

Towards a public and comprehensive budget: Public finance reforms in Guangdong

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In negotiating China's accession to the WTO, the representative of China promised that China 'would continue to improve the efficiency of fiscal expenditure through implementing reform measures such as sectoral budget, centralized payment by the national treasury and zero base budget...'.¹ Indeed the Chinese budget is badly in need of reform, in order that government priorities may be implemented with a reasonable level of efficiency and effectiveness.² The accession to WTO has added urgency to the task, however, not only because the Chinese government would now be held against its own pledges (transparency, equity, participation, etc.), but also because the likely changes to the operating environment of business in the aftermath of WTO would pose new challenges to the task of governance.³

Based on information obtained through archival research and author's interviews,⁴ this paper examines how the task of improving the management of public monies is being handled in the province of Guangdong. Specifically, it outlines Guangdong's attempts to produce change in two arenas: (1) the development of a comprehensive budget, and (2) the withdrawal of government participation from the 'competitive business sectors'. Despite the province's leading economic performance and reputation as a pioneer in reform, this paper notes, the progress of public finance reform at a provincial level has not been impressive. I argue that this is attributable to the continued dominance within the provincial government of the traditional concern over local fiscal autonomy and security. Public finance reform, despite recognition of its potential significance, has been deemed less urgent in view of more pressing concerns. The legacy is that the province will have to speed up reform in order that new challenges in the aftermath of WTO accession may be met.

¹ See Working Party on the Accession of China, WTO, 'Report of the Working Party on the Accession of China', 1 October 2001, para. 26. Other aspects of change in the government, apart from trade practices and tariffs, include a complete review of all laws and regulations (para. 67), increased transparency over laws and policies (para. 320), a review of the judicial review procedures and mechanisms (para. 78), and increased societal and agency participation and transparency in decision-making over government prices (paras. 53, 61).

² This is the conclusion of a study by the World Bank, conducted with full co-operation of the Ministry of Finance in the Chinese Government during 1997-98. See World Bank, *China: Managing Public Expenditures for Better Results*, (restricted circulation) 2000.

³ There has thus been increasing recognition within the government, and in Guangdong, that the government would be the first party to bear the blunt of many challenges posed by WTO accession. See for instance Li Xudong, Zeng Zhiwen, 'The impact of WTO membership on Guangdong's government finance', part 1-2, *Guangdong Caizheng*, 12 (2000), 11-12, and 1 (2001), 33; Liu Shangxi, 'The legality, transparency and equity of government finance: Thoughts in the context of WTO', *Guangdong Caizheng*, 1 (2002), 18-19.

The Backdrop

It is difficult to overstate the importance of fiscal reforms in China, these having always been at the forefront of other changes. Changes in fiscal arrangements have been the main contents of various rounds of jurisdiction adjustment between central and sub-national governments. The onset of economic reform in the late 1970s coincided with changes in inter-governmental fiscal relations and experiments with the taxation system. Towards the mid- and late 1990s, the fiscal system once again featured prominently in a new wave of economic and administrative reforms. Firstly there was the change in 1994 from the contractual system to ‘tax-sharing’ in the fiscal arrangement between the central and provincial governments.⁵ Then the campaign against excessive fees and extra-budgetary charges was given added force, eventually culminating in the adoption of the ‘public finance’ approach to fiscal management in 1998.⁶ This new policy envisages a central role for the budget in governance, as well as new contents in governance itself. The extra-budgetary sector would be gradually incorporated in an integrated, comprehensive budget, which more detailed contents would enable better transparency and control. The government should revise its role in economy and society, so that budget would gear more to the provision of ‘public goods’, which the market fails to provide adequately. Participation in the budgeting process would be enhanced – if only in order to improve the quality of the budget. The scope of intended change is immense. No wonder some Guangdong officials have hailed the public finance reform as perhaps the only ‘genuine’ reform in the reform era, against which all previous measures pale as merely minor improvements to the pre-existing central planning system.⁷

⁴ The author has conducted field interviews in Guangzhou, Shunde, Hubei and Beijing on the subject of public finance reform since 1998. This paper draws on part of this field work.

⁵ State Council Notice No. 85 (1993), ‘A decision on the tax-sharing fiscal system’. For discussion and a preliminary assessment of the 1994 change, see Le-Yin Zhang, ‘Chinese Central-Provincial Fiscal Relationships, Budgetary Decline and the Impact of the 1994 Fiscal Reform: An Evaluation’, *The China Quarterly*, 157 (March 1999), 115-41; Christine P. W. Wong, ‘China’s fiscal reform in 1994’, in *China Review* 1995, Lo Chi Kin, Suzanne Pepper, and Tsui Kai Yuen, eds., Hong Kong: The Chinese University Press, 1995; Jae Ho Chung, ‘Beijing Confronting the Provinces: The 1994 Tax-Sharing Reform and its Implications for Central-Provincial Relations in China’, *China Information*, IX, 2/3 (Winter 1995), 1-23.

⁶ Vice Premier Li Lanqing announced ‘public finance’ as the future approach to fiscal management at the national fiscal meeting in December 1998. See *People’s Daily*, 16 December 1998, 1.

⁷ Respondent Nos. 1 & 2, Guangzhou interviews, November 2001. An article by a provincial fiscal official in 1998 argued that without reform in the government, based on a rethinking of the nature and

The public finance reform has been described as constituting four major facets of change: (1) enhancing the ‘public’ nature of the budget; (2) improving transparency and participation in budget formulation; (3) ensuring equity in resource allocation; and (4) maintaining the integrity and comprehensiveness of the budget.⁸ The breadth and complexity of the subject makes impossible the treatment of all these changes in one paper. I shall thus choose to focus on two issues only, namely the withdrawal policy, and comprehensive budgeting.⁹ The rationale behind the choice is simple. A lion share of developments in public finance reform in Guangdong and nationwide to date took place in the arena of comprehensive budgeting. A focus here will allow us to assess how far the reform has progressed. Meanwhile the withdrawal policy is arguably the most fundamental part of public finance reform, entailing an appraisal of the role, and functions, of the government in society, and a radical shift from the pre-existing conception of the budget. A discussion here shall thus enable us to assess the depth of the reform.

Towards a Comprehensive Budget

The public finance reform owed its origin in the heightening concern over the extra-budgetary sector that started to run out of control during late 1980s. Since then there has been the call to reflect all items of government revenue and expenditure in a single budget. The extra-budgetary sector should be incorporated in the budget, and the illegal ‘off-budget’ sector should be done away entirely.¹⁰ The reform towards a comprehensive budget comprises three dimensions of change. The first, ‘separating fee collection and expenditure’, involves having different agents responsible for fee-collection and expenditure. The objective is to enhance the transparency of fee

role of the government, economic reforms were doomed to be ineffective. Li Xudong, ‘Lun Zhengfu Gaige’ (On the reform of the government), Part 1, *Guangdong Caizheng*, 2 (1998), 15-18.

⁸ Respondent No. 1, Guangzhou interviews, September 2001.

⁹ This means that this paper will not discuss developments such as sectoral (departmental) budgets, enhanced participation of the people’s deputies in budget decisions, and equity issues in budget allocation.

¹⁰ The ‘off-budget’ sector refers to those public revenues and expenditures which are left outside the purview of both the formal budget and the extra-budgetary sector. Some of these may be outright illegal whilst others are legal but have not been incorporated into the management of the extra-budget due to their novel nature. An example of the latter type is social insurance contribution and expenditure commencing in the 1990s. For more discussion, see Christine P. W. Wong, ‘Fiscal dualism in China: Gradualist reform and the growth of off-budget finance’, in Donald Brean, ed., *Taxation in Modern China*, New York: Routledge Press, 1998.

collection and spending, and, by introducing independent intermediaries and thus some degree of checks and balances into the process, to reduce the opportunity for abuse and corruption. The spending units would no longer be collecting the fees themselves. An independent agent, usually the banks, would collect the fees that would then be deposited in a special bank account under the name of the fiscal department. The fiscal department would discharge the funds to the spending department in accordance with pre-approved spending plans. At a minimum, this system would enable fiscal departments to obtain valuable information on the amount of the collected revenue and ensure that monies would only be spent for pre-approved purposes. Transparency itself would not prevent the abuse of funds, but make it easier to detect wrongdoings.

A second, more radical step involves the incorporation of extrabudgetary funds into the budget. This would further enhance transparency and tighten control on the collection and use of funds, if only because the budget is traditionally under tighter scrutiny within the government and, unlike the extrabudgetary sector, requires the formal approval by the People's Congress. Incorporation into the budget would also entail, though not necessarily, 'delinking' fee revenue and expenditure provision for a budgetary unit. Delinking is an important indicator of whether the budget is *integrated*, meaning that compartmentalization in the allocation of fiscal resources is eliminated and all fiscal resources are considered on equal terms in the budget allocation process. With delinking, the fee income originally generated through a certain budget unit would no longer be used solely or primarily by that unit but would enter the pool of fiscal resources subject to reallocation, thus greatly enhancing the government's capacity in reprioritizing spending options.

The third dimension of reform involves the institution of centralized payment mechanisms for revenue collection and expenditure to and from the national treasury. Also seeking to improve the management of the flow of funds, as in the case of the 'separating fee collection from expenditure' reform, centralized payment mechanisms represent a major step forward to stamp out opportunities of corruption and malpractices in fund management from their source. Some specific programmes of change include the centralized government procurement, direct payment of civil servants pay, and centralized payment of capital spending. The comprehensive budget

reform has dominated the scene of public finance reform so far, since the budget needs to become *the* definitive avenue to implement government extractions and expenditure before other changes to the budget – equity, participation, content – may possibly progress, and achieve their intended purposes.

Separating fee collection and expenditure

In November 1991, amidst the national campaign against excessive fees and lack of control, Guangdong's Provincial People's Congress Standing Committee passed a local legislation on the management of administrative fees.¹¹ It was by and large a reiteration of national legislation and regulations on the subject. While it specified the jurisdiction and authorities for approving fees, and explained what made some government fees 'illegal', the piece did not prescribe any specific change in fiscal management practices. For instance, it was stated that fiscal bureaus should oversee the financial management matters of the fees (Article 5), and that all fees should be, as a matter of principle, incorporated in the budget or managed in the extra-budgetary sector. The unanswered questions were: which fees were to be incorporated into the budget, and how could the management of the fees left outside the budget be improved to prevent the reoccurrence of current abuses? Answers to these questions were left to the deliberation of the government authorities (Art. 15), which themselves had previously generated the abuses.

It took two years before an answer began to surface. In 1993, a notice jointly issued by the Party Central Committee and State Council Office on illegal fees and charges mentioned for the first time a new method of fund management, 'separating fee collection and expenditure'.¹² Another Central Committee Document, No. 19, issued at the same time called for improved transparency in the budget through the creation of a new category of revenue, 'administrative fees'.¹³

¹¹ *Regulation on the Management of Administrative and 'Shiye' Fees in Guangdong Province*, passed by the Standing Committee of the Seventh Provincial People's Congress of Guangdong on 22 November 1991.

¹² Central Committee Document (1993) No. 18, 'On conferring the notice by Ministry of Finance on "Resolving the abusive imposition of fees"', 9 October 1993.

Against these national developments the idea of ‘separating fee collection from expenditure’ was first raised in the Guangdong province in 1994.¹⁴ Pilot reforms were launched in localities such as Dongguan and Shenzhen,¹⁵ but serious implementation of the measure on a provincial-wide scale did not commence until late 1996, in the wake of heightened pressure from the central government.¹⁶ In 1997, a new category of ‘administrative fees and penalty charges’ was created in the provincial budget, a lapse of four years after it being required by Central Committee Document No. 19 in 1993.¹⁷ In March 1998, based on pilot experience in Zhuhai, Guangdong Provincial Fiscal Bureau specified banks as the intermediary agents for collecting administrative fees and government funds.¹⁸ This was an important step since without naming the intermediary, in place of the fee-charging units which had always doubled as fee-collecting agents themselves, the ‘separation’ reform could not possibly proceed. Having filled in this operational gap, there was eventually a take-off of the ‘separation’ policy in Guangdong in 1998, starting from four departments attracting substantial fee income, namely the public security, the procuracy, the courts, and the industry and commerce administration bureau.¹⁹ Starting from July 1999, the practice was made compulsory for all extra-budgetary funds in the province.²⁰

¹³ Central Committee Document (1993), No. 19, ‘On conferring the notice by Ministry of Finance on “Implementing budgetary management for revenues from administrative fees and penalty charges”’, 9 October 1993.

¹⁴ A local government regulation ‘Financial Management Methods of Administrative Fees in Guangdong’, was drafted in 1994, which required extrabudgetary fees to be paid into a fiscal special account. *Guangdong Caizheng*, 1 (1995), 12-13.

¹⁵ The early Dongguan reforms were reported in *Guangdong Caizheng*, 1 (1995), 12-13. For a fuller report on Dongguan’s reforms, see Liu Jidong, et al. ‘The double-edge sword of institutions: An analysis of the township fiscal institutional reform in Dongguan, Guangdong’, *Guangdong Caizheng*, 12 (1998), 17-19. Shenzhen started separating collection and charging of penalty fees in 1995, and of administrative fees of selected departments in 1996. See Shenzhen Fiscal Bureau, ‘One step ahead: Strengthening fiscal management in Shenzhen’, *Guangdong Caizheng*, 4 (1998), 22-23.

¹⁶ Respondent No. 3, Guangzhou interviews, November 2001. In 1996 the central government took several major initiatives to improve fiscal management, including the passage by the National People’s Congress of the Administrative Penalty Law in April, and the issuance of the State Council Document (1996) No. 29, ‘A Decision on the Strengthening of Management of Extrabudgetary Funds’, in July. The latter document was particularly important as it was issued in the midst of a nation-wide review and crackdown of extrabudgetary funds, an initiative lasting from April to October 1996, requiring 100% coverage in terms of units.

¹⁷ This is observed by reading through Ministry of Finance, ed., *Difang Caizheng Touji Jiliu*, various years (1996-98), 1996, 42, 1997, 44.

¹⁸ Guangdong Provincial Fiscal Bureau Document No. 16 (1998), ‘Temporary provisions on delegating the collection of administrative fees and government funds to banks’.

¹⁹ Huang Ji, ‘The drums are on again: tightening up the management of extrabudgetary funds’, *Guangdong Caizheng*, 2 (1999), 20-21.

²⁰ Guangdong Provincial Government Notice No. 51 (1999), ‘Management methods of extra-budgetary funds in Guangdong’, reprinted in *Guangdong Caizheng*, 8 (1999), 30-32.

To what extent has this new management practice alleviated the abuses in fee collection and use in Guangdong? It is difficult to give a definitive answer for two reasons. First, there is very limited access to statistics on extrabudgetary revenue in Guangdong. Unlike some other provinces and cities that include such data in their statistical yearbooks, Guangdong has consistently excluded the extrabudgetary sector in its various statistical publications, before or after the introduction of the ‘separation’ scheme and the fiscal special account. As a result it is very difficult to assess the impact of the scheme on the management of extrabudgetary funds. For example, we would not be able to detect the impact of the scheme on, say, the amount of extrabudgetary revenue over the years. Experience in other localities releasing such information have suggested that the transparency impact of ‘separation’ scheme led to a phenomenal increase in the statistics, as a larger portion of fee revenues was brought to the knowledge of the local fiscal departments.²¹ The other difficulty is the opaque nature of abuses, so that any claim of full coverage is by definition contingent on the non-discovery of abuses.

Nevertheless, we may still attempt an assessment using clues from various sources. Firstly, findings of sporadic checks suggest that abuses have stayed. In late 1998, a total of 9.2 billion *yuan* of illegal fees/funds were identified in Guangdong during one check-up exercise, amounting to 63 per cent of the total fee/fund revenue incorporated into the provincial budget in the same year.²² Clues may also be found from official initiatives aimed at improving implementation. In 2000, the Provincial Finance Bureau launched a ‘three-100 per cent campaign’ to extend the coverage of the ‘separation’ scheme. Literally it demanded 100 per cent coverage of the scheme in county level and above in terms of three dimensions: (1) number of fee/fund items; (2) number of fee/fund charging departments/units; and (3) amount of fee/fund revenue.²³ The very launch of the campaign indicated that coverage had not reached saturation. In fact provincial officials admitted that coverage at most reached 80 to 90 per cent as of end 2000, in the *aftermath* of the campaign, with the fee revenue recorded in the

²¹ A noticeable example is Yichang county, as detailed in my paper, ‘Understanding institutional change: Fiscal management reform at grassroots China’, unpublished manuscript.

²² Huang Ji, ‘The drums are on again’, 20.

²³ Wang Ji, ‘The objective of “separating fee collection and spending”: the three 100 per cent’, *Guangdong Caizheng*, 10 (2000), 20-21.

system reaching 30 billion yuan.²⁴ In 2001 the campaign was launched again and further extended to the township level.²⁵

Integrated and comprehensive budget

Alongside the ‘separation’ scheme, efforts were also being made to incorporate the fee revenue managed in the fiscal special account into the budget, and to integrate fee revenue with other regular sources of budgetary revenue in resource allocation. As mentioned above, this involves two distinct steps of change: (1) incorporation into the budget, and (2) delinking the fee revenue and expenditure allocation of a certain budgetary unit.

Step 1 change in Guangdong took place as part of a national move. In 1994, the Ministry of Finance announced that 83 government fee items were to be incorporated into the budget.²⁶ Implementation was slack, however, until 1996 when the incorporation of a second lot of 13 major government funds was announced amidst a major clampdown of illegal fees and tightening up of policy.²⁷ One major indicator of this lack of implementation before 1996 was that in Guangdong as well as elsewhere, there simply was no budgetary entry of fees other than the pre-existing items. In the budgetary revenue breakdown of 1996, only one item of penalty fees appeared in the local government budget – namely the penalty charges arising from audit activities.²⁸ As shown in Table 1, revenue from this item in Guangdong’s 1996 budget was a mere 19.5 million yuan, accounting for 0.04 per cent of total local budgetary revenue of the year. Penalty charges of other categories and administrative fees entered the provincial budget for the first time in 1997. At 4.6 billion yuan, the

²⁴ Respondents Nos. 3 & 4, Guangzhou interviews, November, 2001. The coverage percentage differs with the dimension of coverage the calculation is based on. According to Respondent No. 3, the dimension of fee charging unit will give the highest percentage amongst the three, with the revenue dimension, the most rigorous indicator, giving the lowest. This implies that the real coverage of the scheme, measured in terms of the value of revenue, is much lower than 80–90 %. The 30 billion yuan figure refers to government fee revenue only, and does not include revenue from government funds.

²⁵ Respondent No. 3, Guangzhou interviews, November 2001.

²⁶ Ministry of Finance Notice No. 37, 1994, ‘On incorporating administrative fees into the budget’.

²⁷ This was the famous State Council Notice No. 29, 1996, ‘A decision on strengthening the management of extra-budgetary funds’, hereinafter regarded as marking the beginning of a new era of fiscal management. The slack implementation of Ministry of Finance (MoF) Notice No. 37 (1994) is suggested by statements in SC Notice No. 29, stressing that ‘it is now time to implement effectively MoF’s regulation on incorporating 83 fee items into the budget...’

new revenue item accounted for 8.5 per cent of total local budgetary revenue of Guangdong province in 1997. This share rose to 9.5 per cent in 1998, but dropped to 8.2 per cent in 1999, largely due to a significant absolute decrease in the amount of penalty charges. The rise in administrative fee revenue was steep however, with an almost 90 per cent increase in 1999 over 1998.²⁹ In 2000, administrative fees and penalty charges together witnessed an increase of 30 per cent, pushing up the share in total local budgetary revenue to almost 9 per cent.³⁰ Nevertheless, in terms of the fee revenue total, the share incorporated into the budget is still relatively small. In Guangdong, the proportion was about 30 per cent as of 2000.³¹ This means that for every 30 yuan of fee revenue in the budget, there are at least 70 yuan left outside the budget. For this 70 per cent of fee revenue, reform has stopped at the first step of ‘separating fee collection from expenditure’.

²⁸ Ministry of Finance, ed., *Difang Caizheng Touji Ziliu* (Statistical Information of Local Finance), 1996 (p. 43), Beijing: Caijing chubanshe, 1997 neibu.

²⁹ This was largely because the ‘separation’ mechanism stopped the previous practice of instituting incentive formulas for penalty-charging units in line with the amount of penalty they charged, but have largely left untouched the linkage between the amount of administrative fees collected and spending by the unit.

³⁰ No breakdown figures for the fees and penalty charges were available for year 2000, but given previous trend, it is likely that a large part of this increase came from administrative fees.

³¹ Respondent No. 3, Guangzhou interviews, November 2001. It is likely that this figure covers only administrative fees and penalty charges, and excluding the various kinds of funds, some of which are included in the budget (but in a separate Budget of the Funds) whilst others are left outside the budget. The percentage of budget incorporation of the Funds are not clear.

Table 1 Administrative fees and penalty charges incorporated in the budget, Guangdong (million yuan)

Year	Local Budgetary Revenue (T) #	Administra tive Fees (F)	F/T (%)	Penalty Charges (P)	P/T (%)	F + P	(F + P)/T (%)
1996	479.45	-	-	0.19*	0.04	0.19	0.04
1997	543.95	9.33	0.17	36.79	6.76	46.12	8.48
1998	640.75	14.06	2.19	46.64	7.28	60.70	9.47
1999	766.19	26.30	3.43	35.60	4.65	62.58	8.17
2000	910.56	-	-	-	-	81.76	8.98

* This entry includes only penalty charges derived from audit activities.

This figure refers only to locally derived revenue and does not include transfer payment revenue from the central government (including rebate revenues), revenue from foreign loans, etc.

Sources: Ministry of Finance, ed., *Difang Caizheng Touji Ziliu* (Statistical Information of Local Finance), 1996 (p. 43), 1997 (p. 44), 1998 (pp. 45-6), Beijing: Caijing chubanshe, neibu; *Guangdong Statistical Yearbook*, various years.

After incorporating the revenue into the budget, the next, and key, step to the formation of an integrated and comprehensive budget is severing the connection between fee revenue and expenditure provision of a unit. The progression to this final step is by no means automatic. In most cases fee revenues incorporated into the budget are left ‘untouched’, so that the original fee-charging unit is still allocated the entire portion, or almost the entire portion, of the fee revenue. This crucial step was attempted in Guangdong at a provincial level in 2001, when the Provincial Fiscal Bureau demanded a pilot scheme in six provincial bureaus as from the drafting of the 2002 budget.³² The new scheme asked for the delinking of revenue and spending provision for the six designated departments, namely Justice, Construction, Labour and Social Security, Culture, Forestry, and the Disabled People Association. Within

the province, Foshan and Shunde were amongst the few places having seen some previous successes in this important step.³³

But why should reform stop halfway in most cases, for both the incorporation step and delinking? A main explanation is ‘departmental interest’. In the words of a provincial fiscal official, ‘that departments and units have for so long used to an almost absence of external control on their use of fee revenues that they tend to resent reform measures as encroachments on their autonomy and internal management.’³⁴ To reduce resistance the rhetoric of reform has, interestingly, emphasized the *maintenance* of status quo. It was often cited that the current reform to improve fiscal management was not to infringe upon the ‘rights’ of departments and units to spend ‘their’ monies in the rightful way, but merely to stamp out abuses and eradicate malpractices.³⁵ Thus the fiscal departments and the banks, as the new intermediaries assigned with the tasks of fund management and collection, were often reminded of tendering a good ‘service’.³⁶ Another reason for the gradual pace of reform was that reformers were mindful of the pressure for *themselves*, if changes were to take place more rapidly. Under the new system, for instance, the fiscal department would be charged with the ultimate responsibility of revenue and expenditure management. The pressure of meeting the ends would no longer be dispersed and absorbed among the various spending units themselves but would instead, under the comprehensive budget, be centralized at the fiscal department.³⁷ Given the tight-jacket situation of the budget, this pressure was immense. It was thus in the interest of both the targets of reform, the spending units, and the reformer, the fiscal departments, to phase in the reform

³² Guangdong Fiscal Bureau (2001) No. 18, ‘A notice on incorporating the extrabudgetary funds and penalty charges into the departmental budget’, 27 September 2001.

³³ Foshan city-level government achieved delinking in year 2000, and Shunde in 1999. See *Guangdong Caizheng* 1 (1999), 37-38; Respondent No. 1, Shunde interviews, September 2001, Respondent No. 2, Guangzhou interviews, August and November 2001.

³⁴ Respondent No. 3, Guangzhou interviews, November 2001.

³⁵ Vice Finance Minister Lou Jiwei made a similar reference in his speech at the Annual Fiscal State Treasury Work Conference, 18 May 2001, p. 4. He said that the reform (centralized payment mechanisms) would not change the spending rights and existing fiscal management powers of budgetary units.

³⁶ See, for instance, Liu Jidong, et al. ‘The double-edge sword of institutions’, 19.

³⁷ Under the old system, when departments were encouraged to find monies to meet their ends, the pressure to balance the budget was decentralized and diffused to various units, taking away much pressure from the manager at the centre. The system guided departments, when short of monies, to become more innovative and more effective in generating new sources of income, rather than to lobby the fiscal department for a larger slice in the budget allocation. Respondent No. 3, Guangzhou interviews, November 2001.

gradually. The development of institutional capacity and changes in attitudes required time.

Centralized Payment Mechanisms

Whilst incorporation and delinking are concerned with the scope and design of the budget, centralized payment mechanisms, the third leg of comprehensive budget reform, are about budget implementation. The objective of this part of the reform is to ensure that the revenue and spending decisions made during the budget formulation stage would be duly followed during the implementation stage, and that abuses are minimized in the course of fund management. In a nutshell, it involves the overhaul of the pre-existing highly decentralized, or fragmentary, system of fund management. The inflows of revenues and outflows of expenditure are to be centralized at one point, the treasury.

Under the pre-existing system, fund management was highly dispersed among various departments and units. Each unit often had multiple bank accounts and the flow and use of funds was very opaque. A master plan of reform outlined in the Ministry of Finance directive No. 24 (2001) calls for a complete overhaul of the old system by 2005, with pilot schemes to start immediately in selected departments.³⁸ The new scheme would require a clean-up of bank accounts, the establishment of a unified system of treasury accounts, the centralization of pay-in and pay-out procedures of government revenue into the treasury, and new organizational and legal capacity. The objective is to enhance transparency of fund management and thus to eliminate a major breeding ground of corruption and abuse.

As found in other cases of reform a comprehensive national scheme emerged only out of a full load of local initiatives. Various provinces and sub-provincial localities had experimented on streamlining the fund management mechanisms, with initiatives in various fronts such as government procurement, capital construction, pay-ins of tax and extrabudgetary revenues, and payout of staff salaries, pension and

³⁸ Ministry of Finance Notice No. 24 (2001). 'A joint notice by the Ministry of Finance and People's Bank of China on the Pilot scheme of the State Treasury Management System Reform', 21 March 2001.

welfare payments, to name the major ones.³⁹ Guangdong had its share of pilot schemes. For instance, centralized government procurement first appeared in Shenzhen in 1997-8,⁴⁰ and as of 2000 reached a scale of 2.49 billion yuan provincial wide.⁴¹ Direct payment of civil servants' pay started in Guangdong in 2000, in line with other provinces.⁴² A provincial directive in 2000 prescribed the new centralized procurement procedures for capital construction projects, seeking to rein in a major segment of government spending.⁴³ An indigenous version of centralized payment mechanism was experimented at two county-level cities, Yide and Leizhou.⁴⁴

Problems abounded, however, upon closer examination. Whilst centralized payment of civil servants' pay commenced in January 2000, and provincial leaders had set October 2001 as the deadline of full implementation,⁴⁵ as of June 2001 the scheme covered less than half of the targeted population.⁴⁶ Eventually the provincial budget had to expended a subsidy of 1.12 billion yuan in 2001 to localities with payment difficulties, and in October 2001 the province reported full coverage of the reform.⁴⁷ In fact despite having the largest provincial coffers nationally since 1991,

³⁹ Lou Jiwei's (Vice Finance Minister) speech at the National fiscal treasury work conference 2001, 28 May 2001, Beijing. My paper, 'Understanding institutional change', discussed in detail the pilot reforms in one Hubei county.

⁴⁰ Nan Zhixiong, 'Centralized government procurement in Shenzhen: Practice and exploration', *Guangdong Caizheng*, 9 (1998), 14-15.

⁴¹ Xia Qing, 'Guangdong stepped up centralized government procurement in 2001', *Guangdong Caizheng*, 12 (2001), 19.

⁴² Peng Minguan, 'Centralized salary payment to be in place before deadline', *Guangdong Caizheng*, 6 (2001), 26-27. This was partly a result of provincial initiative to solve the problem in salary payment in some Guangdong's localities, learning from the experience of other provinces, especially from Shannxi, and partly part of a nation-wide development, mandated by the central government. A notice (No. 1) jointly issued by Ministry of Finance, Personnel Ministry and the Office of the Central Organization and Establishment Committee on 21 June 2000 set 1 July 2001 as the deadline for national implementation of direct payment of civil servants' pay.

⁴³ Guangdong Government Notice No. 41 (2000), 'Preliminary methods of centralized payment of fiscal funds in provincial capital construction projects', 3 July 2000.

⁴⁴ This involved the cancellation of bank accounts of various government agencies and the centralization of fund management at the city fiscal bureaus, through the establishment of an 'accounting audit centre'. See Guangdong Provincial Fiscal Bureau, 'The "Zero account initiative" in Leizheng Town, Leizhou city', *Guangdong Caizheng*, 1 (2001), 46-47; Guangdong Provincial Finance Bureau, 'Preliminary success of the "Zero account initiative" at Leizheng town', *Guangdong Caizheng* 3 (2001), 7-8; Guangdong Provincial Finance Bureau, 'A peep into the centralized payment mechanism from Yide city's "zero account initiative"', *Guangdong Caizheng*, 3 (2001), 9-11. I discussed similar experiments in Hubei in 'Understanding institutional change'.

⁴⁵ This was at the demand of Executive vice governor Wang Qishan, reiterated at the Provincial Fiscal Work Conference, *Guangdong Caizheng*, 9 (2000), 5.

⁴⁶ Peng Minguan, 'Centralized salary payment to be in place before deadline', 26.

⁴⁷ Lu Ruihuan, 'Government Report', and Chen Jixing, 'Report on the implementation of 2001 Guangdong provincial budget and the draft 2002 budget', submitted to the Ninth Guangdong Provincial People's Congress, 28 January 2002. The direct payment scheme covered the payment of

some localities in Guangdong had been unable to pay their staff on time.⁴⁸ This testified the impact of intra-provincial wealth disparities, and bureaucratic abuse of power. The size of government had been swelling, and the rate of payment increased, over the years, and more so in areas failing to pay their staff than elsewhere.⁴⁹ Areas with fewer opportunities for economic development became more dependent on the government as the major employer, which exacerbated the fiscal difficulties of these poorer governments. The vicious cycle set in wherein the poorer a locality was the more pressure there was for a bigger government. The fleet of unpaid, or partly paid, officials were then left to abuse the population to make their ends met, and the poorer the locality became. The direct payment reform, designed to eliminate fund misappropriation, was not implemented until substantial amount of new monies was injected into the system. Without radical restructuring of the government and trimming of unnecessary personnel, however, old problems can easily recur and the direct payment system may collapse upon the weight of an expanding payroll.⁵⁰ The initial successful implementation of the direct payment mechanism in Guangdong, in other words, awaits further tests.

Centralized government procurement has also progressed rather slowly. In 2000, centralized government procurement in Guangdong stood at 2.43 billion yuan, or 2.3 per cent of total local fiscal expenditure. The meagre share indicates that centralized government procurement in Guangdong has barely taken off ground.⁵¹ Nationally, Guangdong's share in the national total in 2000 was 7.4 per cent.⁵² Whilst

salary and pensions to all administrative staff, teachers and pensioners, totalling 1.3 million people as of 2001.

⁴⁸ A report revealed that as of August 2000, 29 counties out of a total of 43 in the province had difficulty of paying their government employees on time, owing a total of wage bill of 800 million yuan. See Guangdong Provincial Finance Bureau, 'Why Guangdong failed to pay its staff on time?', *Guangdong Caizheng*, 10 (2000), 14-15.

⁴⁹ It was reported that the total number of state personnel being paid out of the budget in Guangdong cities (prefecture) increased at an average rate of 2.7% per annum, but the rate was higher for cities with payment problem. The latter also tended to pay their staff a higher salary. See *ibid.*, 15.

⁵⁰ In education, the number of teachers allowed by the establishment was excessively large, posing no effective control over the size of personnel and payroll. This needs to be rectified before any effective control over staff numbers and payroll may be sustained. See Li Shulin, et al. 'What is blocking the development of education?', *Guangdong Caizheng*, 9 (1998), 4-5.

⁵¹ This was acknowledged readily by provincial officials, one of whom had indicated that Guangdong still had a long way to go to achieve the international standard of 30 %. Respondent No. 1, Guangzhou interviews, November 2001.

⁵² The national total was 32.8 billion yuan. See Ministry of Supervision Notice No. 5 (2001), 'On stepping up the progress of centralized government procurement', issued jointly with Ministry of Finance and National Audit Commission in August 2001. For an analysis of the national situation, see

this is slightly higher than Guangdong's 6.7 per cent share of total government expenditure,⁵³ the small difference also suggests the limited extent of any lead the province may have. In fact, since the central government had yet to commence centralized government procurement in 2000,⁵⁴ and given that central government accounted for 34 per cent of total government expenditure in 2000, whatever small lead Guangdong initially appeared to enjoy was instantly wiped out.⁵⁵ The situation slightly improved in 2001, which saw centralized procurement value increasing by 80 per cent to 4.4 billion⁵⁶, and a number of normative documents were promulgated during the year.⁵⁷ Centralized procurement value was then 3.3 per cent of total local fiscal expenditure, a very low percentage still.

The lack of progress in the centralized payment mechanism reform was especially exemplified in the case of capital construction projects. Despite the provincial directive No. 41, there had been virtually nil progress in terms of implementation. After one full year of its announcement, no monies had been paid out under the scheme.⁵⁸ In the words of a provincial fiscal official,

‘The system is not yet ready. No project has been placed under it, lest that progress will be unduly affected. Problems are of three kinds. First is a lack of co-ordination from various related parties. Then the procedures are too complicated. Finally, many projects are financed through multiple funding channels, whilst the centralized payment scheme supposedly covers only fiscal funds. This makes the scope of the scheme uncertain. Should we require all

Gao Jigan, ‘Mixed news from centralized government procurement in 2000’, *Guangdong Caizheng*, 11(2001), 35-36.

⁵³ Total local expenditure (excluding transfer payments) in Guangdong in 2000 was 107 billion yuan. *Guangdong Statistical Yearbook 2001*, 235, and *China Statistical Yearbook 2001*, 245.

⁵⁴ The central government lagged behind the provinces in this specific reform, and only aimed at launching it in 2002. See Xiang Huaizheng, ‘Report of the central and local budget: Implementation of the budget in 2001, and the proposed budget for 2002’, submitted to the National People’s Congress on 6 March 2002.

⁵⁵ This calculation sees Guangdong’s government expenditure stands at 10.3% of total local government expenditure, and its 6.7% share in total centralized government procurement value thus compared unfavourably.

⁵⁶ Chen Jixing, ‘Report of the implementation of 2001 Guangdong provincial budget’.

⁵⁷ Centralized government procurement had amounted to 2.56 billion yuan by end of September, surpassing the level of 2001. The normative documents enacted in 2001 included the ‘Planning outline of centralized government procurement for the Tenth Five-Year period’, the ‘Centralized government procurement work plan for 2001’, ‘2001 centralized government procurement catalogue for Guangdong Province’, and the draft ‘Implementation methods of Centralized government procurement in Guangdong’. Xia Qing, ‘Guangdong stepped up centralized government procurement in 2001’, 19.

funds to enter the scheme and to be dispatched centrally, that will not be possible. But if only a small portion of funds financing the projects comes under the scheme, that will make the effect of scheme questionable. In other words, there are as yet many unresolved questions. That is why the infrastructural projects for the national sports events hosted by Guangzhou this September were not placed under the new system. The construction schedule was too tight to allow any risk!’ (Respondent No. 5, Guangzhou interviews, November 2001)

The lacklustre progress of reform was also reflected in the creation of a new division within the Provincial Finance Bureau. The establishment of a centralized payment mechanism required the strengthening of organizational capacity within the fiscal department. At the central level, a new Treasury Department was created in the Ministry of Finance in mid-2000.⁵⁹ In Guangdong, as of late 2001, the Treasury Division existed merely in name and had no personnel of its own.⁶⁰ Guangdong actually trailed the country with Hubei Province being the only other provincial government not yet establishing the new division in the provincial finance bureau.⁶¹

A Public Budget: Withdrawal from the competitive sector

A budget is, ultimately, a collection of government extractions from society (government revenue) and spending to society (government expenditure). It is, in other words, a summary of state-society relations expressed in numeric form. Whilst a comprehensive budget may lay the groundwork, the core of public finance reform rests in changes that address the fundamental *raison d’etre* of the budget. What is a budget for? What are its objectives? What role should the government perform in society, so that the budget would be structured accordingly? Changes in the contents

⁵⁸ Respondent No. 5, Guangzhou interviews, November 2001.

⁵⁹ *Zhongguo Caijing Pao*, 12 July 2001, 2.

⁶⁰ Additional establishment to allow the new division to function properly was rejected in July 2001. Respondent No. 2, Guangzhou interviews, August 2001. Three months later, the division, still not yet in operation, obtained its first staff member - a clerk. Respondent Nos. 5 & 6, Guangzhou interviews, November 2001.

⁶¹ Respondent No. 6, Guangzhou interviews, November 2001. Hubei’s situation was confirmed during author’s interviews with Hubei provincial fiscal officials in December 2001.

and objectives of the budget reflect a repositioning of the government amidst wider changes in state-society relationship.⁶²

That the government should strategically withdraw from certain sectors whilst strengthening participation in others was specifically raised in December 1998, as part of the policy to build the ‘framework’ of public finance, by Vice Premier Li Nanqing during the annual national fiscal work conference in Beijing.⁶³ This decision had been underlined by years of discussion on ‘changing government functions’, which had informed the organizational restructuring reform of State Council ministries in spring 1998, when the number of ministries shrank from 40 to 29 and as many as 50 per cent of personnel were made redundant.⁶⁴ In that reform the Ministry of Finance had seen substantial changes in its internal structure and functions. Micro-management functions, for example, direct intervention into state enterprises, were de-emphasized whilst policy oversight and macro regulation of government revenue and spending was strengthened.⁶⁵

The first specific policy change mandating a withdrawal of government participation from the competitive business sector occurred almost immediately in the banning of new fiscal credits. On 1 January 1999, the State Council approved a notice

⁶² For an example of such rethinking of the role of government by a Guangdong provincial fiscal official, see Li Xudong, ‘Lun Zhengfu Gaige’, 4 parts, *Guangdong Caizheng*, 2 (1998), 15-18, 3 (1998), 14-16, 4 (1998), 12-13, 5 (1998), 12-13. Li was the director of the Research Institute of Financial Science, Guangdong Provincial Finance Bureau. See also ‘Role of government finance under market economy: an interview with He Shengming, Director of the Research Institute of Financial Science, Ministry of Finance’, *Guangdong Caizheng*, 11 (1998), 8-9, for views of a central fiscal research official; and a collection of 7 articles by national and provincial scholars, finance researchers and officials on the subject in *Guangdong Caizheng*, 2 (2000).

⁶³ *People’s Daily*, 16 December 1998, 1, for the coverage of Li’s announcement. For an analysis, see Jia Kang, ‘How our fiscal work may achieve its objectives with ease?’, *Guangdong Caizheng*, 12 (2001), 5-6.

⁶⁴ Liu Zhifeng ed., *Di Qi Qi Gaiming: 1998 Zhongguo Zhengfu Jigou Gaige Biwanglu* (The Seventh Revolution: A Memorandum of the Chinese Government Organizational Reform 1998), Beijing: Jingji chubanshe, 1998, 98-101.

⁶⁵ Bai Jingming, ‘A reform with rich contents: Appraising the organizational reform at the Ministry of Finance’, *Guangdong Caizheng*, 10 (1998), 16-17. See also Jia Kang, ‘The implementation of the “proactive fiscal policy” in China: China’s Fiscal policy 1998’, *Guangdong Caizheng*, 12 (1998), 14-16, for a checklist of areas of ‘withdrawal’ of the Ministry of Finance. They included, (a) no more screening and approval of specific financial matters of state enterprises, no more financial plans and assessment indicators from the MoF; (b) reducing items on the financial management of state administrative (shiyue) units requiring approval of MoF; (c) replacing the annual financial check-up exercise with regularized control mechanisms; (d) banning new fiscal credits; (e) delinking of economic intermediaries (accounting firms, state bonds service companies) from MoF; and (f) stopping the provision of budgetary funds, in principle, for the technical renovation of state enterprises in competitive sectors.

by Ministry of Finance that prohibited new dispatch of fiscal credits, which fiscal departments of various levels had previously used to support specific investment projects in industry and agriculture.⁶⁶ During the 1990s, when investment monies from inside the budget gradually dried up, local governments found fiscal credits a handy means to continue their development plans. In practice, most fiscal credits became bad debts, as many investment projects failed to provide returns. Interestingly, when banning new fiscal credits, the State Council directive made no explicit reference to the notion of 'public finance', or that of 'withdrawal from business'. In fact, the measure was justified largely in terms of tightening up management and containing abuse, with only very general reference to financial and fiscal reforms.⁶⁷

In part this reflected the ambiguity of the new policy and the resistance against it. Whilst calling for a strategic rethinking of the boundary of the government and the market, the policy was abundantly unclear about how and where the boundary should be drawn. Apart from ideological hangovers there was the genuine concern about the 'need' of the as yet developing market for government assistance. Local governments of less developed regions were especially critical of the relevance of the 'withdrawal' policy for their undeveloped markets, citing that developmental efforts by governments were still much required.⁶⁸ Thus the withdrawal policy was highly qualified from the beginning. First, withdrawal was to be gradual. Secondly, withdrawal was to take place in 'general competitive sectors' only. Continued participation, or even enhancing the role, of government in other 'non-general' competitive sectors was to be expected. There was also a differentiation between central and local governmental roles. Some participation activities may be inappropriate for local governments, but not for the central governments.⁶⁹

⁶⁶ State Council Notice No. 1 (1999), 'Approving Ministry of Finance's proposal on tightening up fiscal credits', 1 January 1999.

⁶⁷ This is gathered from a reading of the notice.

⁶⁸ My research on Hubei details the resistance of county officials of this central policy. See Li, 'Understanding institutional change'. Central officials also acknowledged local resistance against the policy and the need for differential speeds of implementation across regions. See Jia Kang, 'How our fiscal work may achieve its objective with ease?', 5. Respondent No. 1, in Guangdong, mentioned that whilst resistance was stronger the lower one went down the hierarchy, there still remained some resistance among the 'departmental' (*Shi*) level officials within the Ministry of Finance, due to sheer weight of customary behaviour and established attitudes (Guangzhou interviews, July 2001).

⁶⁹ It was said that the central government should maintain 'appropriate' participation in competitive sectors, for example, in cross-provincial projects, projects with a long gestation period, and projects with major strategic importance. Jia Kang, 'How our fiscal work may achieve its objective with ease?' The continued use of traditional methods of support in the central government is apparent in the case of

Implementation of the ‘withdrawal policy’ in Guangdong has been reflective of such ambiguity. On the one hand, by 2001, the withdrawal policy appeared to be firmly in place for the failing state enterprises. In a provincial fiscal directive, the provincial government laid down the details of calculation method whereby compensation payments would be given to workers of state enterprises facing ‘withdrawal from the market’.⁷⁰ The reference to the withdrawal policy is explicit in the title of the directive as well as in the content (e.g. Art. 1). In 2001, a total of 308 million yuan was expended from the provincial budget for such purpose, amounting to 0.2 per cent of total local budgetary expenditure.⁷¹ In fact, even before withdrawal was explicitly accepted as government policy, the scale of loss in parts of the state sector was often so large that some state enterprises were simply pushed out of business. In these cases withdrawal had been accomplished *de facto*.⁷²

On the other hand, it is premature to conclude change has thoroughly taken place. In many cases the government had yet to relinquish fully its customary ways of ‘participative’ economic management. Despite national regulation to the contrary, for instance, local governments still habitually returned part of the collected tax revenues to enterprises as their substantive ‘support’ to economic production. A provincial fiscal notice suggested that Guangdong was no exception.⁷³ Localities in Guangdong, if not the provincial government itself, still widely practised various means of tax exemption and tax rebates as part of their economic development strategy. As far as withdrawal has started, therefore, this took place only in sectors where continued investment and spending has proved wasteful. For other cases, the ‘normal’ rule –

electronic industry, as an ‘industrial development fund’ is specially created to provide funding support on a project basis. See Ministry of Finance Notice No. 425 (2001), ‘On announcing the temporary management method of the Electronic and Information Industries Development Fund’, August 2001.

⁷⁰ Guangdong Fiscal Bureau Notice No. 283 (2001), ‘The method of calculating the compensation payment for staff workers of failing provincial state-owned enterprises under the withdrawal policy’, issued in September 2001.

⁷¹ Chen Jixing, ‘Implementation of the 2001 Guangdong provincial budget’. This was but part of the total government expenses on the failing state sector, however. In addition to this 308 million yuan, 490 million yuan was spent on closing coal mines, 110 million yuan on closing sugar cane processing factories and paying the debts due to peasants supplying the sugar cane, and 960 million yuan to subsidize the losing grain trading co-operatives. These add up to 1.4% of total local fiscal expenditure.

⁷² For a discussion of this *de facto* process in a Guangdong locality, see Zhu Linxing, ‘Exploring the avenues of withdrawal for state owned enterprises in Muizhou’, *Guangdong Caizheng*, 10 (2001), 36-37.

⁷³ Guangdong Provincial Government Notice No. 21 (2000), ‘Remitting State Council’s Notice on Rectifying Local Discretionary Policy on Tax Rebates’, February 2000.

intervention and participation - still applied. Here the remarks by a provincial official are indicative:

‘One key issue on which a decision is as yet pending is from which specific industries the government should withdraw participation. The accepted principle is withdrawal from competitive sectors. However, a blanket withdrawal from all sectors is simply impossible because of concerns over social stability, tax revenue implications and market capacity. This has mandated the current policy of ‘gradual withdrawal’. This means that the government seeks to improve the management of existing state enterprises, thereby rescuing them from the prospect of eventual closure and thus withdrawal *de facto*. The government would also work towards concentrating its participation on more profitable industries.’ (Respondent No. 7, Guangzhou interviews, July 2001)

The ‘gradual withdrawal’ policy thus actually meant that, for most enterprises, business would be conducted as usual. In fact, more, not less, assistance from the government would be rendered to most state enterprises in the hope of pre-empting eventual withdrawal in the future. This was apparent in the most recent Government Report of 2002, in which Governor Lu Ruihuan said that technical renovation of existing enterprises would be a major priority of this year’s government work.⁷⁴ The interventionist stance was more explicit for industries targeted for growth, and the provincial government had never hesitated in speaking its role in steering and fostering ‘strategic’ industries.⁷⁵ Not only were funds set aside from within the budget to support desirable projects, but the management methods also reminded of a system in the pre-reform days.⁷⁶ In these areas, the withdrawal policy appeared to be quite irrelevant.

The question is, if the application of withdrawal policy is so selective, why was it applied at all in some occasions? How reform is being selected to practise in

⁷⁴ See reports in *Nanfang Daily*, 29 January 2002, 1.

⁷⁵ This was evident in both the 2001 and 2002 Government Report of the Provincial Government.

⁷⁶ Guangdong Provincial Government Notice No. 15 (2001), ‘Approving the establishment of the Technology and Trade Special Fund vote’, and Guangdong Provincial Fiscal Bureau Notice 82 (2001), ‘Management methods of the Technology and Trade Special Fund Vote’, July 2001.

some cases, and not in others? My contention is that the costs of the reform bear more importance in the consideration for change than perceived benefits to be brought about by reform. Figure 1 depicts a matrix of costs and benefits of pursuing reform.

Figure 1 Cost-benefit analysis of reform

		Costs	
		L	S
Benefits	L	<p>3</p> <p>Large benefits / Large costs</p>	<p>1</p> <p>Large benefits/ Small costs</p>
	S	<p>4</p> <p>Small benefits / Large costs</p>	<p>2</p> <p>Small benefits / Small costs</p>

Probability of reform is highest in the case of large benefits/small costs, second place in the case of small benefits/small costs, third place in large benefits/large costs, and the lowest in small benefits/large costs. The argument is that costs to reform are more immediately felt, often articulated by specific groups of actors, than benefits, which are more diffuse, and often enjoy less vocal and focused support from would-be-beneficiaries. As a result costs override benefits in the consideration of change. The withdrawal policy was applied to failing state enterprises not because of the larger benefits it would bring, but because of the smaller costs. The bargaining position and expectation of workers had been weakened by a history of business failure, in comparison with workers in an enterprise that was still in business. Withdrawal was thus applied to the former but not to the latter despite that potential benefits from applying the policy would be greater in the latter, as earlier withdrawal would have saved the resources that the state would invest in this enterprise, which should not have been invested if the principle of public finance had been strictly followed.

An Assessment

What stands out from this discussion is that the progress of public finance reform has not matched its rhetoric. The official publications were full of coverage on reform, including a quite active theoretical discussion on the boundary of the government vis-à-vis the market. The provincial leadership have also set specific targets, demanding Guangdong to set the pace ahead of the rest of the country.⁷⁷ Nevertheless, when it came to implementation, progress was rather limited and slow to come, and the forerunner in this case appeared to be largely a follower of national initiatives. In spite of hubs of innovation within the province, progress on a provincial-wide scale was slow. Examples are many. The separation of fee collection and spending began to be implemented across the province in a more serious manner in as late as 1998, despite it had been mandated by the central government in 1993. The provincial government has done very little to make its release of financial and budgetary information more transparent. On the disclosure of extrabudgetary revenue and expenditure, for instance, Guangdong Province has historically, and still, lagged behind the central government and the majority of provinces and cities, many of them now habitually include information on extrabudgetary revenue and expenditure in their statistical publications. Only a small portion of extrabudgetary funds has been incorporated into the budget, and the delinking between fee revenue and spending ‘rights’ of the units started with only six bureaus in the provincial government in 2002, as the first batch of provincial departments to compile comprehensive budgets. Centralized payment mechanisms were instituted even more slowly. Centralized government procurement was minimal, with virtually nil progress in the procurement of capital projects. The province lagged behind in making the necessary organizational adjustments in the implementation of the reform. It was among the last provinces nationally in creating a new Treasury Division in its Finance Bureau. For a move that would benefit the bureaucracy itself, the inaction testified the lack of urgency perceived by the provincial leadership of the intended reform.⁷⁸

At the public budget front of reform, there appears to be substantial unevenness in the assertion of political will and application of resources. The withdrawal of government from those state sectors that had gone under for some time

⁷⁷ It was reported that during the provincial fiscal work conference in August 2000, Vice governor Wang Qishan demanded that Guangdong to achieve completing the public finance mechanism by 2003, 2 years ahead of the national target. *Guangdong Caizheng*, 9 (2000), 4.

was established policy, if not *de facto* practice. On the other hand, there was substantial wavering of the boundary between government and market for many surviving state enterprises, and in some cases the reverse had been advocated.

The task is how to make sense of these observations. Why the implementation of comprehensive budget reform has been lacklustre? What does the unevenness in the implementation of withdrawal policy suggest to us? The contention is that the perceived interest of the province, or provincial government, is at stake. The comprehensive budget reform was seen as lying outside the core of interests of the province, if not directly against it. The main interests of the province were perceived to lie in, first, economic development, and, secondly, designing a better mechanism whereby revenue and expenditures would be shared more equitably between the Centre and Guangdong. Provincial fiscal officials, during interviews on public finance reform, have time and again emphasized the importance of having good economic growth and managing the fiscal relationship with the central government. To the extent that public finance reform as a whole was seen as ground-breaking, it was also regarded as less urgent. When I probed for an explanation for the sluggishness of the provincial government in extending the successful experience of some localities within the province, an official described the situation as follows:

‘The main constraint is fiscal capacity. That is, whether we have the monies to implement the reforms. How to achieve a breakthrough? Well, we have to take a gradual approach. The priority is always economic development. Only with a booming economy it is then possible to develop the fiscal capacity for the reforms.’ (Respondent No. 2, Guangzhou interviews, November 2001)

The official was of the view that reform, in many cases, necessitated more spending, if only to lubricate the process. Indeed this has been the experience in Shunde, where in 1999 fee revenue and spending provision had been ‘delinked’, and take-home pay for officials standardized across all departments. The availability of new monies to cushion reform was obviously critical, as Shunde’s fiscal officials readily acknowledged that they had been very generous in the design of the new arrangement,

⁷⁸ This was also admitted by Respondents Nos. 5 and 6, Guangzhou interviews, November 2001.

so that reform would cost dearly to nobody, and the change process was a positive sum game for all.⁷⁹ This would not have been possible if Shunde had not enjoyed a booming economy and an expanding inflow of revenues to the city coffer.⁸⁰ However, it also meant that Shunde's experiences would not be directly transferable for many poorer areas in the province.⁸¹ Without enough additional resources to serve as the lubricant of reform, comprehensive budgeting would entail very substantial reallocation of resources across departments, creating losers and winners.

The real question is: why should the provincial government refrain from pushing for reform short of a win-all game? Why was comprehensive budgeting not a priority? An answer is suggested in the following discussion on the 'comprehensive budget' reform:

'We are aware of the limited coverage of the 'separation' (fee collection and spending) mechanism. Quite substantial amount of revenues are still being left out of the system, not to say to be incorporated in the budget. The point is that people here (officials of the Provincial Finance Bureau) do not even have the intention to bring in these 'left out' revenues. Partly this is simply bureaucratic inertia and inaction. Partly this is deliberate. We are not interested in extending the coverage of the 'separation' mechanism, because once these fees come in the system, they will have to be incorporated into the budget one day. *We are not interested in seeing a bigger budget, as this would almost inevitably invite troubles from the central government.*' (Respondent No. 1, Guangzhou interviews, July 2001) (emphasis added)

⁷⁹ Respondent No. 1, Shunde interviews, September 2001. What happened in Shunde was that the bonus, and other non-standard pay elements were incorporated into the salary, and departments which had had lower levels of these non-standard pay had their pay level increased. After these adjustments, monthly pay for a Shunde middle-ranking official in 2001 was 3000 yuan, which is about the same level of the premier.

⁸⁰ Shunde's economy has been booming, with average annual GDP growth rate of 24.9% during 1991-99. Local fiscal revenue grew by an annual average of 31.1% during the same period, and by a record high 47% in 2000. Jiang Zuozhong, *Jingji Fazhan Zhong di Zhidu Biquan* (Institutional change in economic development: A theoretical and empirical study of Shunde) Beijing: Central Party School press, 2000, 54; and Shunde Planning and Statistical Bureau, ed., *Shunde Statistical Information*, 2000, neibu.

⁸¹ This limitation of Shunde's experience was admitted by Shunde officials themselves. Respondent No. 1, Shunde interviews, September 2001.

At work was thus the traditional concern for fiscal autonomy and security against central encroachment.⁸² Having lived through frequent remapping of boundaries in the past, the provincial, and local, authorities had a large appetite for security-boosting mechanisms. There was a strong feeling in the provincial government that the tax-sharing system instituted in 1994 had been only half-completed, and that a clear-cut division of central and provincial revenue and expenditure had yet to take place.⁸³ In this light Guangdong officials were highly alert of any possible redrawing of the boundaries of central and local revenue.⁸⁴ Ironically, this has had a positive impact on the enthusiasm of tax collection, and may have contributed to the high rate of local revenue growth in some localities in recent years. An official in Shunde said the following when explaining the spectacular 47 per cent increase of city fiscal revenue in 2000:

‘There have been rumours these few years that the central government is going to readjust the division of central and local revenue. This has raised concern within the city government that we need to collect taxes and raise the level of local revenue as much as possible so that when change comes, we will have a higher baseline to start with. It is because vested interests have always been protected in previous adjustment exercises, which always attack the margins. Another factor to the rapid growth in local revenue is the enactment of a new law on tax collection. The law imposes more stringent penalty on lax implementation of taxation laws. However, why should we abide by this law at the local level? Well, this law is better understood as having a reinforcing effect on the former consideration of protecting vested interests. The former consideration makes tax collection potentially beneficial to the longer run interests of local finance, whilst the new law raises the stake for lax tax collection. The combined ‘pull and push’ effect of these two meant that now

⁸² See my book, *Centre and Provinces: China, 1978-1993. Power as non-zero-sum*. Oxford: Clarendon Press, 1998, for a detailed discussion of the impacts of this concern in Guangdong and Shanghai during an earlier period.

⁸³ The completed part, from the perspective of provincial officials, was the surge of central revenue at the expense of the provinces. The most recent reference to this appeared in Zeng Yuqin, ‘What is the implication of WTO accession for Guangdong’s local revenue?’, *Guangdong Caizheng*, 1 (2002), 9.

⁸⁴ Guangdong’s finance officials anticipated threats on the local revenue from the WTO accession as the central government would have to compensate for central revenues foregone as a result of tariff concessions. See Li Xudong and Zeng Zhiwen, ‘The impact of WTO membership on Guangdong’s government finance’, part 1, 21.

the city government had potentially more to gain from higher local revenue, and more to lose from lax tax collection.’ (Respondent No. 1, Shunde interviews, September 2001)

As I noted elsewhere, the struggle to protect local resources and enhance local fiscal autonomy had led the Guangdong authorities to encourage the expansion of the extra-budgetary sector during the 1980s in the first place.⁸⁵ The tolerance of an extra-budgetary sector would appear to contradict the new enthusiasm in revenue collection. Their common link to the concern for local fiscal autonomy, however, resolved the contradiction and made co-existence possible. In fact, the suspicion for central encroachment among Guangdong’s officials was vindicated by the sudden announcement of an adjustment of tax-sharing system over corporate profit tax and individual income tax in 2002, which saw the central government centralizing more resources to finance its transfer payment to the poorer regions.⁸⁶ Given the continued relevance of the autonomy concern, the provincial government had little incentive to pursue an aggressive containment policy on the sector that owed much of its current shape to provincial policy.

Similarly, the withdrawal policy was full of contradiction only if decisions on government participation in business were based on abstract principles of public finance. But they were *not*. What counted were specific assessments of the impact of government participation or withdrawal on economic performance and social stability, in terms of costs and benefits. Based on these considerations, the provincial government was firm and adamant in the need for continued, if not more, government subsidy to the state sector. It also saw little contradiction in policy when prescribing new government subsidy schemes for targeted new industries. Withdrawal was only implemented in sectors where withdrawal in a substantive sense had already taken place – those state enterprises that had been pushed out of business. There the

⁸⁵ Linda Chelan Li, *Centre and Provinces: China, 1978-1993. Power as non-zero-sum*, Oxford: Clarendon Press, 1998, Paper 5.

⁸⁶ From 2002, the increased portion of the corporate profit tax and individual income tax would be shared between central and provincial governments, whilst the ‘baseline portion’ as of 2001 would still go to central (in the case of state enterprises under central government administration) or local governments as before. The change was made public only in the speech by Xiang Huaizheng on the 2002 budget, 6 March 2002, and was largely a unilateral decision of the central government. The central government only entered negotiations with provincial governments regarding the sharing ratio in November 2001. Author’s interviews in Hubei, December 2001.

withdrawal policy allowed the government to stop injecting monies to sectors and enterprises that had been proved beyond rescue. The significant difference between such targeted applications of withdrawal and a wider application rests not on potential benefits but on costs. It may be argued that by limiting the withdrawal policy to the conspicuously failing sector, the policy served largely to legitimize *de facto* withdrawal, and hence helped the government to contain the resistance of relevant parties. The policy became irrelevant in situations where the costs of withdrawal are conspicuously large.

The picture therefrom emerges is a provincial government, mindful of threats on its autonomy, acting strategically in its choice of specific reform policies. As a result it has barely dipped below the surface in its implementation of the comprehensive budget reform, and selective in withdrawal policy. The situation is not simply one of non-compliance with national reform, as the ambivalence in withdrawal policy, for instance, is more a national than a local phenomenon. A practical implication is, in light of the lacklustre progress in Guangdong, that the province has been unable to take advantage of its leading economic and fiscal position in the country to take the lead in public finance reform. Given its privileged financial position, it is unconvincing for Guangdong to keep on arguing that it needs to focus first on economic development *before* extending public finance reform. There is serious drawback to a narrow zero-sum perception of the relationship between fiscal autonomy and reform. With China's accession to the WTO, and the increasing pressure for the government to open up and be more transparent in a new business environment, the existing strategy of Guangdong will soon reach its limits.