CHINA'S LOCAL PUBLIC FINANCE IN TRANSITION

Edited by
Joyce Yanyun Man
and
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Foreword

For the past 30 years, China's economy has developed rapidly following the implementation of economic reforms that have facilitated investment, expanded trade, and introduced market mechanisms and practices. At the same time, reforms of China's public finances have also proceeded, albeit at a somewhat slower pace and with less publicity. The major reform of public finances implemented in 1994 shifted a large share of fiscal revenues from local governments to the central government. This reform set the stage for the issues addressed in this volume because, while successfully moving revenues from local governments, the reform did not substantially transfer expenditure responsibilities from local governments. Following the 1994 reform, local governments were left with 46 percent of revenues and responsibility for 77 percent of public expenditures.

This overall revenue shortfall at the local government level motivated local governments to exploit new revenue sources, many of which were outside of the general budget. Revenue from the conversion of land from rural use to urban use has been one of the most important extrabudgetary revenue sources for many local governments. Conversion involves compensating farmers for their land based on its value in agricultural use, and then converting the land to urban use and selling it for development at its adjusted and much higher urban value. The difference in land values accrues to the local government.

The revenue from land sales has been a major source of funding for investment in infrastructure capital, often required to provide services to the newly converted urban land. In areas where urban land is in short supply, the revenue realized has been large, and the incentive to produce revenue has led to excessive conversion of land to urban use. Symptoms of such excess conversion have been the low density of development in the periphery of some metropolitan areas and the large areas of urban land that remain undeveloped. This is a surprising, and potentially unique, unanticipated land use consequence of a fiscal reform motivated by a need to increase central government revenues.

However, opportunities to convert land to urban use vary greatly across municipalities, and many local governments have received little revenue from this source. Cross-provincial disparities in revenues and expenditures, which have long been significant, have been exacerbated by cross-provincial differences in urban land values.

Three major policy options explored in this volume can address the underlying imbalance between revenues and expenditures at the local level in China. The first is to institute new sources of local revenue, such as a property tax, and much attention has been devoted to this approach in recent years. The second is to reform and enhance transfers of revenue from the central government to local governments, a promising approach that could also address cross-provincial disparities in revenues and expenditures. The third is to revisit the assignment of expenditure responsibilities and to shift some of these from local governments to the central government so that expenditure assignment aligns better with revenue assignment.

The end result is likely to be a mix of all three policy options as part of an incremental reform that will strengthen fiscal decentralization while attempting to reduce cross-provincial fiscal disparities. Current intergovernmental transfers do little to address these disparities. The policy challenge is to reduce these disparities while preserving incentives for local fiscal efforts to raise revenue.

Gregory K. Ingram
President and CEO
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Introduction

1

Local Public Finance in China: An Overview

JOYCE YANYUN MAN

Since 1978, China has undertaken a range of changes and reforms that have fundamentally transformed the country from social, economic, and government finance perspectives. As a result, China has moved from a command-based to a market-oriented economy; from a closed, self-sufficient, and rural society to a powerhouse nation of international commerce and rapid urbanization; from a country with a high reliance on the agricultural sector to an increasingly industrialized economy with a large proportion of manufacturing and service sectors; from a low-income country with a poverty rate of nearly 60 percent to a nation with a growing and increasingly affluent middle class and a poverty rate of less than 10 percent. The rapid growth in the past 30 years has propelled China into the position of the third-largest economy in the world, eager to exert its due influence in every aspect of world affairs.

However, China has lagged in its public finance reform and political reform. The fiscal policy instruments of taxation and spending have been limited in their utilization and influence. The country's tax structure is far from the optimal level of efficiency and equity. In particular, fiscal reforms in the past 30 years have not addressed the assignment of expenditure responsibilities among China's central and subnational governments to be compatible with their revenue capacity and intergovernmental transfer system. China's local governments (provincial, prefecture, county, and township) have not been granted any legal authority for taxing or borrowing and are overloaded with unfunded central mandates. As a result, many local governments turn to extrabudgetary revenue sources such as land leasing fees and numerous other fees and surcharges, as well as indirect borrowing from banks, to finance infrastructure investment and local economic development. At a time when fiscal and administrative reforms have been moved to the top of the Chinese central government's agenda, the efforts and studies in this book are certainly timely and important.

Evolution of China's Fiscal System and the Development of Local Public Finance

The past 30 years have witnessed a structural change in the Chinese public finance system, albeit far from an adequate one. China has been going through a process of fiscal decentralization to promote local governments' fiscal responsibilities and administrative autonomy while maintaining an adequate degree of fiscal control in the central government (Shen, Jin, and Zou 2006). This trend is in striking contrast to the central control and planning system that existed for 30 years before the current economic reforms. In general, China's fiscal system has experienced three significant stages of change since 1949.

Fiscal Centralization Between 1949 and 1978

Before the economic reforms started, in 1978, China had a control system under which the consolidated budget system was initiated, approved, and administered by the central government. The subnational governments served as agents of the central government with little discretionary spending power. Local governments received appropriation and operating budgets from the central government to deliver public services, including education, public safety, health care, social security, and housing. At the same time, local government authorities were commanded to run local enterprises according to the central planning system. Revenues were collected largely from the taxes and fees and the profit sharing from state-owned enterprises (SOEs). An intergovernmental transfer system was set up to balance the fiscal gap between the revenues collected by local governments and the local spending needs approved by the central government. Any fiscal surplus was transferred to the central government, and shortfalls were covered automatically by the central government through budget appropriations. It was a highly redistribution-oriented system. However, it lacked fiscal incentives for subnational governments to promote local economic development and the effective and efficient provision of public goods and services.

Fiscal Contract System Between 1979 and 1993

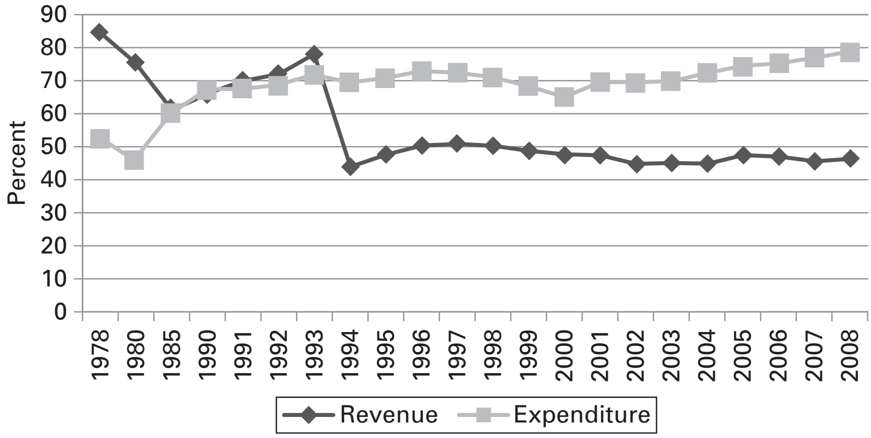
Since the beginning of economic reform in 1978, the central government has initiated a number of fiscal reforms to provide incentives to local governments to promote local economic development and mobilize revenue collection. In 1980 a revenue-sharing system was put in place as an alternative to the highly centralized fiscal structure. Under this system, the central government established the revenue-sharing rules for the central and provincial governments, and each province set the rules for the provincial government and municipalities. The higher-level government determined the revenue-sharing rules for its lower levels of government. Local finance bureaus were largely responsible for revenue collections, which consisted of three types of revenues: central-fixed revenue, local-fixed revenue, and shared revenue (which was split 80–20 between the central and subnational governments). As a consequence of this uniform revenue-sharing structure, fiscal disparity in revenue collection among subnational governments, due to the differences in economic bases and tax efforts, prompted the central government to rearrange this tax-sharing system in 1985. The new revenue-sharing formula took account of the subnational governments' budget balances in previous years and allowed less affluent provinces to retain more revenues; less was allowed for those with high tax capacity. In 1988, the Chinese government implemented a "fiscal contracting system" under which one of six types of revenue-sharing contracting methods would be applied to the provinces (Agarwala 1992; Ma 1997; Shen, Jin, and Zou 2006). However, this tax-and-profit contract system resulted in a drastic decline in revenue collection as a share of GDP and the central government's portion of total revenue. For example, the ratio of total government revenue to GDP dropped from 22.2 percent in 1985 to 12.3 percent in 1993, and the ratio of the central government to the total government revenue decreased from 38.4 percent in 1985 to 22 percent in 1993 (National Bureau of Statistics, various years). The fiscal constraints experienced by the central government and its dependence on local remittances to finance its outlays led to a major fiscal restructuring in 1994.

Tax Sharing System Since 1994

In an effort to mobilize revenue collections and increase revenue shares of the central government, a significant fiscal reform was launched in 1994 that introduced a value-added tax (VAT) to replace the turnover-based product tax; implemented an excise tax on tobacco, liquor, and some luxuries; unified and simplified the corporative income tax; and improved the central-local revenue-sharing arrangements. The tax administration was separated into national tax services (NTS), which were responsible for the revenue collection of central fixed and shared taxes, and local tax services (LTS), which were in charge of local taxes (Bahl 1999; Ma 1997; Shen, Jin, and Zou 2006; Wong 1997). Since the introduction of the tax-for-fee and valued-added tax, central government revenue has experienced rapid growth. By 2008, the central government share of total revenue had increased to 53 percent from 22 percent in 1993. The portion of the tax revenues for the central government reached 64 percent of total tax revenue in China. The ratio of total government revenue to GDP was up by 8.1 percentage points, from 12.3 percent to 20.4 percent between 1993 and 2008.

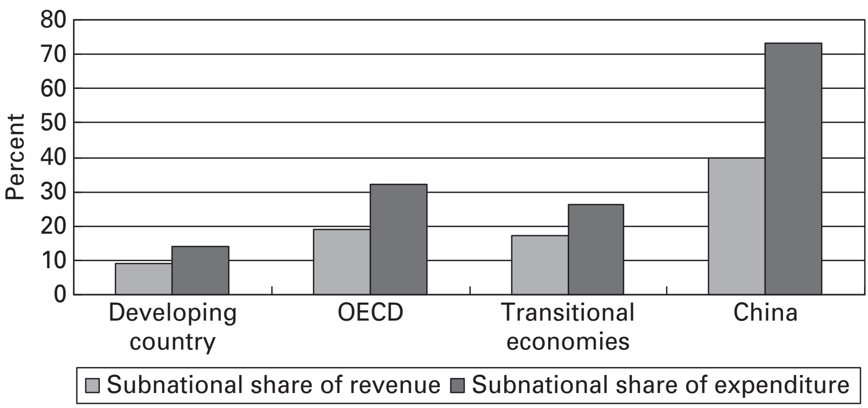
However, the fiscal reforms implemented in 1994 dealt only with revenue assignments, leaving expenditure assignments intact. On the expenditure side, local governments are responsible for the provision of a wide range of public goods and services, including education, health, social services, and economic services. As figure 1.1 indicates, the tax assignment system has resulted in an even bigger fiscal imbalance between revenue and expenditure for local governments in China. For example, subnational governments in China account for 79 percent of total government expenditure but only 47 percent of total government revenues. The mismatch of revenue and expenditure assignments at the subnational level of government in China has led to an increasing reliance on indirect borrowing and on extrabudgetary fees and charges such as land leasing fees to meet the demand for basic public goods and service provision. As figure 1.2 reveals, such a fiscal imbalance far exceeds that of other developing countries, transitional countries, and even OECD countries (Dollar and Hofman 2008).

FIGURE 1.1
Subnational Government Share of Budgetary Revenue and Expenditure in China, 1978–2008



SOURCE: *Chinese Statistical Yearbook,* various years.

FIGURE 1.2
Subnational Government Share of Total Government Revenue and Expenditure in a Comparative Perspective



SOURCE: Dollar and Hofman, 2008.

Local Tax Structure and Fiscal Disparity

The fiscal reforms in 1994 established a tax-sharing system between the central and subnational governments and assigned a number of tax revenues to subnational governments as local taxes. Local government revenues include local tax revenues and shared tax revenues. As table 1.1 indicates, a number of taxes were assigned to local governments as local taxes, including the urban land use tax, land value-added tax, real estate tax, deed tax, vehicle and vessel tax, tobacco tax, farmland occupation tax, and others. In addition, provincial and local governments can share with the central government the revenues from the VAT, business tax, individual and

TABLE 1.1
National Government Revenue of Central and Local Governments, 2008

Item	National Government Revenue (100 million yuan)	Central Government (%)	Local Governments (%)
National government revenue	61330.35	53	47
Total tax revenue	54223.79	57	43
Domestic value-added tax	17996.94	75	25
Domestic consumption tax	2568.27	100	0
VAT and consumption tax from imports	7391.13	100	0
VAT and consumption tax rebate for exports	−5865.93	100	0
Business tax	7626.39	3	97
Corporate income tax	11175.63	64	36
Individual income tax	3722.31	60	40
Resource tax	301.76	0	100
City maintenance and construction tax	1344.09	1	99
Real estate tax	680.34	0	100
Stamp tax	1311.29	72	28
Stamp tax on security exchange	979.16	97	3
Urban land use tax	816.90	0	100
Land appreciation tax	537.43	0	100
Tax on vehicles and boat operation	144.21	0	100
Tax on ship tonnage	20.12	100	0
Vehicle purchase tax	989.89	100	0
Tariffs	1769.95	100	0
Farm land occupation tax	314.41	0	100
Deed tax	1307.53	0	100
Tobacco leaf tax	67.45	0	100
Other tax revenue	3.68	4	96
Total nontax revenue	7106.56	24	76
Special program receipts	1554.10	13	87
Charge of administrative and institutional units	2134.86	17	83
Penalty receipts	898.40	4	96
Other nontax receipts	2519.20	44	56

SOURCE: *China Statistical Yearbook*, 2009.

corporate income tax, resource tax, and urban maintenance and construction tax. As a result, local governments' revenue accounted for 43 percent of total tax revenue in 2008.

Local taxes are administered by subnational governments, and the resulting revenues are used to finance local government activities and expenditure programs. Provincial governments have been granted certain legislative rights for some local taxes. For example, provincial governments have a right to design the implementation details for the real estate tax, urban maintenance and construction tax, vehicle use tax, and urban land use tax and to set the tax rate within the range approved by the central government. In 2007, local taxes generated 287.13 billion yuan and accounted for 14.9 percent of total subnational government tax revenues. Local taxes cover only 12.2 percent of local expenditures, demonstrating that they are not an adequate revenue source for provincial and subprovincial governments to finance public goods and services and economic activities carried out by Chinese local governments.

The current fiscal structure in China has also resulted in enormous fiscal disparities among subnational governments. As table 1.2 shows, the per capita tax revenue ranges from 709 yuan and 730 yuan in Tibet and Gansu, respectively, to 11,165 yuan in Shanghai and 9,140 yuan in Beijing in 2007.

When the share of tax revenue is compared to GDP, table 1.2 also reveals that Guizhou, Gansu, and Tibet were among the lowest in tax revenue per capita, while Shanghai, Beijing, and Tianjin were at the top of the list. This indicates that the tax-sharing reforms in 1994 have achieved the goal of reversing the downward trend in government revenue collection and the central government's share of government revenues, but have failed in achieving fiscal balance among the central, provincial, and local governments. The fiscal inequality poses big challenges to policy makers and public finance scholars in designing a balanced fiscal structure that supports sustained growth and social justice and harmony.

Land and Property Taxation

The Chinese property market is based on a land-use rights system. The ownership of urban land resides with the government. The government leases the land to developers and other users for specified periods of time, and those leases can be bought and sold on the land and housing market. Due to the separation of land ownership and property ownership, property owners are liable for taxes on the property they own and the land they lease from the government in the form of the urban land use tax and the real estate tax. When the transaction occurs, the Chinese government levies a deed or contract tax and a land value-added tax.

Urban Land Use Tax

China has separate taxes on land and housing. The dual land system divides land into state ownership in urban areas and collective ownership in rural areas. The urban land use tax was launched in 1988 and is based on the amount of urban land used by domestic companies, individuals, and some nonprofit organizations. When the land located in an urban area is used, users are required to pay a tax based on the size of the land area acquired, at a rate between 0.6 yuan and 30 yuan per square meter. Before 2007 the rate was 0.2–10 yuan per square meter. Until 1 July 2007, the tax was collected only from domestic taxpayers and foreign companies; individuals were exempted. Since then, individuals have been required to pay this tax, as well, and the entire tax revenue belongs to the local government. As indicated in table 1.3, the revenue generated from the urban land use tax accounts for only 3.5 percent of the total tax revenues of local governments in China.

TABLE 1.2
Per Capita Tax Revenue and Ratio of Subnational Tax Revenue to GDP by Province, 2007

Rank	Province	Tax Revenue per Capita (yuan)	Rank	Province	Tax Revenue / GDP (%)
1	Shanghai	11,165	1	Shanghai	17.02
2	Beijing	9,140	2	Beijing	15.96
3	Tianjin	4,847	3	Chongqing	10.74
4	Zhejiang	3,260	4	Tianjin	10.70
5	Guangdong	2,948	5	Shanxi	10.43
6	Jiangsu	2,935	6	Guizhou	10.40
7	Liaoning	2,519	7	Yunnan	10.27
8	Inner Mongolia	2,047	8	Liaoning	9.82
9	Fujian	1,953	9	Ningxia	9.00
10	Shandong	1,789	10	Guangdong	8.96
11	Shanxi	1,762	11	Hainan	8.85
12	Chongqing	1,572	12	Zhejiang	8.78
13	Xinjiang	1,364	13	Shaanxi	8.69
14	Ningxia	1,312	14	Jiangsu	8.69
15	Hainan	1,282	15	Xinjiang	8.11
16	Shaanxi	1,268	16	Sichuan	8.10
17	Jilin	1,175	17	Inner Mongolia	8.08
18	Heilongjiang	1,152	18	Fujian	7.56
19	Hebei	1,137	19	Anhui	7.38
20	Yunnan	1,078	20	Qinghai	7.24
21	Sichuan	1,047	21	Jiangxi	7.09
22	Hubei	1,036	22	Ganxu	7.06
23	Qinghai	1,027	23	Guangxi	7.03
24	Hunan	954	24	Hunan	6.59
25	Henan	921	25	Shandong	6.45
26	Jiangxi	893	26	Hubei	6.40
27	Anhui	889	27	Heilongjiang	6.23
28	Guangxi	878	28	Jilin	6.07
29	Guizhou	758	29	Tibet	5.89
30	Gansu	730	30	Hebei	5.76
31	Tibet	709	31	Henan	5.74
Average	2,114		Average	8.55%	
Median	1,268		Median	8.10%	

SOURCE: National Bureau of Statistics, 2008.

Real Estate Tax

The real estate tax established in 1986 is levied on the original value or rental income collected from businesses; individuals have to pay the tax only when their property is rented for commercial use. There is no tax on owner-occupied houses. Real estate tax is calculated and paid on the basis of the original value of the property minus a deduction of 10–30 percent. The specific deduction is determined by the people's government of the provinces, autonomous regions, and municipalities

TABLE 1.3
Taxes on Land and Property, 2008

Tax	Implemented Date	Tax Base	Tax Rate	Collection Stage	Share of Local Tax Revenue (%)
Urban land use tax	1/11/1988	Taxable land size (only on domestic taxpayers before 2007)	30 yuan/m^2 to 0.6 yuan/m^2	Possession (recurrent)	3.51
Real estate tax	1/10/1986	Real estate for business use	1.2% of original value or 12% of rental income	Possession (recurrent)	2.93
Land value-added tax	1/1/1994	Land appreciation value	Progressive tax rate (30–60% on the LAV)	Transaction (nonrecurrent)	2.31
Farmland occupation tax	1/4/1987	Farmland size	yuan 1–10/m^2 (yuan 5–50/m^2 after 2008)	Land development (nonrecurrent)	1.35
Deed tax	1/10/1997	Self-reported value of land and house transfer	3–5%	Transaction (nonrecurrent)	5.62

SOURCE: National Bureau of Statistics, 2009.

directly under the central government. The tax rate is 2.9 percent when based on property value and 12 percent when based on rental income.

Before 1 January 2009, foreign companies and individuals were required to pay a separate tax with a tax base and rates similar to those of the real estate tax. The urban real property tax, implemented on 8 August 1951, was based on the market value or rental income of property unless the property was for nonbusiness uses. Local governments were granted the authority to give tax exemptions and tax rate deductions at their discretion. In 2009 property tax reform consolidated the real estate house tax and urban real property tax into a single "real estate tax" to achieve equity and administrative simplicity. Since 1 January 2009, the real estate tax has been levied on real property owned by foreign individuals and enterprises according to the provisional regulations of the People's Republic of China with respect to the use of the tax, basis of tax assessment, tax rate, preferential treatment, exemptions, and management of tax collection.

Land Value-Added Tax

China also collects taxes on land value appreciation, defined as the difference between the original purchase value and the sale price. All businesses and individuals receiving income from the transfer of state-owned land use rights or buildings and their attached facilities are liable for the LVAT. This tax is collected when the transfer of real estate occurs and is levied at the transaction stage with a rate between 30 percent and 60 percent of value appreciation. It is levied upon the land appreciation value, defined as the balance of proceeds received by the taxpayer on the transfer of real estate after deducting the sum paid for the acquisition of the land use rights, the costs and expenses for development of the land, and the costs and expenses for the construction of new buildings and facilities or the assessed value for used properties and buildings. The tax is computed and collected when the transfer of real estate takes place. A progressive tax rate of 30–60 percent on the land appreciation value (LAV) is applied with four brackets as follows:

For LAV <50% of deductible items	30%
For LAV >50% but <100% of deductible items	40%
For LAV >100% but <200% of deductible items	50%
For LAV Over 200% of deductible items	60%

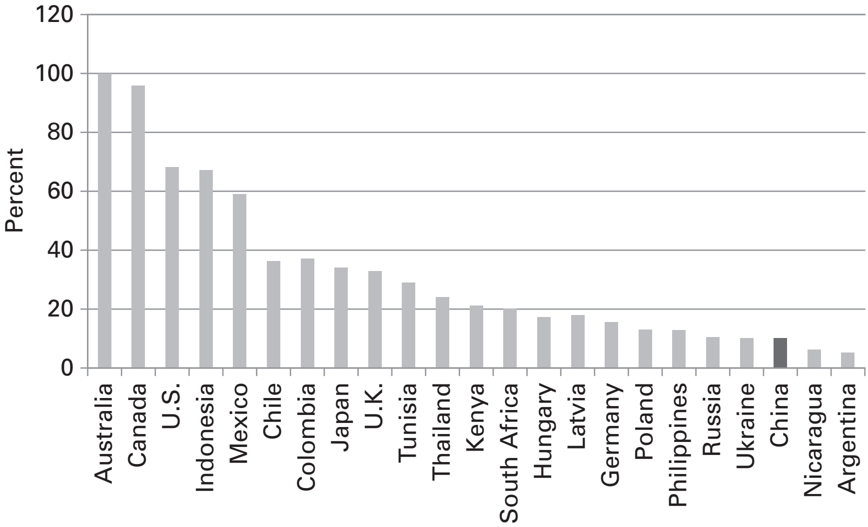
Other Land and Real Estate Taxes

Users of farmland have to pay a farmland occupation tax that has been levied at a rate of 5–50 yuan per square meter since 2008 but at the lower rate of 1–10 yuan per square meter prior to 2008. The deed tax is a tax levied on the contractual value of land use rights and housing during the transaction stage of real property for sales on the market. If the self-reported transaction value of the transferred property is too low, the taxing authority may use an estimated value or the published land base value as the tax base.

Unlike many other countries, China does not tax residential property that is not used for business. But several taxes play the role of property tax. The four main types of taxes relating to real property in China are the urban land use tax, the land value-added tax, the real estate tax, and the farmland occupation tax. These four taxes generated about 2,347 billion yuan in 2008, accounting for only 10.1 percent of local government tax revenue and 8.2 percent of total local government revenue in China. Compared with that of the developed and developing countries in the world shown in figure 1.3, China's land and property tax share of local tax revenue is among the lowest, in the league of Argentina (5.0 percent) and Nicaragua (6.4 percent). It is lower than that of Russia (13.4 percent), Poland (14.01 percent), South Africa (20.3 percent), Indonesia (67.1 percent), and many developed countries.

Land and property tax revenue varies greatly among provinces due to inconsistent enforcement practices, different tax bases, and pressures from interjurisdictional tax competition and other factors. Not surprisingly, Beijing and Shanghai have the highest property tax per capita. The degree of reliance on property tax revenue varies among provinces, as well. It ranged from 1.95 percent of total revenue in Tibet and 7.51 percent in Qinghai Province to 21.26 percent in Jiangxi and 22.55 percent in Shandong Province in 2008. On average, it accounts for 14.64 percent (National Bureau of Statistics, 2009). Such disparity, however, is likely to result in differential effects of the property tax on economic activities in China.

FIGURE 1.3
Share of Property Tax in Local Tax Revenue or Local Revenue in Selected Countries



SOURCES: Richard M. Bird and Enid Slack, *International Handbook of Land and Property Taxation;* Joan M. Youngman and Jane H. Malme, *An International Survey of Taxes on Land and Buildings*; Government website of each country; China's data are compiled by the author.

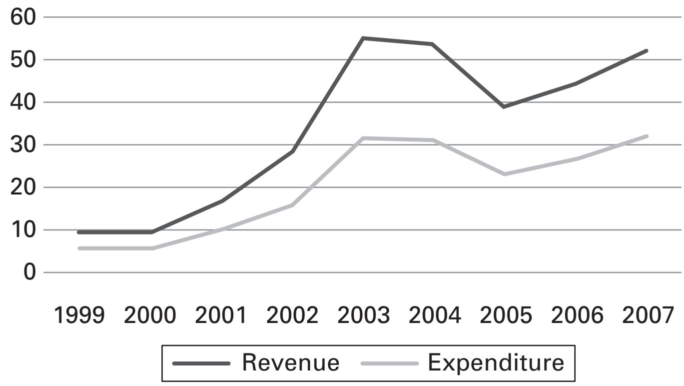
Extrabudgetary Activities and Land Transfer Fees

The Chinese government also relies heavily on extrabudget revenue that is excluded from the revenue accounts compiled by the Ministry of Finance. Extrabudget revenue usually includes user charges for public utilities; fees for public services; surcharges on taxes; earmarked levies for specific purposes or funds, such as education; and revenues from commercial or business undertakings by government enterprises or agencies. Extrabudget revenues amounted to 661.7 billion yuan, or 2.2 percent of GDP, in 2008 (National Bureau of Statistics, 2008).

The imbalance of expenditure and revenue assignments facing provincial and local governments and consequent pressure of fiscal stress and interjurisdictional competition have made local governments turn toward extrabudgetary revenues for government financing, as well (Song, Chu, and Cao 1999). In recent years, most local governments have relied on the sales of land rights for much needed revenue to finance basic public services demanded by their residents and comply with mandates from the central government. As a result, land transfer fees increased from 9.3 percent of total local budgetary revenue in 1999 to 43.5 percent in 2008, as shown in figure 1.4. The revenue from land transfer fees was about 21 percent of total local expenditures in 2008, up from 5.7 percent in 1999, indicating an increasingly heavy reliance on land transfer fees as a revenue source and possible evidence of the existence of so-called land public finance at the local level.

In 2007, per capita land transfer fees revealed large variations among provinces, as indicated in table 1.4. When they are ranked according to the ratio of land trans-

FIGURE 1.4
Importance of Land Transfer Fees by Province, 2007



SOURCE: *Chinese Statistical Yearbook of Land Resources,* 2008.

TABLE 1.4
Importance of Land Revenue by Province, 2007

Rank	Province	Land Revenue / GDP (%)	Province	Land Revenue / Fiscal Revenue (%)	Province	Land Transfer Fees per Capita
1	Sichuan	5.40	Sichuan	66.66	Tianjin	1794.6
2	Chongqing	4.31	Chongqing	40.18	Beijing	1107.9
3	Tianjin	3.96	Anhui	38.40	Liaoning	764.7
4	Hainan	3.24	Tianjin	37.02	Fujian	713.2
5	Liaoning	3.00	Fujian	36.65	Sichuan	697.3

Rank	Province	Land Revenue / GDP (%)	Province	Land Revenue / Fiscal Revenue (%)	Province	Land Transfer Fees per Capita
27	Yunnan	0.45	Shanghai	5.50	Jiangxi	67.1
28	Tibet	0.38	Yunnan	4.43	Yunnan	47.3
29	Gansu	0.31	Gansu	4.40	Tibet	45.6
30	Beijing	0.19	Qinghai	2.39	Gansu	30.9
31	Qinghai	0.17	Beijing	1.21	Qinghai	24.5

SOURCE: National Bureau of Statistics, 2008.

fer fees to total revenues, we can see that the ratio varies from 1.21 percent in Beijing to 66.6 percent in Sichuan Province in 2007. The five provinces that have the highest ratio of land transfer fees to local revenue are Sichuan Province, Chongqing (40.18 percent), Anhui (38.4 percent), Tianjin (37.02 percent), and Fujian (36.65 percent). The fees from land leasing account for about 5.4 percent of GDP in Sichuan Province and 3.24 percent in Hainan. Not surprisingly, Shanghai and Beijing were among the provinces with the lowest portion of land leasing fees in their local revenue.

Such large variations among subnational governments indicate the need for further analysis of the impacts of land-related taxes and fees on the housing market, the net rate of return on capital, and the economic growth in China.

This Volume

In 2007, a joint initiative created The Peking University–Lincoln Institute Center for Urban Development and Land Policy to give Lincoln Institute of Land Policy's China program a presence in China's political capital. Annual conferences on various land-related topics were convened, and this volume collects the proceedings and papers from the 2008 conference entitled "Local Public Finance and Property Tax in China."

An overview of subnational government finance and the tax structure in China reveals that the reforms of the past 30 years have significantly improved the country's fiscal system but have left many tasks unfinished and the mission incomplete. The most noticeable are the much needed fiscal reforms at the subnational level of government—county and township governments, in particular—and the assignment of expenditure responsibilities among central, provincial, and local governments. The fiscal imbalance between expenditure and revenue assignments among subnational governments may lead to a large disparity in revenue sources and expenditure and, consequently, income inequality. Without a timely correction of this problem, it may result in the underprovision of basic public goods and services, unfounded mandates on local governments, lack of accountability, overreliance on land-related extrabudgetary revenue sources, and a hotbed for corruption. It may also lead to the inefficient use of land and natural resources, unsustainable economic growth, and social instability.

To help understand and solve the current problems in China, this book includes chapters written by scholars in the fields of economics, public finance, urban studies, and business administration from universities, academies, and research institutes in the United States, Canada, and China. The book is organized in five parts, including this overview as part 1. Part 2 describes the local expenditure situation in China, with the focus on such aspects as fiscal decentralization, expenditure assignment, and infrastructure-financing practices; part 3 presents the issues of local revenue sources, land finance, and property taxation; part 4 focuses on local intergovernmental transfers; and part 5 elaborates the fiscal reforms of the past and shows the direction for future reform.

In chapter 2 Jorge Martinez-Vazquez and Baoyun Qiao present an assessment of the assignment of expenditure responsibilities in China, as well as the common problems encountered in the international experience. The chapter provides a road map and practical recommendations for the reform of expenditure assignments in China. It argues that a stable, efficient, and fair decentralized system of public finance in China will require an unambiguous and well-defined institutional framework in the assignment of expenditure responsibilities among the different levels of government.

Chapters 3 and 4 focus on public infrastructure financing. In chapter 3 Weiping Wu explores the patterns of financing infrastructure development across different cities and discusses the relationship between infrastructure investment and regional economic performance. While outlining how successive waves of fiscal decentralization in China during the reform era have affected local financing and autonomy, the chapter also examines the increasing disparity in the ability of cities to finance infrastructure development. The conclusion is drawn that infrastructure investment is a statistically significant predictor of regional economic performance, though further research is needed to ascertain the positive contribution of public infrastructure to economic performance.

In chapter 4 John L. Mikesell, Jun Ma, Alfred Tat-Kei Ho, and Meili Niu use Guangdong Province to examine the institutional arrangements and politics of the infrastructure-financing mechanism, to analyze the issues related to "extrabudgetary" revenues and control, and to provide recommendations regarding the current system of capital budgeting and financing. The chapter reveals that the Chinese government still lacks a systematic approach for handling long-term capital improvement plans and developing a regular, comprehensive capital budget. It is important to increase the transparency of capital budgeting decisions and the oversight power of the People's Congress, so that the government can be held more accountable for infrastructure policies and spending decisions.

Donald Brean, in chapter 5, presents an empirical overview of provincial taxation in China, focusing on the recent performance of seven specific provincial taxes in 31 provinces over the years 1999 to 2005. The seven taxes include the value-added tax, operations tax, company tax, individual income tax, resource tax, city construction tax, and contract tax. The chapter also projects the fiscal conditions to 2015. The author's analysis indicates that the disparity of GDP per capita combined with the provincial cross-section disparity in GDP growth rates will eventually give rise to greater disparity in each tax category on a per capita basis.

In chapter 6 Joyce Man and Xinye Zheng empirically test the effects of taxation on economic growth using provincial data from China. Specifically, taxes on business capital income and on land and real property have a negative correlation with economic growth after controlling for fixed effects and simultaneity bias. Results support the hypothesis that distortional taxation lowers economic performance. The results of the study may indicate that sustained growth in China may be achieved by lowering the overall tax burden; reducing taxes on capital income, physical capital, and land; and mobilizing tax resources with efficient administration and enforcement.

Susan H. Whiting, in chapter 7, describes the evolution of the fiscal system since the economic reform and examines the nature of revenue and expenditure assignments, intergovernmental fiscal transfers, and the implications of these factors for coping with revenue inadequacy at the local level and fiscal equalization across local jurisdictions. The chapter introduces some political issues that exacerbate the problems in central-local fiscal relations and develops a case study of one of China's "top 100" counties to examine how it has exploited land to promote revenue generation. The survey of official revenue sources and expenditure responsibilities highlights the fiscal gap that exists for many local governments.

In chapter 8 John Anderson summarizes the major economic impacts of development fees and ad valorem property taxes with applications to the contemporary policy setting of China. Dynamic models of the development process indicate that the policy switch from a lump-sum fee to a property tax would have uncertain effects on both development timing and structural density. Policy insights based on the analytic results for both fees and taxes, with special emphasis placed on transition issues, are provided for the current Chinese situation. More work is necessary to develop appropriate models of a transition from a land-leasing regime to a quasi-ownership regime with taxes or fees used to fund local government provision of public goods.

Using China as a case, Yu-Hung Hong and Diana Brubaker in chapter 9 examine a topic related to real property taxation in transitional countries: taxing public leasehold land. Four scenarios are composed to project property tax impacts on leasehold revenue and land value. By applying the scenarios to China based on ideas of tax and public spending capitalization into property prices, the authors estimate capitalization of property tax liabilities and public goods provision using a random effects regression model and panel data from 1999–2006. Finally, they suggest potential policy implications for the implementation of the proposed property tax reform in China. More research is needed to estimate the capitalization rates of tax and spending.

In chapter 10 Li Zhang and Xinye Zheng discuss the determinants of intergovernmental transfer in China. An empirical analysis based on county-level data sets examines how transfers are allocated to each county. This study analyzes total transfers, as well as different types of transfers. By differentiating between the two broad categories of transfers and two subgroups—NDPCs and non-NDPCs—and then urban and rural counties, the authors found that, due to the effects of the tax rebate, the total government transfer is prorich, although the equalization transfer does play its designated role to equalize fiscal capacity, especially in poor and rural areas.

In chapter 11 Shuanglin Lin examines the determinants of central government transfers, consisting of tax rebates and grants, to provinces. The author found that, even though grants are equity promoting, tax rebates are virtually growth stimulating. The data from 1995 to 2004 for 31 provinces shows that tax rebates dominated the equity-promoting grants in central government transfers; provinces with a higher level of income received more per capita transfers than provinces with a lower level of income; and provinces with a higher growth rate received more per capita transfers than provinces with a lower rate of growth. Thus, the current transfer system is ineffective in reducing the regional fiscal inequality and reforming the transfer system is imperative.

Drawing on a survey carried out by Richard Bird, Loren Brandt, Scott Rozelle, and Linxiu Zhang, chapter 12 provides an analysis of the changes in township and village finance between 2000 and 2004. The survey extends to one hundred villages in fifty townships in twenty-five counties in the five provinces of Jilin, Hebei, Shaanxi, Sichuan, and Jiangsu. This chapter suggests that the development of more responsive and sustainable local fiscal management in China will inevitably require both the devolution of more decision-making power over public finance to local governments and the development of local governments that are more directly responsible to the local people whom they are supposed to serve.

In the last chapter of the book, Roy Bahl reviews the theory and practices of fiscal decentralization and examines whether international practice holds any useful lessons for China. The chapter presents the three key instruments used to decentralize fiscal structures: expenditure assignment, revenue assignment, and intergovernmental transfers. The author compares the international experience with the Chinese practice and examines the special role of the property tax in fiscal decentralization—in OECD countries, low-income countries, and China. The author argues that if China were to develop a local government finance system, international practice could provide good lessons to guide China with intergovernmental fiscal policy.

Given the breadth of the chapter discussions, this book will be a resource for government officials, public finance practitioners, academic researchers, college students, and members of the general public who are concerned with government tax and expenditure policies and practices in China. University instructors will also find this book useful as a supplemental textbook for public finance and economic development courses.

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