as a potential contender for leadership. He's been a faithful supporter of the tax-sharing system in spite of severe resistance from coastal provinces (Author's interview). When he could not get sufficient support from other crucial party leaders such as Deng Xiaoping and Jiang Zemin, He could no longer insist it under immature economic conditions to implement.

⁴⁸ For example, the Jiangsu had to remit 75 percent of its foreign exchange income to the Beijing government, but special economic zones were able to keep all the incomes (*Lianhebao*, 21 September 1992).

(*Lianhebao*, 21 September 1992). When Jiangsu was asked to experiment with the tax-sharing system from 1993, it demanded that the remittance rate should not be more than the current level. In an interview one Jiangsu leader claimed that Jiangsu feared that the introduction of the tax-sharing system would worsen its financial situation unless a guarantee of its stable funding was given (*Lianhebao*, 26 October 1992).

Shanghai did not easily embrace Beijing's plan either. Since the fiscal contract system allowed Shanghai to pay a fixed amount of remittance, Shanghai was able to enjoy greater fiscal autonomy under that system. Shanghai leaders considered the contract system vouchsafed by Deng Xiaoping himself until the year 2000 after it had been sacrificed early in the economic restructuring period. Deng once was quoted as saying that Shanghai would be the last safeguard for the Chinese socialist economy if new market-oriented experiments failed. Therefore, Chinese leadership did not allow Shanghai special treatments in taxation and other measures and maintained the traditional system during the early 1980s (author's interview). Shanghai eventually acquired special taxation treatment with the introduction of the fiscal contract system in 1988. Shanghai, who contributed heavy fiscal remittance to the center during the previous period, then welcomed the fiscal contract system. In the first year of the fiscal contract system, Shanghai quickly increased by 25 percent of its industrial and commercial tax collection (*Renminribao*, 2 January 1989). Shanghai, however, was suspicious of the new centralized fiscal scheme presented by Li Peng.⁴⁹ It is understandable that Jiang Zemin as a former Shanghai leader became the current party general secretary of the CPC should express his support of the fiscal contract system in the fifth plenary session of the thirteenth CPC CC in 1989, the battlefield between two fiscal systems' supporters. In spite of the economic retrenchment policies prevailing until 1991, the Beijing leadership made a decision to continue implementing the fiscal contract system in the early 1990s.

The second round of the battle heated up in the summer of 1993. Although the fiscal contract system improved overall provincial finance situations, rapidly increasing local expenses along with overall economic reforms caused local governments to

⁴⁹ However, the interest of Shanghai was different from Guangdong's because of the heavy fiscal burden of Shanghai. Shanghai handed over nearly three quarters of its revenue to the centre, but Guangdong almost kept 90 percent of its revenue (*Far Eastern Economic Review*, 4 April 1991). Therefore, Shanghai had a certain incentive to support a new fiscal reform if it would help balance.

desperately seek more fiscal resources as their overall growth of expenditure far outnumbered that of their revenues.⁵⁰ In the early 1990s, to solve the financial problem, localities set up a hue and cry for a banking sector reform, which was not capable at that time of supplying sufficient funds for local development, but in general they silenced a fiscal system reform (MOF 1994a, 16). However, the atmosphere in Beijing on the issue was changing as Beijing's financial problems deepened. The report of Hu Angang and Wang Shaoguang pinpointed the country's intensifying fear by referring to the declining fiscal position of the Yugoslavia regime as a major cause of that nation's collapse. The Beijing government was not able to find a way to support the increasing military expenditure without making certain changes in its fiscal arrangements. In the 1993 debates over the introduction of the tax-sharing system, the coastal areas were naturally opposed to fiscal reform. They saw the reform as a reinforcement of that traditional socialist ideology, egalitarianism. It would deprive local initiatives and fail the current economic/fiscal strategy to make the size of the pie bigger. They warned that it would eventually be detrimental to Beijing's finances. Zhu Rongji, who was in charge of drafting the fiscal reform plan, came under heavy fire. It was reported that he dared not call a large meeting with local leaders lest they gang up on him (*South China Morning Post*, 8 December 1993). According to the report, Zhu engaged in shouting with local leaders from coastal areas such as Guangdong, Jiangsu, and Shanghai. In an interview, Xi Zhongwu, Liaoning governor, revealed his unease on the tax-sharing system because Liaoning would be forced to pay 0.7-0.8 billion *yuan* more of the value-added taxes every year under the tax-sharing system (*Jingjiribao*, 18 April 1994). Jiangsu complained of the heavy burden anticipated under the new fiscal reform scheme. Hainan demanded policy consistency (*Zhongguoshibao*, 25 December 1993). In particular, resistance from the Guangdong leaders Xie Fei and Zhu Senlin proved intense as Jiang Zemin called a special meeting with them to make the reform process easier. Zhu Rongji's discussion with Jiangsu leaders Shen Daren and Chen Huanyou were also described as fiery. Zhu also in turn showed his determination by firing the nay-sayers to the tax-sharing system

⁵⁰ In 1992, both the Beijing and local governments suffered from deficit.

in September. One of those fired was Shen Daren, Jiangsu party secretary (*South China Morning Post*, 8 December 1993).⁵¹

Shanghai in the beginning was also reluctant to accept the tax-sharing system, but soon let up on its opposition. One reason was that the increase of fiscal burden on Shanghai caused by the fiscal reform would be minimal: in 1992 Shanghai remitted about eleven billion *yuan* to the central coffers, and in 1994 it is expected to provide twelve billion *yuan*.⁵² This was not a huge burden for Shanghai, considering its economic size and potential. The other more crucial reason might be the confidence of the Beijing leadership in supporting its interests under the new system due in good measure to Jiang Zemin's and Zhu Rongji's strong connection as former Shanghai leaders. Meanwhile, Guangdong remitted the fixed amount of a bit more than six billion *yuan* each year under the previous fiscal contract system, but with the introduction of the tax-sharing system its burden would almost double to 5.6 billion *yuan* more than the previous amount under the tax-sharing system (*Mingbao* 29 November 1993).

On the other hand, the less-developed central and inland provinces embraced the idea of tax-sharing with some caution. Sichuan governor XiaoYang's remarks well illustrated their attitudes (*International Herald Tribune*, 30 October 1993).

Declining revenue was hampering Beijing's ability to invest in major projects. That in turn will slow down regional development

Since the central and inland provinces relied heavily on central subsidies, Beijing's declining revenues would damage their economic development. He added some comments of the new fiscal reform (*International Herald Tribune*, 30 October 1993).

Of course I'd like to give less money to Premier Li Peng, but he should think about the whole country, --- you should give more.

They perceived that Beijing's main targets of strengthening fiscal control through the tax-sharing system were coastal provinces. Most of central and inland provinces did have little burden to remit their revenues to the central government and would not be forced to pay more under the tax-sharing system. For example, Wang Hanmin, Vice-Governor of

⁵¹ I heard a rumor in the field research that Ge, Hongsheng, Zhejiang governor, was also replaced in the 1993 personal reshuffling because of his loud opposition to the tax-sharing system. However, this rumor was not confirmed.

⁵² Regarding Shanghai's complaint of a heavy fiscal burden due to Shanghai's economic difficulties in 1991, see *Wenhuibao*, 1 January 1992.

Qinghai, indicated that his people were not supposed to pay more to the Beijing government under the tax-sharing system since their fiscal base was feeble. On the contrary, he expected that the Beijing government would not only provide more fiscal resources to inland areas after the introduction of the tax-sharing system but also reduce the gaps in economic development across the regions (*Mingbao*, 29 November 1993).

The regions lobbied strenuously for their own sakes when Beijing's political leaders visited them. Henan and Shaanxi requested special treatments, which would reduce the amount of their remittance up to 30 percent over five years. Jiangxi and Ningxia demanded to establish a special inland economic zone (*Zhongguoshibao*, 25 December 1993). After the third plenary session of the fourteenth CPC CC decided to implement the tax-sharing system from 1 January 1994, the economic and finance work conferences held in 1993 became major lobbying and negotiation sites in which to finalize details. They demanded special consideration for poor areas that had been alienated by the rapid economic development policies. Some from the central and inland regions warned that a compromise between the Beijing government and the coastal provinces might distort the original scheme of the tax-sharing system and urged a thorough implementation. They also revealed their fear that the Beijing government might allow privileges to coastal areas at expense of interests of the central and inland areas during the coordination process, arguing further that such favoritism would threaten social and political stability (MOF 1994a, 18).

To calm the fears of the central and inland provinces, the Beijing government responded by promising that it would build up an effective resource allocation system and take into full consideration the differing realities of the different areas (*South Morning China Post*, 6 December 1993). The new fiscal transfer method-to-be, a *yinsu* [factor] method, would be more beneficial to the central and inland areas than the given *jishu* [base] method because the *yinsu* method would be determined by the size of the fiscal transfer along with objective factors such as population, territorial size, per capita income, and level of regional economic development.

After an imminent introduction of the tax-sharing system became apparent, many localities adopted a tactic different from public resistance. They cultivated their own ways of deviating from the central direction. The Beijing government reiterated that it

would pave the way to the tax-sharing system such that every province would have sufficient revenues to meet their expenditures after the introduction of the tax-sharing system. Even the reclaiming of taxes on alcohol and tobacco by the Beijing government would not damage local interests (*Zhongguoshibao*, 4 February 1994.). The *yinchimaoliang* (consuming foods in advance) phenomenon became prevalent when, after the Beijing government guaranteed the amount of 1993's revenue as a base, many provinces collected in advance for part of 1994 taxes to increase the size of 1993 revenues. As a result of such frenzied actions, revenue collection in the provinces soared in the last half of 1993. Even until the third plenary session of the fourteenth CPC CC announced the introduction of the tax-sharing system from 1 January 1994, resistance from localities did not easily abate. While localities had no choice but accommodate the irreversible tide, they focused more on the rules of the game, such as on who would control local taxation bureau reconstruction and sub-provincial finance.

C. Two Ratio Debates and Amassing Support

Throughout PRC history, debates on certain policies have been often closely related to ongoing political struggles and changing balances of power.⁵³ Although policy debates have been restrained from exploding into power struggles among top political leaders during the post-Mao period, they often highlighted a changing power balances. Previous debates in the process of the *replacement of profit by tax* reform are an example, exposing the consolidating power of Zhao Ziyang in the economic area over Hu Yaobang. The debates on the two ratios were no exception, being complicated with bureaucratic politics and intergovernmental relations in Chinese politics. Through the debates, Chinese leaders mobilized support for their preferred policies. Chinese decision norms required a series of pre-coordinating moves in launching a major policy, and instigating debates have been a major mechanism through which to raise issues, ignite support, and propagandize Beijing's intentions during the post-Mao period. Quite broad ranges of views were introduced into the debates. In the process, the successful policy pursuer had to form an obvious majority among the key players. In practice, however, the

⁵³ Regarding this issue, see the well-known Joseph Fewsmith's *Dilemmas of Reform in China* (1994).

debates often ended up in a considered compromise in which no one predominated. Even in spite of unbalanced power, though, a winner could still emerge in the policy-making process. The two ratio debates are closely related to the introduction of the tax-sharing system, so debates between pros and cons on the issue proved fierce, with practical implications.

A concern over the declining capacity of the Beijing government to control revenue was already evident when Bo Yibo's speech at the 8th plenary session of 5th NPC in 1979. Bo suggested as the bottom line of the ratio of the state revenue over national income a figure no less than 30 percent.⁵⁴ The debate then ignited as new fiscal policies began affecting the degree of Beijing's fiscal control on the inception of the overall economic reforms in 1978.⁵⁵ Various views emerged on the fiscal situation and its management. Along with Bo's line, a 1982 internal document written by Sha and Yang suggested strengthening Beijing's fiscal control through its use of administrative power.⁵⁶ They argued that before the inception of the reforms in 1978, the motivational problem in localities and enterprises was serious due to the excessive centralization of fiscal and managerial powers.⁵⁷ Introduction of the fiscal responsibility (contract) system and the division of interests helped resolve the problem; however, these policies brought a major new problem, that of declining fiscal revenue. In 1978, Beijing's total revenue was 112.1 billion *yuan*, a figure that continued to decline to 97.6 billion *yuan* in 1981 for two consecutive years. The average ratio of fiscal income over national income over 30 years was 33.7 percent but fell to 28 percent in 1980 and 26 percent in 1981. In particular, the Beijing government's control over revenue dropped drastically, to less than 20 percent

⁵⁴ Jiang (1984), 33. For the introduction of debates on fiscal deficit, see *Jingjiyanjiucankaoziliao* No. 47 (23 March, 1985): 2-17.

⁵⁵ On the debates, Zhenyi He, and Lingshu Chen, "Caizhengfenfeguilujinliangdeyanjiu [Study on Rules of Fiscal Distribution]." *Caimaojingji* No.1 (1981); Jicai Sha, and Shengming Yang, "Dangqian Woguo Caizhang Wentijianxi [Analysis on Contemporary Fiscal Problem of China]." *Jingjiyanjiucankao* No. 38 (8 March 1982); Xin Jin, *Renminribao*, 15 July 1983; Haikuan Zhao, *Renminribao*, 12 September 1983; Yingguang Jiang, "Guanyucaizhengshouru he Guominshourubiliguanxidetantao [Discussion regarding to the Ratio of Budgetary Revenue over National Income]." *Jingjiyanjiucankaoziliao* No. 100. (4 July 1984); and Ping Fan, and Ding Yi, "Caizhengshouruzhanguominshourubizhongdefenxi" [An Analysis on the Ratio of Revenue over National Income]." *Jingjiyanjiucankaoziliao* No. 20. (8 February 1985).

⁵⁶ See Jicai Sha, and Shengming Yang, "Dangqian woguocaizhang wentijianxi [Analysis on Contemporary Fiscal Problem of China]." *Jingjiyanjiucankao* No. 38 (8 March 1982) and also Task force on the Ratio of Revenue over National Income (1998), 1.

⁵⁷ An excessive investment on basic construction beyond national fiscal capacity was mentioned as the other problem. In Footnote 55, Sha and Yang (1982), 17.

from 80 percent in the past.⁵⁸ In solution, Sha and Yang suggested adjusting given ratios of interest division and fiscal contracts between the central and provincial governments/enterprises along with other measures favoring the Beijing government. A *People's Daily* article by Jin Xin took a the similar line by arguing that the ratio should be maintained around 28 to 30 percent.⁵⁹ That is, Jin favored more centralized fiscal control.

Zhao (1983)⁶⁰ and Jiang (1984)⁶¹ denied the view that the state fiscal capacity was declining by raising a methodological issue of calculating government fiscal capacity. Zhao and Jiang suggested that increases of bank deposits (Zhao) and extra-budgetary revenue (Jiang), which could be controlled by the State, should be included in measuring fiscal capacity. Then, the fiscal capacity had not declined as seen in official revenue data in spite of structural changes in fiscal system and maintained a much higher than 30 percent of revenue ratio to national income as Bo suggested. Fan and Ding (1985)⁶² argued further that the ratio had increased as compared to the period of total fiscal control in 1957, when considering the size of extra-budgetary revenue. However, the main problem resulted from the decreased ratio of budgetary revenue and central government revenue. To guarantee financing of basic projects at the national level, Fan and Ding recommended institutionalization in the fiscal area, including integration of extra-budgetary with budgetary revenues and creating a township-level of financial organization to better control the agricultural area.

He Zhenyi and Chen Lingshu took fiscal decline for granted as a consequence of 1981's fiscal decentralization.⁶³ According to them, revenue income does not necessarily increase as much as national income does. Revenue income can be influenced by the economic and fiscal structures of society and state. In China, maximum revenue

⁵⁸ Sha and Yang (1982), 18. In details, He & Chen informed the ratios over periods. 33.6 percent during the first five-year plan period, 38.6 percent during the second five-year plan period, 34.2 percent during the three-year adjustment period, 1963-65, 31.5 percent during the third five-year plan period, 34.4 percent during the fourth five-year plan period, and 32.4 percent during the fifth five-year plan period. The overall average was 34.3 percent. See He and Chen (1981).

⁵⁹ Jin, Xin's article in *Renminribao*, 15 July 1983.

⁶⁰ Zhao, Haikuan's article in *Renminribao*, 12 September 1983

⁶¹ Yingguang Jiang, "Guanyu Caizhengshouru he Guominshouru Biliguanxidetantao [Discussion regarding to the Ratio of Budgetary Revenue over National Income]." *Jingjiyanjiucankaoziliao* No.100 (4 July 1984).

⁶² Fan Ping, and Ding Yi, "Caizhengshouru Zhanguominshouru Bizhongdefenxi [An Analysis on the Ratio of Revenue over National Income]." *Jingjiyanjiucankaoziliao* No. 20 (8 February 1985).

⁶³ Zhenyi He, and Lingshu Chen, "Caizheng Fenfeguiliu Jinliangde Yanjiu [Study on Rules of Fiscal Distribution]." *Caimaojingji* No.1 (1981).

collection is constrained by the increase of revenue sources in society and local governments as a result of fiscal reform. For example, after fiscal management power was assigned to enterprises and local governments, enterprises enjoyed a possession of more than 28 billion *yuan* during the period of 1979-1981 and local governments increased their extra-revenues to 65 billion *yuan* in 1982, which was equivalent of 57.8 percent of state revenues.⁶⁴ Such decentralization policies certainly helped economic development.

During the early period of reforms, debates on China's fiscal situation posited the two-ratio issue as an important agenda in political discourse. However, as seen in the report at the twelfth CPC Congress in 1982 by Hu Yaobang, General Secretary of CPC, the Beijing leadership's position was to place its emphasis neither on maintaining finance balance nor on allowing more incentives to localities and enterprises for economic development.⁶⁵ Instead, Beijing sought to bring down both birds with one shot. Simultaneously achieving both goals, however, turned out impossible after urban reform started in 1985. Policy priority thus changed to facilitating economic reforms as summarized in the report of Zhao Ziyang at the thirteenth CPC Congress in 1987.⁶⁶ By casting off the ideological shackles of socialism in further reforms and adopting the *theory of the primary stage of socialism*, the report clearly signaled that the balance of power between conservatives and liberals had moved firmly in favor of further reforms. In the fiscal arena, the report gave momentum to the facilitation of fiscal contract system expansion to achieve bolder economic development at the local level. In the midst of the political battle to introduce the fiscal contract system, various views on the two ratios simultaneously emerged. Until this period, the focus of the two-ratio debates had mainly

⁶⁴ The other factor comes from the difference between dramatic increase of production in the agricultural sector and relative insignificance of the agricultural sector in State revenue. For example, increased production in agricultural sector was equivalent of 16.8 billion *yuan*, which was composed of about 76.4 percent of 22.0 billion *Yuan* in national income. See He and Chen (1981).

⁶⁵ Hu, Yaobang, *Hongqi*, No. 18 (1982): 6-30. Also see, Jiyun Tian, "Guanyujiakuaituixing 'ligaishui' de Yijian [A Suggestion to Facilitate Tax for Interest Reform]." *JingjiGuanli* No.1 (January 1983): 9-10.

⁶⁶ Internal documents reveal ideas of fiscal decentralization at the cost of central coffers during the late period of 1980s. See Yiqun Feng, and Daifei Chen, "Guanyu Woguoshuizhi Gaigede Jibengousi [On Basic idea of Fiscal System Reform]." *Jingjiyanjiucankaoziliao* No. 188 (8 December 1988). Some articles urged introduction of tax-sharing system in the wake of fiscal decentralization in 1988. See, Haoran Zeng, and Mingfeng Tang, "Lunfenjicaizheng [On Decentralized Finance]." *Jingjiyanjiucankaoziliao*, No. 24 (15 February 1988), and Xiaoqiu Fang, and Kang Jia, "Shenhua Caizheng Gaigede Gouxiang [Idea on Deepening Fiscal Reform]." *Jingjiyanjiucankaoziliao* No. 179 (19 November 1988).

been on the economic/political implications of the declining ratio of state revenue to central revenue. However, the major concern of the debate gradually moved to the issue of Beijing's capacity for control in the fiscal area.

Some government-sponsored scholars such as from the State Council and the MOF acted as vanguard forces in strengthening fiscal control and introducing the tax-sharing system (author's interview). Zheng and Tang (1988), researchers under the State Council, urged introduction of the tax-sharing system and its divided management approach to administrative responsibility while criticizing the widening gap between fiscal management power and its disposal power. Under the tax-sharing system, state and local taxation bureaus would be separated, and local taxation bureaus would enjoy a broader range of privileges including the powers of setting administrative rules, making tax rate adjustments, and controlling the amount of tax collection under their jurisdictions. Their views were still transitional, however, in that their suggestions were to be applied discretionarily to the fiscal contract system or the tax-sharing system in accordance with local situations.⁶⁷ Meanwhile, Fang and Jia (1988) took for granted the declining ratio of national revenue over national income during the period of fiscal decentralization. According to them, government fiscal control could be accomplished by developing a new fiscal adjustment system such as sound state-property management system, extra-revenue management system, credit market, and tax-sharing system. Under a new economic environment, they argued, the fiscal (contract) system would continue up to the end of the twentieth century, and a long-term fiscal development strategy should be based on fiscal reform.

After the Tiananmen Incident, proponents of the tax-sharing system attempted to eliminate the fiscal contract system to strengthen Beijing government's macro-economic control. The SPC was reported to have presented the scheme (*Lianhebao*, 9 December 1989). The MOF publicly had earlier promoted the issue of the two ratios in the interview with the *Economy Daily* (*Jingjiribao*, 14 October 1989). To raise the two ratios, the practices of controlling extra-budgetary funds, increasing the contract base figure/rate, and replacing the practice of *paying loans before tax* with *paying loans after tax* were

⁶⁷ They also abide by the bottom line suggested by Bo, 30 percent of revenue over national income. See Zheng and Tang (1988), 32.

recommended. The implication of raising the two-ratio issue was obvious since it was impossible that the Beijing government would fail to improve its financial situation under the given fiscal contract system. Suddenly, the two-ratio issue became hot. Opponents of the tax-sharing system resisted the eventuality that the debates on the two-ratio problem should become the issue of introducing the tax-sharing system as a solution. Cong Anni and Su Ming in an editorial in *Guangmingribao* suggested a different solution, that of focusing on the redistribution side to resolve the declining macro-economic control problem (*Guangmingribao*, 9 December 1989). The cause of the problem was attributed to China's recent rapid economic growth achieved at the cost of fiscal stability. However, the solution was to consolidate the fiscal contract system. Zheng Qi suggested a tax surveillance institution by way of solution (*Renminribao*, 25 December 1989).

The SPC and the government finance work conferences at the end of 1989 became the hot loci of proponents and opponents contesting the tax-sharing system (*Lianhebao*, 9 December 1989). The *Lianhebao* report revealed just how fiercely local leaders resisted Beijing's attempt to introduce the tax-sharing system: the central bureaucracies, Li Peng, and Yao Yilin were the major proponents; the local governments in the coastal and southern areas were the major opponents. According to the SPC's plan, the proportion of Beijing's revenues to the local governments' would be about 65 percent as compared to less than 50 percent at that time. It would certainly shrink the size of local finances. The provinces insisted that local finance had already been severely damaged by Beijing's anti-inflationary measures and that the introduction of the tax-sharing system would lead to the serious decline of local economies. Li Peng and Yao Yilin failed, however, to persuade key political figures such as Deng Xiaoping and Jiang Zemin, and local leaders as Beijing's policy priority was to encourage local initiatives and economic development. Accordingly, Li and Yao eventually conceded that the Beijing government would continue to implement the fiscal contract system and emphasized economic and financial stability as priorities for the 1990 economic plan (*Lianhebao*, 9 December 1989; *Renminribao*, 18 December 1989).

Although the debate on the two ratios died down with the Beijing government's decision to maintain the fiscal contract system, it was not altogether extinguished. The Beijing government and scholars became alarmed by the declining speed of operation of

the two ratios in the early 1990s. In particular, after Deng's 1992 southern tour, the gap between the revenue and GDP growth rates proved alarming as the deficit growth rate had already hit the ceiling.⁶⁸ Both Wang Yaping and Yi Ming from the SPC notably indicated that Beijing's intention was crucial in explaining the fiscal decline in the process of economic reforms (Yi 1992; Wang 1992). The main cause of the decline was due to Beijing's policy priorities, that is, the rapid economic development strategy and subsequent preferential policies including the fiscal contract system. Beijing's fiscal difficulties resulted from another reason that Beijing took most burdens for subsidizing enterprises and local governments to guarantee the economic/political stability during the transitional period. One-third of government expenditure was allotted to cover various subsidies.⁶⁹ Although the decline was expected and to some degree intended, the speed of the decline was faster than anticipated. You Xiangdu from the SCRE argued, however, that the two ratios must be guided by practical necessity at certain stages of economic development.

One feature of the debates in this period was that their main subject of the discourse shifted from the issue of overall revenue ratio to GDP to Beijing's revenue ratio to the localities' revenues in the two-ratio issue. Zhang Ning argued that the Beijing government was still very powerful, given its central ability in the areas of banking, direct investment, administrative control, organizational mobilization, and legal and ideological control (Dong et al. 1996). Zhong Pengrong of the CPC's general research office of attributed the decline of the two ratios to the entrenched structure that caused inefficient distribution of expenses. According to him, the introduction of the tax-sharing system would not be auspicious if the roles of governments and enterprises were not separated (*Jingjiribao*, 7 March 1992).

⁶⁸ In 1992, the local governments also recorded 3 billion *yuan* of deficit as well as the Beijing government. That is, all levels of governments began to suffer from a deficit during the period. *Xianggang Dagongbao*, 3 August 1993.

⁶⁹ Wang Bingqian, ministry of the MOF, reported that as of 1989, the size of subsidies in revenue would be 32 percent of it (*Zhognguoshibao*, 22 March 1989). In general, the size of the subsidies of the western countries was less than 2 percent of its revenue and the Soviet Union and eastern European socialist countries less than 20 percent (*Renminribao*, 23 January 1989).

The MOF and the State Taxation Bureau assiduously pursued the introduction of the tax-sharing system as the route to raising the two ratios.⁷⁰ For example, Wang Weixing and Zhou Kaili from the MOF insisted that thorough introduction of the tax-sharing system would be the only avenue to solving Beijing's financial problems (Wang and Zhou 1992). The MOF submitted a schedule for experimenting with the tax-sharing system in nine provinces and cities in the fourteenth CPC Congress in 1992; the experiment began in the same year.⁷¹ Reputedly Chi Haibin, deputy Finance Minister, insisted that the tax-sharing system would be implemented nation-widely during the period of the eighth five-year plan (1991-1995) (*Renminribao*, 20 June 1992).

The fiscal pressure on the Beijing government mounted in 1993. Xiang Huaicheng, deputy Finance Minister, urged fiscal reform to assuage the problem of the declining ratio of central revenues over national income in January 1993 (*Xinaggang Dagongbao*, 27 January 1993).⁷² In early 1993, according to Hu Angang's interview, Jiang Zemin appeared to have become alarmed by the financial problem and now leaned toward implementation of the tax-sharing system (Hu 1999, 201). Thus in April 1993 he directed the MOF and the State Taxation Bureau to prepare for the fiscal reform, insisting that the fiscal contract system was an obsolete system which could no longer accommodate the market system.⁷³ However, until then, the author's interview with Hu Angang coupled with circumstantial evidence indicated that the Beijing leadership had not yet reached any consensus of when the tax-sharing system would be implemented. No sign of the introduction of the tax-sharing system was to be seen in the report of the finance and economy committee in the second plenary session of the standing committee

⁷⁰ As for the various views for the fiscal reform in the MOF, see the interviews in *Xinaggang dagongbao*, 3 August 1993 and *Wenhuibao*, 5 October 1993. A leading researcher for introducing the tax-sharing system was Bai Jingming in the MOF.

⁷¹ The nine provinces and cities were Zhejiang, Liaoning, Xinjiang, Tianjin, Wuhan, Qingdao, Dalian, Shenyang, and Chongqing. Although Shanghai was not included in the experiment, it made a decision to implement a fiscal reform in Podong area, which included the reduction of state-owned/collective enterprise income taxes from the current 55 percent to 33 percent (*Shanghai Wenhuibao*, 19 April 1992). The tax reduction rate was adopted in the 1994 fiscal reform.

⁷² He also mentioned the other two solutions: to increase enterprise efficiency and to reduce the administrative expenses.

⁷³ Accordingly, a small group for restructuring the fiscal system was established (*Xinhua*, 2 August 1993). According to the report by the Liu Zhongli, Finance Minister, in the finance work conference in July, the revenue increase was only 3.5 percent; meanwhile the expenditure increase was 12.5 percent in the first half of the year (*Renminribao*, 20 July 1993). I will explain the combination of succession issue and military buildup but the macro economic problem eventually lead Jiang to make the decision in the next section.

of the eighth NPC held in June 1993 (*Renminribao*, 1 July 1993). Since groups strongly opposed to the tax-sharing system were entrenched in localities and various social and governmental sectors, the Beijing government needed extra-governmental support to stir an assault on the bastion. In this regard, the report by Hu and Wang was timely and pinpointing.

The famous internal report by Hu Angang and Wang Shaoguang of May 1993 shifted the debate to an entirely different level although the issue was not entirely new and was still in line with recurrent debates regarding the two ratios. The report drew tremendous attention from both inside and outside China for several reasons. One was the manner in which they argued, a way in which nobody had ever dared in previous years. According to their argument, the fiscal crisis issue was no longer germane only to the financial area but related to the fate of China's whole political system. The current state of finances was described as close to Yugoslavia's just before its collapse as well as to periods of chaos and break-up in Chinese history (Hu and Wang 1994; Hu 1999).⁷⁴ According to them, increasing the two ratios and in particular, the ratio of Beijing's revenues over local revenues was no longer a matter of policy choice but of sheer survival. Their argument was presented in May 1993 as an internal report of the Chinese Academy of Science; it then quickly circulated among Beijing and provincial leaders. In the report, they argued that the current fiscal crisis was different from that of classic socialism.

The crisis of classic socialism was characterized as low in efficiency and poor in effectiveness in utilizing and allocating resources in society because of the concentration of power in the central government and party. However, China's new crisis of state capacity came from decentralization of fiscal resources. Thus Hu and Wang argued urgently to restore a stronger and more authoritative central government in the fiscal arena, in order to improve the state's declining extractive capacity and to speed up its modernization process. Otherwise, they argue, China might suffer the fate of Yugoslavia.

⁷⁴ Hu argued that during the periods of chaos, the ratio of extraction in the central government over the local governments was a sixth (Hu 1999, 196).

The sense of crisis was orchestrated abroad by parties who spoke of “breaking up China,”⁷⁵ alarming views also shared to some degree by the Beijing leadership. *Dagongbao*, a Hong Kong-based newspaper, reported a remark by Zhu Rongji to the effect that China’s economic problems would translate into a political crisis if the Beijing government could not solve the financial problem quickly (*Xinaggang Dagongbao*, 12 July 1993). Some western scholars also issued warnings that the worsening fiscal capacity of the Beijing government (Overholt 1993) and absence of political leadership after Deng’s death (Segal 1993) would cost the Chinese political system dearly. Still, influential international organizations such as IMF and the World Bank were helping strengthen Beijing’s position vis à vis fiscal reform. Beijing and the MOF actively increased their contacts with international organizations such as the World Bank to seek information and advice for fiscal reform along the lines of the international standard (*Zhongguoshibao*, 29 September 1992). Such efforts provided a space for international organizations to insert their influence in Chinese financial reform. Along with the debates on the dangers to China of weakening its control of the fiscal and regional arenas, the World Bank strongly urged recentralized fiscal measures as a prerequisite for further economic development.⁷⁶

Hu and Wang’s report provided the reasoning to motivate Beijing’s political leadersto strengthen their control over local economic behaviors. Zhu Rongji and the Beijing leaders quickly embraced the idea of Hu and Wang’s report and inspired a turn toward accelerating implementation of the tax-sharing system.⁷⁷ The two ratio problems were speedily publicized, which were previously mainly discussed in the internal circles of Beijing politics. After that, the debate intensified into feuds revolving around organizational and regional interests as they related to the introduction of the tax-sharing

⁷⁵ In the western world, the view of “breaking up” of China became popular around the period. For example, Yan Jiaqi, exiled Chinese scholar, predicted a coup and a break-up of China after Deng dies (*South China Morning Post*, 16 July 1993). Gerald Segal, William Overholt, Nicholas Kristof, and Jack Goldstein were in this line.

⁷⁶ See the contents in the World Bank (1995).

⁷⁷ Hu and Wang handed in the report in May 1993, and the Beijing leadership made a decision to implement the tax-sharing system in the end of July 1993 (on the report, *Wenhuibao*, 23 June 1993; *Zhongguoshibao*, 24 June 1993). Because of the timing and publicity of the report, later on, he was known as Zhu’s think tank in the western academic world. When I asked him whether there was a previous exchange of ideas with Zhu Rongji or other political leaders in Beijing before they handed in the report, he denied a direct relationship with Zhu at that moment (author’s interview). In his new book, he even said that he met Zhu for the first time in a conference in July 1996 (Hu 1999, 2).

system in the fiscal arena.⁷⁸ After the proponents of the tax-sharing system mischievously took the issue of the two-ratios to justify their support for the new fiscal reform, the opponents made a target on Hu and Wang's view to criticize the tax-sharing system.

Some critics remained virulently opposed to the introduction of the tax-sharing system even after Zhu Rongji and Jiang Zemin made intensive trips to persuade localities to accept the new fiscal reform. For example, Yang Peixin of the DRC argued that the decline of the two ratios was not necessarily detrimental to but in fact beneficial for the economic development (Yang 1994). Even in an atmosphere pushing for approval of the new fiscal reform in November 1993, he fearlessly supported the fiscal contract system as a characteristically Chinese fiscal arrangement, arguing that the fiscal contract system was the decision of the fourteenth CPC and that Deng Xiaoping also supported the fiscal contract system (*Xianggang Wenhuibao*, 8-9 November 1993). Fan Gang argued similarly that China's extractive capacity was not in the strict sense low, considering the country's stage of the economic development (Fan 1995). Ma Yining, a respected economist at Beijing University (*Dagongbao*, 13 December 1993) and Tong Dalin, the famous economist, persistently argued that policy priority should be placed on improving local finance. Zhang Shuguang of the CASS, Wei Jie of the People's University (*Renmin daxue*), and Wang Zuo of Guangdong cautiously suggested an adjusted tax-sharing system based on local interests while implicitly supporting the maintenance of the fiscal contract system.⁷⁹ A cadre from a southern province challenged the the validity of Hu and Wang's argument by pointing out that the Soviet Union collapsed even though its central revenue ratio over the total was 54.5 percent (*Zhongguoshibao*, 3 December 1993).

The debates on the two-ratio issue changed their emphases from overall state revenue extractive capacity over GDP to Beijing's extractive capacity over local revenues

⁷⁸ The most crucial work among them would be Wang and Hu's report on National Capacity (1994). However, there are numerous works on this issue in China. For examples, Zhiping Yun, and Hong Wang, "Nulitigao Caizhengshouru he Zhongyangcaizhengshourude Bizhong [Raise the Ratios of Revenue and Central Revenue]." *Qiushi* No. 4 (1990); Yaping Wang, "Caizhengshouru Zhan Guominshourubili Guanxiwentide Tantaoh [Study on Issues of the Ratio of Revenue over National Income]." *Jingjiyanjiu Cankao* No. 57 (27 June 1992); Ming Yi, "Caizhengshouru Zhan Guominshourubili Bianhuade Insufenxi [Analysis of Factors Changing the Ratio of Revenue over National Income]." *Jingjiyanjiucankao* No. 166 (15 November 1992).

⁷⁹ See the logic of Wang, Zuo in *Dagongbao*, 6 October 1993. He argued the introduction of a system combined the tax-sharing system with *Fenchengzhi* [Revenue-Dividing System], which is similar to revenue-sharing ways in fiscal contract system.

over time. Due to the fervid and persistent debates, the Beijing government never suffered from lack of alternatives and ideas. In the debates, proponents for fiscal concentration of revenue appeared to be in the majority. The Beijing government also utilized the debate to propagandize its intention in favor of the tax-sharing system in late 1993. However, regardless of position in the debates, what was common was the idea of separating control over revenue from control over expenditure. Little emphasis was placed on centralization of expenditures although 40 percent of target as Beijing's expenditure share emerged in the debates (author's interview with Hu Angang; MOF 1993). An internal MOF article manifestly held that fiscal power should be concentrated mainly in the hands of the Beijing government but spending in the hands of local governments (MOF 1993, 22-23). Instead, the general consensus was to guarantee local expenditure for economic development and to create a stable fiscal institutionalization locally. The obvious target of the two-ratio debates was the revenue side. As seen in the article by Wang (1992) from the SPC, emphasis on the principles of compromise and coordination operated in the debates, even among the proponents of fiscal centralization. A look at the outcomes reveals that the debates contributed enormously in shaping the contents of the tax-sharing system.⁸⁰

D. Increasing Military Influence in Domestic Politics and the Fiscal Reform

Macro-economic control was both the conventional and official reason for the fiscal reform of 1994. However, one political factor which differed from the conditions

⁸⁰ Even after the introduction of the tax-sharing system was implemented, the issue of the two ratios has continued to be an agenda of the academic discourses. To see examples, Angang Hu, "Yizhizhongyangcaili Jixuxiagang Zhiguanzhongyao [Restraint on Continuing Decrease of Central Revenue Capacity]." *Gaigeneican* 9 (1995); Angang Hu, and Yaoting Zhang, "Tigaoshuishou zhan GDP Bizhong Dayouqianli [Raise Potential of the Ratio of Revenue over GDP]." *Caizhengyanjiu* 5 (1996); Youcai Yang, "Zhengjiazhongyangcaizheng Shourubizhong [Increase of the Ratio of Central Revenue]." *Jingjiyanjiu Cankao* 52 (4 June 1997); Zhaocai Wang, and Ruichao Wang, "Chongsucaizhengfenfeizhuti Tigaocaizhengshourubizhong [Remould a Subjective of Fiscal Distribution and Raise the Ratio of Revenue]." *Jingjiyanjiucankao* 89 (26 September 1997); Weizhen Tian, "Duiguominjingjifazhantaishi, Jingjizongliang (GDP) yu Shuishoushouruxiangguanfenxi Jingjiyanjiucankao" [Correlation Analysis between GDP and Revenue on the Economic Development]." *Jingjiyanjiu Cankao* 107 (21 November 1998); and Task Force on Tax Burden, "Woguoshuishoushouru zhan GDP Bizhongxiagang de Yuanjin [Cause of the Decrease of the Ratio of Revenue over GDP]." *Shuiwuyanjiu* 5 (1999). The lists of following debates are not exhaustive.

ahead of the 1988 fiscal reform, crucially influenced Beijing's decision to precipitate the fiscal reform: increasing military influence in domestic politics with respect to the succession crisis and changing security environment.

1. Macroeconomic Control

The Chinese government and scholars understood a macro-economic control to be the reason for introducing the tax-sharing system. In 1993, the 13.5 percent of the economic growth rate already exceeded the newly adjusted target of 8-9%. The investment increase rate on fixed assets recorded 22 percent. Price inflation on consumer products also went into two digits (13.2 percent). Such economic heat and disorder in the financial sector brought the attention of China's political leaders to the urgency of macro-economic control. According to fiscal specialists in the fiscal research center at the MOF (*Wenhuibao*, 3 August 1993; MOF 1994a), there were four major problems in the fiscal arena. First and most importantly, the size of central revenues was shrinking. Because the Beijing government was unable to subsidize local construction on account of its shrinking coffers, local governments were forced to rely ever more on their own funds and thus grew more frantic to preserve their own financial resources. Second, expenditure growth exceeded revenue growth. As a result, fiscal deficits were much rooming. This increase in deficits was remarkable in spite of China's retrenchment policies of 1990 and 1991. The deficit increase rate increased alarmingly to about 58 percent and 40 percent respectively (calculated from *Xingdaoribao*, 20 September 1992).⁸¹ Third, regional differences in economic development expanded. According to Liu Baogun, vice-director of the department of local finance of the MOF, the unequal price system and tax-holiday policy of open coastal areas served only to widen the gap (*Xianggang Dagongbao*, 3 August 1993). Fourth, the fiscal system had not been able to effectively penetrate fiscal bases. For example, about 80 percent of revenue came from SOEs although the total

⁸¹ Such failure of controlling the deficit seemed to force Wang Bingqian, Finance Minister, to resign, and Liu Zhogli was appointed as Finance Minister. Wang was notorious of his straight-talking style and opposition to pump subsidies into the state sectors. Meanwhile, Liu was reported that he was appointed because of his negotiation ability. It is noticeable that under the financial difficulties, the Beijing government selected a more negotiation-minded officer. See more in *International Herald Tribune*, 5 September 1992.

value of the industrial outputs from collective, cooperative, and private and individual enterprises exceeded 50 percent of GDP (*Zhongguoshibao*, 9 November 1993).

Although the fiscal contract system was not the only cause of these problems, it aggravated the situation by encouraging localism to its extremes. Local governments and enterprises were able to enjoy ever more revenue and economic resources, and indeed local governments were often essentially the owners of local enterprises by virtue of controlling their stocks (*Lianhebao*, 26 October 1992). Local leaders were also capable of keeping more revenue sources under their hands by means of allowing various tax holidays for their enterprises. Therefore, the local government might appear in deficit in the official accounting of the state while the opposite was in fact the case. As a result, the Beijing government suffered the waning of its fiscal situation and macro-economic control. In particular, in the first half of 1993, the financial plight of the Beijing government deepened as revenue growth faltered at the 3.5 percent level while on the expenditure side recording two digits of growth. Beijing's financial troubles were not solely economic but political and military as well. Heavy pressure from the military buildup in the midst of changing international security environments and the Chinese succession crisis in fact precipitated the financial woes of the Beijing government. Around 1993, the Beijing government's financial burden from the increasing military expenditure alone was reaching an unbearable level.

There was no doubt that the financial crisis of the Beijing government brought a sense of grave crisis in Beijing's leadership and bureaucracies. Therefore, a sign of Beijing leaders having reached consensus on restructuring the current fiscal arrangements was slipped out in the spring of 1993.⁸² However, in the Chinese political system adjusting vested interests took time, requiring as it did the same series of negotiations and compromises as were conducted in the previous fiscal reforms before they culminated in the official document of the third entire plenary session of the fourteenth CPC in November 1993.

⁸² See the views of Su Ming, Yang Zhaonan, and Bai jingming at *Wenhuibao* and *Xiangang Dagongbao*, 3 August 1993.

2. Succession Crisis

As in other Leninist party states, the Chinese political system did not have an institutionalized political succession mechanism. Political power was concentrated at the apex of the system and the succession relied on maneuvering among core political leaders at the apex. In China, a deep-seated fear of unchecked power in the hands of an individual political leader brought about a consensus favoring collective leadership with a strong authority over a single dictatorship during the post-Mao period. However, the issue was keenly one of how to establish a stable collective leadership with strong authority during the post-Mao period. To maintain such a leadership, a well-coordinated division of work and a balance of power were required. Deng Xiaoping articulated and guided just such a system in deliberately restraining himself from exerting his policy preference in daily party/government works. He declined to assume the party chairmanship and instead, chose two successors, Hu Yaobang and Zhao Ziyang, whom he encouraged to take on the division of works and to keep the power balance. As indicated by Lieberthal (Lieberthal 1995, 221), Deng and other Chinese core leaders had noteworthy consensus and exerted enormous efforts toward institutionalization of collective leadership as played out in the fiscal arena. The reintroduction of the party secretariat in 1980 helped promising young leaders to take up daily party works upon themselves. The abolishment of the party chairmanship in the 1982 Constitution had sought to dilute individual influence and embrace collective leadership in the established political authority such as of the Politburo and its standing committee. The new leadership in Beijing was able to induce senior party leaders to honorably retire from daily party works to the newly-created Central Advisory Commission at the Twelfth National Party Congress in September 1982, which effectively prevented old revolutionaries from interfering in a discretionary fashion with government work.

The ideals of collective leadership lie in consensus-building on major issues among core leaders, even including senior members. However, consensus-building lacked obvious formal procedures and rules for decision-making and succession while creating an absolute majority or a deliberate bargaining faction among interested parties. When a political leader started to build his power base beyond the consensus among core leaders, political tension and conflicts broke out. The balance of power and collective

leadership of two political leaders contending for post-Deng leadership proved fragile in practice although Deng and other political elders checked any one-sided shift of balance and political conflict. The falls of Hu Yaobang and Zhao Ziyang from power spelled the collapse of Deng's early effort for a smooth power transition. The Tiananmen Incident in 1989 made the prospect of political succession in the Chinese political system much more obscure. In addition, the changing international security environment and mobilization of the PLA in the Tiananmen Incident dramatically increased the influence of the PLA in the succession struggle.⁸³

It was in the fourth plenary session of the thirteenth CPC CC in June 1989 that the third generation of collective leadership came together under the core leadership of Jiang Zemin. The Standing Committee of the Politburo was composed of Jiang Zemin, Li Peng, Qiao Shi, Yao Yilin, Song Ping, and Li Ruihuan. Although Li Ruihuan and Qiao Shi, Hu Yaobang's former protégé, were considered more reform-oriented, the primary characteristic of the collective leadership in this period of the "danger and disaster" were more conservatively-oriented.⁸⁴ The career base of Jiang Zemin had basically not been in the Beijing government although he served in the national import/export management committee in 1980 and in the Ministry of Electronic Industry of the Beijing government. The leadership of Jiang Zemin, as a moderate and pragmatic local leader, perforce heavily relied on support from elder political leaders such as Deng Xiaoping. In addition, in terms of the Chinese political hierarchy, Jiang Zemin's career was inferior to those of Li Peng and Qiao Shi, potential contenders for the leadership. Furthermore, as a leader, Jiang could not boast of any stint in the PLA, whose influence became more visible after the Tiananmen Incident in 1989. Jiang might be challenged by politically ambitious elders with strong military backgrounds such as by Yang Shangkun in the event that Deng died. Jiang did not evince his predecessors Mao and Deng's charismatic leadership during the early 90s. Deng was fully aware of the potential disaster of the succession crisis and Jiang's leadership was far from secure.

⁸³ For example, see Jane Dreyer's view in *The Christian Science Monitor*, 26 February 1992. Clare Hollingworth indicated that after June 1989 the Li Peng and the Chinese government certainly relied on backing of the PLA, which was largely controlled by Yang Shangkun (the state president) and Yang Baibing (director of general political commissar department in the PLA). According to him, the rapid defense budget increase was related to the reliance. See more details, *International Herald Tribune*, 10 May 1991.

⁸⁴ Bo Yibo defined it as the period of the "danger and disaster." See Wu, et al. (1998b), 2171.

Deng's solution was to help Jiang establish his power base to the extent that he could exert leadership at the center of the collective. One effort made by Deng was to hand over the chairmanship of the Central Military Affairs Commission (CMAC) to Jiang. The chairmanship in the CMAC was Deng's last official position in the Chinese politics, and by handing-over the position Deng helped to consolidate Jiang's leadership as well as showed his strong support for Jiang at the fifth plenary session of the thirteenth CPC CC during the period October 30- November 3 in 1989.⁸⁵ Jiang continued to consolidate his power under Deng's tutelage in the PLA by a massive personnel reshuffling after the fourteenth CPC Congress held in October 1992.⁸⁶ Deng also removed the strong military figure Yang Shangkun by replacing him as the president of China with Jiang in March 1993. Jiang was able to replace the deputy chairmanship of Yang Shangkun and Yang Baibing with Liu Huaqing and Zhang Zhen in the Central Military Commission in the eighth NPC in March 1993 (*Zhongguoshibao*, 29 March 1993). A series of personnel reshufflings until 1995 removed followers of the Yang family in the army and replaced them with much younger and more professionalized officers.⁸⁷ Deng Xiaoping convened China's military generals and requested their loyalty to Jiang's leadership after the military reshuffling on 30 November 1993 (*Zhongyangribao*, 17 June 1994). Jiang also made tremendous efforts to garner support from the military, reportedly making at least one visit a month to soldiers in the field during the three years after he became chief of the Central Military Commission (*South Morning China Post*, 3 August 1993). As chief of the Central Military Commission he made the decision to guarantee at least a 10 percent annual increase in military expenditure during the 1990s and actively defended that increase in the military budget as an integral part of the construction of socialist modernization (*South China Morning Post*, 23 March 1993). It became certain by 1994 that Jiang had acquired support from the leaders of the PLA should any political struggle arise. More than half of the generals

⁸⁵ In October 1985, Deng Xiaoping decided to hand over the position to his successor, Hu Yaobang and failed to do it by the opposition from the PLA and his old conservative colleagues. When Zhao Ziyang took over the position of Hu Yaobang as the party general secretary, he was able to get the position of chairmanship but a senior deputy chairmanship in October 1987 (*Zhongguo shibao*, 10 November 1989)

⁸⁶ It was the third massive personnel reshuffling since the establishment of the PRC. The first one was done in 1973 after the demise of Lin Biao and the second one in 1985.

⁸⁷ At least five of the fourteen commanders and commissars, who took part in the Tiananmen Incident, were rewarded in the reshuffle (*The Christian Science Monitor*, 26 February 1992).

in the PLA had been replaced by the end of 1994 after Jiang became chief of the Central Military Commission. Jiang was hailed by the PLA leaders who placed his teachings at the same level as those of Mao and Deng in the articles of *Qiushi* and *Xinhua* in celebration of the 67th year of the founding of the PLA (*South China Morning Post*, 5 August 1994; *Ziyoushibao*, 12 August 1994).

Meanwhile, Jiang and Deng worked together to strengthen Jiang's leadership in the personnel reshuffling. After the Tiananmen Incident in 1989, there occurred a relatively massive personnel reshuffling of provincial leaders in 1990. When the five-year terms of provincial leaders expired in 1993, the Beijing leadership replaced almost all of the provincial party secretaries and governors⁸⁸ in the largest scale of reshuffling during the period of post-Mao reform.⁸⁹ Deng Xiaoping and Jiang Zemin fully utilized the opportunity to strengthen Jiang's leadership by appointing their protégés and reform-minded young leaders although compromise among core leaders occurred in the reshuffling as guided in the decision-making norm (*South China Morning post*, 22 October 1992).⁹⁰

It is also noteworthy that although Deng helped consolidate Jiang's political power, it was not necessary that Deng wished him to possess omnipotent power in Chinese politics. As architect of the succession mechanism, Deng emphasized collective leadership much more than in previous periods even though the Chinese political norm had already emphasized collective leadership in the early post-Mao period.⁹¹ Deng Xiaoping seemed to be seeking to create a tri-pod system in anticipation of the absence of political elders in the near future, who could help maintain and coordinate the balance of power between Hu and Zhao (author's interview).

⁸⁸ See the list in the central policy research office 1999, 939-940. 56 out of 60 provincial leaders were reaffirmed or replaced in 1993.

⁸⁹ Previously, a massive reshuffling of provincial leaders occurred in 1983 and 1988. However, according to the list in the "central policy research office," the reshuffling in 1993 appeared the most massive one. A traditional control method over local and military leaders was to circulate them not to develop their power base. Jiang seemed to adopt the strategy in handling those leaders.

⁹⁰ A visualized example is Xiao Yang, Sichuan vice-governor case. He was a protégé of Zhao Ziyang but was supported by Deng Xiaoping as well. Deng intended to place him in the Politburo by nominating him as both Sichuan party chief and politburo, but he surprisingly failed to be elected to the Central Committee in October 1992. Then, he was eventually appointed as Sichuan governor in 1993 instead of the party secretary. He was a reform-minded and vociferous figure. Ironically, he became a main opponent to the introduction to the tax-sharing system to protect the local interests and antagonistic to Jiang Zemin. Jiang eventually replaced him with Song Baorui in 1996 before his term ended.

⁹¹ See more in Wu, et al. (1998b), 2164-2166.

Jiang Zemin as a moderate stood in between the relatively conservative Li Peng and the reform-oriented Qiao Shi. Jiang himself was also inclusive of various interests and placed a heavy emphasis on the democratic principle of the *democratic centralism* as an organizing and decision-making norm. Such an inclusive position and emphasis on the *democratic centralism* was well illustrated in the sixth plenary session of the thirteenth CPC CC in March 1990 and in Jiang's final speech at the seventh plenary session of the thirteenth CPC CC on 30 December 1990. The emphasis could be an inevitable choice for Jiang if he desperately needed to garner support from key political players, local and military leaders, in the Chinese political system. He might still confront challenges among other leadership contenders after Deng Xiaoping died. Such an inclusive policy in the fiscal arena was Jiang's support of the fiscal contract system. However, it is noteworthy that Jiang changed his stance in the fiscal arena in early 1993 from the fiscal contract system to the tax-sharing system in spite of the latter's unpopularity in the localities. The first reason for this action was that the financial difficulties of the Beijing government, especially with respect to increasing military expenditures, could not be solved by the given fiscal system. However, the other reason could have been because Jiang Zemin had already consolidated his power as a post-Deng leader through consecutive reshufflings of the military and provincial personnel.

3. The Linkage of Fiscal Reform with External Security Factor

Western scholars in the comparative field have recently paid more attention to the two-level game between domestic and external factors.⁹² There are many instances throughout Chinese history when domestic factors influenced China's outgoing policies.

⁹³ Swaine and Tellis made this point succinctly in their recent book (Swaine and Tellis 2000, 77-78).

⁹² See the classical illustration on this issue by Robert Putnam, "Diplomacy and domestic politics: the Logic of Two-Level Games." *International Organization* 42, no. 3 (Summer 1988): 427-460. To see a collaborative project in this field, see Peter Evans, Harold K. Jacobson, and Robert Putnam, eds. *Double Edged Diplomacy: International Bargaining and Domestic Politics* (Berkeley: University of California Press, 1993). For other examples, Howard P Lehman and Jennifer L McCoy, "The Dynamics of the Two-Level Bargaining Game." *World Politics* 44 (July 1992): 600-644; Helen Milner, "International Theories of Cooperation among Nations: Strengths and Weakness," *World Politics* 44 (April 1992): 466-96; Leonard J. Schoppa, "Two-level Games and Bargaining Outcomes: Why *Gaiatsu* succeeds in Japan in Some Cases but not Others." *International Organization* 47, 3 (Summer 1993): 353-386.

⁹³ Regarding examples in this line, see David Bachman (1984) and Susan Shirk (1984).

Chinese history is replete with instance of political leadership groups seeking to use both domestic and foreign policies to outmaneuver opponents. ——— Understandably, the influence of elite power struggles and individual leadership personalities on security policy has generally been greatest when the Chinese regime has been either immersed in intense conflict or led by a particularly charismatic, powerful figure.

However, the often-neglected side is the foreign influence over Chinese domestic politics. Although there are many works on the linkage between domestic and international politics in China, I have not yet seen a work that links fiscal reform with the issue of security. It is difficult to provide hard evidence, but it would be possible to construct quasi-evidence by analyzing authoritative documents, official data, and political situations. For the purpose of tracing the perception of leadership on the international security environment and its consequent strategizing, I conducted a content analysis of the Reports addressed by the political leader in each CPC Congress, which is held every five years in the middle of the five-year plan (see Table 5-5). The process of making the report is often not a simple but a convoluted process, with interest and power struggles to account for in the report-making process. It often became a saddle point among competing political leaders and bureaucracies. However, the reports have still obviously provided a guideline for future behaviors and strategies of subordinates. In addition, the analyses of journals and documents from security-related bureaucracies such as Ministry of Foreign Affairs (MOFA), People's Liberation Army (PLA), and Ministry of State Security (MOSS) also provide information of various views on China's security environments.

I argue that changes to the security environment were often a neglected but significant factor in the drive for fiscal reform in 1994.⁹⁴ When the issue of the changing security environment was combined with the issue of the succession crisis, the role of military appeared enormously vital in Chinese domestic politics.⁹⁵ The increasing role of military exerted an enormous pressure to allocate additional resources to the military. The pressure fell mainly on the Beijing government because it had responsibility for military

⁹⁴ Regarding the linkage between the changing international security environments and the Chinese military doctrine, see Nan Li (1996) and Paul H.B. Godwin (1996); Regarding the constraints of the international system on Chinese Foreign Policy, Michael Ng-Quinn (1984); On the China's Threat Perception and Military Buildup, Allen S Whiting (1996).

⁹⁵ The Tiananmen Incident in 1989 and the succession crisis might provide a momentum of a temporary military buildup. However, it can not explain the subsequent military expenditure increase, which requires further legitimizing factors.

expenditures under its exclusive jurisdiction. Without fiscal reform, there would be no breakthrough allowing the Beijing government to support continuous military buildup. In 1993, the proportion of military expenditure over Beijing's revenue reached 44.5 percent when it had been 28.1 percent in 1988.⁹⁶ In five years, the proportion had increased higher than 16 percent in Beijing's revenue budget. It was unsupportable for any modern government during the peace time to devote almost half of its revenue to military expenditure.⁹⁷

Preconditions

China's political leaders and military specialists saw in the early 1980s that a major hegemonic war was less likely to occur as both the Soviet and U.S. influences in the world diminished; meanwhile, counter-hegemonic forces in the third world increased. The growing economic strength of Japan and Europe in fact opened the window to a multi-polar system (Hu Yaobang 1982; Zong He 1983, A1-A5).⁹⁸ These assessments of the security environment allowed China's leaders the opportunity to place their policy priority on economic development. During the sixth five-year plan period (1981-1985), the proportion of average military expenditure to government expenditure was set at 14.5 percent, 2 percent lower than during the fifth five-year plan period (1976-1980) (Cong and Zhang 1999, 990). This low priority on military construction was also illustrated in the remarks of Deng Xiaoping in the discussions of the Central Military Commission on 1 November 1984 (Wu, et al. 1998b, 2068) and of Yang Shangkun published in *Hongqi* in 1984 (*Hongqi* No.15 1 August 1984). For example, Yang Shangkun pointed out that the Beijing government would not spend as much as the superpowers on military development. Economic conditions should be primarily addressed and massive and rapid military modernization should not be blindly pursued. The priority of Chinese military procurement should be on defensive weapon systems.

⁹⁶ Its proportion to the Beijing government expenditure was 32.5 percent in 1993, which was the highest after 1979.

⁹⁷ An interviewee in the finance section fully agreed with my view. He even stated that the pressure from the increasing military expenditure would be the most crucial factor for the fiscal reform in 1994.

⁹⁸ Regarding Deng Xiaoping's view on the international security, Wu, et al. (1998b), 2073-2074. It was originally addressed in the meeting with Japanese industrial/commercial association members on 4 March 1985.

In a multi-polar world, limited local warfare was more likely than total and massive war to occur. Accordingly, a limited local war doctrine was gradually espoused as Chinese military doctrine during the early post-Mao period.⁹⁹ The local limited warfare doctrine did not require massive armies but swift, effective, modernized elite forces. Organizational changes in the People's Liberation Army (PLA) started up in 1985, reorganizing 35 field armies into 24 group armies. The group armies integrated infantry, armor, and other ground forces into a single command to form an effective combined force (Godwin 1996, 466).¹⁰⁰

Table 5-5: Comparison of Reports at the CPC Congress¹⁰¹

	11 th CPC	12 th CPC	13 th CPC	14 th CPC	15 th CPC
Year	1977	1982	1987	1992	1997
Speaker	Hua Guofeng	Hu Yaobang	Zhao Ziyang	Jiang Zemin	Jiang Zemin
Security Environment	Over all very good for China; Cold War bet. Two Hegemonic Super powers with USSR aggressiveness; Inevitability of War	Two Hegemonic Super powers as a cause of int'l instability, but overall balance with anti-imperialist powers; Possibility of avoidance of war	Peace and Development; Reduced Tension good for China; Avoidance of war	Multi-polar system; Presence of Hegemonic powers; Possibility of avoidance of war, but Possible Local War	Multi-polar system; Relatively stable Int'l relations; Presence of Hegemonic powers; Avoidance of war
Major International Actors	Imperialist Powers, Third World Countries and People	Two Hegemonic Super Powers and their alliances, Third World Countries and People	US plus USSR, Peace-Loving Countries and People	Hegemonic, Oppressive Powers, Third World Countries, UN, and 77 Group	Hegemonic, Oppressive Powers, Third World Countries, UN, and Int'l Organizations
Domestic Development Strategy	Political Mobilization	Planning with supplement of Market and Incentives	Socialist Commercial Economy; Theory of Initial Stage of Socialism	Socialist Market Economy	Socialist Market Economy

Sources: *Hongqi* No. 9 (1977): 3-31; *Hongqi* No. 18 (1982): 6-30; *Hongqi* No. 21 (1987):3-27; *Qiushi* No. 21 (1992): 2-21; *Qiushi* No. 18 (1997): 2-23.

⁹⁹ This strategy didn't reject Mao's people's war doctrine but de-legitimized Stalin's massive war scenario. It emphasized more on modernization of the army and moved toward the limited local war. In character, it was a defensive doctrine fighting on the Chinese soil. My argument is indebted to Ellis Joffe, the founding father in the study of the PLA.

¹⁰⁰ For more detailed information, see Ellis Joffe (1987), Chapter IV.

¹⁰¹ I am indebted to Zhang Dengji (2000) for the idea of this table.

Chinese military specialists and political leaders appeared in 1986 to revise Mao's theory of inevitability of nuclear war (SIPRI 1994, 442). A project to reduce by one million military personnel was launched and planned for 1987 completion. The number of military regions decreased from eleven to seven. The Beijing government had already begun to allocate more resources in the economic sector from 1980 onwards, after the 1979 war with Vietnam. The increase rate of military expenditures recorded consecutively -12.9 percent in 1980 and -13.3 percent in 1981 as the policy priority of the Beijing government shifted to economic developments.¹⁰² The revision of the defense policy was concordant with the policy priority during the 1980s as seen in Table 5-5.

Rapprochement with the Soviet Union in the years following Gorbachev's rise to power after 1985 considerably reduced any threat/possibility of a major war on the Sino-Soviet front. During the period of 1985-1987, the doctrine of local limited warfare was crystallized, to be revealed in debates published in Chinese military journals (Godwin 1996, 467). The new doctrine required a new kind of preparation for future war. The future war would occur not only on Chinese soil but also outside China in a more limited fashion. Under the new doctrine, the Chinese army was no longer on the defensive. The weapon system had to be upgraded and elite units created in conjunction with military reductions. Four major military exercises were conducted in 1988 under the new doctrine.¹⁰³ However, the policy priority of the Beijing government prevented acquisition of an upgraded weapon system and military technology to realize the new doctrine. As seen in Figure 5-1, the 4.8 percent average increase rate of military expenditures was far below the increase rates of revenues and GDP during the period 1985-1988.¹⁰⁴ Overall, as indicated by Andrew Nathan and Robert Ross, China's low military spending reflected the clear policy priority of the Beijing government during the 1980s that subordinated military modernization to economic reconstruction (Nathan and Ross 1997, 148).

¹⁰² To compensate such lack of military expenditures, the Beijing government allowed military to run businesses during the 1980s. See more on this, *Zhongyangribao*, 12 February 1994.

¹⁰³ A counter argument to the general trend is from Zhang Jian, "It is still necessary to base our plans on fighting a major war," *Jiefangjunbao*, 24 April 1987, in FBIS-CHI, 2 March 1987, K32-K35. He argued that China should prepare for a large-scale and nuclear war to constrain the future war to the limited local war.

¹⁰⁴ To compensate the slow increase of the military budgets, the army began to involve a large scale of profit-making enterprise activities during the period. During the eighth five-year plan period (1991-1995), nearly 70 percent of military factories produced civilian goods (SIPRI 1994, 446).

The Surge of Military Expenditures

Essentially, as summarized in the 13th CPC report in 1987, China's political leaders regarded the security situation as being dictated by the trend toward peace and development. The official party journal *Qiushi* published an article written by Xie Yixian a member of the Foreign Affairs College in early 1989; he encouraged active participation in international activities supporting arms control and reduction in accordance with the changing international security environment.¹⁰⁵ Such an optimistic evaluation on the security environment was obvious in the analyses of major think tanks of the Ministry of Foreign Affairs (MOFA) and the Ministry of State Security (MOSS).¹⁰⁶ This relatively peaceful and stable security environment was conducive to implementing the fiscal contract system, which would allow the provincial governments to acquire a considerably increased share of fiscal resources.

However, the increase rate of military expenditures surged from 1989 onward. Some analysts have explained it as a scheduled realization of the new local limited war doctrine.¹⁰⁷ Yet, that scenario was unlikely, for in absence of any immediate security threat or political purpose, there would be, given the policy priority, no reason to increase military expenditures so dramatically despite signs of change in China's military

¹⁰⁵ Yixian Xie, "Bashiniandai Zhongguo Duiwaizhengcede Zhongyao Datiaozheng ji Qiyiyi [A Great Adjustment of the Chinese Foreign Policy in the 1980s and its Implication]." *Qiushi* 1 (1989): 35-40.

¹⁰⁶ The major official think tank of the MOFA is the Institute of International Studies (ISS), whose journal is *Guoji Wenti Yanjiu* [International Studies]. In addition, Foreign Affairs Collage and the Chinese People's Institute of Foreign Affairs also provide advice to the MOFA (see Choi 1998, 5); the MOSS the China Institute of Contemporary International Relations (CICIR), whose journal is *Xiandai Guoji Guanxi* [Contemporary international Relations]. To see the view from the ISS, Wang Shu, "Guoji Xingshide Xinqushi Yushi Shijiemianmaode Xinbianhua [A New Trend of International Situation indicates A New Change of Features in the World]." *Qiushi* 1 (1989): 32-35; for the view from the CICIR, Tingwei. Huang, and Chuanling. Kuo, "Shijie Xingshi Fasheng Zhuanzhexing Bianhua [A Turning Point happened in the Situation of the World]." *Xiandai Guoji Guanxi* 1 (1989): 30-34. Regarding the views of increasing interdependence in the international relations, see Qurong Chen, "Guojiguanxi Minzhuhua yu Shijie Heping [Democratization of International Relations and World Peace]." *Xiandai Guoji Guanxi* 3 (1986): 1-9; Wenxue Wang, and Baozhu Kuo, "Duijianli Guoji Zhengzhi Xinzhiyu Zhanlue Zhuzhangde Sikao [A Reflection on the View of Establishing the Strategy of a New Order in International Politics]." *Xiandai Guoji Guanxi* 3 (1989): 12-16.

¹⁰⁷ Chinese military specialists tended to place more emphasis on continuity of Chinese military buildup program. For example, Godwin (1996) explains the increase of military expenditures in the long-term program for military buildup according to the new doctrine. However, when we carefully examine the issue with the link of domestic politics and policy priority, it was quite extraordinary that the Beijing government increased the military expenditures so dramatically from 1989. Without the Tiananmen Incident and the fall of the Soviet Empire, it would not happen in such a fashion.

doctrine. The MOFA's annual appraisal of international politics in 1988 was decidedly optimistic about peace (Ministry of Foreign Affairs 1989, 1). According to the briefing, the world was about to enter a period of peace and development. The briefing referred to great progress in the areas of arms reduction and East-West relationships. Such an assessment of the international security environment could not provide the momentum for any rapid military buildup in the following year. In addition, as the Beijing government was suffering from increasing deficits, there was no indication of need for changing any policy priority, whose change could not help but bring a major shift of fiscal resources from the current economic area to the military one.

Furthermore, the guiding priority in the fiscal arena was to provide more resources to localities and enterprises even though there were some temporary retrenchment measures taken to calm inflation from the end of 1988 onward. Xu Yaping in a MOF internal report in 1988 revealed how the relationship between military expenditure and national finance would be closely related in the mind of policy-makers and think-tankers. He pointed out that waging an arms race and expanding military expenditures would require an appropriate fiscal capacity,¹⁰⁸ and the fiscal capacity of the Beijing government was not sufficient to spare additional fiscal resources to the military expenditure.

Security environment and perception changes among Chinese leaders opened a window of opportunity to both the newly-formed Chinese leadership and the PLA to utilize them for their own sake.¹⁰⁹ As indicated by Ellis Joffe, the perception change of Chinese leaders toward the former Soviet threat made the launching of major domestic economic reforms possible during the initial period of economic reforms (author's interview). Consequently, the military as a group had been one of the most significant losers in the bureaucratic budget battle during 1980s; however, in the turn-around of the

¹⁰⁸ Yaping Xu, "Geguocaizhengbuzhi Nengbijiao yu Wanshanwoguo Caizhengfenfeizhi Nengdejianyi." *Jingjiyanjiucankao* No.60 (19 April 1988): 3.

¹⁰⁹ Even before the Tiananmen Incident in 1989 and the collapse of the former soviet bloc in the Eastern Europe, the perception of the PLA on the international security environment was more negative than of the ministry of Foreign Affairs. Compare the remarks of He Qizhong, vice-director of the General Staff Department of the PLA, with the briefing of the Ministry of Foreign Affairs (the Ministry of Foreign Affairs 1989,1). See Qizhong He, "Quanmian Baozhang Jundui Gaige he Jianshede Shenru Fazhan [Wholeheartedly Guarantee A Profound Development of Reforms and Construction in the Army]." *Guanlishijie* 2 (1989): 169-176.

1990s, the security environment and its assessment dramatically changed in the minds of Chinese political leaders and think tanks.¹¹⁰ For example, a MOFA briefing on the 1989 international situation succinctly illustrated the change (Ministry of Foreign Affairs 1990, 1): “The situation had severely changed. Various interests were complicated, conflicting, and being rearranged. The international situation was shaking and unstable.”

The Tiananmen Incident in 1989 illustrated how feeble the Chinese socialist system could be without the support of the PLA.¹¹¹ Support of the military in the Tiananmen Incident then strengthened the political influence of the military in Beijing politics. Jiang Zemin, the new party general secretary, also needed continuous military support in his contention for the leadership position in the post-Deng period.¹¹² To make things worse, the downfall of the former Soviet bloc in Eastern Europe in late 1989 as well as the deepening internal crisis of the Soviet Union brought a perception of crisis in the socialist system overall and the Chinese security situation in specific. Bo Yibo described the international and domestic situations during the period as “extremely grim (*shifen yanzun*),” “dangerous and disastrous (*weinan*)” (Wu, et al. 1998b, 2165).¹¹³ The 1990 briefing of the Ministry of Foreign Affairs also defined the period as “a transitional period of uncertainty and instability” (Ministry of Foreign Affairs 1991, 1).¹¹⁴ Then, as they perceived, the bipolar system was breaking down. *Extreme* and *profound* changes occurred in the international politics in 1991 (Ministry of Foreign Affairs 1992, 1).

The external factors provided the fuel to change China’s military doctrine and to strengthen the military position for acquiring more fiscal resources even though these factors might not be a determinant for military buildup. Reportedly the issue of the military expenditure increase became one of main subjects in the conferences of the SPC

¹¹⁰ Regarding the views on the security environment in the late 1980s and early 1990s, See Wu, et al. (1998b), 2464.

¹¹¹ Chinese leadership regarded it being stirred by conspiracy of the US, its allies, and Taiwan according to the strategy of “Peaceful Transition [*Huaping Yanbian*].” See more details on this at *International Herald Tribune*, January 8, 2001.

¹¹² Chinese often called the leadership of Jiang Zemin as taking the position during the dangerous and disastrous period [*fengming yu weinanzhijian*]. See more in Wu, et al. (1998b), 2165.

¹¹³ Deng Xiaoping also indicated the period later as a period of a serious frustration of the socialist movement in the world and an extreme change of the international situation (extracted from *Zhongyangribao*, 11 June 1999).

¹¹⁴ The view on the international situation in the article of Huang Tingwei and Wang Yulin in the official journal of the MOSS shared a similar view with the MOFA although it’s view was slightly more optimistic than the MOFA. See Tingwei Huang, and Yulin Wang, “Jishu Bianhuazhongde Guojixingshi [Rapidly Changing International Situations].” *Xiandai Guojiguanxi* 3 (1990): 3-9.

and the MOF at the end of 1989 and a detailed plan was drafted by the SPC (*Lianhebao*, 9 December 1989). The draft entitled the Suggestion on Ten-Year and Eighth Five-Year Plans for the National Economic and Social Development, directed by Li Peng in the seventh plenary session of the thirteenth CPC CC in 1990¹¹⁵ also reflected the changing security environment and a policy priority on the military. The policy of strengthening efforts for military modernization was emphasized as much as the economic development (Wu, et al. 1998b, 2176). Jiang Zemin's final speech at the seventh plenary session of the thirteenth CPC CC also highlighted the linking of changing international situations with domestic politics (Wu, et al. 1998b, 2181-2182), and his report at the fourteenth CPC Congress in October 1992 continued to place an emphasis on military buildup (Wu, et al. 1998b, 2360).

It is not surprising that a military representative would be involved when a task force dealing with the Issue of Budgetary Revenue Ratio to National Income was organized in the early 1991, whose outcome was reported in 1993 to the State Council and the MOF. The task force team was composed of members from the general logistics department in the navy, the CASS, and scholars and cadres (directorial level) of local governments¹¹⁶ in the finance area. Xiang Huaicheng, MOF vice-minister was also asked to join in the team.¹¹⁷ It was a rare case that a military figure openly served as a member of a task team dealing with fiscal reform. The report indicated that previous peaceful domestic and international situations had kept the size of military expenditures at a low level, but the new circumstance of change justified increasing the military buildup under the imperative of defending the nation and economy. The report's recommendation relating to the military area was that the increase rate in the military expenditure should keep pace with that of revenue and that the military expenditure must maintain the 2 percent level of the Gross National Product value in coming years (Task Force 1998, 7). Given the declining revenue rate over GNP/GDP, the task force's goals were certainly ambitious. In practice, however, they were ill-realized: the increase rate of military expenditure was indeed higher (except 1993) during the period 1989-1994 than the revenue increase rate, after which it dropped. The 2 percent level of military expenditure

¹¹⁵ It was held in Beijing during the period of 25-30 December in 1990.

¹¹⁶ Shanxi and Hunan provinces, and Taiyuan city.

¹¹⁷ He later became minister of the MOF in 1998.

in the GNP was never realized though it did gradually increase from its low point in 1996.¹¹⁸

Subsequently, the power of modern technology during the 1991 Gulf, exerting a profound influence on them, struck the heart of Chinese political and military leadership (*Zhongguoshibao*, 7 December 1992; SIPRI 1994, Whiting 1996, Godwin 1996, Li 1996). The situation, called the *new era*, was considered more threatening than ever before.¹¹⁹ Accordingly, major think-tank organizations, the PLA, the MOFA, and CPC changed their previous assessments of the security situation. The impacts of the Gulf war were quickly embraced in the Chinese military doctrine as in the *limited war doctrine under high-tech conditions (gaojishu tiaojianxia jubuzhan)*. As the unfavorable situations in China's security accumulated in the early 1990s, much greater pressure for the military buildup was exerted. The PLA was able to pressure Li Peng and Jiang Zemin to increase military expenditure during the eighth-five year plan period (*Zhongyangribao*, 25 April 1992).

The rise to power of Liu Huaqing in the Chinese politics also highlighted the new focus on high-tech weapon systems in the PLA.¹²⁰ The new focus also required maintaining a considerably high level of military expenditure. Liu argued in 1993 that the PLA "failed to meet the needs of modern warfare and this is the principal problem with army-building. This problem would be met," he stated, "by the vigorous importation of foreign technology and accelerating the modernization of weapons and equipment through improvements in China's own defense industries and R&D."¹²¹ A report revealed that even Deng guaranteed the PLA leaders of the increase of military expenditure to garner support for the famous southern tour from the PLA (*Mingbao*, 8 May 1992). Accordingly, it was reported that Jiang Zemin and Li Peng bowed to take the PLA pressure and increases military expenditure significantly during the eight five-year plan

¹¹⁸ See the table 5-6. Slight differences existed between GDP and GNP figures. However, the differences are modicum. See the differences in the CSY (1999), 55.

¹¹⁹ At first, Chinese media indirectly hinted the changing international situation, but in mid-July, the Propaganda Department in a meeting of young and middle-aged theorists and academicians admitted the crisis (*China Review* 1991, 23).

¹²⁰ He was a well-known military modernizer and reformer. His rise in power meant that the Chinese military would focus more on strengthening the navy and air forces (*Zhongguoshibao*, 7 December 1992).

¹²¹ Godwin (1996), 473-474. Its original source is Huaqing Liu, "Unswervingly march along the road of building a modern army with Chinese characteristics," *Jiefangjunbao*, 6 August 1993, in FBIS-CHI, 18 August 1993, 18.

period. The decision was to maintain at least a 10 percent increase rate for the next 5-10 years.¹²² Table 5-6 illustrates that the guarantee has been implemented throughout the 1990s.

Table 5-6: Ratios of Military Expenditure over GDP, Budgetary Revenue, and Central Revenue (percent)

	78	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98
ME/ GDP	4.6	2.5	2.1	2.0	1.8	1.5	1.5	1.6	1.5	1.4	1.2	1.2	1.1	1.0	1.1	1.2
ME Inc.	12.6	2.0	6.0	4.8	4.4	4.0	15.4	15.4	13.8	14.4	12.7	29.3	15.6	13.1	12.8	15.0
ME/ CR	95.4	27.2	24.9	25.8	28.5	28.1	30.6	29.3	35.2	38.6	44.5	19.0	19.6	19.7	19.2	19.1

Sources: Calculated from CSY 1999 and CFY 1999.

Note: ME Inc. refers to Military Expenditure Increase Rate; CR, Central Revenue

Two major potential criticisms of my argument that the pressure of increased military expenditure precipitated the fiscal reform of 1994 may arise at this point. The first criticism might well be that actual military expenditure did not increase until the mid-1990s when all the inflationary factors in the share of the national budget are considered. The U.S. Arms Control and Disarmament Agency (ACDA) indicated that China's military budget as percentage of government budget decreased from 26 percent in 1984 to 18 percent in 1994 (ACDA 1995, 69; Nathan and Ross 1997, 148). This line of arguments implied that the increase of military expenditure was not actual but merely a balance of high inflation and economic growth during the period.¹²³ This argument is sensible. However, it is important to note that my concern is about the extent to which the military expenditure burdened the Beijing government's budget. A consensus on the responsibility of the military budget in the debates of the fiscal reforms from the early 1980s was that the responsibility was in the Beijing government (See also the MOF budget list of 1997, 58). The Beijing government was solely responsible for all spending on military expenditure items including military science research and militia. Regardless

¹²² Bo Yibo indicated that the sense of security crisis in the late 1980s and early 1990s was still influential in the preparation of the 15th CPC Congress. See more detail, Wu, et al. (1998b), 2464-2471.

¹²³ An editorial of People's daily rebuffed the view of China threat and military buildup with this line of logic. See in *Renminribao* 27 October 1994. Xu Huizi, deputy chief of the general staffs department of the PLA, and Li Yongtai, the deputy chief of the Chinese air force also explained the increase of the military expenditure in this line of argument. Also see Ellis Joffe's view in *International Herald Tribune*, 10 August 1994.

of its actual proportion to GDP or its actual size, the increase of the military expenditure certainly tremendously pressured Beijing's finances, which were up to almost 50 percent of its budgetary revenues.¹²⁴ As seen in Table 5-6, the average ratio of military expenditure to central revenue during the period of 1984-1988 was 26.89 percent. However, it dramatically increased to 35.62 percent during Jiang Zemin's reign (1989-1993) before the fiscal reform of 1994. In spite of the worsening financial situation during the early 1990s, the Beijing government continued to increase military expenditure from 4.0 percent in 1988, to 15.4 percent in 1989, and to the record-high 29.3 percent in 1994. The 1994 budget report by MOF Minister Liu Zhongli described in the eighth NPC in March 1994 that the financial situation was grim and that the priority of drafting the 1994 budget was tightening control over expenditures. The Beijing government nonetheless still increased to the record high 29.3 percent in military expenditure. The actual efficacy of the increase in the military budget in 1994 might have been offset by depreciation of the exchange rate of the *yuan* in the year. However, the increase rate in military expenditure was much higher than in other spending items such as education, as cited by Premier Li Peng.¹²⁵ The relative burden of the military budget to the Beijing government certainly increased to a certainty.

The other criticism is likely related to the actual size of the Chinese military budget. Given hidden sources of military expenditure, the size of China's military expenditure was already large. Since Chinese military budget accounting differed from those of other western countries, it required reassessment. According to the SIPRI (SIPRI 1994, 445), the Chinese official military budget excludes funds for: "(a) equipment production; (b) certain research, development, testing, and evaluation (RDT & E) costs; (c) the People's Armed Police; (d) a percentage of troop maintenance costs for regional force units;¹²⁶ (e) militia maintenance; and (f) pensions and demobilization costs."¹²⁷

¹²⁴ An interviewee, who was a veteran specialist on the Chinese finance, also fully agreed with the link between the increasing military budget pressure and the fiscal reform of 1994.

¹²⁵ In 1994, the increase rate of the government expenditure recorded 24.8 percent, which was the highest since 1980 (CSY 1999, 271). Also see *South China Morning Post*, 12 March 1994.

¹²⁶ Regarding the hidden subsidies of the local PLA units, see *South China Morning Post*, 1 August 1994.

¹²⁷ The method of currency conversion and establishing equivalent costs had been used in estimating the size of the military expenditure of the socialist countries in the western world. However, it had a difficulty in calculating the size of expenditures because of exchange rate changes, let alone the accuracy of data itself. The SIPRI provided a good example on this matter. "The official defense budget rose to 52 billion yuan, but this is only equivalent to approximately \$ 6 billion at 1994 exchange rates, while the 42.5 billion

Because of the uncertain nature of such data, assessments of the actual size of Chinese military expenditure varied among scholars. For example, its estimated ranges were from twice the announced figure (the CIA 1989, 16), to four-five times (Ellis Joffe; US Ministry of Defense), and even six times (SIPRI 1994, 444).¹²⁸ The implication of these views is likely that the PLA had already enjoyed considerable funding even before 1989. However, Starr cautiously argued that the PLA did not have direct access to all these funds, so the actual figures are highly likely to be inflated (extracted from Starr 1997, 103). Wang Shaoguang estimated that the actual military budget was about 1.5 times the official budget that was approved by NPC, with only 30 percent of it being used for armament procurement. In addition, most profits made by Army business activities, which was 6 billion *yuan* out of 60 billion *yuan* sales in 1993, were spent in non-productive ways such as in corruption and “eating off” (*South China Morning Post*, 20 April 1995). A task force team on fiscal reform also indicated that military spending was not efficient, and only a fifth of the spending was invested in procurement before the 1990s (Task Force 1998, 50-51). It appeared that the PLA had suffered a lack of military budget exclusively designated for the PLA and so had to struggle to feed the Army by increasing economic activities during the 1980s. The pressure of military buildup and efficient use of military funds must have constituted a considerable burden on the Beijing’s finance, which could not resolve the problem with the given financing mechanism.

Jiang Zemin’s report in the fourteenth CPC Congress of 1992 reflected the perception of national threat as well as the possibility of limited local war. An internal document of the Beijing government went so far as to depict the present international situation in a nervous tone, such as with “One cold war has ended – two more cold wars have begun.”¹²⁹ From 1993 on, however, the international security environment was

yuan in 1993 equaled \$ 7.3 billion” (SIPRI 1994, 448). Some observers argued that foreign procurement of military equipment was a major item and came from off-budget funds. However, it is reported that the item was recently included in the official budget. See Starr (1997), 101.

¹²⁸ The official position of the PLA expressed by Zhang Zhen in the discussion of Li Peng’s report in the eighth NPC was that the recent increase of the military expenditure was yet as insufficient as the PLA needed to support their subsistence by producing foods in their own farms (*Xingdao ribao*, 12 February 1995).

¹²⁹ Extracted from Nicholas D. Kristof in *International Herald Tribune*, 22 April 1992. The two cold wars refer to the war between the struggle of capitalism and the remaining Communist countries and between the growing frictions in the Western alliances.

perceived as moving in a more positive direction for China, contrasting to the briefing in 1991 (Ministry of Foreign Affairs 1994, 1). The optimistic attitude continued from 1993 on, as observed by Whiting and his interviewees (Whiting 1996).¹³⁰ In spite of the changing perception of the international security environment, military expenditure was not decreased accordingly. The succession crisis and Jiang's need for support from the PLA provided an engine to maintain the high profile of the PLA in Chinese politics. The increase rate of military expenditure was higher than the growth rate of the GDP. Given Beijing's financial difficulties at that time, maintaining the level of military expenditure provided a tremendous burden on the government. As a solution to appease the PLA, the Beijing government compelled local governments to grant local military units more aid under the circumstance of lack of funds from Beijing (*The Christian Science Monitor*, 26 February 1992).¹³¹ A great majority of provinces and cities thus drafted measures to supply grain and vegetables for the Army and made contributions to improve PLA facilities (*Renmin Ribao*, 31 July 1994). However, the policy was not popular among the provincial governments because it increased local financial burdens when localities already suffered from lack of sufficient funds.¹³²

In 1993, anticipating fiscal reform in the near future, the PLA brought pressure on the Beijing government not to reduce but to increase military expenditures. Central military figures such as Liu Huaqing, Zhang Zhen, Zhao Nanqi, and Chi Haotian publicly supported increasing the military budget. Local military commanders also strongly urged

¹³⁰ A sign of changing military strategy was already reported in 1992. According to the report after analyzing the budget report of the fifth plenary session of the seventh NPC by the state council, the main target area of the Chinese military strategy would move from the north against Russia to the southern pacific area, with a decreasing threat of a major war. See more in *Lianhebao*, 23 March 1992. In an interview at the plenary session, Chi Haotian arduously defended the military buildup although he also recognized the positively changing security environment (*Wenhuibao*, 30 March 1992). However, a revealed central document of the Chinese government also well illustrated the nervousness of Beijing's security being challenged by the new two cold wars. The two wars referred to the war between capitalism and the remaining Communist countries, and second, growing frictions in the Western alliance. It was obvious that the Beijing government had an enormous pressure from the collapse of the communism. See more detail in the article by Nicholas Kristof in *International Herald Tribune*, 22 April 1992.

¹³¹ Jiang Zemin also called on local governments to render financial support to defense construction in early 1994. See *South China Morning Post*, 15 March 1994.

¹³² In addition, economic activities by the PLA at the local level often seemed to cause conflicts with local interests. In the discussion on the defense law in the NPC, several local leaders raised the issue of arbitrariness of the PLA enterprises (*Zilizaobao*, 12 March 1997). However, some rich provinces such as Guangdong were reported that they actively cemented links with the local military leaders in the hope that should a power struggle break in Beijing, they could shield them from the worst scenario as experienced during the Cultural Revolution (*South China Morning Post*, 20 February 1995).

the Central Military Commission to make similar increase.¹³³ The *Liberation Army Daily* (*Jiefangjunbao*) carried an editorial commemorating the sixty-sixth anniversary of the founding of the PLA to promote the increase of military expenditure to build a modern fighting army based on Persian Gulf War technology (*Japan Times*, 2 August 1993). Meanwhile, Zhu Rongji with the advice of Hu Angang strongly urged integration of all PLA spending into the formal budget process to achieve regularization and institutionalization. Zhu demanded that the PLA foreclose on a number of commercial ventures that flourished to supplement insufficient PLA funding during the 1980s.¹³⁴ Jiang Zemin ordered the PLA to reduce business activities below the level of the army unit in November 1993 (*Lianhebao*, 28 March 1994).¹³⁵ The effort to professionalize the PLA certainly reduced its funding and resulted in a heavy fiscal burden on the Beijing government due to the fact that the policy required a heavy reimbursement for the PLA's business losses.¹³⁶

The Beijing government was under severe pressure to find a solution to the problem of supporting the increase of military expenditures in China's formal fiscal arrangements. It was the introduction of the tax-sharing system in 1994 that eventually provided Beijing with an appreciable increase in revenue. The linkage of military buildup

¹³³ There are plenty of examples for the pressure in 1993. See Xu Xin's remarks, a former deputy chief of the general staffs of the PLA in *South China Morning Post*, 2 March 1993; Li Huaqing's interview, the top-ranking military figure and politburo member in *Jiefangjunbao*, 6 August 1993; Interviews by the *Japan Times* in *The Japan Times*, 24 March 1993; the remarks of Zhao Naiqi, the chief of the general logistics department of the PLA, in *Wenhuibao*, 28 March 1993; sources from the PLA in *Lianhebao*, 2 June 1993; Chen Zhangshou, Zhang Zhichen, and Dai Zhongyi, the general logistics department in *Junshi Jingji yanjiu* 8 (1994): 44-47. The junior military leaders started to urge having an aircraft carrier publicly in 1993. According to the "Military Secrecy" published by the Ministry of Public Security (*gonganbu*), China plans to have an aircraft carrier by 2020. However, the MOFA denied it quickly. See more details in *Zhongguoshibao*, 17 September 1993.

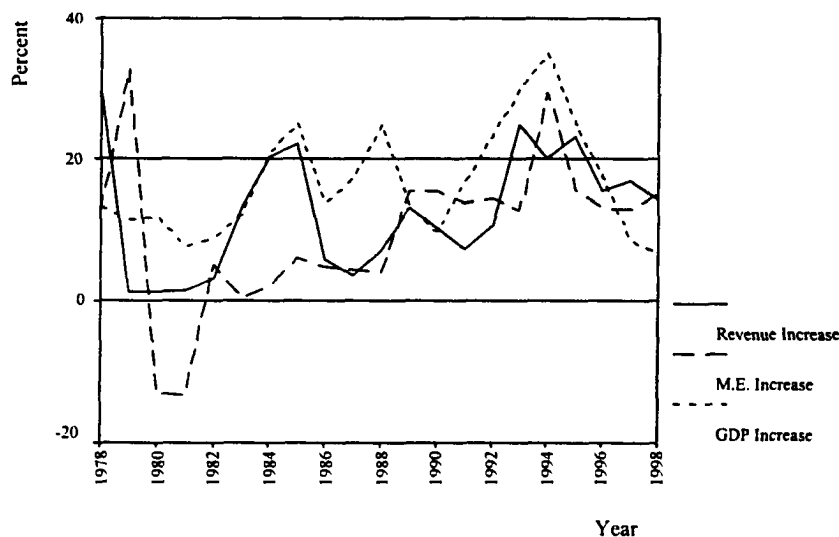
¹³⁴ It was reported that the number of the military run enterprises were more than 20,000 employing several million workers. Because of the PLA's political clout, they enjoyed tremendous privileges over civilian enterprises including generous tax breaks and access to state-subsidized raw materials. They even broke laws with little fear of punishment. Some estimates indicated that the profit rate of the military enterprises was about 30 percent of the total turnover in 1992 and only 5-10 percent in general went to the central coffer. See more in *South China Morning Post*, 8 December 1993; *International Herald Tribune*, 30 May 1994.

¹³⁵ Zhang Zhen, the deputy chief of the CMC, was in charge of this task in practice. This sort of policy already appeared in 1991 when the units below the army were allowed only to produce agricultural products to support their subsistence. As for the relationship between the PLA and localities, Ding Shufan's article in *Zhongyangribao*, 12 February 1995.

¹³⁶ For example, Wang Shaoguang revealed in 1994 that the Beijing government compensated the PLA 1.3 billion yuan for turning over the 38th army's mines to civilian authorities in Shanxi (*South China Morning Post*, 18 August 1994).

with fiscal reform acquired support from the Chinese academic world as well; a small task group in the Chinese Academy of Sciences strongly urged replacing military businesses with formal taxation to support military buildup, which would in return require fiscal reform to strengthen Beijing's fiscal capacity.¹³⁷ With the successful introduction of the new fiscal system, as seen in Table 5-6, military expenditure rate over Beijing's revenue dropped dramatically from 44.5 percent in 1993 to 18.9 percent in 1994 in spite of the 29.3 percent increase in military expenditure in 1994.¹³⁸ Despite complaints of financial distress by the MOF, it was Jiang Zemin who strongly urged giving financial and other support to the military (*South China Morning Post*, 15 March 1993; *China Post*, 12 March 1994; *South China Morning Post*, 15 March 1994).

Figure 5-1: Comparison of GDP, Revenue, and Military Expenditure Growth Rates



Source: Calculation from CSY 1999, 57, 265, 271; As for the figures of 1988, from CSY 2000 CD Rom.
 Note: M.E. Increase refers to military expenditure increase

¹³⁷ Although the report did not reveal the name of scholar in charge of the project, my interview with Hu Angang at the National Policy Research Center of the Chinese Academy of Sciences confirmed that it was his idea. Regarding the content, *Lianhebao*, 18 February 1994.

¹³⁸ Several factors explained the dramatic increase in 1994: arms race in reaction to the Taiwan's purchase of U.S.-made F-16 and French-made Mirage 2000 jet fighters (as for this argument, see *China Post*, 12 March 1994), high inflation (*International Herald Tribune*, 30 May 1994), and the cost for regularization of the military business (*Lianhebao*, 28 March 1994). However, it is also noteworthy that it would have been extremely difficult without the grip of sufficient revenue by the Beijing government in the fiscal reform in 1994. The Western figures on the Chinese military budget in 1994, which translated the Chinese currency value with the U.S. dollar exchange rate, might not be able to interpret the increase appropriately because of the devaluation of the *yuan* by about 33 percent by the elimination of the former two-tiered exchange rate in 1994.

Figure 5-1 shows the relationship among GDP, revenue, and military expenditure growth rates evincing a certain pattern over periods of time. During the sixth five-year plan period (1981-1985), with a successful launch of the economic reforms revenue and GDP growth rates were much higher than the military expenditure growth rate,. However, the policy priority of the seventh five-year plan (1986-1990) moved toward more rapid economic reform and the gap between the GDP and revenue/military expenditure growth rates began widen. The policy priority for the military was obviously low, and military expenditure maintained a steady growth rate below 5 percent until the take-up in 1989. The introduction of the fiscal contract system and the economic adjustment policies in 1988 certainly helped reduce the gap between the revenue and GDP growth rates in 1989. The outbreak of the Tiananmen Incident and the changing international security environment allowed momentum for the military to get a drastic increase of military allocation. The high growth rate in military expenditure continued in spite of overall economic retrenchment policies in 1990.

In the early 1990s, the eighth five-year plan and remarks by Jiang Zemin revealed that the policy priority had moved from a heavy focus on economic development to co-development in the economy and military. Jiang Zemin, who did not have a sufficient power base of his own, began to rely on nationalistic appeal to build a legitimate power base. Jiang frequently emphasized survival, development, strength, the glory of the Chinese nation, and China's international status and prestige (*Japan Times*, 24 March 1993). Such expressions were then fully realized in his incessant emphasis on strengthening the military as well as developing the economic.¹³⁹ According to Jiang, "the modernization of defense will be an integral part of the construction of socialist modernization."¹⁴⁰

In sum, the early eighth five-year plan period was characterized by crisis and readjustment in the economy, which resulted in dampening revenue growth and the high military expenditure rate. Changing domestic/international security environments

¹³⁹ Chi Haotian, the General Staff Chief of the PLA, told reporters the reasoning of the military build-up as a necessary means for peacetime preparation of war although he recognized that the international security threat improved (*Wenhuibao*, 30 March 1992). Also see the report of the relations of military budget increase with Jiang's political purpose in *The Christian Science Monitor*, 6 March 1997 and in the Ellis Joffe's article in *the International Herald Tribune*, 8 May 1997.

¹⁴⁰ Extracted from *the South China Morning Post*, 23 March 1993.

strengthened the influence of the PLA in politics and, consequently, in the fiscal arena. After military expenditure gained its momentum of increase, it has kept pace with the growths of revenue and GDP since 1989 and indeed exceeded both the GDP growth rate from 1997 and the revenue increase rate in 1998. It never returned to the 1980s' practice of keeping the military expenditure increase rate below the GDP/revenue growth rates. Later, the MOF and Premier Zhu Rongji did not necessarily agree such strong presence of the military position in the financial area because they were in charge of fiscal stability and economic development (*Mingbao*, 2 March 1997; *Zhongyangribao*, 2 September 1999), but the PLA was still able to insert its organizational interests into the Chinese politics with the backing from Jiang Zemin.¹⁴¹ Jiang also utilized every opportunity to gain political support from the PLA by supporting military expenditure increases.¹⁴²

The fiscal contract system nurtured localism and weakened the fiscal position of the Beijing government although it did serve as a driving force for local economic developments. During the period 1989-1992, the revenue increase rate remained much lower than the military expenditure growth rate, which aggravated the fiscal burden of the Beijing government. Under the fiscal contract system, the Beijing government was unable to make the fiscal system function for macroeconomic control and finance the central coffers. However, the initial attempt by Li Peng and some central bureaucracies to recentralize the fiscal power in late 1989 and early 1990 failed because of lack of consensus in the central leadership coupled with a strong local resistance. Under the fiscal contract system, the evolving dynamics of reformers and local interests still favored the current system for maintaining privileges and faster economic development. Furthermore, after Deng's southern tour to encourage faster and bolder economic development, the policy priority shifted to faster economic development as a long-term solution to financial problems. As a result, the gap between the revenue and GDP increase rates was considerably widened. The remaining question was how the Beijing government would find a way to support China's increasing military expenditure through

¹⁴¹ The military tension in the Taiwan straits and the conflict with Japan on jurisdiction of *Diaoyu* island in 1996 strengthened the position of the PLA in allocating resources.

¹⁴² The organizational position of the MOF was not to increase the military expenditure over the increase rate of revenue. See this position in the interviews with Cao Gangchuan, the director of the Defense Science and Industry Commission, and Liu Zhongli, minister of the MOF by *Mingbao*, 2 March 1997.

its fiscal system. Otherwise, the Beijing government would suffer from constant pressure from the burden of military expenses.

Early in 1993 Beijing became alarmed by the gap between the revenue increase and GDP increase rates and the problem of macroeconomic control. To redress the gap, a special measure became urgent: the tax-sharing system of 1994. The fiscal readjustment plan appeared to exert much more control over the economy by the Beijing government. The revenue extraction and military expenditure growth rates would be higher than the GDP growth rate. However, the decision-making practice and evolving interests with the fiscal reform complicated introduction of the tax-sharing system. In the next chapter, I will deal with the dynamics of introducing and implementing the tax-sharing system. The dynamics of that feat reveal the political capacity of the Beijing government.

Chapter VI

The 1994 Fiscal Reform and Remaining Issues

A. Gaining Legitimacy for Fiscal Reform: Applying Democratic Centralism

The post-Mao leadership deliberately applied the principle of democratic centralism as a norm of decision-making to guarantee its policy legitimacy. In particular, it was in Jiang Zemin's era that the norm became more actively applied in introducing a major policy.¹ Jiang himself was selected by Deng because of his ability to resolve conflicts and unite others as well as his record in economic and administrative management.² Under pressure for introducing western style democracy as evinced in 1989's Tiananmen Incident and lacking charisma, his solution was to reinforce the principle of democratic centralism as a Chinese characteristic. In the report of the fourteenth CPC, Jiang particularly stressed the principle of socialist democracy (Chi and Tian 1998, 536), declaring that without democracy, there would be no socialism and thus no socialist modernization. However, he also made it clear that the China's democracy would not be a western-style multi-party or representative system.

¹ A change of Deng Xiaoping's position on this matter was observed after the Tiananmen Incident. He had deliberately supported the principle of democratic centralism. Its institutional arrangements at the leadership level were the collective leadership and division of power among leaders. For example, no political leader could acquire the position of the party general secretary, president of the state, and the chairmanship in the CMC coincidentally. However, he concentrated the power in the hands of Jiang Zemin in efforts to give him power to say a final word in decision. However, he still supported an arrangement of collective leadership as a leadership form in the post-Deng period. A FBIS report downgraded it as an expedient stance rather than a system (FBIS-CHI-96-002). However, my interviews at the provincial cadres and scholars revealed that the belief of the collective leadership was more profound than I thought. It was considered a matter of consensus and a source of legitimacy of the Jiang's leadership. The view among populace certainly restrains Jiang's power in the governance.

² Regarding Deng's remarks on Jiang's strength, FBIS-CHI-96-002. Its original source was from Yingru. Zhou, "Inside Story of Personnel Reshuffle in Central Military Commission." *Hong Kong Ching Pao*, 1 November 1995.

Deng Xiaoping was well-known for having a final word on a key policy. Nobody could replace his charisma in his era. However, when his working style is examined, it is not difficult to see that he prudently abode by the democratic principle in giving the final word, still leaving space for further policy-modification in the details by means of reserving his word on detailed matters. Although he appeared to be the initiator of particular policies, in fact, he collected information on different views and in advance coordinated with different views well to garner sufficient support behind him. His 1992 famous southern tour was a case. As economic retrenchment policies hampered economic growth and development, he undertook a southern tour to encourage bolder economic development policies in 1992. Before the southern tour, he secretly met the military leaders of various regions to assure their support, which he reinforced by promising a military expenditure increase (*Lianghebao*, 21 March 1992).³ The powerful Yang Shangkun, Yang Baibing, the PLA, and local leaders firmly supported Deng's southern tour and in doing so made the bolder reform drive virtually irreversible (*Mingbao*, 13 March 1992; *Wenhuibao* 19 March 1992; *Zhongyangribao*, 13 April 1992; *Xingdaoribao*, 13 May 1992).⁴ Deng's approach acquired an ardent support in the NPC and the CPPCC (Chinese People's Political Consultative Conference) in March 1992. When the reform appeared to be an irreversible trend, party conservatives such as Song Ping and Chen Yun also made a speech to support bolder economic development as well as their own trip to Shenzhen (*Zhongyangribao*, 13 April 1992; *Xingdaoribao*, 13 May 1992).

Efforts to introduce the tax-sharing system in the Beijing government resulted, however, in bitter conflicts due to the nature of diversified interests involved in it. In terms of authority and political charisma, Jiang Zemin and the Beijing government were not as strong as during the periods of Mao and Deng. Provincial governments were being much more assertive in behalf of their own interests as a result of the deliberate central

³ It is noticeable that the SCRE already drafted regulations reducing the tax burdens of state-enterprises from 55 percent to 30 percent even before Deng's southern tour, and Li Peng and Zhu Rongji supported the state-enterprise reform. It appeared that Political leaders in Beijing were already ready to reduce its economic austerity policies and accept economic development at a faster pace. Regarding the detail, *The Christian Science Monitor*, 13 January 1992 and *Lianhebao*, 11 February 1992.

⁴ Deng pointed in the meeting with military leaders that the basic lines of the party (economic reforms and opening up) must be implemented for 100 years; the policies must not be shaken; and the speed of economic development must be faster (*Wenhuibao*, 19 March 1992). The Liberation Army's daily (*Jiefangjunbao*) declared its support of active economic reform and opening up policies (*Jiefangjunbao*, 14 March 1992).

policies that allowed them to keep more resources for their own use and encouraged them to voice their interests more loudly. The Beijing government confronted enormous resistance from localities as well when it sought to retrieve some privileges that localities once enjoyed. In particular, as it became obvious that the Beijing government was accelerating implementation of the tax-sharing system and would adopt fiscal centralization measures, resistance from local leaders flared up. Beijing utilized the democratic centralism to get through the difficulty.

Gaining legitimacy from interested parties through the principle of democratic centralism was crucial for reform's smooth implementation. As discussed, a broad consensus on necessity of the introduction of the tax-sharing system was already established in the Beijing leadership in principle even before the fiscal contract system was introduced as a temporary measure.⁵ However, the key issue was when and how to implement. As in other major draft-making processes, it required a long period of draft-making, revisions after consultation with political leaders and other professionals, and then negotiations with interest groups affected by this policy. Persuading localities would be the last hurdle. To succeed, the Beijing government utilized various economic work conferences, a series of high-level meetings with provincial leaders, NPC annual meetings, and personal contacts by the Beijing leaders. By so conferring, the Beijing government could harvest several benefits. The first would show the people how highly it placed efforts to observe the democratic principle in amassing various ideas. The second would assure eliciting a saddle point or place where conflicting interests could compromise to ensure implementation of the new policy. Such measures resulted in enhancing the legitimacy of the implementation. Since China does not have the western-style institutionalized input system for listening to public opinion in most policy-making, the more controversial the new policy, the more crucial would be China's *democratic* procedure in building legitimacy when the leader did not possess charisma such as Mao and Deng enjoyed.⁶

⁵ Jia and Yan argued that the central leadership already made a decision to implement the tax-sharing system in 1987 with other reform measures. However, with the delay of other reforms, the plan was cancelled in the end of 1986 (Jia and Yan 1999, 60).

⁶ In this respect, it is noteworthy that the "democratic" principle had been emphasized since the rein of Jiang Zemin. Regarding the emphasis on "democratic," see the summary of the academic discussion in

The principle of democratic centralism was very actively applied in the introduction of the tax-sharing system as well. The inception of the system was politically quite controversial and triggered serious feuds among various interest parties. Premier Li Peng and Finance Minister Wang Bingqian revealed their strong preference for the tax-sharing system in the taxation and finance work conferences in July 1992 (*Jingjiribao*, 30 July 1992; also see *Renminribao*, 6 December 1992), but enforcement was an entirely different issue that would require an unforeseeable amount of time. First, consensus in the Beijing leadership needed to be reached. Such a political issue had to be handled with care according to the principle of democratic centralism. Although small groups in the MOF and the SPC prepared proposals for the fiscal reform at the stage of draft-making, the Beijing government invited various interest groups to give their inputs. Invitees included scholars at the Chinese Academy of Social Science and Development Research Center as well as local leaders.

There are several institutionalized channels in which to exchange views and promote policies. The first one was the annual NPC meeting held in the spring to discuss the annual government plan. The second was the workshops of taxation, finance, and the SPC generally held in the summer; these workshops provided a staging ground for the Beijing government to exchange views with professionals and to sell its policy to them. The third mechanism was the economy/finance work conferences mostly held at the end of each year. At the conferences, at least two levels of negotiations and exchanging ideas existed. One was between political leaders and the other between professionals representing each financial sector of the government.

In general, details were discussed at the level of professionals. Mostly, one or a few provinces were assigned to a MOF officer specialized in fiscal negotiations. The officer dealing with his specialized province and a finance department director of the province became the negotiation partners on a one-to-one basis. Since the MOF officer was quite familiar with the provincial situation and its details, provincial officers did not enjoy the same advantage of information in negotiations as many people conventionally and theoretically thought. Annually, therefore, both parties faced a very tough negotiation

the 120th celebration of the Paris Commune in *Guangmingribao*, 18 March 1991; also see on the socialist democracy in *Renminribao*, 19 April 1991 and 2 August 1991.

process in which a room for adjustment was quite limited. However, negotiations on special preferential policies and treatments for specific reasons could later be exchanged at a higher level. In this case, at least a vice-governor level of provincial leader and a vice-premier/premier in charge of the financial issue were the major partners.⁷ The final institutionalized channel was an impromptu-style of economic work conference, which though not held annually, but often convened in unspecified periods on a demand-basis determined by the Beijing leaders. The channel was extensively utilized in 1993 for exchanging views and persuading local leaders by Jiang Zemin and Zhu Rongji in their efforts to introduce the tax-sharing system (*Xingdaoribao*, 24 May 1993). The Beijing government proved quite skillful in exchanging views, persuading the indecisive, and negotiating with provincial leaders on the introduction of the tax-sharing system through this kind of (semi) institutionalized channels.

Encouraged by the policy priority shifting after Deng's southern tour in 1992 to a rapid economic reform and development, supporters of the fiscal contract system also became active in promoting the fiscal contract system. The regional cadres and many former brains⁸ for Zhao Ziyang and Hu Yaobang were behind the promotion. Under an atmosphere of overall relaxation of the economic austerity policy in early 1992, state-enterprise sector representatives such as Zhou Guanwu, chairman of *Shougang* iron/steel company in Beijing, urged further decentralization of economic power and promoted the fiscal contract system as a mechanism to encourage productivity initiatives in the political consultation conference (*Xingdaoribao*, 30 March 1992). Consecutively, Chinese Industrial and Economic Association, Enterprise Management Association, and industry-related ministries held a conference in July 1992 to promote the fiscal contract system, in which they praised the fiscal contract system as an effective way to motivate the enterprises motivated and connect the fiscal system to Deng's theory (*Guangmingribao*, 2 August 1992). An article by Dai Jing from Hunan suggested that the *tiao-tiao* and *kuai-kuai* problems could be overcome by facilitating the fiscal contract system (*Jingjiribao*, 2 September 1992). In May 1993, *Renminribao* reported that proponents of the fiscal

⁷ Zhu Rongji was in charge of the financial area before 1994 and then, Li Lanqing took over it after 1994 (author's interview).

⁸ For example, they were Yu Guangyuan, Tong Dalin, MaYining, Xiao Zhouji, Zhu Houze, and Wu Mingyu.

contract system again organized a similar conference in which they hailed the fiscal contract system. In particular, Minister of Construction Hou Jie made a major speech in support of it (*Renminribao*, 21 May 1993).⁹

On the other hand, Li Peng, Zhu Rongji, the SPC, and the MOF were able to place the policy guideline, which would intensify efforts for the new fiscal reform from 1993 onward, in the new revision of the eighth five-year plan, passed in the second session of the fourteenth CPC CC on 7 March 1993 (Liu 1999, 274). Accordingly, SPC director Zou Jiahua and MOF minister Liu Zhongli drafted suggestions for restructuring the fiscal system in their report on the 1992 budget accounting and 1993 budget draft in the first session of the eighth NPC on 16 March 1993 (Liu 1999, 274). On July 22 in the general office meeting of the State Council the schedule for implementing the fiscal reform was set up as 1 January 1994 at the central level (Liu 1999, 280). In June 1993 the General Taxation Bureau quickly initiated a small leadership group for restructuring the fiscal system and submitted a comprehensive report on fiscal reform to the general office meeting of the State Council, State Council Standing Committee meeting, and Politburo Standing Committee meeting during the period from late August to early September (Liu 1999, 263, 281). These meetings approved the fiscal reform plan in principle.

As one MOF interviewee from recalled, since then, Beijing's political leaders and MOF officers after that made very frequent visits to the provinces to negotiate and persuade local counterparts and leaders on the new fiscal reform. Over 1993 and 1994 the new leadership of Jiang Zemin, Li Peng, Qiao Shi, and Zhu Rongji extensively visited all provinces, in particular making frequent visits to coastal provinces such as Shanghai, Guangdong, and Shandong (Policy Research Board of the Centre, 949-988). Zhu Rongji himself visited about 90 party and governmental organizations in sixteen provinces and cities and 80 meetings during the period from the end of August to early November (*Zhongguoshibao*, 2 December 1993). Along with 60 fiscal specialists he also made a very special visit in October 1993 to Shanghai to discuss the tax-sharing system (*Wenhuibao*, 28 October 1993). Jiang Zemin demanded acceptance of the fiscal reform

⁹ As a direction of the future fiscal reform, strengthening the relative independence of provincial finance was also raised by Liu Lisong of Beijing municipality finance bureau. See Lisong Liu, "Shenhua Shengji Caizhengtizhi Gaigede Lilun Sikao [A Thought on the Theory of Deepening the Reform of Provincial Fiscal System]." *Jingjiyanjiu cankao* 141 (13 October 1992): 46-54.

according to the principle of democratic centralism in a southern meeting with provincial leaders in September (*China Post*, 1 November 1993; *Mingbao*, 4 October 1993). The Beijing government also labored to persuade individuals and groups alike that a smooth implementation would be guaranteed for the new fiscal plan. Then, when it garnered a sufficient support, Beijing persuaded obstinate supporters of the fiscal contract system to follow the mainstream while flexibly compromising with them over details. When agreement was finally reached, the Beijing government acquired the legitimacy to implement the policy according to the principle of democratic centralism. In particular, the relatively rich coastal provinces became major targets of persuasion. Guangdong was the most problematic because it stood to lose the most by introducing the new fiscal reform.

The strategy of the Beijing government in persuading Guangdong was to give incentives and apply the principle of democratic centralism: first democratic persuasion and negotiation and then imposition of centralism. When Guangdong's resistance became apparent, the Beijing government attempted to encircle it by, to begin with, eliciting agreements from other provinces on Beijing's side.¹⁰ Most coastal provinces such as Shanghai, Liaoning, and Heilongjiang resisted but finally reluctantly accepted the tax sharing system.

Guangdong was the biggest beneficiary of the previous reforms as implied in its comparison to Shanghai in Tables 6-1 and 6-2. Since the 1978 economic reforms, the Beijing government allowed Guangdong to wield discretionary power in fiscal management while Beijing placed most other provinces under a relatively tight control. Guangdong enjoyed its fame as a champion of the fiscal contract system, its economic and fiscal success under the contract system intensifying its position in negotiations with the Beijing government. Accordingly, Guangdong resisted most vehemently the new *tax-sharing scheme*. When Premier Zhu visited Guangdong in September 1993 to persuade its leaders, he had to promise in the negotiation that during the transitional period the tax-

¹⁰ Guangdong economy composed of low rates of SOEs, low rates of fiscal transfer to the center, and relatively small amount of subsidies on trade and agriculture, so it was easy to account in experimenting the tax-sharing system, thus a good place for the experiment of the tax-sharing system. However, resistance from Guangdong and its fiscal position forced the Beijing government not to include Guangdong in the experiments of the tax-sharing system implemented in June 1992 at nine

sharing system would only cover that part of revenue that Guangdong province directly controlled, which was less than one-third of Guangdong's entire revenue.¹¹ Even then it was not easy to persuade the province to accept the new fiscal policy, and in the process of negotiating, the Beijing government in the end utilized the principle of centralism to press Guangdong, saying "If all other provinces agreed, you should obey (author's interview)."

Table 6-1: Taxation Management Power of Shanghai

	Before 1984	1985-1987	1988-1993	After 1994
Tax Policy & Law Making	No	No	No	No
Interpretation of Tax Law	No	No. Exception only in value-added tax	No. Exception only in value-added tax	No
Setting Taxes	No	Very limited	Very limited	Yes over local taxes, but still very limited
Tax (rates & items) Adjustment	No	Very limited	Very limited	Yes over local taxes
Tax Holiday Endowment	Very little	Yes (reducing tax rate & tax exemption)	Yes (reducing tax rate & tax exemption)	Yes over local taxes
Control of Tax Base and Management	Very little	More than before	Yes over the increased portion of fixed amount	Yes over local taxes

Source: Based on Author's Interview

Note: Interviews confirmed that the control over Shanghai finance by the central government before 1988 was much tighter than that over Guangdong.

Table 6-2: Taxation Management Power of Guangdong

	Before 1978	1979-1987	1988-1993	After 1994
Tax Policy & Law Making	No	No	No	No
Interpretation of Tax Law	No	No, but in realty Yes	No, but in realty Yes	No, but in realty a little bit flexible
Setting Taxes	No	Relatively flexible	Relatively flexible	Yes over local taxes
Tax (rates & items) Adjustment	No	Relatively flexible	Relatively flexible	Yes over local taxes
Tax Holiday Endowment	No	Relatively flexible	Relatively flexible	Yes over local taxes
Control of Tax Collection and Management	No	Relatively flexible	Relatively flexible	Yes over local taxes

Source: Based on Author's Interview.

Note: Since it is base on the interview from the point of Shanghai, it might be a bias. However, it was obvious that Guangdong was much more flexible in managing its fiscal system than Shanghai.

Yet an institutional mechanism could not be the sole predictable variable of policy enforcement in China. The leadership factor was the other crucial variable in enforcing

provinces and cities: Zhejiang, Liaoning, Xinjiang, Tianjin, Wuhan, Qingdao, Dalian, Shenyang, and Chongqing (*Renmin Ribao*, 20 June 1992).

¹¹ *Xingdaoribao*, 9 February 1994. Even after the introduction of the tax-sharing system, as a result, the fiscal contract system had still been applied to city and county levels of finance in Guangdong.

¹³ Regarding the report of Jiang's acceptance of the new fiscal reform, *Lianhebao*, 12 August 1993.

the tax-sharing system. Reaching consensus in leadership was an institutional prerequisite for a smooth enforcement. However, it was often difficult and time-consuming under the principle of democratic centralism. The Chinese organizational feature for information-gathering was not designed to facilitate communication among horizontal organizations in the government and among provinces. Each ministry or province is mainly responsible for promoting its own interests. Each has its own information and agenda, but only the central leaders or government had exclusive control of them all. Such exclusive power allowed the Beijing government an edge over its subordinate organizations. When consensus was not reached in Beijing, localities probably had a better chance of inserting their own interests. However, provincial power was far from being unchecked. Since unbalanced distribution of power with the Beijing government still existed, it was crucial for localities to struggle to decipher symbolic actions from Beijing to gauge the range of their immunity.

Jiang Zemin showed his keen support for introducing the tax-sharing system by taking command of it. He himself presided three times in April 1993 at the Central economy/finance small group meetings to listen to the reports on the fiscal reform presented by Jin Xin, State Taxation Bureau director, obviously delivering his concerns and will to the others. When Zhu Rongji fell under fire from local leaders, Jiang Zemin openly revealed his support for the tax-sharing system by traveling to coastal regions to promote the new system.¹³ For example, in late September 1993 just before the third plenary session of the fourteenth CPC CC in which the fiscal reform would be a key issue, he flew to Guangzhou and met with ten coastal and southern region leaders to discuss the economic works.¹⁴ Jiang attempted to persuade them to follow Beijing's policy priority, in the meeting emphasizing the principle of *democratic centralism* to promote the intergovernmental relations (*China Post*, 1 November 1993; *Mingbao*, 4 October 1993). He also presided over the first theoretical discussion conference of provincial and ministerial levels of leaders in November 1993 (Central Research Board of Policy-Making, 960). His actions certainly showed the determination of and consensus in

¹⁴ Party secretaries and governors from Guangdong, Henan, Hubei, Hunan, Guangxi, Hainan, Sichuan, Yunnan, Guizhou, and Xizhuang gathered there.

Beijing's leadership, and accordingly opponents of the new fiscal reform came to regard it as *a fait accompli* after the third plenary session in November 1993.

When Zhu Rongji and other Beijing leaders intensified the campaign to introduce the tax-sharing system as a means of macro-economic control, Deng Xiaoping in September 1993 issued a second warning on economic austerity measures issued by the Beijing government to the effect that excessive concentration on economic restructuring should not detract from the primary task of a fast-paced growth. He urged growing the economy by 10 percent or even more (*South China Morning Post*, 26 October 1993), which frightened Zhu and other central planners seeking to avoid double-digit inflation.¹⁵ Deng's strong interference encouraged the proponents of the fiscal contract system. Although Deng did not publicly announce his support for the fiscal contract system, his remarks were taken as a proxy for it. Six non-governmental research organizations gathered to support further economic decentralization and economic growth in October.¹⁶ Other liberal economists such as Ma Yining (*Dagongbao*, 13 September 1993), Gao Shangquan, and Xiao Zhuoji from Beijing University (*South China Morning Post*, 19 October 1993), Wang Jue from the Central Party School (*Dagongbao*, 26 October 1993), Zhang Shuguang from the CASS, Wei Jie from Renmin University (*South China Morning Post*, 26 October 1993), Yang Peixin from the DRC, Wang Zuo of Guangdong, and many others actively responded to Deng's calls for faster reform and supported the fiscal contract system. In general, they disagreed with the view of economic overheatedness; instead, they regarded fast economic development as a positive sign for overall reform. By providing more financial resources to the localities and enterprises for faster development, they argued, the Beijing government would in the long run get more revenue. They also insisted that a serious problem was the Beijing government's direct

¹⁵ The growth rate of GDP was 6 percent in the original plan of the eighth five-year plan, but it was readjusted to 8 percent after 1992. Most Chinese economists agreed that 8-9 percent of GDP growth would be the optimistic growth rate. However, Deng seemed to favor a much bolder and faster economic growth. See more in *South China Morning Post*, 26 October 1993 and concerning the eighth five-year plan, Cong and Zhang eds. (1999), 1002-1007.

¹⁶ They were Wang Daohan's East Research Institute (*dongfang yanjiusuo*), Yu Guangyuan's Chinese Market Economy Forum (*zhongguo shichang jingji luntan*), Tong Dalin's World Observation Research Institute (*shijie guancha yanjiusuo*), Wang Jue's Chinese Market Economy Research Institute (*zhongguo shichang jingji yanjiusuo*), Dong Funai's Chinese International Information Research Institute (*zhongxin guoji yanjiusuo*), and Wu Jinglian's Reform (*Gaige*). See more in *Dagongbao*, 26 October 1993.

intervention in economy and recentralized measures such as the introduction of the tax-sharing system against economic logics. Their policy preference favored certainly faster economic development over macro-economic control. These groups vigorously lobbied and negotiated for a faster pace of liberalization in advance of the third plenary session of the fourteenth CPC in November 1993 (*South China Morning Post*, 19 October 1993).

A practical necessity probably encouraged Deng Xiaoping to accelerate economic reforms. Only rapid economic development could shore up the party's credibility in the face of the collapse of the former Soviet block and the hue and cry in China to expand military expenditure. When he sensed the potential danger that economic retrenchment policies coupled with slow economic growth might cause greater political disaster than fast and bold economic reforms, he showed the strong will needed to back up further economic reforms in his famous southern tour of 1992 and in September 1993 in the midst of a drive by Beijing for economic austerity policies. However, his showing was not made in the dark and his idea already having been backed by a sufficient number of people and regions. When a deadlock situation existed, his *benign* interference added weight on a side to make the view decisive. When the Beijing leaders elaborated all efforts to introduce the tax sharing system, Deng certainly ignited local leaders and other people who loudly opposed to the new fiscal reforms in the fall of 1993.

General Secretary Jiang Zemin, Director of the SPC/vice-Premier Zou Jiahua, and Vice-Premier Li Lanqing all expressed their support of Deng's slogan "development before all else" (*South Chin Morning Post*, 27 October 1993). Oppositely, Yao Yilin, Song Ping, Li Peng, and Zhu Rongji did not chant Deng's slogan; therefore, they were called conservatives by those who were seeking to maintain the fiscal contract system. Yet Beijing leaders did not give up on their original plan to introduce the tax-sharing system as well. Meanwhile, Jiang Zemin and other Beijing leaders still embraced Deng's view in their policy: they compromised and negotiated with the opponents of fiscal reform as the Chinese decision norm guided them.

Ironically, the Beijing leaders needed to negotiate in order to remove negotiation practices in the fiscal area. To begin with, Beijing assuaged local opposition by guaranteeing that localities would be able to maintain current levels of revenue. Beijing would reimburse any short-fall of local expenditure incurred by the new fiscal reform

over the next three years. *Mingbao* reported that the new plan set up a three-year transitional period of implementation from the *tax-contract system* to the tax-sharing system (*Mingbao*, 29 November 1993). In the first year, the Beijing government would get 60 percent of revenue, but should return the amount of revenue stipulated by criteria based on the previous system. In the second year, it would return 10 percent of its revenue to provinces. In the third year (1996), it would at last get the 60 percent of revenue as the original scheme indicated.¹⁷ Finance Minister Liu Zhongli also gave assurance that the new fiscal measures would not increase the burdens of enterprises and people (*Jiefang junbao*, 18 December 1993). A tax cut benefit from 55 percent to 33 percent on SOEs would extend support for the tax-sharing system from the SOEs where the rates of taxes were relatively high. Interestingly, the Beijing government took up that very “pie story” to persuade provincial governments and to introduce the tax sharing system that was often used by the opponents. The “pie story” argued that as the Beijing government extended the range of local tax base, the pie for provinces would grow larger in the long-run and help local finances to become more independent (*South China Morning Post*, 23 November 1993).

Fiscal reform was eventually presented as the main agenda at the third plenary session of the fourteenth CPC held in November 1993.¹⁸ The session provided Beijing and regional leaders with another round of meetings in which to discuss concerns about issues of the fiscal reform. In the session, Jiang Zemin again referred to the principle of democratic centralism that gave pressure on local leaders to agree with the passage of the fiscal reform (*Zhongguoshibao*, 19 January 1994). The session adopted a “Decision on Issues Concerning the Establishment of a Socialist Market Economic Structure.”¹⁹ Among the provisions of the decision was a package of measures aiming at reforming the fiscal system. This package was remarkably comprehensible because it marked the first attempt by the Beijing government to fundamentally change the two central features of the Soviet fiscal system: the differential rates of indirect taxes across products and sectors

¹⁷ However, the scheme was changed and the proportions of the Beijing government adjusted to a much lower level than the original plans in later rounds of negotiations and compromise.

¹⁸ It is noteworthy that the title of a leading article in commemoration of the centenary of Mao Zedong’s birthday in December 1993 in *Finance*, China’s main monthly journal on Finance was “Reflection on the Study of Central-Local Government Relations.” See in Feng Tong, “Reflection on the Study of Central-Local Government Relations,” *Finance* No. 12. (1993): 2-5.

that allowed taxes to play an unintended resources-allocation function, and the joint “ownership” of revenues which required negotiated sharing between the central and local governments and eroded incentives and local tax collection (Wong ed. 1997, 37).

The Beijing government would dramatically increase its control over revenue, but in return, it guaranteed that provinces would enjoy spending at least at the level of 1993. In addition, Beijing paved the way for more transparent and independent local finance by increasing the number of items assigned for local taxation. In this respect, the 1994 fiscal reform was a turning point for decentralization in the fiscal arena beyond the delegation of power by the Beijing government. The introduction of the new fiscal measures was accepted as an irreversible trend by local leaders. It was reported that in the session, the Beijing government was not met by strong opposition from regions including Guangdong, where the introduction of the tax-sharing system was officially documented (*South China Morning Post*, 23 November 1993; *Lianhebao*, 5 December 1993). Indeed, Vice-Premier Zhu Rongji praised Guangdong for its support of the fiscal reform in his speech (*South China Morning Post*, 23 November 1993).

The final negotiations and compromises in matters of detail before the introduction of the tax-sharing system were made in the various economic conferences in December 1993. Although opponents of the tax-sharing system were not entirely convinced, its introduction was taken for granted as an irreversible trend. The SPC, the MOF, and the SCRE declared their support for the tax-sharing system in their annual conference respectively (see details in *Jiefangjunbao*, 6 December 1993). The PLA also expressed its support in the editorial of its organizational daily newspaper, *Jiefangjunbao* (14 December 1993). The fiscal reform evinced a strong characteristic of zero-sum game in the revenue arena between Beijing and provincial governments as the self-reliance index (see Table 5-1) succinctly illustrates. The self-reliance scores dramatically changed from 0.73 to 1.66 in the Beijing government and from 1.02 to 0.57 in the local governments after the fiscal reform in 1994.

Beijing political leaders and bureaucrats certainly won an enormous victory by reversing a major trend in the revenue area. Even in spite of Deng’s several warnings and relentless resistance from localities and liberal economists, central leadership was

¹⁹ *China Daily*, Supplement, November 17, 1993.

successful in introducing the tax-sharing system. The bottom line was that Beijing got what it wanted the most: the control of the revenue flow. The new system also curbed the declining tendency of tax revenue as a proportion of GDP. However, such achievement did not happen for free. The application of the *democratic* principle, enforcement of centralism, and Beijing's compromise with opponents paved the way for the introduction of the tax-sharing system. As in previous fiscal reforms, a series of negotiations and compromises changed the original scheme to create a space for the non-zero-sum game. As a result, fiscal reform was not a mere centralization measure. Contrary to the conventional view, it was also a major step to establishing the local finance system's independence from the Beijing's administrative power by providing local finances with a legal basis of revenue sources. In this respect, a genuine decentralization rather than a delegation of power was launched in the fiscal reform in 1994. If the reforms proved successful, the Beijing government would gain greater macroeconomic control; meanwhile, local governments would be able to have greater microeconomic control over regional economies. In the next section, we will discuss details of changes and the enforcement.

B. Implementation and Organizational Changes

The new fiscal reform in 1994 was a major attempt to institutionalize the Chinese fiscal system.²⁰ Although centralization on the revenue side had been a well-publicized goal, it was more likely a crossroad for fiscal decentralization in terms of the institutional approach. It was designed to establish more responsible local finance by assigning their own revenue sources and delineating administrative jurisdiction for funding.²¹ However,

²⁰ See the political report of Li Peng in the second plenary session of the eighth NPC on 10 March 1994. (Central Document Research Office 1996, 726). Xing Zhongxin and Kuo Daimo reemphasized this point of view just before the plenary session of the fourteenth CPC made a decision for the fiscal reform. See more detail in their respective editorials in *Jingjiribao*, 22 October 1993. In particular, regarding the emphasis on the importance of institutionalization, see Xiang (1998).

²¹ An episode confirms this argument. According to the account of Wu Yanghua, Chief of Budget Department of Guangdong Finance Bureau, when Zhu Rongji visited Guangdong to negotiate for the tax-sharing system in September 1993 for the first time, Guangdong was willing to exchange more revenues to Beijing with the guarantee of maintaining the fiscal contract system until 2000. However, the pre-assumption of Guangdong on the intention of Zhu's visit went wrong when Zhu declared that he came to Guangdong to introduce a more standardized fiscal system rather than to extract more

decisional practices in Chinese politics and organizational incapacity in China's overall economic system resulted in far less institutionalization than was originally planned. When two major conflicting views on a certain issue existed, the Chinese practice placed more emphasis on creating a win-win situation for a smooth implementation than on enforcing a one-sided policy. The incessant effort for institutionalization in the fiscal arena was adjusted for purpose of compatibility with the cardinal principle of the necessity of economic development, as insisted upon by Deng and the localities. As a result, the degree of institutionalization and central control over revenue were not as high as planned but the fiscal reform still brought dramatic changes in fiscal management and intergovernmental relations.

The centerpiece of the fiscal reform was the introduction of the tax-sharing system. Under the new system, taxes were divided into three categories: central, local, and shared taxes between central and local governments.²² To simplify tax management, the number of tax items in the industrial and commercial taxes was also drastically reduced from more than 30 down to 17. Along with the economic reforms, the number of tax items increased substantially to exploit new revenue sources and to redistribute societal incomes complicated due to change of economic environments, but such adjustments was not only unable to accommodate new demands for taxation but also proved too chaotic to control.²³ Simplification and division of taxes would certainly help the tax system be more transparent and regularized. Based on the assignment of taxes, the state/local taxation bureaus would collect taxes under their jurisdiction. In respect to the division of revenue sources under the new system, Beijing's objective was to stop the erosion of its revenue share in the total revenue.

revenues. Then, Guangdong was forced to negotiate with Beijing at the basis of accepting the tax-sharing system. Regarding this, *Guangdong Caizheng* No. 10 (1999), 38.

²² Central taxes comprise custom duties, the consumption tax, VAT revenue collected by customs, income taxes from central enterprises and from banks and non-bank financial intermediaries, the remitted profits, income taxes, business taxes, urban construction and maintenance taxes of the railroad, bank head-quarters, and insurance companies, and resources taxes on offshore oil extraction; Local taxes are business taxes (excluding those assigned for the central fixed incomes), income taxes and profit remittances of local enterprises, urban land use taxes, personnel income taxes, the fixed asset investment orientation tax, the urban construction and maintenance tax, real estate taxes, the vehicle utilization tax, the stamp tax, the animal slaughter tax, agricultural taxes, the title tax, inheritance and gift taxes, the capital gains tax on land, state land sales revenues, and resource taxes on land-based resources; and Shared taxes are the VAT (75 percent vs. 25 percent) and the new securities trading tax (50 percent vs. 50 percent).

According to an estimate by the World Bank,²⁴ the sharing ratio was more in favor of the Beijing government. The sharing formula for the value-added tax, heavily favored the Beijing government.²⁵ In the experiments conducted with the *tax-sharing system*, the sharing rate in the value-added taxes was 50-50. Most of the value-added taxes were originally a part of the local taxes, but as the value-added tax was the fastest growing tax source the Beijing government would take 75 percent of it back under the new *tax-sharing system*. The Beijing government would take responsibility for the collection of all shared taxes as well as the fixed central taxes. Most consumer taxes were previously allotted in the hands of local government, but under the new formula they would return to the coffers of the Beijing government to become the second largest tax source in Beijing's revenue. As of 1994, the percentages of value-added tax and the consumption taxes in the total revenue were 44 percent and 12.8 percent respectively.²⁶ After the division of sharing, the proportion of the Beijing government revenue over total revenue would gradually increase from about 40 percent in 1992 to 52 percent by the year 2000.²⁷ The tax-return system was also introduced in the fiscal reform. Since the value-added taxes were assigned to the shared taxes, of which the Beijing government would take 75 percent and the consumption tax was the centrally-assigned tax, the Beijing government had good reason to worry about local noncompliance. To encourage local tax efforts, then, the Beijing government would return 30 percent of increase above the base figure of 1993 in value-added and consumer taxes.

According to my interview with Hu Angang, the Beijing government originally planned to have about 60 percent of revenue and 40 percent of expenditure,²⁸ after which

²³ See the evolution of taxes in SGTB (1997), 3.

²⁴ The World Bank argued that this estimation was based on historical trends. The new value added tax will grow at the rate of 15 percent, the excise tax at 10 percent, the other central fixed taxes at 13 percent, and local taxes at 10 percent annually between 1993 and 2000. The World Bank (1995), 69-70.

²⁵ Provinces are to retain an amount equivalent to 25 percent of the 1994 value added collections. The rest of the value added tax collections and all revenue from the excise taxes is to be assigned to the center. As of 1993, the percentages of value added tax and the excise taxes in the total revenue were 22.5 percent and 37.2 percent respectively. See the World Bank (1995), 196.

²⁶ Calculated by author from CSY (1999), 267 and CFY (1999), 450.

²⁷ A task force from the SCRE argued that the proportion of the revenue of the Beijing government over the total revenue should reach at least 50 percent and eventually 66 percent. See in the task force, "Jianliyigeguifan, Youxiaode Caizhengxintizhi [Establish a New Standardized and Effective Fiscal System]." *Gaige* (11-15 June 1993): 51-55.

²⁸ The ratio 60:40 is in line with the pattern in most other countries. See Tsang, 778.

about 20 percent would be remitted to provincial governments through *fiscal transfer* during the ninth five-year plan period.²⁹ The plan was drafted by the research center of the State Council for the third plenary session of the thirteenth CPC CC in October 1993 (*Lianhebao*, 9 October 1993). However, in the process of negotiations the target appeared to be adjusted to the lower level of about 50 percent (CTY 1995, 535). The net transfer to local governments would jump from a negative transfer of 14 percent in 1992 to a positive transfer of about 35 percent of tax collection upon introduction of the new system. These new arrangements for intergovernmental fiscal relations would lead to a greater centralization on the revenue side.

A benefit of the fiscal reform for local governments was that the localities could enjoy more stable local revenue bases. Local governments were guaranteed the right to spend locally-assigned taxes for their own sake. The range of negotiations with which to acquire more tax revenues was considerably reduced, and the negotiation practices also proved bothersome for localities as well as the Beijing government. Since the local governments were only responsible for collecting local taxes, they would be more capable of identifying local tax bases. A negative side of the new fiscal reform for localities was that, in practice, sub-national levels of governments would in large measure lose the financial ability of self-reliance (see Table 5-1). As the Beijing government took major tax sources, local governments would be strongly motivated to expand their tax collection to compensate for their loss under the new fiscal system. However, all levels of local governments would still have to rely on the fiscal transfer and subsidies from the Beijing government to finance their own spending.³⁰ In particular, no province in the central and inland regions would be free from the fiscal transfer or the subsidy. All provinces were subjected to tax return from the Beijing government; 18 provinces to the fiscal transfer coupled with the previous subsidy recipients of 17 provinces (see Tables 4-2 and 6-4).

Many anecdotal stories relate how localities cultivated every opportunity to increase their own revenue at the expense of the Beijing government. The simple indication of the revenue increase rate at each level of government during the period of

²⁹ *Mingbao* also reported the same scheme (29 November 1993).

³⁰ Also see Hu Angang's fiscal reliance index in Hu (1999), 165.

1995-1997 reveals something more than the stories. The average revenue increase rate of the Beijing government was 13.3 percent and the local governments 24.1 percent. It was obvious that localities exerted much more effort to increase their own revenue, but the increase rate of the Beijing government also indicates that it achieved more than its target of 10 percent during the ninth five-year plan period.³¹ In this respect, the Beijing government succeeded in encouraging local revenue efforts under the new fiscal system. The overall revenue increase rate was remarkable during the ninth five-year plan, especially in exceeding the GDP growth rate (see Figure 5-1).

Another key change was a sign that the Beijing government paid more attention to spending side than ever before. Economic reforms considerably increased demands for spending for economic development and public service at every level of government. As the policy priority of the Beijing government gradually moved to faster economic development, the destitution problem in spending threatened enterprises and localities. The Beijing government did not seek to regulate the expenditure side as its policy basically moved to encourage expanded local spending. The national level of annual surveillance focused relatively more on the revenue collection side. As a result, during the 1980s the average growth rate of expenditure outstripped that of revenue in spite of all efforts of the Beijing government to achieve for fiscal balance. The free-rider problem was pandemic in public spending with increasing localism.

With the ongoing stress of economic development, the solution was to clarify each government's administrative responsibility of expenditure. This move would not threaten the size of local expenditure but rather make each government's spending more transparent and effective. Local governments would be responsible for the locally-administrated spending in local construction, local administration, and local price subsidies. The Beijing government would take charge of nationally-covered areas beyond the local responsibility, such as of national defense, trans-regional construction, and other country-wide programs. What was noticeable was that the burden of the price subsidies was handed over to local governments. However, the Beijing government would pay for the tax- return for import/export taxes in its own pocket. Later on, this tax return caused much more trouble in Beijing's finances because the local governments and enterprises

³¹ Regarding the detail of the target, see CTY (1997), 69-76.

dramatically increased the amount of the tax return.³² The Beijing government had to postpone paying several billion *yuan* by dividing the amount for several years and then lowering the tax return rates twice in 1995 to get it under control (Jia and Yan 1999, 163-164). The unanticipated surge of the tax return considerably reduced room for the planned fiscal transfer by the Beijing government; otherwise, most central and inland provinces would be beneficiaries. It was only in 1997 that the tax return rate dropped from 16.28 percent in 1996 to 9.8 percent of circulation taxes (CFY 1999, 469).

The most controversial issue in the area of responsibility for expenditures was the investment in production and construction, which had the character of public goods. Local governments did not want to spend their funds on the public goods unless it would bring immediate profits for their economy and finance. Otherwise, it tried to hand over the responsibility to the Beijing government. Oppositely, when its own fiscal resources suffered shortfalls, the Beijing government sought to dump the responsibility back on the local governments. Such a deadlock situation was not fully solved in the fiscal reform and remained ambiguous. An interviewee complained about this situation when I visited the local state taxation bureau in Sichuan in 1999. He said that a highway between Chengdu and Chongqing remained unrepaired for almost one year because no clear responsibility of spending for it was delineated among Beijing, Sichuan province, and Chongqing city governments (author's interview), each government seeking to place the burden on the backs of the others. However, a series of efforts to regulate local expenditures by the Beijing government appeared to gain some momentum thereafter. For example, the average proportion of extra-budgetary expenditure over budgetary revenue was about 68 percent during the period 1986-1993 at the provincial level but fell to about 42 percent during the period 1994-1998. In particular, the reduction from 86 to 49 percent was apparent in the coastal regions.³³

The Beijing government made serious institutional efforts to strengthen the taxation system. On 19 April 1993, to begin, the State Council renamed the State Taxation Bureau as the State General Taxation Bureau, took it away from the *kou*

³² For example, the tax return rates in Zhejiang and Fujian were about 20% and 30% of the tax income from value-added and consumption taxes respectively. See Kang (1998), 151.

management of the MOF, and placed it under the direct control of the State Council. On 22 December 1993, the Bureau was officially elevated to the Ministerial level of organization. Then, on 4 February 1994, Minister of MOF Liu Zhongli was co-named director of the State General Taxation Bureau in pursuit of strong coordination between the MOF and the State General Taxation Bureau for purpose of accelerating the fiscal reform. The previous director Jin Xin was appointed as a vice-director but allowed to keep a ministerial-level status. As a result, the State General Taxation Bureau became the bureaucracy possessing two minister-level leaders.

To regulate non-standardized practices in fiscal management, the budget law was introduced in 1995. It placed considerable constraints on soft-spending practices by each government division. The MOF classified in detail all items of revenues and expenditures according to the budget law, which included codes, names, and explanations of each item (MOF 1997a). The list of items was then to be circulated as an internal document to standardize practices in budget and accounting. However, the situation still seemed far from realizing a satisfactory fiscal management system in the spending area. A MOF task-team indicated in their 1998 investigation that soft-constraint practices and neglect of regulations in budget law still posed serious problems in the spending area. Let alone to the lack of discipline and observance of rules and regulations, it was attributed to the lack of a surveillance system on the expenditure side because the surveillance was focused on the revenue side as previously. The other problem was due to an imperfect and vague division of responsibility in expenditures as seen in the case of Sichuan above (see MOF 1998).

The ambitious plans in the second *ligaishui* reform in 1985 by Zhao Ziyang, such as separately-assigned taxes and relatively independent management of local finances were eventually comprehensively introduced from 1994. As an effort toward fiscal institutionalization, the Beijing government provided legal status for the tax-sharing system in the eighth clause of the budget law of the PRC, passed in the second session of the NPC on 22 March 1994 (Liu 2000, 299). The legalization of the tax-sharing system provided a decidedly more stable basis of enforcement. One key issue in the revenue

³³ Calculated by author based on respective year figures of all provinces but Hainan and Tibet in the CFY. However, the figures did not include the off-budgetary funds and fees, whose size is generally

arena throughout the post-Mao reform period was who would control the revenues although few disputes existed on providing sufficient funds for enterprises and localities. In this regard, a policy priority of the tax-sharing reform was to recover the power of the Beijing government to control bottlenecks of revenue flow; it was certainly not to choke the spending of local governments but to provide sufficient funds for localities and enterprises for rapid economic development. A look back on the history of spending reveals that a sharp decline in the expenditure ratio of the Beijing government over total expenditure occurred only after urban reform was launched in 1985.³⁴ It was after 1994 that the Beijing government placed a priority on establishing regulations in expenditure management.³⁵

The 1994 fiscal reform also instigated a dramatic organizational change in the structure of Chinese fiscal management. During the post-Mao reforms, a major problem in the financial arena had been a lack of institutionalization. Therefore, throughout the post-Mao reform period Chinese leadership has made an enormous effort toward institutionalization according to increasing market-oriented economy. In this respect, however, the introduction of the fiscal contract system was a major setback though often called a positive product of the post-Mao reforms, a setback in that it heavily relied on negotiations and discretionary policies with the provinces in the fiscal arrangements. Zhao Ziyang and other central bureaucracies such as the MOF, the SPC and the SCRE in the fiscal arena threw their enormous weight behind institutionalization of the fiscal system by introducing standardized tax and management systems during the early 1980s as already discussed in Chapter 3.

Relentless efforts to expand organizational capacity in the fiscal arena have never ceased even after Zhao Ziyang's ostracization. In about 1989 China had almost completed five levels of budgetary system administratively at the levels of state, Beijing, provincial, county, and township governments (Li, Yang, and Zhang 1992, 20). The Beijing government also established an audit bureau in each of 41 bureaucracies under

regarded almost equivalent to that of the extra-budgetary funds.

³⁴ In the beginning of the reforms in the early 1980s, the ratio increased from 46.7 percent in 1977 up to 52.5 percent in 1984 but dropped to 39.7 percent in 1985. These figures do not include the payment of the principal and interests of domestic and foreign debts and the expenditure for capital construction using foreign loans. See the State Statistics Bureau (1999), 268.

³⁵ See the internal document written by Wang Luqi and Lu Zhou (1995), 2.

the State Council and intensified auditing of enterprises under each central bureaucracy in August 1988. More than 500 audit offices were accordingly established in 22 provinces and cities (*Renminribao*, 3 August 1988). This measure would enhance the Beijing government's tight control in the audit area over the country's loosely-controlled central enterprises. The dual budget system was introduced, which makes budget and accounting systems more transparent and reliable for the market-oriented mechanism by distinguishing construction (*jianshexing*) items from general (*jingchangxing*) ones. As of 1992, the Beijing government was already able to expand its penetration in the fiscal area to the township (*Xiang* and *Zhen*) level of government. More than 96 percent of township governments established their own financial organs.³⁶ However, in spite of such organizational expansion, the Chinese government was still not confident of its enforcement ability in the taxation area. The lack came from two sides: structural and non-structural. The problems of poor training, inexperience, and lack of personnel in the taxation area were still pandemic although the situations were much improved by the incessant efforts of the Beijing government.³⁷ For example, unintentional tax evasion posed a serious problem because of the lack of experienced professional accountants who could detect it. Finance Minister Liu Zhongli confessed that the government needed 300,000 qualified accountants but would have only 15,000 by the end of 1993 (*China News*, 29 November 1993) before the new fiscal reform was launched in 1994.

Yet a more fundamental problem was the rampant localism. The fiscal contract system only aggravated the problem. From the organizational perspective, the biggest problem was that the taxation bureaus were still under control of local governments. Weak central control over revenue collection was the Achilles heel of the Chinese fiscal system. A fundamental surveillance problem also remained because its execution was mainly left in the hands of local governments. In particular, the Beijing government had no actual surveillance mechanism to check the township levels of government. As a result, tax holidays and evasion were most severe at the township level (Interview by

³⁶ The proportion of the personnel working in the township level of the financial organs was 56 percent of the total number in the financial area (*Renminribao*, 2 October). As of 1987, 91.4 percent of township level of local governments already established its own financial organization (*Jingjiribao*, 12 April 1988). It was a considerable level of institutionalization, given the almost total destruction at that level during the Cultural Revolution.

Mingbao, 29 July 1993). The annual great surveillance, a joint work between the central and provincial governments, was often used to provide local information to Beijing for the next round of fiscal negotiations between Beijing and the provinces rather than to supervise local behaviors (author's interview). The Beijing government obviously needed cooperation from local governments and local finance bureaus to implement its fiscal policy. However, given organizational arrangements of personnel appointments, salary payments, and the rise of strong localism under the fiscal contract system local finance and taxation bureaus were subjected even more to the guidance of the local governments although they were under dual leadership in principle.³⁸ In practice, the local governments were the collector of revenue as well as the supervisor of the collection. Such an abnormality in the fiscal area was contributed to the declining fiscal position of the Beijing government. Since the inception of the fiscal contract system, according to an internal MOF document, less than 10 percent of increased revenue at localities had been remitted to the Beijing government; meanwhile more than 90 percent stayed in the hands of local governments (MOF 1994, 40).

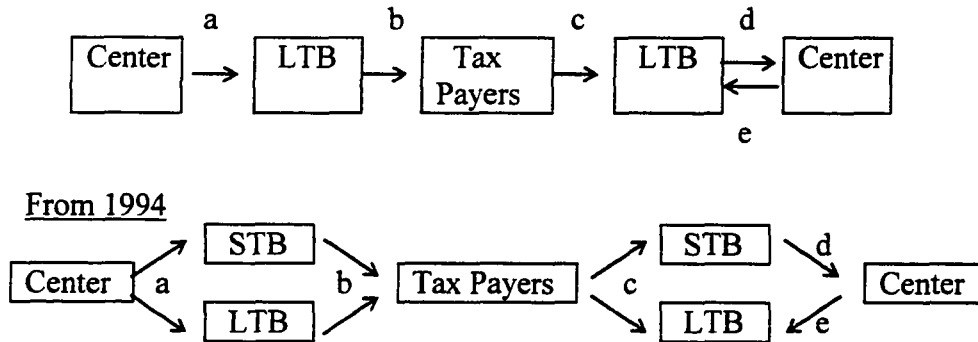
The solution was to create an organization directly controlled by the Beijing government while providing incentives to the local governments to increase tax efforts. In the 1994 fiscal reform, the local state taxation bureau was separated from the original local taxation bureau with priority of the state taxation bureau. For example, in Anhui, the establishment of the central and local tax bureaus started in December 1993 and ended on 26 August 1994. Of the 20,000 tax personnel in Anhui, around 12,000 were been reassigned to the state tax bureau and about 8,000 to the local tax bureau (FBIS-CHI-94-168, 30 August 1994).³⁹ It constituted a dramatic alteration of the previous tax management system, going as it did from a single-track system with decentralized

³⁷ Regarding this point by director of the state taxation bureau Jin Xin, see *China Post*, 19 November 1993.

³⁸ The dual leadership has been an institutional mechanism for localities to insert its own preference in personnel management system in the financial area. It requires an agreement in negotiation between the locality and the central government before the list sends to the central government for screening for the personnel appointment of local leaders under dual leadership. See more details, in Xie et al, eds. 379-383. My interviewee told that in practice, it would be in great trouble for the Beijing government to operate if local governments and leaders opposed an appointment in the finance area because of local sabotage. For the report on the local control of chiefs of local banks, see *Xingdaoribao*, 27 December 1993.

management to a dual-track management system mandated by the new fiscal reform.⁴⁰ The local state taxation bureau would collect all central taxes and shared taxes for the Beijing government under direct control of the General Taxation Bureau of the State Council from 1994. Figure 6-1 illustrates the changing relationship between the central and local governments in the fiscal arena.

Figure 6-1: Revenue Sharing Structure before and after 1994 Fiscal Reform
Before 1994



Source: Author's creation. If any mistake, it is attributed to my fault.

Note: LTB-local taxation bureau; STB-state taxation bureau

a: rendering authority, contracting, and issuing policies

b: imposing taxes

c: paying (collecting) taxes

d: contributing to central revenue (including loan to central government)

e: remittance, grants, and subsidies

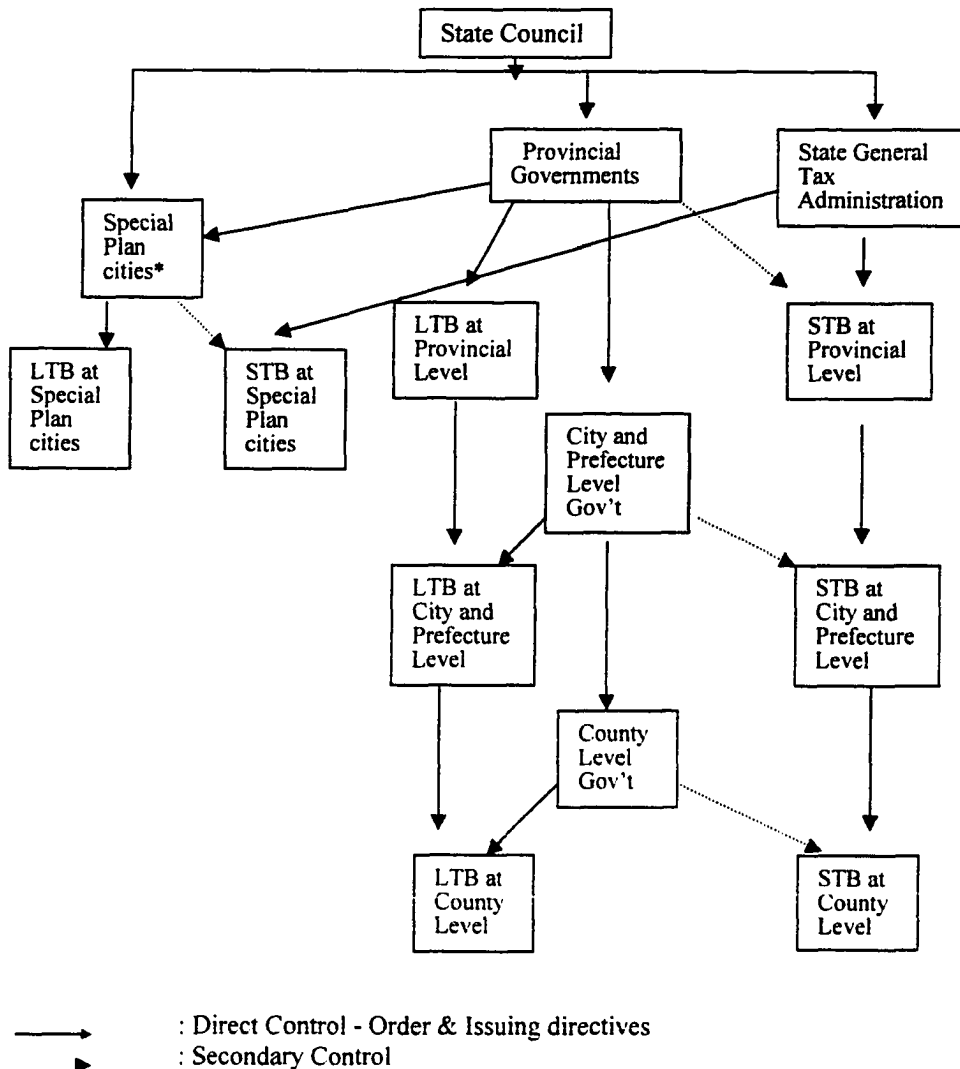
Figure 6-2 also illustrates the administrative web of control exerted by the Beijing government in the fiscal arena after the 1994 fiscal reform. In principle, the local state taxation bureau would be directly controlled by the State General Taxation Bureau in Beijing, and the same level of local government would have no direct formal ties with the local state taxation bureau. In practice, however, some connections between the local state bureau and its local governments still existed albeit in indirect ways. First of all, the local state taxation bureau was separated from the local taxation bureau and basically was staffed with local people. Thus elements of localism still remained in the organization. Second, although the power of appointing the local state taxation bureau director and vice-director was placed one level higher in the State Taxation Bureau, ultimately in the

³⁹ In Heilongjiang, tax collectors at all levels have been transferred to the state and local tax bureaus in a similar fashion with the Anhui case (*Heilongjiangribao* 18 September 1994).

⁴⁰ The World Bank (1990), Section III.

State General Taxation Bureau the appointment required consultation with local government leaders. In practice, if local leaders vetoed, the appointment could not be filled. In daily work, cooperation from local governments would also be requisite for making the local state taxation bureau function smoothly at the region (author's interview).

Figure 6-2: Authority Structure in the Fiscal System after 1994



Source: The author built this figure based on information from the ministry of Finance (1996), 819, 921; Yuan and Men, 4-25; The Ministry of Finance 1996, 29-33. The author is responsible for all errors if any.
 Note: 1. LTB= Local Taxation Bureau; STB=State Taxation Bureau

1. In terms of economic management, the power of the special plan city was equivalent to that of provincial government under the direct control of the State Council, but administratively subjected to the control of provincial government.

Yet this organizational change still significantly intensified the power of the Beijing government over provinces and plan cities in the tax collection system by establishing the local state taxation bureau and placing it under the direct control of the Beijing government, which would cover much more than 60 percent of tax collection. It is worthy to note that although the establishment of the planned city system⁴¹ was designed to function as a local bastion for regional economic development, it also played a certain role in checking provincial power. The planned cities were often in conflict with their respective provincial governments in the areas of economic management, fiscal arrangement, and resource acquisition,⁴² but the Beijing government was able to directly control the plan cities.⁴³ The new organizational reform in the fiscal arena would reinforce Beijing's control and substantially reduce the previous monitoring problem in the taxation process. The Beijing government eventually cancelled 8 cities from the status of planned cities⁴⁴ and placed them under the control of their respective provinces from 1997. The cancellation was done in an effort to regularize administrative structure, but without confidence of the Beijing government in its control of provinces, the cancellation of the planned cities might have not happened.

The local taxation bureau was assigned only for fixed local taxes. The Beijing government would no longer require the comprehensive joint surveillance system if the fiscal reform were implemented. Accordingly, Beijing abolished the general office for the *great surveillance on taxation, finance, and price* under the State Council in 1993

⁴¹ The planned city system existed from the early period 1949-57 of the PRC. The idea of establishing the planned city system was already a hot issue in 1981 in the debates on a city-centered economic development strategy. See "Youguan Zhongxin Chengshide Jige Wenti [Some Issues regarding the Central Cities]" *Jingjiyanjiu cankao* No. 27 (17 February 1982): 2-10. The planned city system was introduced in 1983. As of February 1987,

⁴² An internal report by Tian, Zhu, and Zhao dealt with this point seriously. See Tian Jia, Zhu Limin, and Siyuan. Zhao, "Guanyu Chenshi Jihuadanlie Wentide Yanjiu Baogao [A Research Report on the Issues of Planned Cities]." *Jingjiyanjiu cankao* No. 13 (21 January 1988): 8-21. From 1986, the planned cities were allowed to issue local regulations under the permission of standing committee of provincial peoples' Congress. Their position was to allow the planned cities the *legal* status, equivalent to province, instead of discretionary decision by the standing committee of the NPC.

⁴³ As of 1988, the total proportion of revenues and profits of 14 planned cities in the nation was higher than 16 percent. The proportion in the gross product output was 14.65 percent. However, the official statistics often disguised the conflicts by integrating the figures of planned cities into provincial figures. See more detail in Guanghui. He, ed. *Zhongguo Chengshi* [Chinese Cities] (Beijing: Gaigechubanshe, 1990), 10-11.

⁴⁴ They are Shenyang, Changchun, Haerbin, Nanjing, Wuhan, Guangzhou, Chengdu, and Xian. Regarding this, CTY (1998), 89-90.

although the surveillance mechanism itself eventually ended its existence in 1998. If necessary, the MOF would be in charge of the surveillance at the Ministerial level (Wu Jie ed. 420). The establishment of the local state taxation bureaus down to the county level could solve the fundamental organizational problem in the Chinese fiscal management system. In this respect, the new fiscal reform was a big stride toward fiscal institutionalization.

The Beijing government continued the rule-making process flexibly in consultation with localities and enterprises to supplement the lack of detailed preparation and to smoothly enforce the new fiscal scheme. Within three months after the implementation of 1 January 1994, the Beijing government produced about 80 documents to solve unanticipated and imminent problems (Jia and Yan 1999, 157). Given the decision-making structure, however, the decision to implement the tax-sharing system and to establish the local state taxation bureau after only four months of massive campaign was still considered a swift one. It was obvious that many localities were not happy with the new fiscal reform although they accepted it as inevitable and irreversible. Most localities would not have sufficient time to prepare for the implementation. A newspaper in Guangdong reported a hectic situation surrounding implementation of the new tax regulations.⁴⁵ It cited that the new tax regulations took effect only 18 days after they were promulgated, and details of how the regulations should be enforced were only publicized five days before being effective.

Localities appeared to comply passively with Beijing's request as seen in the case of establishment of the local state taxation bureau.⁴⁶ Although the policy to separate the local taxation bureau was issued in the end of 1993, the separation work seemed to make little progress even after four months of the new fiscal reform's implementation. On April 24-25, the State General Taxation Bureau issued telegrams twice to request that localities report their plans for establishing the local state taxation bureau. Table 6-3 illustrates that

⁴⁵ The source refers to *Yangcheng Evening News* (Extracted from *South China Morning Post*, 24 January 1994).

⁴⁶ The idea of establishment of the local state taxation bureau was publicly presented on 23 July 1993 by Zhu Rongji in the national finance/taxation work conferences. Then, on 16 November 1993, the State Council informed every taxation bureau in the form of telegram that the establishment of the two kinds of taxation bureaus at localities were to begin. See CTY (1995), 535-536.

more than half the provinces were unable as of 30 July 1994 to establish their bureaus at the provincial level.

Table 6-3: Separation of Taxation Bureaus

Region (number provinces)	As of July 30, at the provincial level *	As of September 15, at the county level **
Coastal (11)	Tianjin, Hebei, Liaoning, Jiangsu, Fujian, Guangdong	Beijing, Tianjin, Hebei
Central (9)	Shanxi, Jilin, Henan, Hubei	Shanxi, Inner Mongolia, Heilongjiang, Anhui
Inner (8)	Yunnan, Gansu, Xinjiang	Yunnan, Gansu, Ningxia, Xinjiang

Source: * *China Daily* 30 July 1994. ** *Xinhua News Agency* (domestic), 15 September 1994; *Renmin Ribao*, 16 September 1994.

Note: Hainan and Tibet are not included.

The State General Taxation Bureau invited to Beijing 11 provincial taxation bureau directors, who had already completed the task, to urge the others toward the speedy implementation. It also again issued an urgent notice on August 16 that the implementing should be done by the end of September. On September 5, local taxation bureau directors from the relatively less-compliant provinces were called to Beijing and urged to comply. In the end, the separation of tax offices at the provincial level was completed by the end of September as urged. However, the separation at the county level was not completely enforced even by the end of 1994.⁴⁷ In general, coastal provinces were quicker in establishing the state taxation bureaus; 6 out of 11 provinces in the coastal regions had already created the bureau, but only 7 out of 17 in the other regions. However, the coastal regions were tardy in establishing their bureaus down to the county level. Although the coastal provinces responded to Beijing quickly in establishing their local state taxation bureaus at the provincial level, they had complex vested interests in exposing their affluent tax base and consequently were likely to be reluctant to embrace thorough implementation at the county level. As of September 15, only three coastal provinces had completed the establishment at the county level.

The impacts of the fiscal reform varied according to regions. The Beijing government placed resource taxes on the category of local fixed taxes. It would help local finance mainly in the central and inland provinces because most resources were concentrated in those regions. However, the louder and richer coastal provinces were able

to protect their own interests in the face of Beijing's continuing emphasis on economic development. In addition, coastal regions acquired strong support from the State Commission for Economy and Trade (SCET), which was established in 1993 and whose organizational status was placed just behind the SPC and ahead of the SCRE. The SCET argued to maintain preferential policies in the coastal regions because it worried that the removal of preferential policies would negatively influence the volume of investments and be detrimental to the economic development and further opening-up (*Renminribao*, 5 January 1994).⁴⁸

The Beijing government allowed a preferential enterprise income tax rate to special economic zones plus fourteen open cities/provinces and technology development zones in the coastal region. The enterprise income tax rate was set at 33 percent in the new fiscal reform, but the tax rate in the special economic zone was 15 percent and in the fourteen open cities/provinces and technology development zones 24 percent (SPC 1994, 44). After all considerations of the given preferential policies, the State General Taxation Bureau anticipated realistic tax rates in various types of enterprises, whose original tax rate was set at 33 percent: the state-owned enterprises at 28.72 percent,⁴⁹ collective enterprises at 23.64 percent, individual enterprises at 25.59, and the average tax rate at 26.77 percent (SPC 1994, 44).⁵⁰ The allowance of the special rates certainly dampened down the original target of the revenue sharing out of the Beijing government.

In addition, the factor method (*yinsufa*) in calculating the tax base figure, which was heavily favored by the central/ inland provinces, was not adopted in 1994;⁵¹ instead, the previous base number method was maintained. The base number method (*qishufa*)

⁴⁷ 27 provinces completed the separation by that time. See *Zhongguo Shuiwu Nianjian* 1995, 536.

⁴⁸ The Ministry of Foreign Trade also had a similar interest on this issue. See *China News*, 13 May 1994.

⁴⁹ The Beijing government also reduced the tax rates as a transitional measure to 27 and 18 percent for the state-owned enterprises whose profit rates were relatively low. See *Renminribao*, 5 January 1994.

⁵⁰ Compared to the previous tax rates under the fiscal contract system, the tax rate of the state-owned enterprises dropped by 0.74 percent; the collective enterprises increased by 2.44 percent; the private enterprises dropped by 2.17 percent; and the average increased 0.27 percent.

⁵¹ The factor method was strongly urged by Kuo Daimo in October 1993 just before the tax-sharing system was rectified by the CPC session. The factor method calculated the local base figure for expenditure in terms of various factors in the locality such as population, administrative responsibility, personnel disposition, GDP, industrial structure, local revenue, natural conditions, and preferential minority policies. It would bring more fiscal resources for the central and inland provinces than the base number method, which recognizes the previous privileges. See more in *Jingjiribao*, 22 October

was certainly favorable for the coastal provinces because it guaranteed high tax retention rates in those areas. To maintain the base number was to guarantee the interests of coastal provinces. Although such arrangements in negotiations allowed the Beijing government to make the new fiscal system operational, it was far from the original plan of an institutionalized tax system mandated by legal and economic principle.

Table 6-4: Intergovernmental Fiscal Relations after the 1994 Fiscal Reform (including planned cities) (100 Mil. Yuan)

Province	1995				1998			
	Revenue	Tax Return and Subsidy	Local Remittance	Fiscal Transfer to Local	Revenue	Tax Return and Subsidy	Local Remittance	Fiscal Transfer to Local
Beijing	115.3	69.4	36.7		229.5	106.7	37.2	
Tianjin	61.9	44.8	28.6		101.4	64.7	28.6	
Hebei	120.0	73.8	20.7	0.69	206.8	116.3	21.0	1.91
Liaoning	184.4	113.5	54.1		264.6	181.9	55.7	
Shanghai	219.6	149.8	120.0		380.7	216.8	121.0	
Jiangsu	172.6	137.0	80.7		296.6	196.2	81.2	
Zhejiang	116.8	102.9	45.5		198.1	137.8	45.7	
Fujian	117.3	56.0	5.4		187.9	75.0	5.5	
Shandong	179.0	104.3	25.0		352.4	158.2	25.4	
Guangdong	382.4	162.3	26.8		640.8	196.4	29.1	
Guangxi	79.4	54.0		1.09	119.7	85.5	0.06	2.98
Shanxi	72.2	39.1	7.0	0.35	104.2	63.3	7.3	1.96
Inner Mongolia	43.7	47.5		2.47	77.7	94.2	0.3	5.76
Jilin	63.3	43.9			93.6	94.1	0.5	1.34
Heilongjiang	142.0	57.2	11.4	0.5	157.3	124.8	7.8	1.92
Anhui	83.8	47.1	9.4	0.81	159.2	98.8	9.9	2.05
Jiangxi	64.1	32.5		0.77	97.2	91.7	0.4	2.43
Henan	124.6	76.6	15.2	1.41	208.2	136.2	16.7	4.32
Hubei	99.7	67.7	28.4	1.34	169.0	136.5	27.5	3.03
Hunan	108.2	70.6	12.1	0.95	156.8	137.7	12.5	2.34
Sichuan	167.0	103.4	16.4	1.81	197.3	124.2	0.7	3.81
Guizhou	38.8	39.8		2.59	65.3	71.0	0.1	5.58
Yunnan	98.4	126.0		0.12	168.2	165.9	4.2	0.24
Shaanxi	51.3	36.1		0.55	93.3	76.1	0.3	2.72
Gansu	33.9	34.6		0.71	54.0	71.6	0.16	2.29
Qinghai	8.6	13.0		1.04	12.8	30.2		3.97
Ningxia	9.0	11.1		1.04	17.8	27.5		2.21
Xinjiang	38.3	35.2		2.46	65.4	80.1	2.4	5.97
Mean	105.5	69.6	19.4	0.74	174.1	112.8	19.3	2.03

Sources: MOF, Local Finance Bureau (Internal Documents) 1995 & 1996. Finance Yearbook of China 1998 and 1999. The data of 1998 on central subsidies and local remittance were extracted from each provincial statistical yearbook.

Note: 1. "Local Remittance" refers to local remittance to the Beijing government according to the previous contract. "Fiscal Transfer to Local" refers to fiscal transfer to provincial governments according to the new tax sharing system. 2. Tax Return and Subsidy included the amounts of tax return according to the new two-tax sharing system and subsidy according to the previous contract by the Beijing government.

1993. To make the factor method applicable, the reliability in data on various factors was strongly required. A report from the SPC placed its emphasis on this point. See the SPC (1994).

After deducting the total rebates and subsidies to local governments as promised, the amount of increased revenue for the Beijing government would be much less than what it was supposed to be,⁵² which was 55.7 percent in 1994 (22.0 percent in 1993). This meant that the Beijing government was still lacking sufficient funds for the fiscal transfer for the central and inland provinces as promised.

The amount of the fiscal transfer remained minimal. However, to standardize the fiscal transfer system and to improve fiscal imbalance among the regions, the Beijing government adopted a *Method of Fiscal Transfer in the Transitional Period* in 1995, in which the new factor method would gradually replace the traditional base figure method, although the situation seemed not to be much improved in the short-term (Jia and Yan 1999, 163-164). The central and inland regions would be beneficiaries in the long-run, and of course they welcomed the change.

Table 6-4 illustrates how the new fiscal system was not fully regularized by a tax-based system until 1998. The Chinese fiscal system still possessed the relics of the fiscal contract system in the form of the contract rates of revenue remittance and fixed rate subsidies. Local remittance in the table indicates the amount that provincial governments had to pay under the fiscal contract system. Under that contract system, the Beijing government in practice often tapped extra-revenues (*tizhiwai shangjie*) from coastal provinces in a discretionary fashion that was not included in the formal contract.⁵⁵ However, under the new fiscal system the Beijing government took much more revenue by instituting tax items in favor of the Beijing government.

Tax Return and Subsidies largely refer to a tax return from what the Beijing government took from localities, which was 25 percent of the value-added tax and 30 percent of the increased amount of consumer taxes. In 1995, provincial governments had to rely on the tax return and subsidies equivalent to about 65 percent of their own revenues, and the situation was not changed even in 1998. In my estimation, which was a

⁵² Tsang argued that the disposable income of the Beijing government was equivalent to only 25 percent of the total revenue. See Tsang (1994), 775.

⁵⁵ For example, Guangdong remitted to Beijing at least as much as the contracted amount in 1990. See *Guangdong Caizheng* No. 10 (1999): 34.

calculation of the fiscal exchanges between the Beijing and provincial governments including the amount of local remittance, contrary to the previous system it was obvious that the actual fiscal burden in the coastal region was much higher than the other regions under the new system.⁵⁶

In 1998, the situation of heavier burdens on the coastal provinces continued, but the degree of burden appeared to be reduced considerably. The amount of burden was equivalent to a little less than 30 percent of the regional revenue. The slight decrease in the burden rate in their revenues likely came from coastal areas' active mobilization of its own revenues rather than the reduced burden from the Beijing government. During the period 1995-1997, the average growth rate of the central revenue was 13.3 percent but that of provincial revenue 24.1 percent (Liu 1999, 100). In spite of all odds relating to the actual size of Beijing government's revenue these figures still illustrates that the Beijing government was able to garner revenues and to encourage local fiscal efforts more effectively than in the previous fiscal contract system.⁵⁷

The Beijing government made considerable progress in organizational capability in the area of revenue collection after 1994. By the end of 1996, more than 90 percent of enterprises registered their voluntary tax reports after experiments started in 18 provinces and cities from 1994 that would tremendously reduce the burden of taxation bureaus. About 92 percent of the taxation bureaus at the county level of government established a specialized surveillance system. MOF minister Xiang Huaicheng's speech in the national tax collection work conference illustrated that a considerable progress was being made in

⁵⁶ The calculation formula, $Y = [\text{Total Amount of Revenue} - \text{Local Budgetary Revenue} - \text{Tax Return and Subsidies} + \text{Local Remittance}] / \text{Local Budgetary Revenue}$. However, I did not include the amount of the fiscal transfer or any other irregular tax returns and subsidies. By calculating so, I was able to figure out at what degree the Beijing government took the fiscal resources from each region. The "Total Amount of Revenue" refers to the total amount of revenue collected by each region before the Beijing government took its portion. Regarding the source of data until 1997, see *Difang Caizheng* (Local Finance) No. 3 (1998), 64. The data of 1998 came from each local statistical yearbook and author's regressive calculation from the local statistical yearbook. According to the estimation, the Beijing government took revenues from the coastal region, whose size was equivalent to about 48 percent of the regional revenue in 1995; meanwhile, the national average was about 37 percent. The author is responsible for a mistake if any.

⁵⁷ One noticeable thing was that Guangdong still enjoyed a remarkably low rate of the revenue burden under the new fiscal system. In 1995, the size of Guangdong's contribution to the central coffer was merely 14 percent, compared to 76 percent of Shanghai and 46 percent of the regional average. However, in 1998, its average rose to 25 percent, contrary to the declining trend in the region, which became closer to the regional average 28.8 percent.

the area of data collection of tax sources and their management via the use of various modern technologies such as computers and specialized personnel (CTY 1997, 85). All these show that the Beijing government was able to enjoy much improved capacity of control on the revenue side at the end of the 1990s.

C. Nomenclature Politics and Revenue Effort

The area of personnel control has been a major mechanism in implementing the will of the Beijing government and the CPC in the Chinese political system. The Beijing government took decentralizing measures in the personnel management system along with economic decentralization during the 1980s. Since then, local governments enjoyed quite extensive power in appointing local cadres. In the fiscal area, local governments in practice became a more dominant factor in the management of local finance and taxation bureau cadres during the 1980s and early 1990s. However, the Beijing government made a decision to recentralize cadre management in the fiscal area along with the efforts of the new tax-sharing fiscal reform. It was only in late 1992 that the Beijing government publicized its policy to more actively control personnel in the fiscal arena.

Introduction of the one-level downward management system (*xiaguanyiji*) in 1984 replaced the so-called two-level downward management system (*xiaguanliangji*) laid down by the department of organization (DOO) in 1980 (Wu et al. 1998a, 488).⁵⁸ Under this system, the DOO was responsible for cadre management only at one level lower in the administrative hierarchy. The shortcoming of the one-level system was that it encouraged localism and nepotism by allowing localities more appointment decisions (Manion, 1985). In principle, local cadres were under dual leadership, where they should be responsive to the one-level higher organization as well as to their own local government or local people's congress. In practice, they were more likely to function as local agents rather than national civil servants for several reasons. First, as their administrative expenditures were mostly paid from local coffers, local cadres lacked sufficient independence from local interests. Second, as the decline of the socialist

⁵⁸ The other major change was a retirement policy. The policy abolished the customs of life-time positions and set terms of positions. See Wu et al. (1998a), 488.

ideology as the criterion of loyalty and conformity, the extent to which local cadres could bring successful economic development in their localities, became an equivalent standard for promotion. Third, although the bureaus of the DOO enjoyed the overwhelming power to finalize an appointment, the appointment procedures required that appointments elicit agreement from other local members and that opinions be sought from local leaders according to the principle of democratic centralism.

Throughout my interviews,⁵⁹ I found a practical veto power in the process of appointment of cadres in the state taxation bureau, in particular by top local leaders. In the process, the Beijing's bureau carefully scrutinized local acceptances and sought coordination from local people and local political leaders were asked their views and were able to place their inputs on appointments. Therefore, in this circumstance ambitious cadres might well find that it was wise to perform as a local man to acquire support or at least acceptance by local people while satisfying the central guidelines. Although in the formal system Beijing's bureau had the power to appoint the directors of local state taxation bureaus, local approval in practice was often more crucial if the Beijing government did not pursue a certain policy at all costs.

To tackle localism, the Beijing government retained several mechanisms. Foremost, the central DOO retained institutional power to appoint the leaders of functionally crucial administrative units such as the provinces, the local DOO, and local personnel bureaus (Huang 1996, 662).⁶⁰ It also had the power to change the rules of the game in the personnel management system. For example, the Beijing government executed recentralization for key party and government positions at prefecture-level governments and planned cities (*jihua danlie shi*) in 1990 when necessary (Chung 1999, 22). Second, it introduced a number of procedures and rules in detail that each appointment decision had to abide by. These included conditions for qualifying for nomination, levels of information about a nominee to be reported to the central DOO or Ministry of personnel (MOP), guidelines to avoid nepotism, and at least six stages of

⁵⁹ Author's Interviews

⁶⁰ Regarding the importance of institutions in the post-Deng period in the area of elite politics, see Hongwu Ouyang (1998).

appointment procedure in detail.⁶¹ Third, the four periods of institutional reforms of the personnel management system during the post-Mao period have strengthened the institutional power by upgrading the status of the personnel management units.⁶² Fourth, the well-filed record of each individual in the DOO and the MOP bureaus, which contain careers, awards, punishments, and political affiliation,⁶³ has been the major determinant of the individual's future career. The required recommendation from the party committee in recruiting cadres both in the party and in the government can be a bar effectively preventing entry of those whom Beijing does not want to be elected. During the evaluation process of candidates, the party can wield its discretionary power.⁶⁴

The Chinese personnel management system was centralized in that once the Beijing government made a decision to solicit local compliance at all costs, localities had very few options but to subdue their relative independence that came mainly from institutional power differences. However, no systemic evidence was apparent that the Beijing government linked local annual economic performance with personnel appointment during the rapid economic development period after urban reform. The Beijing government loosened its control at the level of local cadre managements and applied the *yindizhiyi* [suiting measures to local conditions] policy. In particular, in the fiscal area the tendency was obvious until the Beijing government adopted

⁶¹ For more details, see Wu et al. (1998a), 487-511 and Liu (1996), 160-198. The six procedures are as follows: (a) planning by DOO or MOP; (b) arrangement of recruiting numbers and conditions by the DOO or the MOP with administrative units relating to the recruits; (c) combined tests by written and oral exams; (d) evaluation of political loyalty and conformity; (e) nomination; and (f) double checks on political loyalty, work ability, and health conditions during the period of apprentice and final decision. As for these procedures, see Wu et al. (1998a), 490.

⁶² The four periods are as follows: (a) 1978.3-1980.7: the establishment of personnel bureau under the ministry of civil affairs; (b) 1980.8-1982.5: Personnel bureau under the direct control of the State council; (c) 1982.5-1988.4: the establishment of the ministry of labor and personnel; and (d) after 1988.4: the establishment of the ministry of personnel with preparation for the civil service system. For more details, see Liu (1996), 161-163.

⁶³ It includes activities during the Cultural Revolution.

⁶⁴ Conventionally, a provincial governor has often been a vice-secretary of the local party or equivalent to the level. Contrary to party heads, being government heads from provincial level down to county level requires an election or approval votes at local people's congress or standing committee of the people's congress. This practice has been established with "the law on organization of local people's congress and local government" in 1979 and its revision in 1986. As a result, this institutional format leaves leeway for local representatives to reject those whom the Center favors. Those who want to be a leader in a local government have to seek local approval. As a consequence, under the new institutional scheme, a governor is more likely defiant to the Center and vociferous for local interests than a party secretary.

recentralization measures in an effort to gain control over the macro-economy and rampant localism at the end of 1992.

It was in 1989 that the General Taxation Bureau suggested linking fiscal performance with personnel appointment and rewards in an effort to strengthen the tax surveillance system (Liu 2000, 482-483). The implementation required cooperation from and coordination among respective local government and party organs at the local level and the Ministry of Personnel and Department of Organization at the central level. The Beijing government strengthened its hierarchical (*tiao-tiao*) control over organizational arrangement and cadre management within the taxation bureau as well as over the expenses of local taxation bureaus. In the end of 1992, the management of directors and vice directors of 27 provinces had already returned to the control of the Ministry of Personnel (Liu 2000, 550). The policy of linking fiscal performance with an award system also gained publicity.

According to a decision issued by the State General Taxation Bureau and the Ministry of Personnel on 17 November 1993, they would cooperate in linking the taxation efforts of local personnel and organizations with an award system (CTY 1994, 757). After separation of the local state taxation bureau from the local taxation bureau in 1994, the appointments of director and vice-director of the state taxation bureau fell under direct control of the one-level up state taxation bureau. The appointment of director of the provincial local taxation bureau required agreement from the State General Taxation Bureau before the local government would officially process the appointment. The State General Taxation Bureau issued a document regarding state taxation cadre management at the provincial level on 2 March 1995. It detailed the conditions of appointment, the rules of disposition, screening, and appointment management. The suggestions issued on 3 September 1997 even indicated the number of personnel and sub-organizations according to the degree of economic development and the size of tax collection (Liu 2000, 570-571). All these measures were a significant departure from the past toward a more systematic and institutionalized personnel management system by the Beijing government.

It became obvious that the Beijing government intervened much more actively in personnel management by linking fiscal performance. Better fiscal efforts by local cadres

in the fiscal area would enhance their chances for rewards and promotion. What was uncertain was whether the fiscal performance influenced personnel reshuffling over provincial leaders, that is, over the provincial governor and party secretary. Did provincial leaders care for fiscal performance? No positive evidence has been revealed; however, a reasonable explanation may come from an institutional arrangement. Among items on every personnel evaluation made by the Ministry of Personnel, fiscal performance in the region was included (author's interview).

According to my interview, since fiscal performance is a part of several performance evaluation forms, its effect on personnel reshuffling may not be revealed in the regression analysis.⁶⁵ However, since every point in the evaluation is crucial for local leaders who want to be promoted, they do care about their performance in the fiscal arena or at least try to avoid appearing deficient in their careers. However, during the period of rapid economic development and in particular, the period of the fiscal contract system (1988-1992), the demand for local economic development and local fiscal efforts were often incompatible. In practice, the conflict did not burden the local leaders because the Beijing government was not very demanding on the side of fiscal efforts at the expense of local economic development as seen in the contents of the fiscal contract with provinces. Furthermore, excess fulfillment of fiscal target caused troubles for both sides. A MOF interviewee described the situation as "*tai mafan* [very bothersome]." Since there was no reward mechanism for the fiscal achievement of setting the annual target, the fiscal effort had a negative effect for the province in the next year's target-setting negotiation, that is, whose target became much higher. On the contrary, the provinces tended to argue that their efforts should be counted (author's Interview). The optimal solution was to follow the target guideline and avoid making any trouble by under-fulfilling or over-fulfilling the target.

To empirically test the effect of personnel reshuffling over fiscal performance, I built a personnel integration index (PII) by coding provincial turnovers of first party secretaries and governors during the period from 1978-1998 as either an insider or an

⁶⁵ Author's interview.

outsider in terms of their career background.⁶⁶ An outsider here means one whose major career is not from the provincial party, government, and mass organization hierarchy. For each province, there are two values: one for the governor and one for the Party secretary. I added values, zero for an insider and one for an outsider, to each province. In the year of personnel reshuffling, I coded a newcomer as the person in charge of the year if he was appointed no later than September 1. I treated provincial variations in fiscal efforts not as random event but as systematic consequences of different degrees of personnel integration as suggested by Huang (Huang 1996, 189). Insiders are more likely to represent local interests than outsiders, and vice versa.⁶⁷

⁶⁶ I am indebted for this idea to Huang, Yasheng. There are more officials at the provincial level whom the Beijing government directly controls – such as vice governors and deputy provincial party secretaries. However, as background information of these officials is insufficient, only first party secretaries and governors are covered. Huang previously categorized them into a concurrent centralist, a centralist, an outsider, and an insider in terms of their career backgrounds (Huang 1996, 210). He was very kind by sharing his data with me. I constructed my own index on personnel integration. The lists of governor and party secretary were extracted from *Zhongguo Renwunianjian 1998* [Personnel Encyclopedia of China] and *Wenxian wu Yanjiu* [Document and Research]. Their backgrounds were traced from following books: The editorial board. *Zhongguo Renming Dacidian* [Encyclopedia of the CPC Personnel] (Shanghai: Shanghai cidian Chubanshe, 1989); The editorial board. *Contemporary who's who of China* (Beijing: Shanghai Renminchubanshe, 1991); Jintian. Liu, et al. *Lijie zhonggong Zhongyangweiyuan Renmingcidian* [Encyclopedia of Central Committee Members of the CPC] (Beijing: Zhonggong Dangshi Chubanshe, 1992); The editorial board. *Chugoku Jinmei Jiten* [A Bibliographical Dictionary of Chinese] (Tokyo: Nichigai Associate, 1993); The editorial board. *Who's who in China: Current leaders* (Beijing: Foreign Language Press, 1994); Xueming. Shen, et al., *Zhonggong Dishiwujie Zhongyangweiyuanhui, Zhongyang Jilujianchaweiuyuanhui Weiuyuanminglu* [List of Members of the Fifteenth Plenary Session of the Central Committee and Central Inspection Committee] (Beijing: Zhongyangwenxian Chubanshe, 1999); Zhonggong Renminglu editing committee, ed. *Zhonggong Renminglu* [A Bibliographical List in the CPC]. (Taipei: Zhengzhidaxue Guojiguanxizhongxin, 1999). However, when I was not able to get sufficient background information, I use Huang's data. Huang Yasheng kindly provided his precious data. They are nine governors from Beijing, Inner Mongolia, Jilin, Zhejiang, Hubei, Gansu, and Qinghai appointed during the late 70s or early 80s. When I used Huang's data, I categorize centralist and outsider as an outsider because they are assumed to be relatively free from local interests in a designated province than an insider. In the case of concurrent centralist, I may need a discretionary judgment, but it does not happen for the nine cases. Regarding empirical analyses on the effect of elite turnover over economic performance at the provincial level, see more details in Tong (1989) and Huang (1996).

⁶⁷ The principal-agent theorem implies that due to their roles as a principal as well as an agent, provincial party secretaries and governors are under dual pressure from the bottom and the above. As a result of the political reform in the mid-80s, the governor is more likely to represent local interests than party secretary because a rectification process by vote in the local people's congress is required to be a governor. However, it does not mean that all local cadres' behaviors follow this logic. An interviewee (author's interview) gave me the example. "Zhu was not an insider. However, when he became a mayor of Shanghai in 1988 and a party secretary in 1990, he worked hard for the interests of Shanghai and negotiated hard to bring more interests to Shanghai with the Beijing government. Then, after he was appointed as a vice-premier in the Beijing government, he represented the Beijing government." He added. "Chinese political system became relatively tolerant for local leaders to speak out for their local interests against the Beijing government after the post-Mao reform was launched."

Table 6-5: Personnel Integration Scores across Regions during the period 1979 -1998

	High (24-30)*	Medium (18-22)	Low (7-16)
Region**	Guizhou, Shaanxi, Henan, Jiangxi, Jilin, Tianjin, Ningxia, Fujian, Gansu	Qinghai, Beijing, Hubei, Liaoning, Inner Mongolia, Shandong, Hebei, Zhejiang, Anhui	Heilongjiang, Sichuan, Shanghai, Guangdong, Guangxi, Yunnan, Shanxi, Jiangsu, Hunan, Xinjiang

Source: see the footnote 55.

Note: * (N) = Personnel Integration Scores: 0 = when both party secretary and governor are insiders; 1 = when either party secretary or governor is insider; and 2 = when both party secretary and governor are outsider. ** It is ordered by descending score.

According to the integration scores, overall the Beijing government has tended to appoint more insiders as governors (about 57.1 percent), who are more familiar with local situations, and outsiders as party secretaries (about 56.1 percent), who can deliver Beijing's policy more faithfully during the post-Mao reform period. As seen in Table 6-5, relatively large provinces in terms of economic and fiscal size such as Shanghai, Guangdong, Jiangsu, Sichuan, and Heilongjiang enjoy greater autonomy. However, the wide score distribution reveals that personnel appointments vary quite differently from province to province. Xinjiang and Hunan show the lowest integration scores, which mean that these two provinces have enjoyed the highest autonomy in personnel assignments. Meanwhile, Guizhou has the highest score closely followed by Shaanxi and Henan. An insider party secretary has never worked in Inner Mongolia, Guizhou, and Ningxia. Meanwhile, Jiangsu has always had an insider party secretary. Insider party secretaries presided over Fujian, Jilin, Heilongjiang, Gansu, Tianjin, Henan, and Beijing for periods of no more than five out of twenty years. On the governor side, Inner Mongolia and Heilongjiang have never had outsider governors. Furthermore, Guangxi, Yunnan, Xinjiang, Hunan, Zhejiang, and Shanghai have had insider governors for more than fifteen out of twenty years. With little information of what have been guiding principles in the personnel assignment system, it is difficult to explain the distribution in a systematic manner.

When I retrogressively analyzed the index, however, I found spatial and temporal patterns of personnel assignments. Overall, the proportion of insider party secretaries was lower than that of insider governors over regions. The Beijing government assigned about 42 percent of party secretaries with insiders regardless of regions throughout the post-Mao period. On the side of governor, the Beijing government appointed about 58 percent

of insider governors. However, the coastal regions have enjoyed relatively higher autonomy than any other regions, and the inland regions the least autonomy. Temporally, as seen the period 1979-1984 in Table 6-6, the Beijing government exerted a relatively tight grip on personnel appointments, in particular on the side of the party secretary during the initial period of economic reform. Coastal regions were under the tightest control.

Table 6-6: Regional Proportion of *Insider* Party Secretary and Governor during the Period 1979-1998, (percent)

Region	1979-1984		1985-1987		1988-1992		1994-1998	
	Party Secretary	Governor	Party Secretary	Governor	Party Secretary	Governor	Party Secretary	Governor
Coastal	12.1	43.9	60.6	72.7	72.4	69.1	47.3	83.6
Central	48.1	63.0	59.3	85.2	44.4	60.0	26.7	37.8
Inland	14.6	56.3	58.3	54.2	62.6	50.0	42.5	30.0

Source: see the footnote 55.

After the urban reform started in 1985, the proportion of insiders increased considerably in both party secretary and governor positions. The proportion of insiders occupied more than half the total appointees in every region. In particular, coastal regions were the most obvious beneficiaries of the decentralization policy as seen in Table 6-6. The Beijing government wielded its discretionary power by dramatically changing leaders of coastal regions to insiders, to boost local economic developments. The introduction of the fiscal contract system had little impact on the previous pattern, although Beijing's control was slightly strengthened on the central and inland regions. On the one hand, the continuity was inseparable from Beijing's policy priorities placed on rapid local economic developments. As a result of such relaxation in economic and personnel management, declining control over the economy and finances by the Beijing government had become a key issue during the early 1990s.

With fiscal recentralization in 1994, the Beijing government retreated from its previous relaxed stance over provinces in both the party secretary and governor positions. In particular, its tightened grip was apparent in the party secretary position in every region in its appointment of much more outsiders. The only exception was on the side of the governor in the coastal regions, where compared to the previous period, the proportion of insider governors increased from 69.1percent to 83.6percent; meanwhile,

the Beijing government increased control on the side of the party secretary in the coastal regions. The pattern clearly coincided with the dual tasks in the 1994 fiscal reform: the continuation of economic development and the macroeconomic control. By allowing more insider governors in the coastal regions, Beijing inserted its will in encouraging further economic development in the fastest developing regions while seeking more control over myopic local behaviors by means of appointing more outsider party secretaries. This changing stance was inevitably related to the introduction of the tax-sharing system. As the administratively-separated fiscal system was implemented, the Beijing government had to revive an old and traditional mechanism to control localities, that is, to exercise control over personnel. The patterns and relationship between personnel appointments and fiscal systems certainly reveals that the Beijing government very likely controlled and utilized local personnel appointments in order to achieve its policy priorities.

Table 6-7: Mean Values of Economic Performance and Local Party and Government Personnel Integration during the Period 1979-1998

	Personnel Integration=0	Personnel Integration=2	Party Secretary = 0	Party Secretary = 1	Governor = 0	Governor = 1
GDP per capita (Yuan)	3164 (150)*	1977 (148)	2867 (237)	2291 (323)	2837 (325)	2116 (235)
Revenue per capita (Yuan)	302 (149)	217 (147)	262 (236)	238 (322)	276 (324)	208 (234)
Revenue over GDP (%)	11.0 (150)	13.6 (126)	10.9 (233)	12.8 (298)	11.6 (318)	12.6 (213)
Revenue Elasticity (%)	95.9 (146)	85.9 (148)	94.5 (237)	72.4 (323)	77.8 (325)	88.5 (235)

Source: see the footnote 55.

Note: * (N) = Case numbers

A rising question is whether the personnel reshuffling encouraged the kind of economic and fiscal performance at the provincial level that the Beijing government wished. The mean values of GDP per capita, revenue per capita, revenue burden, and revenue elasticity as seen in Table 6-7 allow us to find certain patterns in the relationship between the personnel reshuffling and the economic and fiscal efforts. When an insider is in charge, GDP per capita and revenue per capita are higher, but when an outsider is in charge, regardless of the position of party secretary or governor, the fiscal efforts of the region are higher than when an insider is in charge. These results indicate that insiders are capable of developing the economy and increasing the tax bases. In particular, when the

governor is an insider, the effects are larger than when the party secretary is in office. On the side of the fiscal effort, however, the data show that outsiders outperformed insiders. Outsiders in both governorships and party secretaries have been able to increase the proportion of revenues over GDP and are more compliant to the Beijing government's requests.

In the other parameter of revenue efforts, revenue elasticity, no trend exists. The personnel integration index, which combined party secretary and governor indexes, shows that when both party secretaries and governors are insiders, revenue elasticity score⁶⁸ is 10 percent higher than when they are both outsiders. This finding is rather surprising in the sense that outsiders supposedly make greater revenue efforts. When I create a combined index of governor and party secretary, the configuration of outsider governor and insider secretary scores 92.2 percent; meanwhile, that of insider governor and outsider secretary registers 69.0 percent. Appointing outsider governors is more likely than appointing outsider secretaries to be effective in encouraging tax efforts.

Table 6-8: Regression Analysis on the Effects of Personnel Reshuffling and Regional Differences over Provincial Economic/Fiscal Performance

Year	Variable	GDP per capita (<i>yuan</i>)	Revenue per capita (<i>yuan</i>)	Expenditure per Capita (<i>yuan</i>)	Revenue/GDP (%)	Expenditure/GDP (%)
79-84	Personal Integration	-6.5 *	22.3*	8.82*	3.2 (0.01)	2.03 (0.01)
	Region	-283.2 (0.01)	-123.9 (0.01)	-2.63*	-3.7 (0.01)	5.72 (0.01)
	Adjusted R Square	0.17	0.13	0	0.13	0.39
88-92	Personal Integration	-175.8*	-19.8*	-12.0*	0*	0.35*
	Region	-765.2 (0.01)	-123.0 (0.01)	-34.1 (0.05)	-0.3*	3.84 (0.01)
	Adjusted R Square	0.25	0.16	0.03	-0.01	0.46
94-98	Personal Integration	-1568.4 (0.01)	-162.8 (0.01)	-197.9 (0.01)	-0.53 (0.05)	-0.55*
	Region	-2728.4 (0.01)	-176.1 (0.01)	-158.0 (0.01)	0.21*	2.85 (0.01)
	Adjusted R Square	0.39	0.23	0.16	0.03	0.37

⁶⁸ It is the percentage of the amount of revenue increase over the amount of GDP increase.

⁷⁰ The mean value of each province is as follows: Shanxi (110.8), Hunan (75.2), Guangdong (79.1), and Yunnan (112.0), and Xinjiang (160.9).

Source: Revenue per capita figures of the period 1979-1997, *Difang caizheng* No. 3 (1999), 63; Expenditure figures of the period 1979-1997, *Difang caizheng* No. 2 (1999), 62; GDP figures of the period 1979-1997, *Difang caizheng* No. 12, 51; Population figures of the period 1979-1997, *Difang caizheng* No. 3 (1999), 62; all 1998 figures, CFY 1999, 394-395, 541; Personal Integration, the footnote 55.

Note: 1. Significance level in parenthesis; * not significant at 0.10 level. 2. Personal Integration: 0=all insiders; 1=one insider between governor and party secretary; 2=both outsiders.

3. Region: 1=coastal; 2=central; 3=inland.

Looking at the integration index, only Shanxi (83-93), Hunan (78-92), Guangdong (86-98), Yunnan (86-94), and Xinjiang (82-95) have had both an insider party secretary and governor concurrently for more than 9 consecutive years. The mean values of revenue elasticity of these provinces were close to or higher than the total mean value (82.1 percent).⁷⁰ However, only Guangdong is located in a coastal region among these provinces. This illustrates that the Beijing government is more likely to concurrently assign insiders in the positions of both party secretary and governor in relatively underdeveloped inland and central regions, and those regions are more compliant with the Beijing government in terms of their revenue efforts.

The mean value method, however, does not provide an idea of the causal relationship of personnel reshuffling at the local leadership level or regional differences over economic and fiscal performance at the provincial level. To understand the nexus, I conducted a simple regression analysis. Table 6-8 briefly illustrates the results of the regression analysis. In the table, GDP per capita is a proxy of economic development. As a proxy of fiscal effort/consequence I used a revenue/expenditure per capita measurement to keep the population factors remain at the least. Revenue (expenditure)/GDP is another proxy of the fiscal performance. The other method of tax efforts, that is, the revenue increase rate over GDP increase rate was also tested. However, as this tax effort method turned out to be insignificant over periods, I dropped this measurement in this table. Noticeably, the overall explanatory power of the personnel reshuffling and regional differences became much stronger during the period of the tax-sharing system than the period of the fiscal contract system.

In the beginning of the economic reforms, the personnel reshuffling factor was not significant with regional economic development and revenue/expenditure per capita. Insiders or outsiders made no difference in economic development and size of revenue/expenditure per capita. It is understandable in that the development of regional

economies, taxation, and spending was more likely subjected to the planning of the Beijing government under the strong legacy of the planned economy. However, in the areas of revenue (expenditure)/GDP, outsiders performed better. This implies that cadres loyal to Beijing made greater revenue efforts and spent a greater proportion of expenditures over GDP as a return. However, during the fiscal contract system period, the personnel reshuffling factor was not significant over all outcome variables.⁷¹ This may imply that the Beijing government made no significant discretionary policy in the personnel reshuffling during the period. It assigned local leaders in a non-systematic fashion.⁷² Leaders' performance also varied over areas.

Yet the personnel reshuffling factor became statistically significant in all tested areas except the proportion of expenditure over GDP in the tax-sharing system period. Insiders more likely performed better in economic development and revenue efforts and spent a higher proportion over GDP in the regional economy. The *yindizhiyi* policy of the Beijing government appeared to bear fruits. In the middle of recentralization on the revenue side, the Beijing government still appointed a much higher percent of insider governors in the coastal regions, and the results proved to be very positive for both the Beijing and the provincial governments, although the larger proportion of insider governors also provided academic spectators with expressions of some concern as a sign of Beijing's waning control over localities. The degrees of economic development and revenue effort were better than the targets (8 percent and 10 percent respectively) set during the period (see Figure 5-1). The win-win situation was apparent, which the Beijing government sought to create under the institutional constraints of democratic centralism.

The regional factor is also significant over periods. In the beginning of the reforms, the coastal regions had a higher effort score in economic development, revenue collection and spent less in proportion to expenditure. The situation continued over the periods. However, a look into the coefficients reveals that the regional gap appeared to increase over time. The differences of spending proportion declined over time, but the differences of the coefficients between economic development and revenue collection per

⁷¹ Although they were not statistically significant, it is noteworthy that the coefficients of GDP per capita and revenue (expenditure) per capita changed to be negative. It means that insiders probably did better performance in those areas as principle-agent theorem implies.

capita over time implies that the gap of regional economic development had enlarged; meanwhile, the revenue burden did not increase along with the increase of GDP per capita. It tells us that the regional disparity problem became serious under the reign of Jiang Zemin. Exacerbation of the regional disparity problem was also related to a policy priority in the fiscal area.⁷³ In the implementation process of the *tax-sharing system*, the coastal region still acquired various favorable treatments by Beijing in the early years of the implementation stage to further the economic development and smooth implementation of the new fiscal reform.

D. Tentative Evaluation and Remaining Issues

The 1994 fiscal reform was not a mere fiscal centralization but came with institutionalization efforts in the fiscal system as well. In the beginning, the major goals of the tax-sharing system were to increase the two ratios.⁷⁴ To achieve the goals, a fundamental change of previous fiscal organizations and rules would be required in favor of the Beijing government. Current practices of soft-rules, less-transparent fiscal contracts, and discretionary policies would have to be regulated by a rule-based system. Consequently, intergovernmental and social relations would be changed in major ways, causing many to fear that that the Beijing government might wield a formidable power in the control of fiscal resources as a result of the reform. Consensus coupled with the determination of the current Beijing leadership on fiscal reform certainly ensured the adoption of the tax-sharing system and enabled the restructuring of fiscal organizations at both the central and local levels.

However, the practice of democratic centralism concurrently allowed all interested parties to give their inputs in formulating the detailed rules and policies.

⁷² The Ministry of Personnel was established in 1988 to strengthen the cadre management in the government.

⁷³ The sense of pain from the disparity in the rural area might be much bigger than illustrated by the figures. Peasants were often victims of fiscal mismanagement of local governments. It was exacerbated by the policy of the State General Taxation Bureau that standardization of taxes should be enforced in the urban areas first, which had larger tax bases and were mainly located in the coastal regions. It allowed local governments to levy more illegal taxes and fees on peasants. See Liu (2000), 492-493; *The Japan Times*, 27 January 1994).

⁷⁴ Interview with Bai Jingming by *Lianhebao*, 7 April 1994.

Democratic centralism demanded that the Beijing government follow *democratic* procedures in formulating a major political policy, whose policy would change an intrinsic nature in the various interest relations. It would likely produce a win-win formula, which would help smooth implementation of the fiscal reform. In draft-making and a series of coordination, the cardinal principle was assured that economic development should not be sacrificed to fiscal reform. As a result, given local interests were guaranteed. Accordingly, the original targets of increasing the two ratios were adjusted at much lower levels. The scheme of complete institutionalization in the fiscal area was thus impaired although it still paved the way for further development. Accordingly, He Zhenyi (*Lianhebao*, 7 April 1994), an avid supporter of the tax-sharing system from the CASS along with the SPC (1994) warned that such adjustments would avail little in improving the fiscal position of the Beijing government in the short-term and that the drawbacks of the old fiscal system might indeed return.

Was China's fiscal reform successful? The evaluation of that question also varies according to different foci of views. Stephen Herschler (1995), Yang Zhong (1996), Barry Naughton (1997), and Andrew Wedeman (1999) focused more on the success of the fiscal reform and the strengthening of the Beijing government's power. The views on fiscal reform of Chung (1995) and Wong (1995) leaned more on the limits of the Beijing government and left the prospect uncertain. Meanwhile, Linda Chelan Li (1998) avoided the conventional dichotomous approach of conflict vs. cooperation in central-local relations, seeing fiscal reform as a convergence of mutual interests between the Beijing and local governments. In fact, observation of China's fiscal/economic performance can support any view with plentiful evidence since the political nature of the fiscal reform produced a hybrid of various interests and eclectic outcomes.

To begin with, a look at the data in the macroeconomic/fiscal area reveals that the Beijing government was unable to increase the two ratios sharply within several years after the 1994 reform. However, it shows an obvious success when the longer-term trend in the two ratios of revenue and expenditure are examined. At least the Beijing government was able to stop the declining tendency of state revenue ratio over GDP and the retention rate of central revenue over total revenue. Additionally, the ratios of central revenue and expenditure were gradually increasing.

The average annual revenue growth rate was about 18 percent during the period 1994-1998, a figure much higher than projected in the ninth five-year plan. In particular, the growth rate of industrial and commercial taxes averaged about 18 percent during the first three years (1996-1998), a figure higher than the 10 percent, target of the ninth five-year plan period.⁷⁵ As targeted by MOF from 1995 on, the revenue increase rate kept pace with the GDP increase rate and eventually exceeded it from 1997 onward. The percentage of government revenue to GDP also increased from 11.2 percent in 1994 to 14 percent in 1999 (CSY 2000, 256). As a report of the Economic Research Institute of SPC anticipated in the beginning of the *tax-sharing* implementation in 1994, the 57 percent target of the central share of revenue share might not be realized until 2000;⁷⁶ in fact, the Beijing government could not reach the level until 1998.

However, the Beijing government was able to increase its share in revenue up to a dramatic 55.7 percent in 1994 and maintained about the 50 percent level through the fiscal reform. The percentage moved up from 48.9 percent in 1997 to 51.1 percent in 1999 (CSY 2000, 267). Prior to the fiscal reform of 1994, the level of 50 percent in the share of the Beijing government of revenue had never been achieved since 1960. As a result of the increase, the Beijing government was able to gain control of subsidies and fiscal transfers, a point made by Andrew Wedeman (1999). Although the Beijing government promised to redistribute its revenues to localities in a certain proportion, it still possessed the ultimate power of disposal. It could play gatekeeper in the fiscal flow, for without subsidies and fiscal transfers from Beijing, no province could be debt-free.

On the expenditure side, the Beijing government targeted its 40 percent share over national expenditure in its original plan after it handed over one-third of its revenues to subsidize localities. However, it agreed not to increase its share dramatically in the process of negotiations after guaranteeing at least the current level of spending to localities. Although Beijing's share slightly increased for two years higher than at the level of the year of 1993, the Beijing government's annual share basically maintained its 1993 level, about 28 percent (CFY 1999, 468). The outcome was certainly a product of

⁷⁵ Calculated from CFY (1999), 450.

⁷⁶ See the Economic Research Institute of the SPC, "Caishui xintizhi yunxingzhong liyigejude biandong, yingxiang ji jianyi [Change and Influence of Interest Relations in the Implementation of the New Fiscal System, and Suggestions]." *Jingjigaige yu Fazhan*. August 16-23, 1994.

compromise, but as a result the Beijing government was still essentially financially destitute. A sign of success of the fiscal reform is, however, to be seen in the fact that the expenditure share of the Beijing government still improved from 28.3 percent in 1993 to 31.5 percent in 1999 (SSB 1999, 267-268).⁷⁷ Compared to the share in revenue, the percentage of expenditure of the Beijing government has often been regarded as a sign of the Beijing government's weakness. Importantly, however, the main target of the Beijing government in the fiscal reform in 1994 had not been to increase its share of expenditure. Rather, it aimed to control the revenue side.

As Linda Chelan Li argued, the 1994 fiscal reform evinced strong characteristics of the non-zero sum game. It was neither lopsided centralization nor decentralization but the product of compromise. Contrary to conventional assessments of the reform as fiscal centralization, a meaningful decentralization measure was also launched in the fiscal reform in 1994. Previously, the Beijing government had delegated various fiscal powers to local governments while still retaining the authority to retrieve them in a discretionary fashion (SPFRC, 42). From 1994 on, however, local governments could secure revenue bases in a more formalized fashion. The local revenue bases were legally guaranteed and would be considerably less subject to discretionary intervention by the Beijing government. In this respect, a more meaningful local finance system started from 1994. However, the characteristic of the non-zero sum was that it was not an isolated event but was related to the semi-institutionalized decision norm. The other noticeable fact is that the co-operation and compromise between the Beijing and local governments did not happen on an equal-power basis. The initiatives of the Beijing government were more dominant in the fiscal reforms, and local governments and other proponents for the fiscal contract system found countermeasures *within the range of permissible rules*. The famous phrase "*shangyou zhengce, xiayou duice*" [leaders have policies, subordinates have countermeasures] sarcastically described the situation with the emphasis of rising localism. When they went beyond the rules, however, the defiant were punished as in the case of Ye Xuanping, the former governor of Guangdong province. On the other hand, the Beijing government responded to localities by embracing their interests and never conducted a predatory or a lopsided enforcement.

⁷⁷ All data came from State Statistics Bureau (1999), 12, 267-268.

The acquisition of sufficient funds for the increase in military expenditure was the preeminent issue in Beijing's finance, as argued in a previous chapter. However, the eclectic outcomes of the fiscal reform meant that the Beijing government was not able to secure sufficient funds for increasing military expenditure in spite of the fiscal reform. Right after the fiscal reform, the increase rate in military expenditure soared to about 30 percent. Although China experienced a 21.7 percent increase in the retail price index in 1994, the military expenditure increase rate was still much higher than the average government expenditure increase rate of 24.8 percent in the year. However, the politics of compromise between the Beijing and provincial governments in the process of fiscal reform still caused the fundamental financial burden of the military expenditure increase on the Beijing government to remain unsolved even after the fiscal reform. To supplement insufficient funding, the Beijing government announced in 1994 its plan for selling bonds worth 100 billion *yuan* (*China Post*, 19 March 1994).⁷⁸ This case may be taken as a sign of the Beijing government's weakness; nonetheless, the Beijing government still succeeded in providing the promised annual 10 percent increase in military expenditure by an increased rate of revenue collection with the 1994 fiscal reform, which became higher than the GDP increase rate.

The results of the fiscal reform were far from curing all diseases in the fiscal area. Remaining problems still abounded. In the short-term, the Beijing government was unable to enforce standardized rules and targets as planned. The target of the revenue share of the Beijing government by 2000 was set at 57-58 percent (*Xinhua News Agency*, 10 January 1996; CTY 1997, 71) though that target could not be reached. The share of expenditure by the Beijing government was also far below the original target of 40 percent. As a temporary measure, the Beijing government retained the old contracts on tax collection and sharing between the central and local governments. So as not to disturb given interests drastically, in particular the coastal region's interests, various preferential policies on income and circulation taxes were allowed to operate until 1998.⁷⁹ In light of Beijing's tolerance, localities continued to seek free rides and moral hazard problems also

⁷⁸ With the fiscal reform in 1994, the Beijing government stopped the practice to borrow loans from banks to support its fiscal deficit. Instead, it decided to rely on selling bonds. See *Guangmingribao*, 4 February 1994.

remained widespread at the expense of Beijing's interests as seen in the sharp rise of local revenue collection over central revenue after the 1994 fiscal reform.

Institutionalization in the areas of tax collection, fiscal management, monitoring systems, and spending has not been completed.

Another problem was that intergovernmental transfer system was not yet fully standardized in accordance with the factor method, whose adoption would help reduce regional differences. After maintaining the previous base figure method allowing the established interests of coastal regions to continue even after the fiscal reform in 1994, the factor based-method was eventually introduced in the amount of 2 billion *yuan* from 1996; the amount of transfer was unconditional fiscal one similar to subsidies. By using regression analysis, the Beijing government determined a province's revenue capacity and standardized expenditure index, after which the funds would be transferred to poorest provinces. Although constituting a major step toward standardization in the fiscal transfer, the amount of the transfer was only 0.5 percent of government revenue. It still requires a longer-term to replace the base figure method with the factor method in the fiscal transfer.⁸⁰ On the other hand, earmarked fiscal transfers also suffered from insufficient regulations and dispersed managements.⁸¹ The degree of standardization of responsibility on the earmarked funds was quite low, so the bulk of the earmarked funds was in effect used as an unconditional transfer. Political discretion was still crucial in determining the amount of *yuan* that a province would acquire (SPFRC, 43).

The third problem was the widespread existence of extra/off-budgetary funds. Their entrenched existence was a remnant of the Chinese economic reform, and the Beijing government generally allowed them in supplementing expenses for every administration. The base figure method in the contract system encouraged local governments to diligently collect their own revenue because the more they collected

⁷⁹ Then, it was again protracted to the year 2000. See SPFRC (1999), 24. Regarding details of tax rules and preferential policies, see Liu Zuo (1998).

⁸⁰ In a longer term, there was a positive sign that the fiscal transfer would play active roles as planned. The size of returned taxes for import/export goods, which the Beijing government was responsible for, has been considerably reduced from 16.28 percent of the circulation taxes in 1996 to 6.64 percent in 1998 (CFY 1999, 469). It would create a considerable space for the Beijing government to increase the amount of the fiscal transfer.

⁸¹ The number of the earmarked transfers was more than 100. It was managed by various bureaucracies. See SPFRC, 43. Regarding the impact of the new fiscal reform on tobacco industry, see Zhou (2000).

beyond contracted assignments the more they possessed. However, they also had an incentive to hide their revenue sources because the base figure might rise if their revenue sources were exposed. The consequence was the decline of the fiscal position of the Beijing government. Therefore, a goal in the fiscal reforms was to absorb irregular budgetary revenues into official budgetary revenues thereby to regularize local government finances.

Table 6-9: Budgetary Integration Index

1986-1993 (average 0.82)		1994-1998 (average 0.75)	
High (above 90%)	Low (below 70%)	High (above 90%)	Low (below 70%)
Inner Mongolia	Tianjin	Zhejiang	Beijing
Jilin	Hubei	Jiangsu	Guizhou
Ningxia	Guangdong	Hunan	Gansu
Beijing	Yunnan	Shanxi	Shaanxi
Xijiang	Shanghai	Guangxi	Heilongjiang
Shanxi		Fujian	Inner Mongolia
Heilongjiang			Qinghai
			Hubei
			Liaoning
			Tianjin
			Yunnan
			Guangdong
			Shanghai

Sources: CFY and provincial Statistical Yearbook respective year.

Note: The list is in order: the top the highest percentage. Hainan and Tiber are not included.

Table 6-9 illustrates that the implementation of the tax-sharing system provided deep impacts on the practices in the extra-budgetary revenue area. The relatively standardized tax system reduced the size of the extra-budgetary revenue over the budgetary revenue. During the period 1986-1993, the proportion of average extra-budgetary revenue over budgetary revenue at the provincial levels was about 82 percent, though that figure declined to about 75 percent during the period 1994-1998. During the period 1986-1993, only five provinces had a fiscal structure in which the proportion of extra-budgetary revenue over budgetary revenue was lower than 70 percent. However, the number increased to thirteen during the period 1994-1998. Given the tendency of expansion in extra-budgetary revenue since the inception of the economic reforms, the decreased average budgetary index score during the period 1994-1998 was remarkable for the period after the introduction of the *tax-sharing system*. On the expenditure side, five provinces (Shanghai, Beijing, Jiangsu, Liaoning, and Tianjin) enjoyed higher than 90

percent in their proportion of extra-budgetary expenditure to budgetary expenditure prior to the reform. However, no province proved higher than 90 percent after the reform. Zhejiang was the highest with 84 percent. The overall average score in expenditure also illustrates that rampant extra-budgetary expenditures in provinces had been stanchied. The average proportion fell from 68 percent in the period 1986-1993 to 42 percent in the period 1994-1998.

Since the tax-sharing system placed the consumption taxes⁸² and the value-added taxes under central control, whose taxes were the main sources of local extra-budgetary funds, local governments were placed under considerably more financial pressure. As a solution, they sought to alleviate their insufficiency from a wider range of off-budgetary sources. As of 1996, according to an SPFRC estimate, the proportion of extra-budgetary funds over total revenue (1500 billion *yuan*), which was two times more than the size of the official government revenue of the year, stood at about 26 percent and off-budgetary funds at about 25 percent (SPFRC, 26). In particular, township enterprises were made highly vulnerable where the level of institutionalization and the control of the Beijing government were relatively weak (Zhou 1997, 12-123). With the effort of fiscal institutionalization, the State Council, the SPC, and the MOF consecutively issued notices, decisions, and regulations to regulate the (extra) off-budgetary funds and fees in 1997 and 1998 (see the lists in the SPFRC, 267). In March 1998, Premier Zhu Rongji suggested in the NPC session that the *feigaishui* [replacement of fees by taxes] reform would be one of five main reform targets (Wang et al. 1999, 763-770). The reform aimed at increasing transparency and reliability in this area. However, off-budgetary funds still remained as one of areas that the tax-sharing system had not yet solved.

The other negative consequence of the tax-sharing system was the widening regional differences. Many government organizations and scholars called attention to increasing regional gaps during the 1990s.⁸³ As previously discussed, a gap could be attributed to characteristics of the fiscal contract system during the economic reform period. The features survived under the new fiscal system because the Beijing

⁸² It was a part of the product taxes prior to the 1994 fiscal reform.

⁸³ For example, the MOF, Finance Science Research Institute (1999), 125-154; Hu Angang (1999), 311-319; Lu and Xue (1997), 297-315. Also see the articles in the 1996 tax theory conference

government conceded maintaining preferential policies enabling coastal regions to secure smooth implementation of the fiscal reform and to continue their economic development. Although Beijing introduced the factor method into the fiscal transfers from 1996, whose adoption would be favorable to non-coastal regions, the size of funds were still too small to improve the regional gap. Regional differences in the proportion of extra-budgetary figures over budgetary figures revenue also imply a widening regional gap in economic development.

Table 6-10: Regional Differences in Budgetary Integration Index (Percent)

Region	Period	1986-1993		1994-1998	
		Revenue	Expenditure	Revenue	Expenditure
Coastal		78	86	77	49
Central		87	65	78	43
Inland		81	47	75	30

Sources: Author's calculation from CFY and provincial Statistical Yearbook in respective year.

Note: Integration Index refers to the ratio of extra-budgetary funds over budgetary funds. In this calculation Hainan and Tibet were not counted.

A look at Table 6-10 reveals that the fiscal reform had greater impacts on the expenditure side. The coastal regions spent a higher proportion and that pattern did not change with reform. On the revenue side, as previously mentioned, non-coastal regions actively utilized extra-budgetary funds to supplement their insufficient revenues prior to the 1994 fiscal reform. However, as the Beijing government took away extra-budgetary revenue sources away from consumption and value-added taxes through the reform, their ability to locate new sources was relatively constrained. However, the coastal regions could still find sources in business and various income taxes, which were generally assigned to local taxes and abundant in the fast-developing regions. Although the new fiscal reform reduced the overall proportions of extra-budgetary funds, it also contributed to widening the regional gap.

Despite these problems the Beijing government made appreciable progress in two major areas of macroeconomic control and institutionalization. Although doubts among many scholars existed on the effects of the reform, the Beijing government certainly strengthened its ability to control the fiscal arena without sacrificing economic

regarding the relationship between fiscal preferential policies and regional gap in economic development. Chinese Academy of Taxation ed. (1997), 210-246.

development. As planned in the ninth five-year plan, the average GDP growth rate kept to about 8 percent in spite of the East Asian financial crisis. The revenue growth rate was higher than the GDP growth rate during the planned period. In terms of fiscal institutionalization, the fiscal reform was a major leap. The establishment of local state taxation bureaus and assignment of taxes under divided jurisdiction manifestly reduced the range of discretionary mores of local governments. Its long-term effects in revenue collection already appeared in the gradual increase. Although it was far from completion, revenue increase rate steadfastly made progress. In short, the new fiscal reforms of 1994 at least provided an institutional mechanism for fundamentally changing the roots of various problems, such as arbitrary behaviors and rampant localism, in the previous fiscal contract system.

Around 1998, the Beijing government was appearing more comfortable and confident of its monitoring capability in the fiscal area. In spite of the continuing demand for sufficient fiscal revenue, Beijing made a decision in 1998 to stop its nationwide inspections of financial affairs, taxation and commodity prices, whose inspections started in 1985 in the effort to intensify central control over local behaviors in the midst of economic decentralization. The MOF explained the reason such as a daily monitoring network consisting of financial, taxation, auditing, and other social auditing organizations was able to function like daily supervision (*Xinhuashe*, 31 July 1998). My interview also confirmed as much. A cadre in Shanghai explained that the demand of the Beijing government to inspect local behaviors in the fiscal arena dramatically decreased after it established the state taxation bureaus under the direct control of the Beijing government. Beijing's confidence in controlling localities was also revealed in its personnel reshuffling of provincial leaders. Since 1994, inlanders were systematically assigned more in the coastal region in spite of increasing worries of localism inside and outside China.⁸⁴ Table 6-6 also supports this argument.⁸⁵

⁸⁴ It was statistically significant at the 0.01 level. Its formula $Y=0.482 + 0.311 X$. Y refers to personal integration index, in which insider was counted 0 and outsider 1. X refers to regions: coastal=1, central=2, and inland=3. I also tested the period prior to 1994, which was not significant.

⁸⁵ Bo Zhiyue argued by constructing an indicator of provincial power for provincial representation in the CCP central committees that provincial power politically declined during the era of economic reforms. See Bo (1998), 1-18.

Chapter VII

Characteristics of the Fiscal Reforms and Implications

The view that the power of the Beijing government has waned simultaneously with economic decentralization seems to be common sense. Numerous anecdotal cases and theoretical analyses also support that view. Field research in China's localities would reveal that whenever they find a chance it is not difficult to find that localities seek their own parochial interests at the expense of the Beijing government. However, this study integrating the intentional aspect of Beijing's policies into analysis argues that Beijing still matters. A bad outcome in a certain area can sometimes be a deliberate choice of the Beijing government to achieve its primary goal. The waning fiscal position of the Beijing government under the fiscal contract system had the intentional aspect of encouraging local economic development, although the fiscal position worsened faster than the Beijing government and scholars anticipated.

A look at the practices of the fiscal reforms throughout the post-Mao era reveals that the Beijing government was still capable of commanding politics and economy. It did not fall victim to a predatory nature, whose event is all too common in developing countries. Its efforts for fiscal institutionalization were steadfast and eventually proved successful in replacing the previous planned socialist type of fiscal system with a more market-friendly system. In the process, the Beijing government was far from behaving like an omnipotent power as depicted by the totalitarian model. In fact, the government never intended omnipotence during the post-Mao era.

The principle of democratic centralism provided a semi-institutionalized decision-making mechanism for channeling various conflicting interests into a non-zero sum game. This semi-institutional mechanism made the consensus-building process crucial in the success of policy enforcement and resulted in policies on key issues moderate and acceptable rather than radical. No political leader alone, including Deng Xiaoping, could

(did) have made a crucial decision under the decision-making norm. Before taking an initiative, Chinese political leaders cautiously undertook consultations and compromises to make sure of acquiring sufficient support. Every crucial decision was made by a group after consensus-building under the *democratic* norm, and the decision-making process provided the legitimacy and authority that the Beijing leadership needed to execute policies. When the Beijing leadership reached sufficient consensus, the policy was effectively implemented, as seen in the 1994 fiscal reform, no matter what the local preferences were. Even in this case, however, the norm still required consultation/compromise processes with the localities although the localities could not determine a policy.

The democratic centralism decision-making norm was not designed for efficient policy-making and quick implementation but rather for maintaining political stability and effective enforcement of policy priorities. These features explain why in general the Chinese decision-making process was so time- and energy-consuming, and the resulting fiscal reforms appeared rather non-linear, gradual, and eclectic. The norm was resistant to adopting quick and radical measures to meet newly arising challenges.

Without doubt the cardinal goal of the Chinese leadership during the post-Mao period was to promote economic development based on political stability. To achieve that goal, the Beijing government delegated various economic powers to localities and enterprises. The fiscal arena was in general subjected to the goal. However, policy priorities varied over time because they were susceptible to contextual changes and sometimes appeared to conflict with the cardinal goal. In the fiscal arena, the term *decentralization* does not likely explain the main features of the changes. All the elements of centralization, decentralization, and non-zero sum game were intertwined. The Beijing government delegated fiscal power to local governments, in particular to certain provincial and city governments, to encourage more effective revenue collection, public services, and local economic development. Unquestionably, the Beijing government enforced recentralization measures by using its political and administrative power whenever necessary. However, the imbalance of power did not prevent bargaining with localities in areas of mutual interest.

The Beijing government constantly strove to institutionalize a rational, transparent, and rule-based tax system for providing stable revenue sources and later for meeting the demands of a more market-oriented economic system. The way to that goal was impeded by various obstacles due to the unpredictable nature of reforms, politics of interests, and fiscal organization's incapacity. External factors in other issue areas sometimes spilled over into the fiscal area. For example, high inflation, low incentives, and lack of reforms in other areas occasionally threatened to reverse the institutionalization efforts, as seen in the introduction of the fiscal contract system in 1988. The problem of macroeconomic control and the heavy burden of increasing military expenditure precipitated the 1994 fiscal reform.

A detailed look at fiscal reforms, however, reveals that Beijing's institutionalization efforts in the fiscal area were much stronger than observed by outsiders. All premiers of the State Council incessantly prepared for the rule-based fiscal system and expanded organizational capacity in the fiscal area throughout the post-Mao reform era. Central bureaus such as the SPC and the MOF as well as elder conservative party leaders such as Chen Yun and Li Xiannian also supported institutionalization of the fiscal system to acquire a stable revenue supply. Although its role in the fiscal reform was somewhat tarnished after the demise of Zhao Ziyang, the SCRE also played an active role in promoting the rule-based tax system in the early 1980s. When the policy priority of the Beijing government moved to more rapid economic development as imminent economic problems pressed Beijing leaders and bureaucracies, the Beijing government postponed institutionalizing the fiscal system. Importantly, however, most political leaders, bureaucracies, and scholars understood the postponement as a temporary measure. The basic framework of the rule-based fiscal system was eventually implemented with the 1994 fiscal reform.

In practice, the road to institutionalization was not easy. Institutionalization entailed a surfeit of political struggles, negotiations, coordinations, and compromises among the various interest parties. In this respect, the 1994 fiscal reform was the benchmark for all efforts for fiscal institutionalization. It completed the construction of a basic framework for the rule-based system even though the level of institutionalization still needed considerable improvement after getting through such political and

institutional constraints. The separation of local taxation bureaus, assigned tax systems, expansion of taxation bureaus, establishment of surveillance systems on the township level, and strengthening of the linkage of fiscal performance with a personnel management system were completed. As a result, the Beijing government was able to stabilize its level of revenue collection and increase at a higher rate than the GDP increase without the sacrifice of economic development. The target of the GDP increase rate was about 8 percent and the tax revenue increase rate about 10 percent during the ninth five-year plan period (CTY 1997, 70-71; Shen et al, 794). During the period 1996-1999, the actual GDP increase rate was 7.7 percent and the revenue increase rate about 16 percent. In spite of the 1999 economic crisis in East Asia, overall achievements of GDP and revenue growth rates were more than impressive.

In introducing the fiscal reforms and enforcing them, the principle of democratic centralism was a crucial factor in determining the process and producing a more eclectic policy. Democratic centralism has two faces: democratic and central. The democratic feature tends to lead to coordination and compromise among vested-interest parties starting in the drafting stages. Although the official rule of being *democratic* in decision-making is achieved through majority voting, the Chinese characteristic of democratic norm or practice in making key policies favored a consensus and at least, appeared to require an absolute majority beyond the arithmetic majority. To reach such a level, political leaders had to be willing to compromise with each other after extensive exchanges of ideas, mobilizations of supporters, and policy propagandization. Various interest parties played first to gain a majority position and then, the blessings of Deng Xiaoping and other elder leaders.

In an implicit but still obvious way, the democratic process revealed which policy was in the majority or was the major trend of the times, and the revelation prevented conflicting interests from waging an unchecked power struggle. However, it also often leads to a deadlock situation as seen in the scheduling of the introduction of the tax sharing system. In general, when the policy-making process stalled, the solution was to take time until "all conditions were rife." To break the stalemate, the leadership of the top political figures often became critical, though intervention did not occur without a prearranged consensus within the court. The *centralism* principle was eventually applied

after the Chinese leadership gained legitimacy, to enforce priority policies in accord with the *democratic* principle.

Most scholars agree that China adopted a piecemeal strategy or style of reforms during the 1980s and 1990s. However, looking at the details, I argue that at least in the fiscal area that was not necessarily its strategy. China did not adopt a piecemeal strategy when it initiated reforms; its leaders experimented with a range of solutions to their political and economic problems. Initial political and economic conditions, institutional constraints, and response by leaders to newly-arising problems shaped the evolution of Chinese reform policies and goals. As guided by the Chinese decision-making norms, the Beijing government prepared painstakingly to introduce the *replacement of profits by taxes (ligaishui)* reform. However, the decision to introduce was quite radical and dramatic in terms of the nature of the reform. It would replace the traditional profit remittance system under the socialist planned economy with a market-oriented tax system. Each level of government spending would be supported by its own tax base. Zhao Ziyang and certain central bureaucracies such as MOF and SCRE constituted the main driving force for comprehensive fiscal reform in the early 1980s and launched the *ligaishui* reform in 1983.

However, the attempt could not be fully realized: although Zhao and his supporters ambitiously introduced the tax-based fiscal system and sought dramatically to enhance the level of institutionalization with transparent rule-based fiscal reform during the period of 1983-1985, radical reform in one area would not work without coordination with reforms in other areas. Technically, the Beijing government was unable to provide an objective criteria of values without price reform under market conditions. Preferential policies over SOEs and coastal regions also distorted market and fiscal bases.

In addition, the *democratic* decision-norm contributed in changing the nature of the reform to a more piecemeal character by allowing other interested parties to give their inputs in the policy-making process. Since institutionalization measures were interpreted to be centralization and provided little incentive for localities and enterprises to undertake tax collection, the policies were unpopular with localities and industry-related bureaucracies and soon incited local tax collection resistance. The efforts for institutionalization also went against the new policy priority of more rapid economic

development as encouraged by Deng Xiaoping. When it was proved premature to maintain the transparent rule-based fiscal system, the Beijing government in 1988 decided to return to the more discretionary fiscal contract system.

This study also emphasized the importance of formal mechanisms and major documents, such as the annual government report to the NPC by the Premier and Minister of the MOF, reports in the Party Congress by the Party Secretary General, and five-year/ten-year plans because they contained guidelines for policy priorities. The Chinese decision-making norms under democratic centralism explain why. The document contents were not a mere assertion of interests of a faction or of a few powerful leaders. Those formal conferences were no longer a mere rubber stamp as depicted in popular images of the totalitarian socialist system. In the conferences, leaders and subordinates had ample opportunities to exchange their views and proffer their ideas. If the documents are examined or access to the contents of conference discussions is available, they provide a keen venue of consensus for ideas among various interest groups and leaders on certain issues in given periods. Subordinates and localities also took pains to understand the guidelines of their policies and behaviors therein. Therefore, they deserve more attention than they have received in the past.

This argument does not necessarily insist that the Chinese decision-making system is democratic or ideal by Western ideals. Relatively small groups of people participated in the decision-making process. No formal binding rules were set up to detail how precisely to reach a decision. A discretionary fashion still prevailed. Informal adjustment, coordination, and compromise were certainly more important in such a system than in the Western style of procedural democratic system. However, the Chinese democratic process has a meaningful function. First, the process contributed political stability by preventing policy orientation from becoming falling to extremism. It helped to enforce a policy without degeneration into political struggle. The system though far from efficient sufficed to achieve political stability. It also provided various alternatives for particular policies. Although a policy might become dominant, other options still remained as alternatives. Therefore, the Chinese leadership was never starved of alternatives in fiscal reform. For example, a basic idea of the tax-sharing system

implemented in 1994 had been suggested in 1982 in an internal document by He Zhenyi from CASS.¹

The degree of enforcement in the fiscal arena varied according to the nature of the policy and the level of consensus, as revealed in the long process of drafting and documenting in the (in)formal system according to the democratic principle. At the beginning of the reforms, the main players were central leaders and bureaucracies as seen in the introduction to the *replacement of profits by taxes* reform. However, because localities gained more autonomy and resource disposition power as reforms proceeded, they became major players as seen in the battle to introduce the tax sharing system in 1994. Over time, *tiao-tiao* conflicts as a major ground of contention gradually moved to *kuai-kuai* ones in the fiscal arena. It is also noteworthy that localities did not compete with the Beijing government as an equal partner or competitor. Rather, the localities looked for all possible signs of Beijing's changing policy priorities and shrewdly behaved within the limits of Beijing's tolerance.² Beijing also did not interfere with detailed local matters as long as the localities fulfilled their budget targets.

The other remarkable thing was the professionalism exhibited by the policy stances of China's premiers in the fiscal reforms, stances that precluded political maneuvering and predatory action for political gain. Rather, they concerted their efforts for institutionalization of the fiscal system in spite of the vicissitudes of the economy and the temporary concessions to a more discretionary fiscal system in 1988. Indeed, the Secretaries General Hu Yaobang and Jiang Zemin proved more flexible on this matter, eschewing predation for their own personal material gain even though corruption problems were rampant in Chinese society and they were not entirely exempt from accusation. This quality of leadership in a reform period was an asset, which most developing countries in fact failed to enjoy.

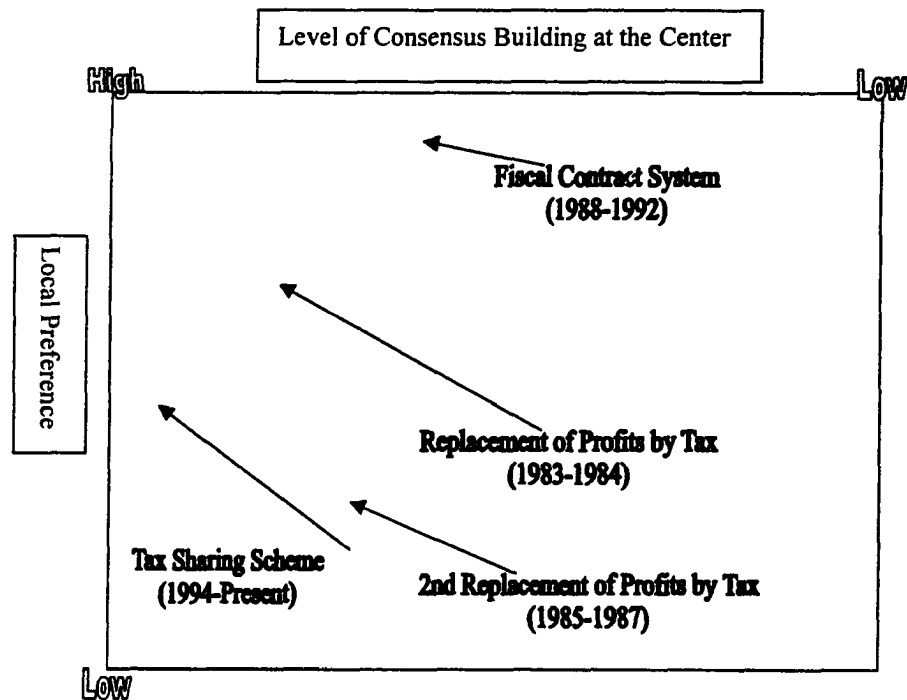
Figure 7-1 illustrates how the degree of consensus at the center and the predatory nature of policy as concerned local interests influenced the degree of compliance and enforcement in the four periods of fiscal reforms discussed in Chapters III-VI. Although

¹ It is not necessarily the first time that the tax-sharing concept was suggested.

² The famous Chinese cliché "*shangyou zhengce, xiayou duice* (The leader has a policy and subordinates have a countermeasure)" has been often used to indicate inability of control over local behaviors by the Beijing government. However, ironically, it also implies the power of the Beijing government.

the evaluation could be controversial in terms of viewpoints, I viewed all but the second *replacement of profits by tax* reform, which was replaced by the fiscal contract system, as being relatively successful. In the moderate sense, the judgment is based on whether the Beijing government achieved results in accordance with its policy priorities.

Figure 7-1: Influence on the Level of Compliance by Local Preference and Consensus Building



Note: The figure is based on Author's discretionary judgment. The beginning point indicates the situation at the drafting stage and the end of arrow the situation at the stage of implementation. The author is responsible if any mistake.

During the period of the second replacement of profits by tax system reform, the Beijing government did not seek either to increase the level of proportion of Beijing's revenue or to provide incentives for localities for further economic development. The bold attempt for a more transparent rule-based tax system was not capable of stabilizing the system, but it was soon handed over to the more discretionary fiscal contract system. The *relative* success of the first *replacement of profits with tax* reform and the reform for tax-sharing can be attributed to the *relatively* high level of consensus in the central

leadership in spite of the nature of policies ill-favoring local interests.³ In particular, Beijing's determination was crucial in the successful introduction of the tax-sharing system. The fiscal contract system was successfully enforced because it was welcomed by localities even in spite of the fact that the consensus level was initially *relatively* low in the Beijing government. As illustrated, a unitary factor was not necessarily dominant in Chinese fiscal reforms. However, there was a trend in that direction in all fiscal reforms. The democratic decision norm guided all reforms in the process of drafting and documentation in the direction of the upper left side in Figure 7-1, which induced both a higher level of consensus in the Beijing leadership and bureaucracies and a higher level of special treatments for local interests.

Rome was not built in a day. Transformation into a new market-oriented economic system with the baggage of an old political system is necessarily an extremely difficult and risky venture. No previous experiences, blueprints, appropriate organizational structures, and sufficient number of trained personnel existed for the journey ahead, as most developing countries discovered when launching their reforms. Highly volatile domestic and international factors acted to keep the context of reform unpredictable. In such a transitional period, adjusting the political/economic interests of various parties was a tremendously challenging task and always carried the possibility of explosive conflicts as seen in the Tiananmen Incident in 1989. The (semi) institutional norm of democratic centralism provided a mechanism for reaching key decisions, and political leaders prudently abode by it. The outcome was a combination of non-linear, gradual, eclectic movements toward reform, although the Beijing government and leaders did strenuously attempt to surmount the problems of the old economic/political system since the 1978 inception of reform. The main concern of leaders in implementing a policy was not oriented by thorough enforcement or efficiency but by political stability and practical effectiveness. What characterizes the process is the less-standard, less-transparent, and somewhat discretionary features adopted by the Chinese leaders. Although these features have been often described as the weaknesses of Chinese reform and as the overall incapacity of the Chinese government, they nonetheless provided

³ Here I use the term *relative*(ly) to distinguish it from an absolute criterion. When a major policy was introduced, it already enjoyed a considerable level of consensus and coordination.

flexibility in challenging a new problem in the absence of a blueprint. That China did not devolve into a state of a predation under predatory leaders was due to the quality of the leadership and the constraints of the semi-institutionalized decision norm, which many developing countries failed to enjoy.

The Chinese leadership was able to provide meaningful short- to mid-term guidelines, revise them when necessary, and lead reforms without threatening political stability. The (semi) institutional constraints in fact prevented the Chinese reforms from falling in practice into the hands of a few leaders operating in a discretionary fashion, instead making the reforms flexible enough to adapt to new contexts. The Chinese leaders often allowed a range of delinquent behaviors to localities to achieve their primary goals, even if at the expense of Beijing's interests. The relevance of this intentional aspect should not be ignored. However, when China's leaders needed to enforce a certain policy, they were quite capable of doing just that, basically not by force but indeed by the decision norm of the democratic principle. Enforcement followed a series of multi-layered consultations, coordination, negotiations, and compromise. The result was always at some distance from the original plan, but the process ensured enforcement of policy priorities in the a direction in which the Beijing government intended to move, which cannot in fact be a weakness on the Beijing's part as some might see it. It was strength during the transitional period. Also noteworthy is that behind the democratic practice the ultimate power of the personnel reshuffling still firmly remained the Beijing government's, making it a practical mechanism to keep the *centralism* principle working. As seen in the fiscal reforms, the Beijing government persistently worked for institutionalization of their system according to the new rationality of the market mechanism. The trend was not to be avoided. China's leadership will confront stronger demands to make their political institutions more transparent coupled with increased pressure to expand the range of political players. Thus far, however, the Beijing government and its leaders have demonstrated their ability to establish norms with which to make the Chinese system workable in respect to setting primary goals and abiding by them.

Bibliography

- ACDA (The US Arms Control and Disarmament Agency). *World Military Expenditures and Arms Transfers*. (Washington DC: ACDA, 1995).
- Agarwala, Ramgopal N. *China: Reforming Intergovernmental Fiscal Relations*. Washington, D.C.: The World Bank, 1992a.
- Agarwala, Ramgopal N. "Financial Liberalization and Economic Development in China." *China Report* 35:1 (1999): 27-40.
- Almond, Gabriel A. and James S. Coleman, eds. *The Politics of the Developing Areas*. Princeton: Princeton University Press, 1960.
- Almond, Gabriel. "The Development of Political Development." in *Understanding Political Development*, edited by Myron Weiner and Samuel P. Huntington, 437-490. Boston: Little Brown, 1987.
- Almond, Gabriel, ed. *A Discipline Divided: Schools and Sects in Political Science*. Washington D.C.: Sage Publisher. 1990.
- An, Qihong. "Some Comments Deriving from the Turing About of a Big Ship." *Hongqi* 20 (October 16, 1985) excerpt from FBIS, 15 November, K8-11.
- Ardant, Gabriel. "Financial Policy and Economic Infrastructure of Modern States and Nations." in *The Formation of Nation States in Western Europe*, edited by Charles Tilly. Princeton: Princeton University. 1975.
- Aslund, Anders. "Soviet and Chinese Reforms." *The World Today* (1989): 188-91.
- Aslund, Anders. "Principles of Privatization," in *Systemic Change and Stabilization in Eastern Europe*, edited by Laszlo Csaba, 17-31. Dartmouth, U.K.: Aldershot, 1991.
- Aten, Robert H., "Gross State Product: A Measure of Fiscal Capacity," in *Measuring Fiscal Capacity*, edited by Reeves, H. Clyde. Boston: Oelgeschlager, Gunn &Hain, 1986.
- Bachman, David. *Bureaucracy, Economy, and Leadership in China*. Cambridge: Cambridge University Press, 1991.
- Bachman, David. "Implementing Chinese Tax Policy," in *Policy Implementation in Post-Mao China*, edited by D.M. Lampton, 119-153. Berkeley: University of California Press, 1989.
- Bachman, David. and Li, Cheng., "Localism, Elitism, and Immobilism: Elite Formation and Social Change in Post-Mao China," *World Politics* 1989.
- Bhagwati, Jagdish. "Democracy and Development." *Journal of Democracy*, Vol. 33 (1992):37-44.
- Bahl, Roy. "Regression Approach to Tax Effort and Tax Ratio Analysis." *I.M.F. Staff Papers*, XVIII, No. 3 (1971): 572-582.
- Bahl, Roy. "Representative tax System Approach to Measuring Tax Effort in Developing Countries." *IMF Staff Papers*, XIX, No. 1 (1972): 87-122.
- Bahl, Roy W. and Shyam Nath. "Public Expenditure Decentralization in Developing Countries." *Government and Policy* 4 (1986): 405-18.

- Bahl, Roy, Alm, James., and Murray, Matthew N., "Tax Base Erosion in Developing Countries." *Economic Development and Cultural Change* Vol. 39 (July 1991): 849-72.
- Bahl, Roy and Linn, Johannes. "Fiscal Decentralization and Intergovernmental Transfers in less Developed Countries," *The Journal of Federalism*, Vol. 24 (Winter 1994): 1-19.
- Balassa, Bela. "The Lessons of East Asian Development: An Overview." *Economic Development and Cultural Change* Vol. 36, No.3 (April 1988): s273-s290.
- Barnett, A.D., *Caders, Bureaucracy and Political Power in Communist China*. NY: Columbia University Press, 1967.
- Barro, Stephen M., "State Fiscal Capacity Measures: A Theoretical Critique." in *Measuring Fiscal Capacity*, edited by Reeves, H. Clyde. Boston: Oelgeschlager, Gunn & Hain, 1986.
- Bates, Robert H. *Markets and States in Tropical Africa*, Berkeley: University of California Press, 1981.
- Baum, Richard. "China after Deng: Ten Scenarios in Search of Reality," *China Quarterly*, No. 145 (March 1996): 153-175.
- Beijing University, Project Research Team. "An Outline of the Reform of the Chinese Economic System, 1988-1995." *Chinese Economic Studies* Vol. 24, No.1. (Fall 1990): 85-88.
- Berg, Andrew and Sachs, Jeffrey., "Structural Adjustment and International Trade in Eastern Europe: The Case of Poland." *Economic Policy* 14 (April, 1992): 117-73.
- Bird, Richard. "Note on Tax Sacrifice Comparison", *National Tax Journal*, XVII (September 1964): 303-308.
- Bird, Richard. "Measuring Fiscal Centralization and Fiscal Balance in Federal States." *Government and Policy* no. 4 (1986): 384-404.
- Bird, Richard. *Tax Policy & Economic Development*. Baltimore: Johns Hopkins University Press, 1992.
- Bird, Richard. "Threading the Fiscal Labyrinth: Some Issues in Fiscal Decentralization." *National Tax Journal* Vol. XLVI No. 2 (1993): 207-27.
- Bird, Richard and Chen, Duanjie. "Intergovernmental Fiscal Relations in China." in *Taxation in Modern China*, edited by Brean, Donald J.S. New York: Routledge, 1998.
- Bo, Zhiyue. *Chinese Provincial Leaders: Economic Performance and Political Mobility*. Ph.D. Dissertation in the University of Chicago, 1995.
- Bo, Zhiyue. "Provincial Power and Provincial Economic Resources in the PRC." *Issues and Studies* 34, no. 4 (April 1998): 1-18.
- Boycko, Maxim. "The Higher Incomes Reduce Welfare: Queues, Labor Supply, and Macro Equilibrium in Socialist Economies." *Quarterly Journal of Economics*, 107(3) (August 1992): 907-20.
- Boycko, Maxim., Robert, Shiller and Andrei Korobov. "Popular Attitudes towards Free Markets: The Soviet Union and the United States Compared." *American Economic Review*, 81(3) (June 1991): 385-400.
- Boycko, Maxim. Shleifer, Andrei., and Vishiny, Robert. *Privatizing Russia*. Cambridge: MIT Press, 1995.

- Brandt, Loren and Zhu, Xiaodong. "Redistribution in a Decentralized Economy: Growth and Inflation in China under Reform." *Journal of Political Economy*, Vol. 108, No. 2 (2000).
- Breslin, Shaun G. *China in the 1980s: Center-Province Relations in a Reforming Socialist State*. NY: St. Martin's Press, Inc., 1996.
- Buchanan, James. "Rent Seeking and Profit Seeking," in *Toward a Theory of the Rent-Seeking Society*, edited by James Buchanan, Robert Tollison, and Gordon Tullock, 3-16. College Station: Texas A&M University Press, 1980.
- Burke, Edmund. *Reflections on the Revolution in France*, edited by Cornor O'Brien. Harmondsworth: Penguin Books, 1969.
- Cai, Jingying. "Shehuizhuyi Minzugainiande Zhuanyiyu Xianjizhijie Xuanju [The Changes of the Concept of Socialist Democracy and Direct Election at the County Level]." in *Zhongguominzuyufazhi* [Democracy and Judiciary System in China], edited by Hong Kong College Student Association, 37-51. Hong Kong: Guangjiaojing Chubanshe, 1984.
- Cameron, David. "Expansion of the Public Economy: A Comparative Analysis," *American Political Science Review*, Vol. 72 (1978): 1243-61.
- Carroll, Glenn R. "Stochastic Model of Organizational Mortality: Review and Reanalysis." *Social Science Research* 12 (December, 1983): 303-29.
- CASS Economic Research Institute. "Jianchi Shidu Fenquanfangxiang Chongsu Guojiaguanlidgeju [Maintain the Direction of Appropriate Decentralization and Re-mould the State Management Structure]." *Jingjiyanjiu* 6 (June 1987): 16-25.
- CASS Project research Team. "An Outline of the Reform of the Chinese Economic System: Intermediate Stage, 1988-1995." *Chinese Economic Studies* Vol. 24, No.1. (Fall 1990): 83-84.
- CASS Study Group of Economic Construction and Reform, "Duijinianlai Jingjijianshe yu Jingjigaigede Fansi [Reflection on Economic Construction and Economic Reform in Recent Years]." *Jingjiyanjiu* 3 (March 1987): 3-10.
- Central Document Research Office, ed. *11 Jie 3 Zhongquanhui Yilai Zhongyao Wenxian Xuandu* [Collection of Key Documents since the Third Plenary Session of the Eleventh CPC]. Beijing: Renmin Chubanshe, 1987.
- Central Document Research Office, ed. *12 Da yilai* [Since the Twelfth CPC]. Beijing: Renmin Chubanshe, 1988.
- Central Document Research Office, ed. *13 Da yilai* [Since the Thirteenth CPC]. Beijing: Renmin Chubanshe, 1991.
- Central Document Research Office, ed. *14 Da yilai* [Since the Fourteenth CPC]. Beijing: Renmin Chubanshe, 1996.
- Central General Office. *Mao Zedong, Deng Xiaoping Lundangde Minzujizhongzhi* [Remarks of Mao Zedong and Deng Xiaoping on Party's Democratic Centralism]. Beijing: Renmin Chubanshe, 1990.
- Central Party School, Project Research Team. "An Outline of the Reform of the Chinese Economic System, 1988-1995." *Chinese Economic Studies* Vol. 24, No.1. (Fall 1990): 89-90.

- Central Policy Research Board. *Gaigekaiifang ershinian dashiji :1978.12 – 1998.3* [Chronology of Twenty Years' Reform and Opening]. Beijing: Renmindaxue Chubanshe, 1999.
- Central Policy Research Board. *Gaigekaiifang 20 nian Zhongda Juece Shuyao* [Summary of Important Decisions on Reform and Opening up for 20years]. Beijing: Zhongguo Jingji Chubanshe, 1999.
- Chang, Maria Hsia. "China's Future: Regionalism, Federation, or Disintegration?" *Studies in Comparative Communism*, Vol. 25, No. 3 (September, 1992): 211-227.
- Chelliah, Raja J. "Trends in Taxation in Developing Countries." *National Tax Journal*, XXIII, No. 3 (September, 1970): 254-331.
- Chelliah, Raja., Beas, H.T., and Kelly, M.R. "Tax Ratios and Tax Effort in Developing Countries, 1969-74." *I.M.F. Staff Papers*, XXII (March, 1975): 187-205.
- Chelliah, Raja J. and Sinha, Narain. *Measurement of Tax Effort of State Governments, 1973-76*. New Delhi: Somaiya Publications Pvt. Ltd., 1982.
- Chen, Jiajun. *Difeng caizheng zengzhang* [Increase of Local Finance]. Shanghai: Shagnhai Shehui Kexueyuan Chubanse, 1999.
- Chen, Jingxin. "Zaigaigezhong zengqiang Caizhengde Huoli [Increase Invigoration of Finance during the Reform Period]." *Caizheng* No. 9 (September 1985): 7-8.
- Chen, Kang., Jefferson, Gary., and Singh, Inderjit. "Lessons from China's Economic Reform." *Journal of Comparative Economics* No. 16 (1992): 201-225.
- Chen, Yizi. "The Decision Process behind the 1986-1989 Political Reforms." in *Decision-Making in Deng's China*, edited by Carol Lee Hamrin and Suisheng Zhao, 133-152. New York: M.E. Sharpe, Inc., 1995.
- Cheng, Tun-jen, "Political Regimes and Developmental Strategies: South Korea and Taiwan." in *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia*, edited by Gary Gereffi and Donald Wyman. Princeton: Princeton University Press, 1990.
- Chinese Academy of Taxation ed. *1996 nian Quanguo Shuishoulilun Yantaohui* [National Taxation Theory Conference in 1996]. Beijing: Zhongguo Shuiwu Chubanshe, 1997.
- China Statistical Bureau (CSY), *Zhongguo Tongji Nianjian 1985-2000* [China Statistical Yearbook, 1985-2000] Beijing: China Statistical Publishing House.
- Chinese Economic Studies. "Readjusting Central-Local Relations in Revenue Distribution: China's 1994 Fiscal Reform." in *Chinese Economic Studies*, translated by Guo Xiaolin,. (July-August, 1996): 1-106.
- Chi Fulin and Tian Fu eds. *Zhonghua Renmin Gongheguo Zhengzhi Tizhishi* [The History of Political System of the People's Republic of China]. Beijing: Zhongyang Dangxiao Chubanshe, 1998.
- Chung, Jae-Ho. "Studies of Central-Provincial Relations in the People's Republic of China." *The China Quarterly*, No. 142 (June, 1995): 487-508.
- Chung, Jae-Ho. "Central-Provincial Relations." In *China Review 1995*, 3.1-45. Hong Kong: The Chinese University Press, 1996.
- Chung, Jae-Ho. *Joonggukeui joong-ang jibang gwangaeron* [Central-local Relations in China]. Seoul: Nanam Press, 1999.

- Chung, Jae-Ho, ed. *Joongguk jeongchie Yeonguron* [Study of Chinese Politics]. Seoul: Naman, 2000.
- CIA. *The Chinese Economy in 1988 and 1989: Reforms on Hold, Economic Problems Mount*. EA 89-10023 (August 1989).
- CIA. *The Chinese Economy in 1991 and 1992: Pressure to Revisit Reform Mounts*. EA 92-10029. (August, 1992).
- CIA. *China's Economy in 1992 and 1993: Grappling with the Risks of Rapid Growth*. EA 93-10016 (August 1993).
- CIA. *China's Economy in 1993 and 1994: The Search for a Soft Landing*. EA 94-10016 (August 1994).
- Coase, R. "The Nature of the Firm," *Economica* Vol. 4, No.16 (1937): 386-405.
- Cohen, Carol., Lucke, Robert., and Shannon, John. The ACIR Representative Tax System Method for Estimating the Fiscal Capacity of the Fifty State-Local Systems," in *Measuring Fiscal Capacity*, edited by Reeves, H. Clyde. Boston: Oelgeschlager, Gunn & Hain, 1986.
- Cohen, Youseff, Brian R. Brown, and A.F.K. Organski. The paradoxical nature of state-making: The violent creation of order." *American Political Science Review* No. 75 (December 1981): 901-910.
- Committee on Tax System. *Dalu shuizhi yanjiu* [A Study of Tax System of China]. Taipei: Xingfeng, 1994.
- Confederation of British Industry. *Taxation in Western Europe*. London: Confederation of British Industry, 1974.
- Cong, Shuhai and Zhang Heng, eds. *Xinzhongguojingji Fazhanshi 1949-1998*. [The History of Chinese Economic Development, 1949-1998] Shanghai: Shanghai Caijingdaxue Chubanshe, 1999.
- Cui, Shukun. and Bokun Zhao. "Tantan 1983nian Caizheng Guanlitizhi [Discussion on Fiscal Management System of 1983]" *Caizheng* No. 7 (July 1983): 37-38.
- Dai, Yuanchen. "Duiliangge Caizhenglilun Wentide Sikao. [Reflection on Two Theoretical Problems in Finance]" *Caizheng* No. 11 (November 1986): 25-26.
- Dai, Yuanchen and Suoheng He, "Zaicaizhengkunnanshi Suomianlinde Hongguanzhengce Xuanze [Imminent Macro-Policy Choices in the Period of Financial Difficulty]." *Jingjiyanjiu* No. 5 (May 1987): 26-32.
- Deng, Xiaoping. *Deng Xiaoping Wenxuan* [Deng Xiaoping Collections]. Beijing: Renmin Chufanshe, 1993.
- Deutsch, Karl W. "Social Mobilization and Political Development." *American Political Science Review* No. 55 (September 1961): 493-514.
- Dewatripont, Mathias., and Roland, Gerard. "The Design of Reform Packages under Uncertainty." *The American Economic Review*, Vol. 85 (5) (December 1995): 1207-1224.
- Ding, Shufan. *Zhonggong Junshi Sixiangde Fazhan: 1978-1991* [Development of the Chinese Military Thoughts, 1978-1991]. Taipei: Tangshan Chubanshe, 1996.
- Dong Funai at al. *Jiquan yu Fenquan* [Centralization and Decentralization]. Beijing: Jingjixue Chubanshe, 1996.

- Donnithorne, Audrey. "Center-Provincial Economic Relations in China." *Contemporary China Papers* No. 19. Canberra: Contemporary China Center, Australian National University, 1981.
- Donnithorne, Audrey. "China's Cellular Economy: Some Economic Trends since the Cultural Revolution." *The China Quarterly*, No. 52 (October-December 1972): 605-619.
- Donnithorne, Audrey. "Central Economic Control in China." In *Contemporary China*, edited by R. Adams, 151-78. London: Peter Owen, 1969.
- Donnithorne, Audrey. "Comment." *The China Quarterly*, No. 66 (June 1976): 328-340.
- Dou, Zhongju. *Jianquandangde Minzujizhongzhi* [Strengthen Party's Democratic Centralism]. Sichuan: Sichuan Renmin Chubanshe, 1985.
- Dreyer, June Teufel. "China's Military Power in the 1980s." in *China Briefing, 1982*, edited by Boulder, Colorado: Westview Press, 1983.
- Du, Feijin. "Relationship between Center, Localities viewed." *FBIS-CHI-94-145*. (28 July 1994): 21-25, excerpted from *Renmin Ribao* 15 July 1994.
- Editorial. "Shixingyishuidaili Qiyezengtianhuoli Guojiazhngjiashoulu [Implementation of the Replacement of Profit by Tax Reform Invigorates Enterprises and Increases National Revenue Income]." *Caizheng*, No.4 (1983): 4.
- Editorial Board. *Collection of 1981 Financial Regulations and Systems*, Vol. 1. Beijing: Zhongguo Caizheng Jingji Chubanshe, 1985.
- Editorial Board. *History of Chinese Communist Party: A Chronology of Events: 1919-1990*. Beijing: Foreign Language Press, 1991.
- Ekiert, Grzegorz. "Democratization Processes in East Central Europe." *British Journal of Political Science* Vol. 21 (1991): 285-313.
- Epstein, Edward C. "Legitimacy, Institutionalism, and Opposition in Exclusionary Bureaucratic-Authoritarian Regimes: The Situation of the 1980s." *Comparative Politics* 17 (October 1984): 37-54.
- Evans, Peter. *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil*, Princeton: Princeton University Press, 1979.
- Fan, Gang. "Lungonggongshouzhi de Xinguifan [New Regulations on Public Revenue and Expenditure]." *Jingjiyanjiu* No. 6 (June 1995): 34-43.
- Feng, Yi and Hui Zhang, "Provincial Distribution of Direct Foreign Investment in China: A Pooled Time-Series Empirical Study." in *Financial Market Reform in China*, edited by Chen Baizhu, Dietrich Kimball, and Yi Fang. Westview Press, 1999.
- Fernandez, Raquel and Dani Rodrik. "Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty." *American Economic Review*, Vol. 81, (5) (December 1991): 1146-1155.
- Ferris, Wayne H. *The Power Capabilities of Nation-States*. Lexington: D.C. Heath and Company, 1973.
- Fewsmith, Joseph. *Dilemmas of Reform in China*. Armonk, New York: M.E. Sharpe, 1994.
- Finance Bureau of Hunan Province Administration. "Shixing Xincalzhenztizhi [Implement the New Finance System]." *Caizheng* no. 1 (January 1986): 18-19.

- Frank, J. Henry. "Measuring State Tax Burdens." *National Tax Journal*, XII (June 1959): 179-185.
- Friedland, Roger and Robert R. Alford,. "Bringing Society Back In: Symbols, Practices, and Institutional Contradictions." in *The New Institutionalism in Organizational Analysis*, edited by Walter W. Powell and Paul J. Dimaggio, 232-263. Chicago: University of Chicago Press, 1991.
- Frydman, Roman. and Andrzej Rapaczynski, *Privatization in Eastern Europe: Is the State Withering Away?* London: Central European University Press, 1994.
- Gerschenkron, Alexander. *Economic Backwardness in Historical Perspective*, Cambridge: Harvard University Press, 1961.
- Gold, Steven D. "Measuring Fiscal Effort and Fiscal Capacity: Sorting Out Some of the Controversies." in *Measuring Fiscal Capacity*, edited by Reeves, H. Clyde. Boston: Oelgeschlager, Gunn & Hain, 1986.
- Goldstein, Avery. "Trends in the Study of Political Elites and Institutions in the PRC." *The China Quarterly* Vol. 139 (September 1994): 714 - 730.
- Goldstone, Jack A. "The Coming Chinese Collapse." *Foreign Policy* No. 99 (Summer 1995): 35-52.
- Goode, Richard. "Obstacle to Tax Reform in Developing Countries." in *Taxation in Developing Countries*, edited by Richard Bird and Oliver Oldman. Baltimore: Johns Hopkins University Press, 1990.
- Goodman, David. *Center and Province in the People's Republic of China*. Cambridge: Cambridge University Press, 1986.
- Goodman, David and Gerald Segal, eds. *China: Deconstructs*. London: Routledge, 1994.
- Goodman, David. ed. *China's Provinces in Reform*. London: Routledge, 1997.
- Goodwin Paul H.B. "From Continent to Periphery: PLA Doctrine, Strategy and Capabilities Towards 2000." *The China Quarterly* 146 (1996): 464-487.
- Granick, David. *Chinese State Enterprises*, Chicago: The University of Chicago Press, 1990.
- Grilli, Vittorio et al. "Political and Monetary Institutions and Public Financial Policies in Industrial Countries." *Economic Policy* (1991): 341-92.
- Gu, Jialin. *Congjigougai Daoxingzhengtizhigaigede Shijian yu Sikao* [A Practice and Reflection of the Reforms from Institutions to Administration System]. Beijing: Zhongguo Fazhan Chubanshe, 1997.
- Gu, Kang and Jingming Bai. "Zhongguozhengfushoululaiyuan ji Wanshanduiceyanjiu [Revenue Sources of Chinese Government and its Strategy]," *Jingjiyanjiu* No. 6 (June 1998): 46-54.
- Guo, Jianzhong. *Zhongguo Dalu Zhongyang yu Difangde Guanxi* [Relationship between the Central and Local Governments in Mainland China]. A paper presented in Political Science Association in Taiwan, 1997.
- Guo, Jianzhong. *Zhongguodalu Shuishou Zhidu* [Taxation System in Mainland China]. Taipei: Wunan Chubanshe, 1996.
- Hall, Peter. *Governing the Economy*. New York: Oxford University Press, 1986.
- Halpern, Nina P. "Studies of Chinese Politics." in *American Studies of Contemporary China*, edited by David Shambaugh. Armonk, N.Y.: M.E. Sharpe, 1993.

- Hamrin, Carol Lee. *China and the Challenge of the Future*. Boulder, Colo.: Westview Press, 1990.
- Hamrin, Carol Lee and Suisheng Zhao, eds. *Decision-Making in Deng's China*. Armonk, New York: M.E. Sharpe, 1995.
- Han, Guochun and Bokun Zhao. "Huafenshouzhi Fenjibaogan Caizhengguanlitzhijianjie [Introduction of Clarifying Revenue and Expenditure and Divided Fiscal Management Responsibility System]." *Caizheng*, No.7 (1982): 8-9.
- Han, Sangguk. *Zoonggukeui Jaejungmunjehwa Dangmyun Kuaje* [Chinese Fiscal System and its Current Problems]. Seoul: Kilf, 1997.
- Han, Sung-joo. "Student Activism: A Comparison Between the 1960 Uprising, and the 1971 Protest Movement." In *Political Participation in Korea: Democracy, Mobilization, and Stability*, edited by Lim-chong Kim. Santa Barbara: Clio, 1980.
- Han, Yingjie., Du, Lingfeng, Yang, Xiujin. *Zhongguoxianxing Shuishouzhidu* [Contemporary Chinese Taxation System]. Beijing: Zhongguorenmindaxue Chubanshe, 1989.
- Harding, Harry. *China's Second Revolution*. Washington D.C.: The Brookings Institution, 1987.
- Harding, Harry. "The Evolution of American Scholarship on Contemporary China." in *American Studies of Contemporary China*, edited by David. Shambaugh. Armonk, N.Y.: M.E. Sharpe, 1993.
- Hart, Oliver. "An Economist's Perspective on the Theory of the Firm." *Columbia Law Review*, Vol. 89 (1989): 1758-60.
- Hayek, Friedrich A. "The Price System as a Mechanism for Using Knowledge." in *Comparative Economic Systems*, edited by Morris Bornstein. Homewood, IL: Richard D Irwin, Inc., 1974.
- He, Zhenyi. "Zhuanhuanjizhi Cainengshixian Caizhengdejinxing [Change of Mechanism Can Accomplish Fiscal Development]." *Caimao Jingji* No. 2 (February 1998).
- He, Zhenyi. "Guanyugaige Zhongyang yu Difangcaizhengtizhide Jianyi [Suggestions regarding Reforms of the Central and Local Fiscal System]." *Jingjiyanjiu cankao ziliao* No. 30 (February 27, 1984): 4-7.
- He, Zhenyi. "Guanyugaijin Ligaishui Jutibanfade Jianyi [Suggestions regarding Detailed Methods of Improving "Replacement of Profit by Tax" System]." *Jingjiguanli* No. 8 (August 1983): 17-18.
- Herschler, Stephen B. "The 1994 Tax Reform: The Center Strikes Back." *China Economic Review* Vol. 6(2) (1995): 239-245.
- Hobsbawm. E.J. and Ranger Terence. *The Invention of Tradition*. Cambridge: Cambridge University Press, 1983.
- Hsiao, Katharine. *The government Budget and Fiscal Policy in Mainland China*, Taipei: Chung-Hua Institute for Economic Res., 1988.
- Hu, Angang. *Zhongguo Fazhan Qianjing* [Prospect for China's Development]. Zhejiang: Zhejiang Renmin Chubanshe, 1999.
- Hu, Angang and Ping. Zou, eds. "Shehui yu Fazhan [Society and Development]." *Zhongguo Guoqing Fenxi Yanjiu Baogao* No. 59 (July 22, 1999), 1-30. Beijing: CSS, Guoqing Yanjiu Zhongxin [State Policy Research Center].

- Hu, Qiaomu. "Zhongguolingdaoceng zenyangjuece [How the Chinese Leadership Makes a Decision?]." in *Gongheguojingjidajuece* [Great Decisions on Economy in the PRC], edited by Wang Lin et al. Beijing: Jingji Chubanshe, 2000
- Hu, Yaobang. "Quanmiankaichuang Shehuizhuyi Xiandaihua Jianshede Xinjumian [Comprehensive Introduction of the New Era of Building Socialist Modernization]." *Hongqi* 18 (September 1982): 6-30.
- Hua, Sheng., Jiacheng He, Xuejun Zhang, Xiaopeng Luo, Yongzhuang Bian, and Haiyan Du. "Lishixingde zhuanzhe yu xiwang [Historical Change and Hope]." *Jingjiyanjiu* No. 3 (March 1987): 11-15.
- Hunag, Daxiao and Yonghua Xu. "1988nian Zhongyang yu Defang Yusuan Shourujice Huafen Bianhua Qingkuangde Shuoming [Explanation of Changes of Budgetary Income Division between the Central and Local Governments in 1988]." *Caizheng* No. 4 (April 1988): 17-19.
- Huang, Philip. "The Paradigmatic Crisis in Chinese Studies: Paradoxes in Social and Economic History." *Modern China*, Vol. 17, (July 1991): 299-341.
- Huang, Yasheng. "Web of Interests and Patterns of Behavior of Chinese Local Economic Bureaucracies and Enterprises During Reforms." *China Quarterly*, Vol. 123 (September 1990): 431-58.
- Huang, Yasheng. "The Strategic Investment Behavior of Chinese Local Governments during the Reform Era." *China Economic Review* Vol. 6(1) (1995): 169-186.
- Huang, Yasheng. "Administrative Monitoring in China: Institutions and Processes." *The China Quarterly*, No. 143 (September, 1995b): 828-843.
- Huang, Yasheng. "The Statistical Agency in China's Bureaucratic System: A Comparison with the Former Soviet Union," *Communist and post-Communist Studies*, Vol.29, No.1 (March 1996): 59-75.
- Huang, Yasheng. "Central-local Relations in China during the Reform Era: The Economic and Institutional Dimensions," *World Development*, Vol. 24 (April 1996a): 655-672.
- Huang, Yasheng. *Inflation and Investment Controls in China*. NY: Cambridge University Press, 1996b.
- Inglehart, Ronald. *Cultural Shift in Advanced Industrial Societies*. Princeton: Princeton University Press, 1990.
- International Monetary Fund. *Government Finance Statistics Yearbook 1991*, Washington D.C.: IMF, 1991.
- Jackman, Robert. *Power Without Force*. Ann Arbor: The University of Michigan Press, 1993.
- Jefferson, Gary., Thomas, Rawski., et al. "Growth, Efficiency and Convergence in China's State and Collective Industry." *Economic Development and Cultural Change*, Vol. 40 (January 1992): 239-266.
- Jia, Hao, and Zhimin Lin. *Changing Central-Local Relations in China*. Boulder: Westview Press, 1994.
- Jia, Kang and Yan, Kun. *Zhuanguizhongde Caizhengzhidu Biange* [Fiscal System Reform in Transformation]. Shanghai: Shanghai Yuandong Chubanshe, 1999.
- Jiangsu Finance Bureau. "Jiangsusheng Caizheng Shoulu Sanshiwunian Fansifan [The Revenue of Jiangsu Province Turned Over Four Times for 35 Years]." *Caizheng* No. 9 (September 1984): 15-17.
- Jin, Xin., Liu Zhicheng, and Wang Shaofei. *Zhongguo Shiwu Baike Quanshu* [Encyclopaedia of Taxation in China]. Beijing: Jingjiguanli Chubanshe, 1991.

- Joffe, Ellis. *The Chinese Army after Mao*. Cambridge: Harvard University Press, 1987.
- Johnson, Chalmers. "What's Wrong with Chinese Political Studies?" *Asian Survey*, Vol. XXII, No. 10 (October 1982): 919-933.
- Jowitt, Ken. *New World Disorder*. Berkeley: University Of California Press, 1992.
- Jurkovic, P. "Designing a Tax System to Promote Structural Change." *The Role of Tax Reform in Central and Eastern European Economies*. Paris: OECD, 1991.
- Kamath, S. "Foreign Direct Investment in a Centrally Planned Developing Economy: The Chinese Case." *Economic Development and Cultural Change*, Vol. 39(1990): 107-130.
- Kang, Xuejun. "Gediqu Caizhengshoulu zhan GDP Bizhongde Bijiao Fenxi [Comparative Analysis on the Ratio of Regional Revenues over GDP]." in *Caishui Gaige Zonglun Vol.II* [Extensive Discussion on Taxation Reforms, Vol. II] edited by Zhang Youcai, 147-153. Beijing: Jingjixue Chubanshe, 1998.
- Katzenstein, Peter J. "Conclusion: Domestic Structures and Strategies of Foreign Economic Policy." in *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*, edited by Peter J. Katzenstein, 295-336. Madison: University of Wisconsin Press, 1978.
- Kim, Heungkyu. "The Role of Ideas in Chinese Economic Reforms." Unpublished Article, presented in the Western Social Science Conference (1996).
- Kim, Jun-yeop. *Zhongguk choigeunsesa* [Chinese Modern History]. Seoul: Iljogak, 1976.
- Kelliher, Daniel. "The Political Consequences of China's Reforms." *Journal of Comparative Politics* (July 1986): 479-494.
- Kohli, Atul ed. *The State and Development in the Third World*. Princeton: Princeton University Press, 1986.
- Kohli, Atul. "Democracy and Development." in *Development Strategies Reconsidered*, edited by John P. Lewis and Valeriana Kallab. New Brunswick: Transaction, 1986a.
- Kohli, Atul. *Democracy and Discontent: India's Growing Crisis of Governability*. Cambridge: Cambridge University Press, 1990.
- Kornai, Janos. *The Socialist System: The Political Economy of Communism*. Princeton: Princeton University Press, 1992.
- Korpi, Walter. *The Democratic Class Struggle*. London: Routledge and Kegan Paul, 1983.
- Kou, Tiejun. *Zhongyang yu Difang Caizheng Guanxi Yanjiu* [Study of Fiscal Relationship between the Central and Local Governments]. Dalian: Dongbei Daxue Chubanshe, 1996.
- Krasner, Stephen D. *Defending the National Interest: Raw Material Investments and U.S. Foreign Policy*. Princeton: Princeton University Press, 1978.
- Kueh, Y. Y. "Growth Imperatives, Economic Recentralization, and China's Open-Door Policy." *The Australian Journal of Chinese Affairs* No. 24 (July 1990): 93-119.
- Kuo, Jianzhong. *Zhongguodalu Shuishou zhidu: 1950-94* [A Tax System in Mainland China: 1950-94]. Taipei: Wunan Press, 1996.

- Kuznets, Simon. *The Economic Growth of Nations*. Cambridge: Harvard University Press, 1971.
- Kuznets, Simon. *Modern Economic Growth*. New Haven: Yale University Press, 1996.
- Lampton, David. ed. *The Making of Chinese Foreign and Security Policy*. Stanford: Stanford University Press, 2001.
- Lardy, Nicholas. "Centralization and Decentralization in China's Fiscal Management." *The China Quarterly*, No. 66 (June 1976): 340-354.
- Lardy, Nicholas. "Centralization and Decentralization in China's Fiscal Management." *The China Quarterly*, No. 16 (March 1975): 26-60.
- Levi, Margaret. *Of Rule and Revenue*, Berkeley: University of California Press, 1988.
- Levinthal, Daniel. "Random Walks and Organizational Morality." *Administrative Science Quarterly* No. 36 (September 1991): 397-420.
- Li, Hongfeng and Zhaozi Long, "Duishoushui daiti jiege hongganzuoyongde zhuyue yinsude tantao [Study of Restraining Factors on Replacing Price with Taxes]." *Jingji Yanjiu* No. 6 (June 1985): 76-77
- Li, Nan. "The PLA's Evolving Warfighting Doctrine, Strategy and Tactics, 1985-95: A Chinese Perspective." *The China Quarterly* 146 (1996): 443-463.
- Li, Sahogang. and Guoqiao. Xu, eds. *Zhongguo Shuifa Jingjie* [Introduction to Chinese Tax Law] (Beijing: Falu Chubanshe, 1994),
- Li, Wanfu. *Zhongguo Jingji Zhuanxingqide Shuizhi Jinashe* [The Construction of Tax System during the Period of Economic Transference in China]. Beijing: Zhongguo Jingji Chubanshe, 1999.
- Liang, Guiquan, ed. *Gaige Kaifang 20niande Lilunyushijian, Guangdong* [20Years Reform and Opening-up in Theory and Practice, Guangdong]. Beijing: Zhongguo Dabaikequanshu Chubanshe, 1998.
- Lieberthal, Kenneth G., and Bruce J. Dickson. *A Research Guide to Central Party and Government Meetings in China, 1949-1989*. Armonk, N.Y.: M.E. Sharpe, 1989.
- Lieberthal, Kenneth G., and Michel Oksenberg. *Policy Making in China*. Princeton: Princeton University Press, 1988.
- Lieberthal, Kenneth., and David Lampton, eds. *Bureaucracy, Politics, and Decision Making in Post-Mao China*. Berkeley: University of California Press, 1992.
- Lieberthal, Kenneth. *Governing China*. New York: W.W.Norton & Company, Inc., 1995
- Liew, Leong. "Gradualism in China's Economic Reform and the Role for a Strong Central State." *Journal of Economic Issues*, Vol. 29 (3)(1995): 883-896.
- Li, Jinyan. *Taxation in the People's Republic of China*. NY: Praeger, 1991.
- Li, Linda Chelan. "Provincial Discretion and National Power: Investment Policy in Guangdong and Shanghai, 1978-93." *The China Quarterly*, No. 152 (December 1997): 778-804.
- Lin, Shangli. *Guonei Zhengfujian Guanxi* [Relationship among Governments in China]. Hangzhou: Zhejiang Renmin Chubanshe, 1998.
- Lipset, Seymour Martin. *Political Man: The Social Bases of Politics*, London: Heineman, 1960.

- Lipton, David and Jeffrey Sachs. "Creating a Market Economy in Eastern Europe: The Case of Poland." *Brookings Papers on Economic Activity* (1990): 75-133.
- Li Yang, Yang Zhigang, and Zhang Jingdong. "Zhongguo Chengshi Caizhengde Huigu he Zhanwang [Reflection and Prospect of the City Finance in China]." *Jingjiyanjiu cankao* No. 141 (13 October 1992): 16-36.
- Li, Yungming. *Zhonggong yanjiu fangfalun* [Methodology of Communist China Studies]. Taipei: Yangzhi wenhua, 1996.
- Lin, Linwen. *Post-Socialist China: From Mao, Deng to Jiang*. Taipei: Shengzhi Press, 1997.
- Liu, Desheng. *Zhongguorenshi Xingzhengzhidugaishu* [Introduction of Chinese Personnel Administration System]. Beijing: Zhongguoshehuikexue Chubanshe, 1996.
- Liu, Shaoqi. *Liu Shaoqi Xuanji, Shang* [Liu Shaoqi Collection, Vol.1]. Beijing: Renmin Chubanshe, 1985.
- Liu, Shuling. *Zhongguo Dalu Zhuanxingqi Zhongyang, Difang Zhengfu yu Difangqiye Caishui Hudong Guanxizhi Yanjiu* [A Study of Interactions among the Beijing, Local Governments, and Enterprises during the Transitional Period of Mainland China]. Taipei: Master Thesis at National Chengchi University, 1998.
- Liu, Zhongli. *Zhongguo Caizheng Fazhan Wenti Yanjiu* [Study of Financial Development in China]. Beijing: Zhongguo Caizheng jingji Chubanshe, 1999.
- Liu, Zuo. *Zhongguo Shuishou* [China's Taxation]. Hong Kong: JPC. LPH Law Media Co. Ltd., 1998.
- Liu, Zuo. *Zhongguo shuizhi wushinian (1949-1999)* [Fifty years of Chinese Taxation System]. Beijing: Zhongguo shuiwu chubanshe, 2000.
- Long, Pingping, et al., eds. *Ershinian zhongdajuece beiwanglu* [Memorandum of Crucial Decisions for 20 Years]. Fuzhou: Fujian Jianyu Chubanshe, 1998
- Lu, Dadao and Xue, Fengxuan et al. *1997 Zhongguoquyufazhanbaogao* [1997 Report on regional development in China]. Beijing: Shangwuyin shuguan, 1997.
- Lu, Hongyou. "Feishuicaizhengshouluyanjiu [Study of Non-Tax Revenue]." *Jingjiyanjiu* No. 6 (June 1998): 55-61.
- Luo, Nengqing. *Zhonggong Fushuizhidu Zhi Yanjiu: 1950-1987* [Study of Taxation System of China: 1950-1987]. Taipei, Zhongguozhushui Yanjiuhui, 1987.
- Lupia, Arthur, McCubbins Mathew, and Popkin Samuel, eds. *Elements of Reason*. New York: Cambridge University Press, 2000.
- Lu Ximing. "Guanyu Caishuitizhi Gaigede Sikao [Reflexion on Restructuring the Fiscal System]." *Jingjitizi gaige* (Internal Reference) No. 15 (1993): 19-21.
- Lynn, James. *Comparing Provincial Revenue Fields: The Tax Indicator Approach*. Toronto: Canadian Tax Foundation, 1968.
- Ma, Guonan. "Budget Deficits and Fiscal Policy Targets in China." in *Chinese Economy in Transition*, edited by Yanrui Wu and Xiaohe Zhang, 131-148. Adelaide: Chinese Student's Society for Economic Studies, 1992.

- Ma, Jun. *Intergovernmental Relations and Economic Management in China*. New York: St. Martin's Press, Inc., 1977.
- Ma, Licheng and Ling, Zhijun. *Jiaofeng*. Beijing: Jinrizhongguo Chubanshe, 1998.
- MacFarquhar, Roderick. *The Origin of the Cultural Revolution*. Vol. 1. *Contradictions among the People, 1956-57*. New York: Columbia University Press, 1974.
- MacFarquhar, Roderick. *The Origin of the Cultural Revolution*. Vol. 2. *The Great Leap Forward, 1958-60*. New York: Columbia University Press, 1983.
- Manion, Melanie. "The Cadre Management System, Post-Mao: The Appointment, Promotion, Transfer and Removal of Party and State Leaders." *China Quarterly* No.102 (June 1985): 203-33.
- Martin, Allison and W. Arthur Lewis. "Patterns of Public Revenue and Expenditure." *The Manchester School of Economic and Social Studies* 24 (September 1956): 203-44.
- McKinnon, Ronald. *The Order of Economic Liberalization*. Baltimore, MD: Johns Hopkins University Press, 1993.
- McMillan, John. and Naughton, Barry. "How to Reform a Planned Economy: Lessons from China." *Oxford Review of Economic Policy*, Vol. 8(1) (Spring 1993): 130-143.
- McNeil, William H. *The Pursuit of Power*. Chicago: University of Chicago Press, 1982.
- Meisner, Maurice. *Mao's China and After*. NY: The Free Press, 1986.
- Migdal, Joel S. "Studying the Politics of Development and Change: The State of the Art." in *Political Science: The State of the Discipline*, edited by Ada Finifter, 309-338. Washington D.C.: American Political Science Association, 1983.
- Migdal, Joel S. *Strong Society and Weak States: State-Society Relations and State Capabilities in the Third World*. Princeton: Princeton University Press, 1988.
- Mills, W deB. "Leadership Changes in China's Provinces." *Problems of Communism* Vol. 34(3) (1985): 24-40.
- Ministry of Foreign Affairs. *Zhongguo Waijiao Gailan* [Briefing on the Chinese Foreign Relations], 1987-1998. Beijing: Shijiezhishi Chubanshe, 1988-1999.
- Ministry of Personnel, ed. *Renshibumin Bangongshigongzuo Shiyongshouce* [Practical Handbooks regarding Office Affairs of Personnel Departments]. Beijing: Beijinggongyedaxue Chubanshe, 1991.
- Mo Huilin and Zhu, Chongguang. "Ligashuide Banfaxuyao Yanjiugaijin [A Suggestion regarding "Replacement of Profit by Tax" Method and Demand]," *Jingjiguanli*. (February 1983): 44-45.
- Ministry of Finance (MOF). *Zhongguo Shuizhi Zhidu* [Tax System of China]. Beijing: Qiyeguanli Chubanshe, 1996.
- MOF, Department of Budget. "Tantan Xinde Caizheng Guanlitzhe [Discussion on the New Fiscal Management System]." *Caizheng* No. 6 (June 1985): 10-12.
- MOF, Editing Board. *Zhongguo Caizheng Nianjian* [Finance Yearbook of China (CFY)] 1995-1999. Beijing: Zhongguo Caizheng Zazhishe, 1996-2000.

- MOF, General Office for Fiscal Reform. "Dangde Shiyijie Sanzhongquanhui yilai Caishuigaigede Zhuyao Chengxiao [Major Achievements in Fiscal Reforms since the Third Plenary Session of the Eleventh CPC CC]." *Caizheng* No. 10 (October 1987): 1-2.
- MOF, General Office for Fiscal Reform. "Shenhua Yusuanguanlitizhi Gaige Cujinjingjifazhan [Deepen Reform on Budgetary Management System, Promote Economic Development]." *Jingjiguanli* No. 10 (October 1988): 39-37, 39.
- MOF, Department of Finance. *Zhongguo Caizheng Tongji 1950-1991*. [China's Fiscal Statistics 1950-1991] Beijing: China Financial and Economic Publishing House, 1992.
- MOF. "Lunshiquan yu Caiquande Guanxi [A View on the Relationship between Administrative and Fiscal Power]." *Jingjiyanjiu cankao* No. 121 (7 August, 1993): 18-24.
- MOF, Tax System Committee. *Dalu Shuizhi Yanjiu* [A Study of Tax System in Mainland China]. Taipei: Caizhengbu Shuizhi Weiyuanhui, 1994.
- MOF, "Gefang Dui fenshuizhi Gaigede Yixiekanfa [Various Views on the Tax Sharing System]." *Jingjiyanjiu cankao* 1 (1 January 1994a): 13-22.
- MOF. "1980nian yilai Woguo zhongfujian Caizheng guanxide Yanbian [Changes of Chinese Intergovernmental Fiscal Relations of since 1980]." *Jingjiyanjiu cankao* 1 (1 January 1994b): 31-44.
- MOF, Department of Statistics. *Yearbook of Financial Statistics of the Republic of China, 1996*. Taipei: Department of Statistics Press, 1997.
- MOF, Editorial Board. *Zhongguo Caizheng Gongzuo Zhishishouce* [Handbook on Knowledge of Fiscal Works in China]. Beijing: Zhongguo Caizheng Jingji Chubanshe, 1999.
- MOF, Local Finance Bureau. *Difangcaizheng Tongjiziliao* (1995, 1996) [Statistical Data of Local Finance, 1995, 1996]. Hebei: Xinhua Chubanshe, 1996, 1997.
- MOF. *1998nian Zhengfu Yusuan Shouzhi Kemu* [Lists of Revenue and Expenditure of Government Budget in 1998]. Beijing: Zhongguo Caizheng Jingji Chubanshe, 1997a.
- MOF, Finance Science Research Institute. "Difang Caizheng Zhichude Shizheng fenxi ji Guanli Duice [Positive Analysis and Management Measures on Local Revenue and Expenditure]." *Jingjiyanjiu cankao* No. 77 (21 August 1998): 40-52.
- MOF, Department of Budget. *Difang Caizheng Juesuan Wenjian Ziliao* [Document Resources of Local Finance Accounting]. Beijing: Zhongguo Caizheng Jingji Chubanshe, 1999.
- Morse, Ronald A. "Broken China." *International Economy* (Jan/Feb 1995): 30-32.
- Most, Benjamin A., and Harvey Starr. *Inquiry, Logic and International Politics*, Columbia: University of South Carolina Press, 1989.
- Nabli, M K., and Jeffrey Nugent. "The Institutional Economics and Its Applicability to Development," *World Development*, Vol. 17 (1989): 1333-1347.
- Nathan, Andrew and Robert Ross. *The Great Wall and the Empty Fortress*. New York: Norton, 1997.
- National Defense University Board. *Deng Xiaoping Sixiang Yanjiu* [Study on Deng Xiaoping Thought]. Beijing: Guobangdaxue Chubanshe, 1993.

- Naughton, Barry. "False Starts and Second Wind: Financial Reforms in China's Industrial System." in *Political Economy of Reform in Post-Mao China*, edited by Elizabeth J. Perry and Christian Wong, 223-52, Cambridge: Harvard University Press, 1985.
- Naughton, Barry. "Implications of the State Monopoly over Industry and its Relaxation." *Modern China*, Vol. 18 (January 1992): 14-41.
- Naughton, Barry. "What is Distinctive about China's Economic Transition?" *Journal of Comparative Economics* Vol. 18 (June 1994): 470-490.
- Naughton, Barry. *Growing Out of Plan: Chinese Economic Reform, 1978-93*. NY: Cambridge University Press, 1995.
- Naughton, Barry. "Fiscal and Banking Reform: The 1994 Fiscal Reform Revisited." in *China Review 1997*, 251-276. Hong Kong: The Chinese University Press, 1998.
- Nee, Victor. "A Theory of Market Transition: From Redistribution to Markets in State Socialism." *American Sociological Review*, Vol. 54 (October, 1989): 663-681.
- Nelson, Joan M. "The Politics of Economic Transformation: Is Third World Experience Relevant in Eastern Europe?" *World Politics* 45 (April 1993): 433-63.
- Ning, Xeuping, and Min. Zhang, eds. *Caiwukuaiji wu Caishui, Jjinrongtizhi Gaige Shouce* [A Handbook of Reform on Fiscal Accounting, Tax and Banking Systems]. Beijing: Dabaik Quanshu Chubanshe, 1994.
- North, Douglass and Thomas, Robert Paul. *The Rise of the Western World*. NY: Cambridge University Press, 1973.
- North, Douglass. *Structure and Change in Economy History*. NY: W.W. Norton & Company, Inc., 1981.
- North, Douglass. *Institutions, Institutional Change and Economic Performance*. NY: Cambridge University Press, 1990.
- Nye Joseph S. "China's Re-emergence and the Future of the Asia-Pacific." *Survival* vol.39, no.4 (Winter 1997-1998): 65-79.
- Oates, Wallace E. *Fiscal Federalism*. New York: Harcourt Brace Jovanovich, 1972.
- Oates, Wallace E. "Searching for Leviathan: an Empirical Study." *American Economic Review* 75 (September 1985): 748-57.
- Oates, Wallace E. "Fiscal Decentralization and Economic Development." *National Tax Journal* Vol. XLVI No. 2 (1993): 237-43.
- O'Brien, Kevin J. *Reform without Liberalization: China's National Congress and the Politics of Institutional Change*. New York: Cambridge University Press, 1990.
- O'Brien, Kevin. & Lianjiang Li. "The Politics of Lodging Complaints in Rural China." *The China Quarterly*, (1995): 751-783.
- Oksenberg, Michael and James Tong. "The Evolution of Central-Provincial Fiscal Relations in China, 1971-1984: the Formal System." *The China Quarterly*, No. 125 (March 1991): 1-32.
- Oi, Jean. *State and Peasant in Contemporary China*, Berkeley: University of California Press, 1989.

- Oi, Jean. "Fiscal Reforms and the Economic Foundations of Local State Corporatism in China." *World Politics*, Vol. 45 (1992): 99-126.
- Organski, AFK. *The Stages of Political Development*. New York: Alfred A Knopf, 1965.
- Organski and Kugler, *The War Ledger*. Chicago: University of Chicago, 1980.
- Ouyang, Hongwu. "The PRC's New Elite politics: The New Institutionalism Perspective." *Issues and Studies* 34, No. 5 (1998): 1-21.
- Overholt, William. *The Rise of China: How Economic Reform is Creating A New Super Power*. New York: W. W. Norton, 1994.
- Park, Albert. Rozelle, Scott. Wong, Christine, and Ren, Changqing. "Distributional Consequences of Reforming Local Public Finance." *The China Quarterly* No. 147 (September 1996): 751-775.
- Party history study board ed. *Zhonggugongcandangshi Dashiji, 1919.5 – 1987.12* [The History of Chinese Communist Party]. Beijing: Renmin Chubanshe, 1987.
- Parvathy, K. A. *Economic Policy and Tax Effort of State Governments*. Delhi: Criterion Books, 1992.
- People's Congress Standing Committee Research Board ed. *Renmindibiaodahui Wenxianxuanpian* [Selected Works of People's Congress]. Beijing: Zhongguominzuzufazhi Chubanshe, 1992.
- Perry, Elizabeth and Ellen V. Fuller. "China's Long March to Democracy." *World Policy Journal* 4, 3 (1991): 663-683.
- Perry, Elizabeth J., "Trends in the Study of Chinese Politics: State-Society Relations." *China Quarterly* No.139 (September 1994): 704-13.
- Petracca, Mark. and Xiong, Mong. "The Concept of Chinese Neo-Authoritarianism." *Asian Survey* Vol. 30 (November 1990): 1099-1117.
- Phillips, D.C. *Holistic Thought in Social Science*. Stanford: Stanford University Press, 1976.
- Poggi, Gianfranco. *The Development of the Modern State: A Sociological Introduction*. Stanford: Stanford University Press, 1978.
- Polanyi, Karl. *The Great Transformation: The Political and Economic Origins of OurTime*. Boston: Beacon Hill Press, 1944.
- Pomfret, R. "Foreign Direct Investment in a Centrally Planned Economy: Lessons from China: Comments on Kamath." *Economic Development and Cultural Change*. Vol. 43(1994): 413-417.
- Pommerehne, Werner W. "Quantitative Aspects of Federalism: a Study of Six Countries." in *Political Economy of Fiscal Federalism*, edited by W. Oates, 275-355. Lexington, MA: D.C. Heath, 1977.
- Portes, Richard. "Introduction to Economic Transformation of Hungary and Poland." *European Economy*, Vol. 43 (March 1990): 11-18.
- Przeworski, Adam. "Some Problems in the Study of the Transition to Democracy." in *Transitions from Authoritarian Rule*, edited by Guillermo O'donnell , Philippe C. Schmitter and Laurence Whitehead, 47-63. Boltimore: The Johns Hopkins University Press, 1986.
- Putnam, Robert. *Making Democracy Work*. Princeton: Princeton University Press, 1993.

- Putnam, Robert. "Diplomacy and Domestic Politics." in *Double-Edged Diplomacy*, edited by Evans Peter, Harold Jacobson, and Robert Putnam, 431-468. Berkeley: University of California Press, 1993a.
- Pye, Lucian. *The Dynamics of Chinese Politics*. Cambridge: Oelgeschlager, Gunn, and Hain, 1981.
- Radice, H. "The Role of Foreign Direct Investment in the Transition of Eastern Europe." in *The Transformation of the Communist Economics*, edited by Ha-joon Chang and Peter Nolan. New York: St. Martin's Press, 1985.
- Rankin, Mary Backus. *Elite Activism and Political Transformation in China: Zhejiang Province, 1865-1911*. Stanford: Stanford University Press, 1986.
- Reeves, H. Clyde. Ed. *Measuring Fiscal Capacity*. Boston: Oelgeschlager, Gunn & Hain, 1986.
- Renmin University, Project research Team. "The Plan for the Reform of China's Economic System, 1988-1995." *Chinese Economic Studies* Vol. 24, No.1 (Fall 1990): 91-92.
- Research Center for Technological, Social, and Economic Development of the State Council, the Wu Jinglian Project Research Team. "Outline of the Plan for Reform of the Chinese Economic System in the Intermediate Period." *Chinese Economic Studies* Vol. 24, No.1 (Fall 1990): 93-95.
- Riker, William H. and David Weimer. "The Economic and Political Liberalization of Socialism: the Fundamental Problem of Property Rights." *Social Philosophy and Policy* No. 10 (1993): 79-102.
- Riker, William H. and David Weimer. "The Political Economy of Transformation: Liberalization and Property Rights." In *Modern Political Economy*, edited by Banks, Jaffrey and Eric A. Hanushek, 80-107. Cambridge: Cambridge University Press, 1995.
- Roland, Gerard. "Political Economy of Sequencing Tactics in the Transition Period." in *Systemic Change and Stabilization in Eastern Europe*, edited by Laszlo Csaba, 47-64. U.K.: Aldershot, 1991.
- Roland, Gerard. "The Political Economy of Transition in the Soviet Union." *European Economy* No. 49 (March 1993): 197-216.
- Roland, Gerard. "On the Speed and Sequencing of Privatization and Restructuring." *The Economic Journal* 104 (September 1994.): 1158-68.
- Rowe, William T. *Hankow: Commerce and Society in a Chinese City, 1796-1889*. Stanford: Stanford University Press, 1984.
- Rubinson, Richard. "The World Economy and the Distribution of Income within States." *American Sociological Review* Vol. 41 (August 1976): 638-59.
- Ruttan, Vernon. *Agricultural Policy in an Affluent Society*. New York: Norton, 1969.
- Sachs, Jeffrey. *Poland's Jump to the Market Economy*. Cambridge, MA: MIT Press, 1993.
- Sachs, Jeffrey. and Woo, Wing Thye. "Structural Factors in the Economic Reforms of China, Eastern Europe, and the Former Soviet Union." *Economic Policy* (April 1993.): 102-45.
- Schultz, Theodore. *Economic Growth and Agriculture*. New York: McGraw-Hill, 1968)
- Schurmann, Franz. *Ideology and Organization in Communist China (2nd Edition)*. Berkeley: University of California Press, 1970.
- SCRE, Research Group on Urban Economic Reform. *Gaige [Reform]*. Beijing: Jingji Chubanshe, 1986.

- SCRE, Comprehensive Planning Office. "Reform: Options during a Key Period." *Chinese Economic Studies* Vol. 24, No.1 (Fall 1990): 76-81.
- Secretary Bureau of the State Council General Office et al. eds. *Zhongyang Zhengfuzuzhi jigou* [Structure of the Central Government Organizations]. Beijing: Zhongguo Fazhan Chubanshe, 1995.
- Segal, Gerald. "China Changes Shape: Regionalism and Foreign Policy," *Adelphy Paper* 287. London: IISS, 1994.
- Sehrt, Kaya. *Banks vs. Budgets: Credit Allocation in the People's Republic of China, 1984-1997*. Ph.D. Dissertation in the University of Michigan, 1999.
- SGTB (State General Taxation Bureau), Planned Finance Department ed. *Zhongguo Shuiwutongji 1950-1994* [China's Taxation Statistics: 1950-1994]. Beijing: Zhongguo Shuiwu Chubanshe, 1997.
- Shambaugh, David., ed. *American Studies of Contemporary China*. Armonk, N.Y.: M.E. Sharpe, 1993.
- Shao, Chu and Yi Ding, "Yunyongshuishougongju Jijucailipingheng Yusuan [Achieve Budget Balance by Utilizing Taxes]." *Jingjiyanjiu* No.5 (May 1983): 37-40.
- Shen, Baoxiang. *Zhenli biao zhun wenti taolunshimo* [The Whole Story of Debates on the Standard of Truth]. Beijing: Zhongguoqingnian Chubanshe, 1997
- Shen, Liren et al. eds. *Zhongguojingji Zhongdajueceshimo* [The Whole Stories of Great Decisions on Chinese Economy]. Nanjing: Jiangsurenming Chubanshe, 1999.
- Shi, Shaoyou. and Yonghua Hu, "Tantanligaishui Dierbu Gaigehoude Caizhengjiesuan Wenti [Discussion regarding Fiscal Accounting after the Second "Replacement of Profit by Tax" Reform]." *Caizheng* 11 (November 1984): 18-19.
- Shirk, Susan. *Competitive Comrades: Career Incentives and Student Strategies in China*. Berkeley: University of California Press, 1982.
- Shirk, Susan. *The Political Logic of Economic Reform in China*. Berkeley: University of California Press, 1993.
- Shue, Vivienne. *The Reach of the State: Sketches of the Chinese Body Politics* Stanford: Stanford University Press, 1988.
- Stockholm International Peace Research Institute (SIPRI). *World Military Expenditure*. Oxford: Oxford University Press, 1991, 1994, 1997).
- Solinger, Dorothy. *Chinese Business under Socialism*. Berkeley: University of California Press, 1984.
- Solinger, Dorothy. "Despite Decentralization: Disadvantages, Dependence and Ongoing Central Power in the Inland- the Case of Wuhan." *China Quarterly* No. 145 (March 1996): 1-34.
- Solnick, Steven. "The Breakdown of Hierarchies in the Soviet Union and China," *World Politics* Vol. 48 (January 1996): 209-38.
- SPC, Finance Bureau. "Guanyu Caili Pinghengde Jihua Gongzuo [Regarding the Work for Fiscal Balance Plan." *Caizheng* 5 (May 1985): 12-13.
- SPC, Project Research Team. "Basic Line of Thought for Reform of the Economic System in the Next Eight Years." *Chinese Economic Studies* Vol. 24, No.1 (Fall 1990): 96.

- SPC, Economic Research Institute. "Caishui Xintizhi Yunxingzhong Liyigejude Biandong Yingxiang ji Jianyi [Change and Influence on Interest Relations in the Enforcement of the New Fiscal System and Suggestions]." *Jingjigaige and Fazhan* (16-23 August 1994): 43-49.
- SPFRC (Shanghai Finance University, Public Finance Research Center). *Zhongguo Caizheng Fazhan Baogao* [Report on China's Financial Development]. Shanghai: Shanghai Finance University Press, 1999.
- Starbuck, William H. "Organizational Growth and Development." in *Handbook of Organizations*, edited by James G. March, 451-533. Chicago: Rand McNally, 1965.
- Starr, John Bryan. *Understanding China*. New York: Hill and Wang, 1997.
- State Council General Office and Central Publishing Committee Office, eds. *Zhongyangzhengfu Zuzhi Jigou* [Organizational Structure of the Central Government]. Beijing: Zhongguo Fazhan Chubanshe, 1995.
- State Council General Office and Central Publishing Committee Office, eds. *Zhongyangzhengfu Zuzhi Jigou* [Organizational Structure of the Central Government]. Beijing: Gaige Chubanshe, 1998.
- State Restructuring Office. *Zhongguo Caizheng Gaige Ershinian* [Twenty Years of Chinese Fiscal Reform]. Zhengzhou: Zhongzhouji Chubanshe, 1998.
- State Statistics Bureau (SSB). *Zhongguo Guonei Shengchan Zongzhi Gesuan Lishi Ziliao* [The Gross Domestic Product of China, 1952-1995]. Dalian: Dongbei Daxue Chubanshe, 1997.
- SSB. *Xinzhongguo 50nian tongji Ziliao Huipian* [Comprehensive Statistical Data and Materials on 50 Years of New China]. Beijing: Zhongguo Tongji Chubanshe, 1999.
- Stepan, Alfred. *The State and Society: Peru in Comparative Perspective*. Princeton: Princeton University Press, 1978.
- Su, Zhenhong. *Shanghai yu Zhongyang Zhengfu Caizhengguanxizhe Yanjiu* [Study of Financial Relations Between the Beijing and Shanghai Governments]. Taipei: Master Degree Thesis at National Chengchi University, 2000.
- Sun, Tanzhen. *Xiandaizhongguonongcun Caizhen wentiyianjiu* [Study of Rural Finance in Contemporary China]. Beijing: Jingjixue Chubanshe, 1995.
- Swaine, Michael D. *China: Domestic Change and Foreign Policy*. Santa Monica: LAND, 1995.
- Swaine, Michael. & Tellis, Ashley. *Interpreting China's Grand Strategy: Past, Present, and Future*. Washington, D.C.: RAND, 2000.
- Tanzi V. "Tax Reform and the Move to a Market Economy." *The Role of Tax Reform in Central and Eastern European Economies*. Paris: OECD, 1991.
- Task Force. *Zhongguo Shichang jingjixia Caizhengbiyao Guimode Yanjiu* [Finance Requires Norms under the Market Economy in China]. Beijing: Zhongguo Caizheng jingji Chubanshe, 1997.
- Task Force in Economy Research Institute at the CASS. "Jianchi Shudufenquanfangxiang Chongsuguojiaguangleju [Uphold an Appropriate Direction of Decentralization, Remould the Structure of State Management]." *Jingjiyanjiu* No. 6 (June 1987): 16-25.

- Task Force on the Ratio of Revenue over National Income. *Zhongguo Shichangjingjixia Caizhengbiyaoguidemode Yanjiu* [Study on Sufficient Fiscal Size under Market Economy of China]. Beijing: Zhongguo Caizheng Jingji Chubanshe, 1998.
- Teiwes, Frederick. "Provincial Politics in China: Themes and Variations." in *China: Management of Revolutionary Society*, edited by J. Lindbeck, 116-189. London: Allen & Unwin, 1971.
- Teiwes, Frederick. *Politics and Purges in China*. White Plains, N.Y.: M.E. Sharpe, 1979.
- Teiwes, Frederick. *Politics at Mao's Court: Gao Gang and Party Factionalism in the Early 1950s*. Armonk: M.E. Sharpe, 1990.
- Temkin, Gabriel. "Information and Motivation: Reflection on the Failure of the Socialist Economic System." *Communist and Post-Communist Studies*, Vol. 29, No. 1(1996): 25-41.
- Thimmaiah, G. *Revenue Potential and Revenue Efforts of Southern States*. New Delhi: Oxford India Book House, 1979.
- Tian, Hongmao and Zhu, Yunhan eds. *Jinag Zemin's Lishi Kaojuan* [China under Jiang Zemin]. Taipei: Xinxinwen Trend, 2000.
- Tian Jia, Zhu Limin, and Cao Siyuan. "Guanyu Chengshijihua Danlie Wentide Yanjiu Baogao [A Report on the Study of the Planned City Issue]." *Jingjiyanjiu cankaoziliao* No. 13 (21 January 1988): 8-21.
- Tian, Yinong "Caizhengtizhide Gaige Tongjihuaingji de Guanxi [Relationship between Finance System Reform and Planned Economy]." *Jingjiyanjiu* No. 5 (May 1984): 16-20.
- Tilly, Charles, ed. *The Formation of Nation-States in Western Europe*. Princeton: Princeton University Press, 1975.
- Tong, James. "Fiscal Reform, Elite Turnover and Central-Provincial Relations in Post-Mao China." *The Australian Journal of Chinese Affairs* No. 22 (July 1989): 1-28.
- Tsang, Shu-ki., and Cheng, Yuk-shing. "China's Tax Reform of 1994," *Asian Survey*, Vol. XXXIV. No. 9 (September 1994).
- Valenzuela, J. Samuel, and Arturo Valenzuela "Modernization and Dependency: Alternative perspectives in the Study of Latin American Underdevelopment," *Comparative Politics* Vol. 10, No. 4 (July 1978): 535-557
- Veseth, Michael. *Public Finance*. Reston: A Prentice Hall Company, 1984.
- Wakeman, Frederic. "The Civil Society and Public Sphere Debate." *Modern China*, Vol.19 (1993): 108-38.
- Walder, Andrew. *Communist Neo-Traditionalism: Work and Authority in Chinese Industry*. Berkely: University of California Press, 1986.
- Walder, Andrew. "Local Governments as Industrial Firms: An Organizational Analysis of China's Transitional Economy." *American Journal of Sociology*, Vol. 101, no. 2 (September 1995): 263-301.
- Wang, Bingqian. "Cong 1979-1980 nian Woguocaizhengkan Zonghepinghengwenti [The Issue of Comprehensive Fiscal Balance during the Period of 1979-1980]." *Chaizheng* no. 5 (May 1988): 1-3.
- Wang, Bingqian. "Measurement in Budgetary Balance to Serve Economic Development and System Reform." *Chaizhengyanjiu* No. 9 (1986).

- Wang, Jingxin et al. *Zengzhishui shiyong shouce* [A Handbook on Practice of Value-Added Tax]. Beijing: Zhongguo Shuiwu Chubanshe, 1996.
- Wang, Lianqing et al. eds. *Zhongguo Shuiwu Dacidian* [Encyclopedia of Chinese Taxation System]. Beijing: Jingji Chubanshe, 1996.
- Wang Lin et al. eds. *Gongheguojingjidajuece* [Great Decisions on Economy in the PRC]. Beijing: Jingji Chubanshe, 1999.
- Wang Luqi and Lu Zhou. "Dao 2000nian Woguo Caizheng Tizhi Gaigede Mubiaoqixiang yu Caozuo Buzhou [Goals and Operation Steps in the Chinese Fiscal Reform until 2000]." *Jingjiyanjiu cankao* No. 178 (20 November 1995): 2-10.
- Wang, Shaofei. "Chengbaojingying he Shuizhigaige Keyihuxiangcujin [Contract Management and Fiscal Reform Can Be Mutually Promoted]." *Renminribao*, 5 February 1988.
- Wang, Shaoguang. "The Rise of the Regions: Fiscal Reform and the Decline of Central Capacity in China." in *The Waning of the Communist State*, edited by Andrew G. Walder, 87-113. Berkeley: University of California Press, 1995.
- Wang, Shaoguang. and Angang. Hu, eds. *Zhongguo Guojia Nengli Baogao* [A Report on National Capability of China]. Honk Kong: Oxford University Press, 1994.
- Wang, Shaoguang. and Angang. Hu, eds. "Wang Shaoguang Proposal I & II," *Chinese Economic Studies*, Vol. 28, No. 3-4 (May-August 1995).
- Wang, Shaoguang. and Angang. Hu, eds. "Zhengcui Renshi he Chuli Shichangjingji Zhuanxingzhong Zhongyang yu Difang Guanxi [A Correct Understanding and Treatment of the Central and Local Relations during the Transformation of Market Economy]" In *Jiquan yu fenquan* [Centralization and decentralization], edited by Dong funai et al. Beijing: Jingji Kexue Chubanshe, 1996.
- Wang, Shaoguang. and Angang. Hu, eds. *Zhongguo: Bu Pingheng Fazhan De Zhengzhi Jingji Xue* [China: Political Economy of Unequal Regional Development]. Beijing: Zhongguo Jihua Chubanshe, 1999.
- Wang, Chuanlun. and Pingwu. Wang, eds. *Zhongguo Xinshuizhi Yewu Quanshu* [A Complete Textbook of Chinese New Tax System] (Beijing: Zhongguo Jinrong Chubanshe, 1994)
- Wang, Weixing. and Kaili. Zhou, eds. "Xiangfenshuizhi Maichude Jinashide Yibu [A Firm Step toward the Tax Sharing Scheme]." *Jingjiyanjiu Cankao* No. 92 (13 August, 1992): 29-33.
- Wang, Xinxian. "Dangdai Xifang Zhongguo Yanjiuzi Xinzhidudianfan Fenxi [Analysis of Contemporary Western China Studies on Neo-Institutionalism]." *Zhongguo Dalu Yanjiu*, Vol. 43, No. 8 (2000).
- Wang, Yaping. "Caizhengshoulu Zhanguominshoulu Biliguanxi Wentide Tantaoy [A Speculation on the Relationship of the Ratio of Revenue over National Income]." *Jingjiyanjiu cankao* No. 57 (27 June, 1992): 17-32.
- Wang, Zuyin. "Gaige Caizhengtongji Gongzuode Qianjian [A Humble Opinion of Reforming Finance Statistics Work]." *Caizheng* No. 11 (November 1985): 35-36.
- Wasylenko, Michael. "Fiscal Decentralization and Economic Development." *PublicBudgeting and Finance* No. 7 (1987): 57-71.
- Wayman Frank, Singer J. David, and Goertz Gary. "Capabilities, Allocations, and Success in Militarized Disputes and Wars, 1816-1976." *International Studies Quarterly* 27(1983): 497-515.

- Weber, Max. "Politics as a vocation." In *In Max Weber: Essays in Sociology*, edited by H. Gerth and C. Wright Mills, 77-128. New York: Oxford University Press, 1946.
- Wedeman, Andrew. "Agency and Fiscal Dependence in Central-Provincial Relations in China." *Journal of Contemporary China* 8(20) (1999): 103-122.
- Weingast, Barry R., et al. "Federalism, Chinese Style: The Political Basis for Economic Success in China." *World Politics* Vol. 48 (October 1995): 50-81.
- Weingast, Barry R. "Political Institutions: Rational Choice Perspectives." in *A New Handbook of Political Science*, edited by Robert E. Goodman and Hans-Dieter Klingemann, 167-190. New York: Oxford Press, 1996.
- White, Stephen. "Economic Performance and Communist Legitimacy." *World Politics* 38 (April 1986): 462-82.
- Whiting Allen S. "The PLA and China's Threat Perceptions." *The China Quarterly* 146 (1996): 596-615.
- Whiting, Susan Hayes. *The Micro-Foundations of Institutional Change in Reform China: Property Rights and Revenue Extraction in the Rural Industrial Sector*. A Dissertation for the Degree of Ph.D in the University of Michigan. 1995.
- Whitney, J. *China: Area, Administration and National Building*. Chicago: University of Chicago Press, 1969.
- Whitson, William. "The Field Army in Chinese Communist Military Politics," *China Quarterly* No. 37 (1969): 1-30.
- White, Gordon. *Riding the Tiger*. Stanford: Stanford University Press, 1993.
- White, Lynn T. *Unstately Power*. New York: M.E. Sharpe, 1998.
- Whyte, Martin. "Urban China: A Civil Society in the Making?" in *State and Society in China*, edited by Arthur Lewis Rosenbaum. Boulder: Westview Press, 1992.
- World Bank. *China: Revenue Mobilization and Tax Policy*. Washington, D.C.: The World Bank, 1989.
- World Bank. *Proceedings of the World Bank Annual Conference on Development Economics*. Washington, D.C.: The World Bank, 1991.
- World Bank. *Reform and the Role of the Plan in the 1990s*. Washington, DC: The World Bank, 1992.
- World Bank. *China: Macroeconomic Stability in a Decentralized Economy*. Washington, D.C.: The World Bank, 1995.
- Wong, Christine P. "Between Plan and Market: The Role of the Local Sector in Post-Mao China." *Journal of Comparative Economics* Vol. 11 (1987): 385-398.
- Wong, Christine P. "Central-Local Relations in an Era of Fiscal Decline," *China Quarterly* (December 1991): 185-198.
- Wong, Christine P. "Fiscal Reform and Local Industrialization." *Modern China* (April 1992).
- Wong, Christine P. "Fiscal Reform in 1994." In *China Review 1995*, edited by Kin Lochi, Suzanne Pepper, and Tsui Kai Yuen, 20.1-13. Hong Kong: The Chinese University Press, 1996.

- Wong, Christine P. ed. *Financing Local Government in the People's Republic of China*. Hong Kong: Oxford University Press, 1997.
- Wong, Christine., Heady, Christopher. and Wing T. Woo, eds. *Fiscal Management and Economic Reform in the People's Republic of China*. Cambridge: Oxford University Press, 1995.
- Wong, John. *Understanding China's Socialist Market Economy*. Singapore: Times Academic Press, 1993.
- Woo, Wing Thye. "The Art of Reforming Centrally Planned Economies: Comparing China, Poland and Russia." *Journal of Comparative Economics* 18 (1994): 276-308.
- Wu, Guoguang, "Documentary Politics." in *Decision-Making in Deng's China*, edited by Carol Hamrin and Suisheng Zhao, 24-38. Armonk, New York: M.E. Sharpe, 1995.
- Wuhan City, Shuiwu Xuehui. *Shuishou Jingji Yanjiu [A Study of Taxation and Economy]*. Wuhan: Renmin Chubanshe, 1993.
- Wu, Jie. et al. *Zhongguo Zhengfu yu Jigougaige Vol.1-2 [Chinese Government and Institutional Reform Vol. 1-2]*. Beijing: Guojia Xingzheng Xueyuan Chubanshe, 1998.
- Wu, Jie. et al. *Huimou Shijichao, Vol. 1-3 [Looking Back the Trend of the Century Vol. 1-3]*. Beijing: Guojia Xingzheng Xueyuan Chubanshe, 1998b.
- Wu, Jinglian. and Bruce. Reynolds, eds. "Choosing a Strategy for China's Economic Reform." *American Economic Review* (May 1988): 461-466.
- Wu, Jinglian. "Zhongguojingji tizhi Gaige Mianlinde Jushi yu Xuanze [Imminent Situations and Choices of the Chinese Economic Reforms]." *Guanli Shijie* No. 4 (1988): 1-12.
- Unger, Jonathan. "The Struggle to Dictate China's Administration: The Conflict of Branches vs Areas vs Reform." *The Austrian Journal of Chinese Affairs* 18 (July 1987): 15-45.
- Xi, Shujin., Yang, Gongliang., and Qin, Feng. eds. *Zuixin Zhongguo Shuizh tongshi [A General Guide of Chinese Taxation System]*. Beijing: Guoji Wenhua Chubangongsi, 1994.
- Xiang, Huaicheng. ed. *Zhongguo Caizheng Wushinian [50 Years of Chinese Finance]*. Beijing: Zhongguocaijing Chubanshe, 2000.
- Xiang, Huaicheng. "Caizhengtizhigaigede Huigu ji Duijinhoudede Zongtishexiang [Retrospect of Fiscal System Reform and Comprehensive Prospect]." *Guanli shijie* No. 1 (1989): 34-43.
- Xie, Chuntao ed. *Gaibian Zhongguo [Change China: Major Decision-Makings around the Third Plenary Session in the Eleventh CPC Congress]*. Shanghai: Shanghairenmin Chubanshe, 1998.
- Xie Qinggui, Xiao Yang, and Yan Jirong eds. *Dangdai Zhongguo Zhengfu [Contemporary Chinese Government]*. Shenyang: Liaoning Renmin Chubanshe, 1996.
- Xing, Hua. "1950 nian Shixinggaodujizhong Tongshoutongzhide Caizhengtizhi [Highly Centralized Unified Revenue and Expenditure Fiscal System in 1950]." *Caizheng* No.11 (1982): 37-39.
- Xing, Hua. "Yiwushiqi Shixingjizhongtongyi yu Fenjiguanlixiangjuehe Cezhongjizhongde Caizhengtizhi [A level by level Management System with Emphasis on Centralization during the Period of the First Five- Year Plan]." *Caizheng* No. 3 (1983): 13-15.
- Xing, Hua. "1958 nian dui Caizhengtizhi Jinxingle Zhongdagaigedechangshi [Crucial Attempt for Reform on the Fiscal System in 1958]." *Caizheng* No. 4 (1983a):13-15.

- Xing, Hua. "Shiniandongluanshiqi Caizhengtizhi Biandongpinfan (Shang) [A Frequent Change of Fiscal System during the Ten-Year Turbulence period Vol.1]." *Caizheng* No.8 (1983b): 22-24.
- Xing, Hua. "Shiniandongluanshiqi Caizhengtizhi Biandongpinfan (Xia) [A Frequent Change of Fiscal System during the Ten-Year Turbulence period Vol.2]." *Caizheng* No. 9 (1983c): 8-11.
- Xing, Hua. "1980 Nian Kaishide Caizhengtizhi Zhongdagaige [A Great Reform on Financial System launched in 1980]." *Caizheng* No. 1 (1984): 13-15.
- Xu, Riqing., Anshuang Du, and Qitai Zhao, eds. "Jinyibu Wanshan Shuizhide Tantaotao [Study toward Perfect Tax System]." *Jingjiguanli* No. 7 (July 1985): 6-8.
- Xu, Yi. "Hongguan Kongzhi yu Zonghecaizheng [Macro-Control and Comprehensive Finance]." *Jingji Yanjiu*, No.1 (1982): 26-31, 61.
- Xu, Qijian., and Jiayu. Cai., eds. *Zhongguo Dalu Fenshuizhixiade Zhongyangdifeng Guanxi* [Relationships between the Beijing and Local Governments under the Tax Sharing System in Mainland China]. Taipei: The 5th Conference of Taiwan Academy of Political Science, 1998.
- Xue, Muqiao. *Bashi niandaide Zhongguojingji* [The Chinese Economy in the 1980s]. Beijing: Jingji guanli chubanshe, 1992.
- Yabuki, Susumu. *China's New Political Economy*, translated by Stephen M Harner. Boulder: West View Press, 1995.
- Yang, Dali. "Reform and the Restructuring of Central-Local Relations." in *China Deconstructs*, edited by David Goodman and Gerald Segal, 59-98. London: Routledge, 1994.
- Yang, Dali. *Calamity and Reform in China*, Stanford: Stanford University Press, 1996.
- Yang, George. "Mechanism of Foreign Policy-making and Implementation in the Ministry of Foreign Affairs." In *Decision-making in Deng's China*, edited by Carol Lee Hamrin and Suisheng Zhao. New York: M.E. Sharpe, 1995.
- Yao, Meiyuan., and Luyu. Hao, eds. *Zhongguo Xinshuishouzhidu Yingyongzhinan* [A Guide to Chinese New Taxation System] (Beijing: Zhongguo Duiwai Jingjiwuyi Chubanshe, 1994)
- Ye, Zhenpeng. "Caizheng yu Jiage gaige [Finance and Price Reform]." *Jingjiyanjiu* No. 1 (January 1986): 58-61.
- Yi Ming. "Caizhengshoulu Zhanguominshoulu Bilibianhuade Yinsu Fenxi [An Analysis of Factors relating to the Change of the Ratio of Revenue over National Income]." *Jingjiyanjiu Cankao* No. 166 (15 November, 1992): 23-36.
- You Xiangdu. "Luncaizheng Tezheng he Caizheng Kunnan [A View on Characteristics and Difficulties of Finance]." *Jingjiyanjiu cankao* No. 20 (29 February, 1992): 10-19.
- Young, Susan. "The Chinese Private Sector in Two Decades of Reform." *Journal of the Asia Pacific Economy* 3(1) (1998): 80-103.
- Yu, Guoguang. ed. *Chaishui* [Finance]. Beijing: Zhongguo Chaizheng jingji Chubanshe, 1993.
- Yu, Guoguang. ed. "Shiyijie Sanzhongquanhuiqiande Zhongyanggongzuohuiyi Zhuiji [Memoir of the Central Work Conference before the Third Plenary Session in the Eleventh CPC Congress]." in

- Gaibian ZhongguoMingyunde 41tian* [Forty- one Days that Changed the Fate of China], edited by Yu Guangyuan et al. Shenzhen: Haitian Chubanshe, 1998.
- Yuan, Zejun and Sulian Men, eds. *Guoshui Yewushouce* [Working Manual for State Taxation]. Beijing: Qiyeguanli Chubanshe, 1995.
- Zhang, Chenwu and Xuezhi Jie, “Jingjitizhigaigezhong de Caizhengzhuangui [Financial Transformation in the Economic Reform].” *Jingjiyanjiu* No. 1 (January 1986): 53-57
- Zhang, Dengji. “Zhonggong Bada zhi Shiwuda Lingdaoren Zhengzhibao Shewaiyuanlun Neirongfenxi [Content Analysis of Political Reports of Political Leaders from the Eighth to the Fifteenth CPC Congress].” In *2000 Dongya Yanjiusuosheng Lunwen Fabiaoji*, 37-55. Taipei: Dongya Yanjiusuo, 2000.
- Zhang, Fuzhen. “Duiyu Dachengshi Luhejianli Quyijicaizhengdetantao [Research on How to Build Regional Level of Finance].” *Caizheng* No.5 (1981): 19-20.
- Zhang, Jun. “Caizhen Shuishoutizhi Gaige [Reforms of Fiscal and Taxation System],” in *Zhongguojingji zhongdajueceshimo* [The whole Stories of Great Decisions on Chinese Economy], edited by Shen, Liren et al., 532-552. Nanjing: Jiangsurenming Chubanshe, 1999.
- Zhang, Leyin. “Chinese Central –Provincial Fiscal Relations, Budgetary Decline and the Impact of the 1994 Fiscal Reform: an Evaluation.” *China Quarterly* No. 157(1999): 115-141.
- Zhang, Luofu. “Xinxingshixia Caizhenggongzuode Jigejibenguannian [Several Views on Finance Work under New Circumstances].” *Caizheng* No. 2 (1982): 1-2.
- Zhang Wei. *Zhongguoshuishou yu GDPdefenpei* [Chinese Taxation and GDP Distribution]. Beijing: Renminchubanshe, 1999.
- Zhang, Weiping, ed. *Xinbian Dangwugongzuoquanshu* [New Guide of Party Works]. Beijing: Zhongguoyanshi Chubanshe, 1995.
- Zhang Youcai ed. *Caishui Gaige Zonglun Vol. I-III* [Extensive Discussion on Taxation Reforms, Vol. I- III]. Beijing: Jingjixue Chubanshe, 1998.
- Zhang, Zhuoyuan., Fanzhang Huang, and Guangan Li, eds. *20nianJingjigaige Huigu yu Zhanwang* [Retrospect of 20 Year’s Economic Reform and its Prospect]. Beijing: Jihua Chubanshe, 1998.
- Zhao, Dexin, ed. *Zhonghua Renmingonghuaguo Jingjishi* [Economic History of the People’s Republic of China]. Beijing: Henan Renmin Chubanshe, 1989.
- Zhao, Ziyang. “Yanzheyozhongguotesede Shehuizuyidaolu Qianjin [Along the Way to Chinese Characteristics of Socialism].” *Hongqi* No. 21 (October 1987): 3-27.
- Zhao, Ziyang. “Zhengfu Gongzuo Baogao [Work Report of Government].” in *Shierdayilai* [Since the Twelfth CPC Congress], edited by the Central Document Research Center, 317-357. Beijing: Renmin Chubanshe, 1988a.
- Zhao, Ziyang. “Guanyu Zhiding ‘qiwu’ Jihuajianyiye Shuoming [Explanation of the Suggestion regarding the Make of the Seventh Five-Year Plan].” in *Shierdayilai* [Since the Twelfth CPC Congress], edited by the Central Document Research Center, 785-793. Beijing: Renmin Chubanshe, 1988b.
- Zhao, Ziyang. “Zhengfu Gongzuo Baogao [Work Report of Government].” in *Shierdayilai* [Since the Twelfth CPC Congress], edited by the Central Document Research Center, 1310-1323. Beijing: Renmin Chubanshe, 1988c.

- Zheng Yongnian. "Fenquan Zhanlu yu Lianfangzhide Yanjin" [A Change of Decentralization Strategy and Federation System]. in *Guojia, Shichang yu shihui* [Nation, Market, and Society], edited by Wu Guoguang, 72-81. Oxford: Niujin Daxue Chubanshe, 1994.
- Zhong, Yang. "Withering Governmental Power in China? A View from Below." *Communist and Post-Communist Studies* Vol. 29, No. 4 (1996): 363-375.
- Zhou, Huizhong. "Fiscal Decentralization and the Development of the Tobacco Industry in China." *China Economic Review* 11 (2000): 114-133.
- Zhou, Weilin. *Zhongguo Difangzhengfu Jingjixingwei Fenxi* [Analysis of Economic Activities of Local Governments]. Shanghai: Fudan Daxue Chubanshe, 1997.
- Zhu, Fulin. "Duijinjinian Woguocaizhengtizhigaigede Jidiancanfa [Some Views on Recent Fiscal Reform]." *Caizheng* No. 2 (1983): 16-17.
- Zhu Guanglei. *Dangdai Zhongguo Zhengfu Guocheng* [Government Process of Contemporary China]. Tianjin: Tianjin Renmin Chubanshe, 1997.
- Zhu, Jiamu. "Chen Yun yu Shiyijiesanzhongquanhui [Chen Yun and the Third Plenary Session of the Eleventh CPC Congress," in *Gaibian ZhongguoMingyunde 41tian* [Forty-one days that changed the Fate of China], edited by Yu Guangyuan et al. Shenzhen: Haitian chubanshe, 1998.
- Zhu, Li. "Lunwoguocaili Fenbeide Zhongda Biange [Discuss Crucial Changes in China's Fiscal Resource Distribution]." *Guanlishijie* 9 (November 1987): 29-30.
- Zhong, Ding. *Dalu Caizheng Xiankuang* [Current Financial Situation in Mainland China]. Taipei: Xingzhengyuan Dalu Weiyuanhui, 1993.
- Zong, Hesi. "Liuwushiqide Caizhengtizhigaige [Fiscal Reform during the Sixth-Five Plan Years]." *Caizheng*, No.11 (1986): 19-21.
- Zweig, David. *Agrarian Radicalism in China, 1968-1981*, Cambridge: Harvard University Press, 1989.