

## THE GROWING FISCAL AUTHORITY OF PROVINCIAL-LEVEL GOVERNMENTS IN CHINA

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### INTRODUCTION

THE economic reform that began in China in 1979 has already gone through two phases, and is now entering a third. The first phase involved the breakup of people's communes and the establishment of production contract responsibility for individual farmers. During that phase, the overall direction taken may be summed up in the policy slogan, "central planning is dominant and the market supplementary." Phase two, which lasted from 1984 or 1985 to the autumn of 1989, shifted the emphasis of reform to the urban economy and adopted the slogan, "the articulation of planning and market economy." During that time the central government adopted a policy of transferring over to provincial-level governments and state-owned enterprises various forms of administrative authority that it had formerly claimed exclusive prerogative to.

From the autumn of 1987, a third phase of reform was planned centering around the issues of wages and prices. Similarly, the policy slogan was changed to "the state regulates the market, the market guides enterprise." However, due to the overheating of the economy and price inflation, the implementation of these policies had to be postponed; but after three years of stringency measures, the government in 1992 decided to again promote a third phase of reform.

In a Stalinistic centrally planned economy, markets are for all practical purposes closed, and the economy is managed through the issuance of government directives and central public finance. Economic reform weakens this type of fiscal authority and gives way to a market economy.

It is the aim of the present paper to show how fiscal policy changed in China under the above-mentioned reform directions and what kind of contradiction these policies brought about through an examination of the changing relationship between the central government and local authorities.

### I. THE CONCEPT OF "PUBLIC FINANCE" IN CHINA

#### A. *Administrative Institutions and Fiscal Units*

Administrative and fiscal institutions are virtually inseparable in China. After the founding of the People's Republic in October 1949, the history of administrative institutions can be divided into the two stages: the period up to 1954, and the

period since then. The two administrative systems corresponding to these two stages are shown in Figure 1.

Large administrative regions set up during the military regime that followed the establishment of the People's Republic consisted of six blocks, each governed by a military administrative committee. Examples include the Northeast military administrative region, covering the three provinces of Heilongjiang, Jilin, and Liaoning, and the North China military administrative region, which included the provinces of Hebei, Shanxi, and Henan, as well as the capital of Beijing. Under these larger districts were placed provinces and municipalities administered by people's governments.

With the inception of the First Five-Year Plan in 1953 and its major task of economic building, the military districts were separated from their administrative counterparts, resulting in the removal of large administrative regions from the administrative system in June 1954.

From that time on, a more or less five-level administrative setup was employed.<sup>1</sup> As for minority nationality autonomous prefectures, they had already been given the administrative status of provinces as early as August 1952 under a directive concerning self-governance for China's various ethnic groups.

During the second stage, from the founding of people's communes in 1958 until their disappearance in 1983, townships (*xiang*) and towns (*zhen*) were transformed into commune management committees.

As of 1990, there are a total of thirty provincial-level governments: twenty-two provinces, five autonomous regions, and three municipalities directly under the central government. Prefectural-level governments, which up through the 1950s were referred to as sub-provincial administrative regions (*zhuanqu*), were originally not governing bodies at all, but merely had liaison offices linking county authorities to the provincial government. Today, however, there are 151 prefectural-level governments with autonomous administrative powers. There are two statuses for cities: 185 "at the prefectural level" and 279 "at the county level," bringing the total to 464 in all. There are 1,903 county-level governments. Six hundred fifty-one of the larger cities contain *shiqu* (city proper) governments that are ranked administratively as prefectures. There are 44,446 township (*xiang*) governments, 2,557 minority nationality township governments, 11,392 town (*zhen*) governments, 230 minority nationality town governments, and 743,278 village committees [4, p. 3].

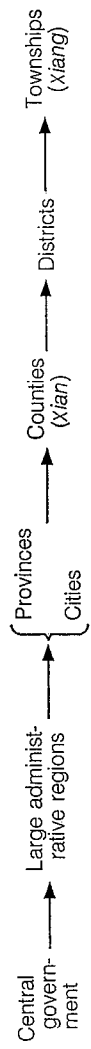
In general, what could be called the "state-managed sector" includes governmental authorities from the county level on up. The sector that falls outside of its sphere of control is defined as the agrarian rural sector, which is subsumed directly under county-level governments. In practice, this sector includes governments from the township level down to the village level. Managing bodies for townships operate under a principle known as "collective-ownership economy."

Fiscal units in China, however, do not correspond to the above five-level administrative organizational units. Before June 1954, when the administrative exclusion of large administrative regions was carried out, China had adopted a

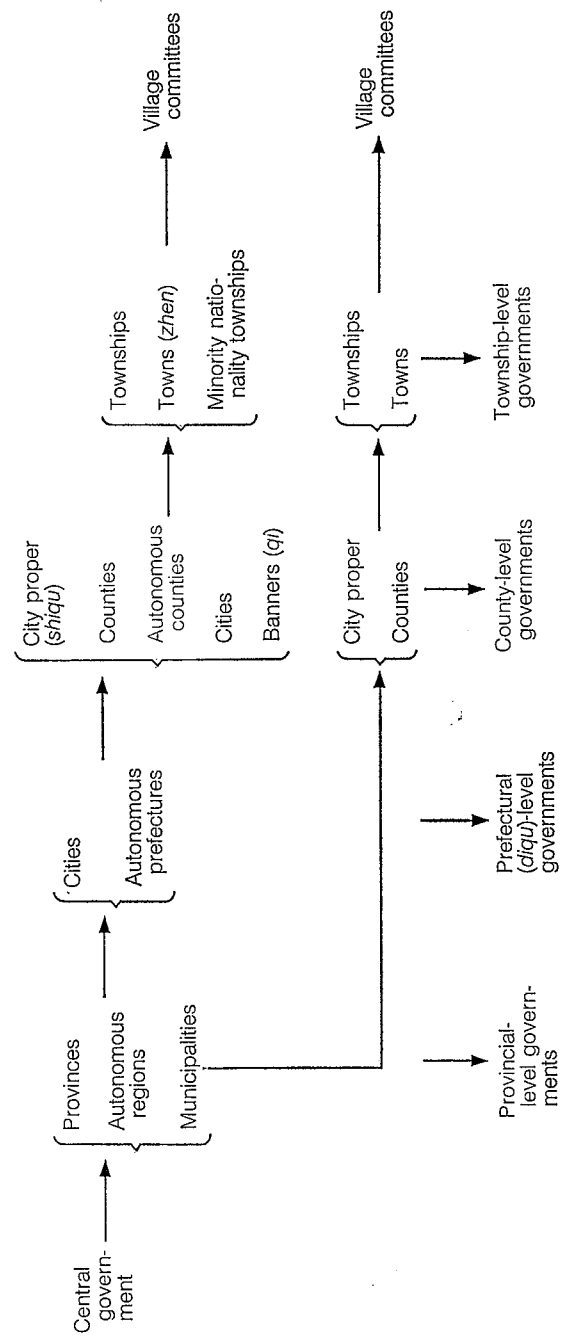
<sup>1</sup> The system was reduced to four levels in some areas with the elimination of autonomous prefectures.

Fig. 1. Administrative System

First Stage, 1949-54



Second Stage, 1954-present day



fiscal system with only three levels: that is, only the central government, large administrative regions, and provincial/municipality districts were funded through the national budget. The expenditures of government from the county-level on down were not directly figured into the national budget, even though there were allotments of fiscal funds from higher-level governments and fiscal revenues which each particular governing body had raised on its own.

After the large administrative regions were eliminated, the three-fiscal unit system was changed to cover the central, provincial, and county governments. Governmental bodies below the county level were dealt with in the same manner as prior to 1954. Even after the establishment of people's communes in 1958, the fiscal funding for these local bodies was not included in the national budget. During the early 1980s, the people's communes were dismantled, and township-level governments replaced them in the administrative structure. The year 1983 saw a government directive aimed at building up township-level fiscal structure, and in May 1985 the Ministry of Finance promulgated a provisional township/town fiscal management act that for the first time incorporated the fiscal cost of this level of government into the national budget. This resulted in the present-day four-level fiscal system including central, provincial, county, and township units [1, p. 20].

#### B. *The Broad and Narrow Meanings of Public Finance in China*

How the term "public finance" is interpreted in terms of breadth in China depends on arbitrary judgments arrived at on the part of the central government. Due to such arbitrariness, unceasing competition for funding now exists between governments and state-owned enterprises on all levels and between the center and local governments.

With respect to the budgetary fight between governments and state-owned enterprises on each fiscal level, first of all it should be mentioned that state-owned enterprises, i.e., enterprises managed by governments from the county-level on up, are defined as such because in principle all of their capital is owned by the state. Nevertheless, the questions of to what extent the fixed and liquid capital generated by these enterprises are in practice under government control, what portion of their corporate finance has been included as a budgetary item, and what portion is under enterprise management have tended to fluctuate over the years.

The items which tend to be the foci of these questions are the profits and corporate taxes paid to governments by these enterprises, as well as accumulated funds to cover depreciation costs. The method for paying out profits in China is similar to practices in capitalist countries with government-managed corporate monopolies. That is to say, profits after the payment of corporate taxes are not placed under the control of these monopolies, but are recovered as a part of government fiscal revenue. Under Stalinistic centrally planned economies almost all corporate profits after taxes are paid to the government, with only a very minute portion being retained under enterprise control.

The question of whether or not public enterprise profits are to be incorporated as fiscal revenue causes significant changes in the scale of annual state income.

Moreover, whether or not fixed capital investment in these enterprises should come from the budget or from loans issued by the national bank causes significant changes in the scale of fiscal expenditures.

Secondly, in a broader sense, governments at all levels have access to secondary budgets called "flexible resource funds" (*jidong caili*). In terms of accounting, these budgets are different in character from the general and special accounting methods used by most capitalist countries. In China, revenue forms such as surtaxes and income from government services are by law recognized as "extra-budgetary" revenue sources. Total funding from the central government on down to the township level is composed of three categories: budgetary funding, extra-budgetary funding, and self-generated funds. Of this total only the first category of budgetary funds is calculated into the official budgets of each government level. This is what constitutes the narrow meaning of public finance, while the inclusion of flexible resource funds and self-generated funds constitutes the fiscal budget in its broadest sense.

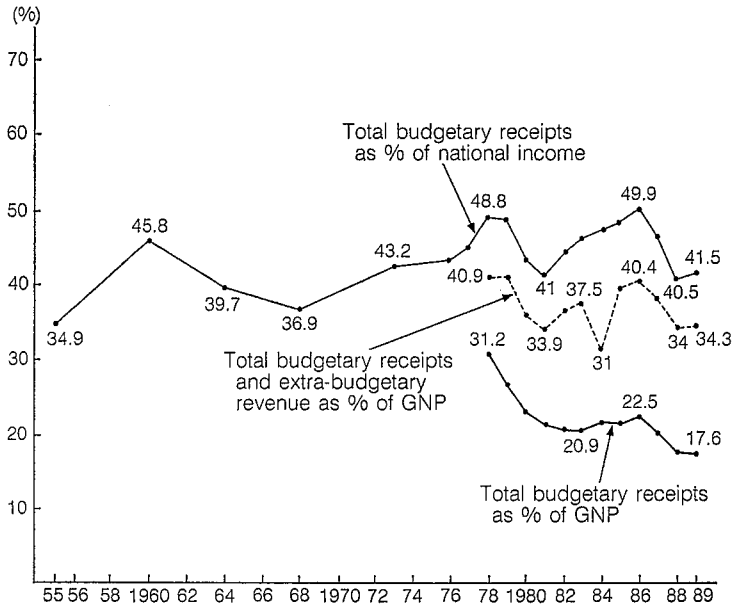
Over the past forty years great changes have occurred in the scale and scope of the extra-budgetary fund management authority that has been transferred from the central government to state-owned enterprises, supervisory bureaus, and local government bodies. For this reason, because of changes in the definition of government public finance, it is impossible to discover any integration or continuity when looking at the data concerning either fiscal scale or percentages of GNP. During the thirty years up to the end of 1979, the breadth of normal budgetary funding was very great, whereas since 1980 many former narrowly defined budgetary items have been incorporated into extra-budgetary categories.

## II. CHANGES IN THE POSITION OCCUPIED BY NARROWLY DEFINED BUDGETING WITHIN THE NATIONAL ECONOMY

Due to the economic reforms that have been implemented in China since 1979, the position occupied by public finance in the national economy has decreased significantly in importance. To repeat, under Stalinistic forms of centrally planned economy, public finance characteristically plays an overwhelming role in managing and developing the national economy. Figure 2 shows the scale of public finance compared to national income and GNP in China since 1955. Here national income is measured by net domestic material production figures (the so-called service sector has been excluded), while GNP has been measured by including services other than those provided by the public administration sector.<sup>2</sup> The figure shows a sharp decline in the share occupied by total budgetary receipts (central and local governments combined) in the GNP since 1978, with the most dramatic fall beginning in 1987. That is to say, the fiscal share of GNP has fallen below 20 per cent since 1987. This is a very low figure when compared to most capitalist nations, which tend to average somewhere around 30 per cent.

<sup>2</sup> GNP statistics prior to 1978 have not been published.

Fig. 2. The Scale of Public Finance within the Chinese Economy, 1955-89



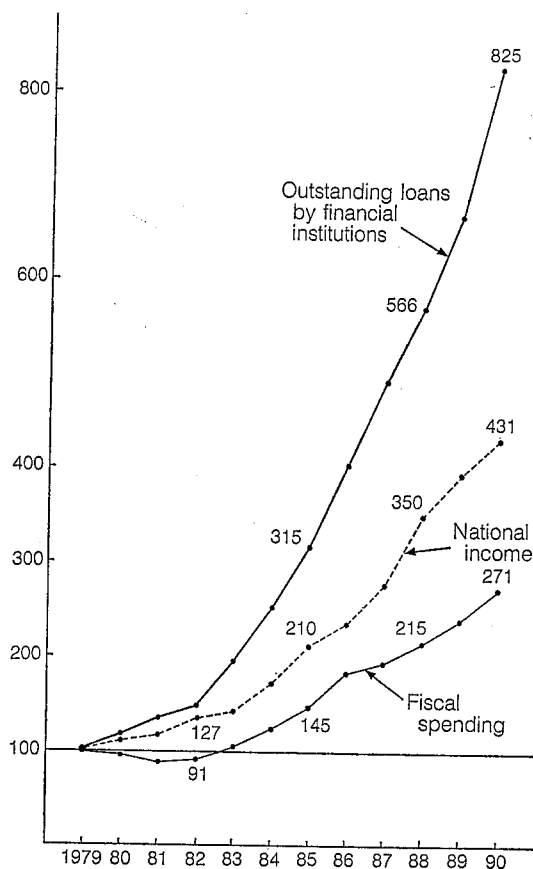
Source: [4, pp. 31-32, 272].

Note: 1955 figures are 1953-59 averages; 1960 figures are 1958-62 averages; 1964 figures are 1963-65 averages; 1968 figures are 1966-70 averages; and 1973 figures are 1971-75 averages.

On the other hand, the figure also shows that the sum of total budgetary receipts and extra-budgetary funds dropped only slightly during 1978-86. Extra-budgetary funds will be explained later on in detail. Economic subjects can retain these funds which are not absorbed into formal government public finance.

Figure 3 shows from another aspect this same decrease in importance of public finance in China's national economy. Here, 1979 has been established as the base year (100) for three indexes—outstanding loans by financial institutions, national income, and fiscal spending—showing that the growth in fiscal spending was much lower than the growth in national income. On the other hand, outstanding loans grew at a much higher rate than national income. Under Stalinistic forms of planned economy, monetary system serves the sole function of registering fiscal fund circulation; therefore, in China before the economic reforms that began in 1979, outstanding loan figures were exceptionally low; that is, they formed very small denominators. For this reason the scope of monetary activities markedly expanded as economic reform permeated Chinese society. Within this process,

Fig. 3. Comparative Growth in Fiscal Spending and Outstanding Loans, 1979-90

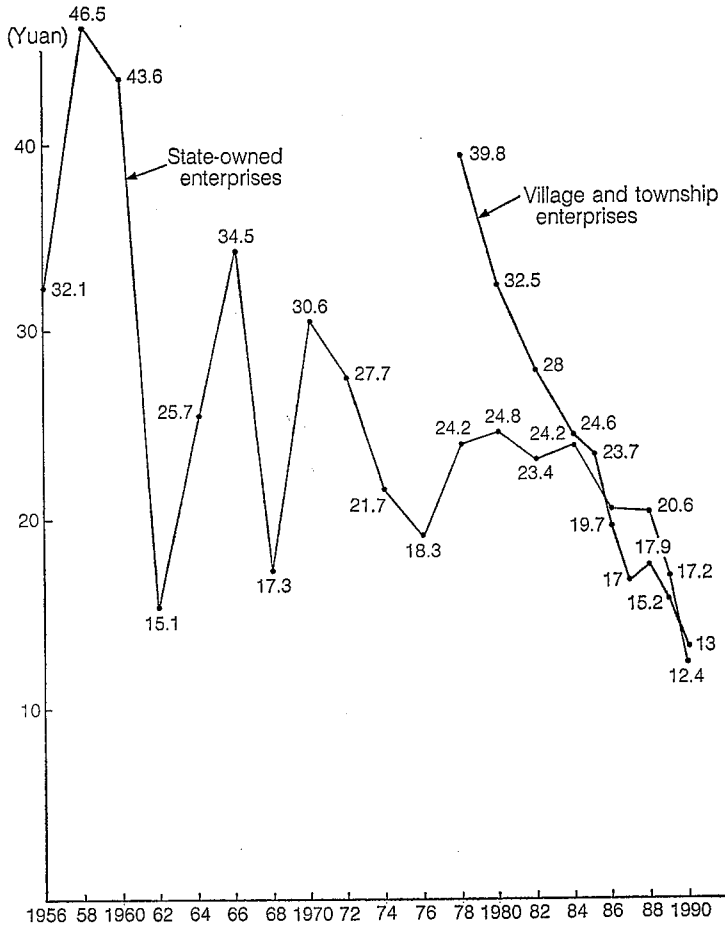


Source: [4, pp. 32, 209, 642] and *Zhongguo tongji nianjian* (1983 edition), p. 450.

Note: At current prices (1979=100).

the role of public finance in the area of capital circulation is gradually weakening in favor of monetary system. There are two factors at work in this diminishing role being played by public finance within the national economy. The first is indicated by Figure 4, which shows the percentage of total enterprise capital taken up by payments to the government by businesses in the form of taxes and profits. The indicator is intended to show what portion of every 100 yuan of capital is paid by state-owned industrial enterprises to the government. It should be mentioned here, however, that since "village and township enterprises" (*xiangzhen qiye*) are collectively owned businesses, profits paid out to the respective local

Fig. 4. Taxes and Profits Realized by the Government from Each 100 Yuan of Fixed and Liquid Capital, 1956-90



Source: [4, pp. 379, 416].

- Notes: 1. Village and township enterprises include all businesses, state-owned enterprises include only manufacturing businesses.
2. Village and township enterprise data prior to 1984 is for village and township government-managed enterprises only. The data since 1984 includes figures for private enterprises as well.



TABLE I  
PERCENTAGE SHARE OF GOVERNMENT REVENUE BY SOURCE

	Taxes	Revenue from Enterprises	Debt Revenues	Funds from the Special Levy for Key Construction in Energy and Transportation	Other Revenues
First Five-Year Plan (1953-57)	49.8	41.8	4.7		3.6
Second Five-Year Plan (1958-62)	43.3	55.4	0.4		1
Adjustment period (1963-65)	45.3	53.5			1.2
Third Five-Year Plan (1966-70)	44.6	54.9			0.7
Fourth Five-Year Plan (1971-75)	44.4	54.6			1
Fifth Five-Year Plan (1976-80)	41.3	45.2	1.6	2.8	
1981	57.8	32.5	6.7		3
1982	62.3	26.4	7.5		3.9
1983	62.1	19.3	6.4	7.4	4.8
1984	63	18.4	5.1	8.2	5.2
1985	86	1.8	3.8	1.2	2.2
1986	80.9	1.6	5.4	6.1	6.1
1987	78	1.6	6.2	6.6	7.7
1988	77.8	1.7	8.8	6	5.7
1989	76.9	1.8	7.9	5.7	7.6
1990	72.5	2	9.6	4.8	11

Source: [4, p. 212].

government bodies are not dealt with as budgetary funds in the narrow sense. It was in 1985 that a steady decline began in the contribution made by state-owned enterprises, resulting in a 50 per cent decline in the 24.2 yuan figure for 1984 by 1990. With respect to village and township enterprises, 1984 marked a widening in scope to include a large number of privately and cooperatively owned businesses in addition to local government-managed enterprises, no doubt resulting in a significant increase in the total capital denominator.

The structures of yearly government revenue and taxation are shown in Tables I and II. The two largest items making up fiscal income are taxes and profits from business enterprises. In 1990 they accounted for 74.5 per cent of government revenue. Taxes alone accounted for 72.5 per cent, 70 per cent of which came from industrial and commercial enterprises. China does not depend on the "turn-over tax" like the former Soviet Union did, but rather obtains revenue from enterprises by means of taxation and direct payments of profits. However, as

TABLE II  
PERCENTAGE SHARE OF GOVERNMENT TAX REVENUE

	Industrial and Commercial Tax	Special Tax on Using Oil as Fuel	Salt Tax	Tariffs	Agricultural and Animal Husbandry Taxes	Construction Tax
First Five-Year Plan (1953-57)	70.2		3.8	3.7	22.3	
Second Five-Year Plan (1958-62)	76.8		4.7	3.3	15.1	
Adjustment period (1963-65)	80.2		3.5	2.6	13.8	
Third Five-Year Plan (1966-70)	80.6		3.5	2.7	13.3	
Fourth Five-Year Plan (1971-75)	86.1		2.6	2.8	8.6	
Fifth Five-Year Plan (1976-80)	87		2.1	5.2	5.8	
1981	85.5		1.4	8.6	3.1	
1982	86.4	1.3	1.4	6.8	4.2	
1983	84.8	2.5	1.3	6.9	4.2	0.2
1984	81.3	1.9	1.1	10.9	3.7	1.1
1985	57.7	0.8	0.5	10	2.1	1.1
1986	62.2	0.8	0.5	7.4	2.1	1.1
1987	64.1	0.7	0.4	6.7	2.4	1.4
1988	66	0.6	0.4	6.5	3.1	1.1
1989	68.8	0.4	0.4	6.7	3.1	1.1
1990	69.9	0.4	0.3	5.8	3.1	1.4

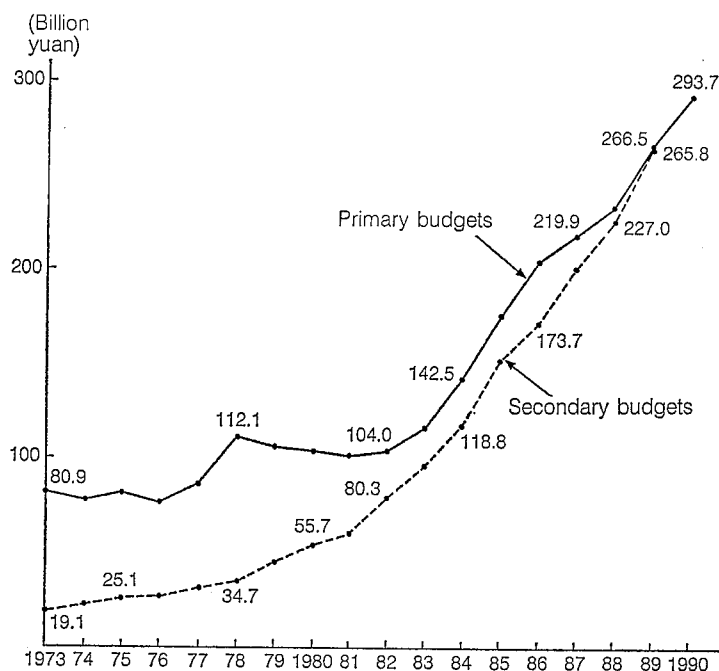
Source: [4, p. 213].

shown in Table I the share of government revenue taken up by the latter form began to decrease sharply beginning in the 1980s as taxes on corporations replaced direct profit payouts. Moreover, the declining revenue share taken up the combined total of corporate taxes and direct profit payments shown in the tables means none other than a weakening of the revenue base of China's fiscal structure.

The second factor in the diminishing role being played by central public finance in China's national economy is the expansion taking place in the extra-budgetary funds being made available to the managers of local governments and enterprises by virtue of the central government's transferring more fiscal jurisdiction to them. This shift in authority has brought about relative increases in their revenues vis-à-vis the central government. Figure 5 shows how this tendency has progressed over the years in primary and secondary budgets. That is to say, secondary budgets amounted to 23.6 per cent of debt-free central government revenue in 1974, then increased to 31 per cent in 1978 and finally reached around 100 per cent in 1989.

Combining the above findings with figures on government expenditure during

Fig. 5. Trends in Primary and Secondary Budgets, 1973-90



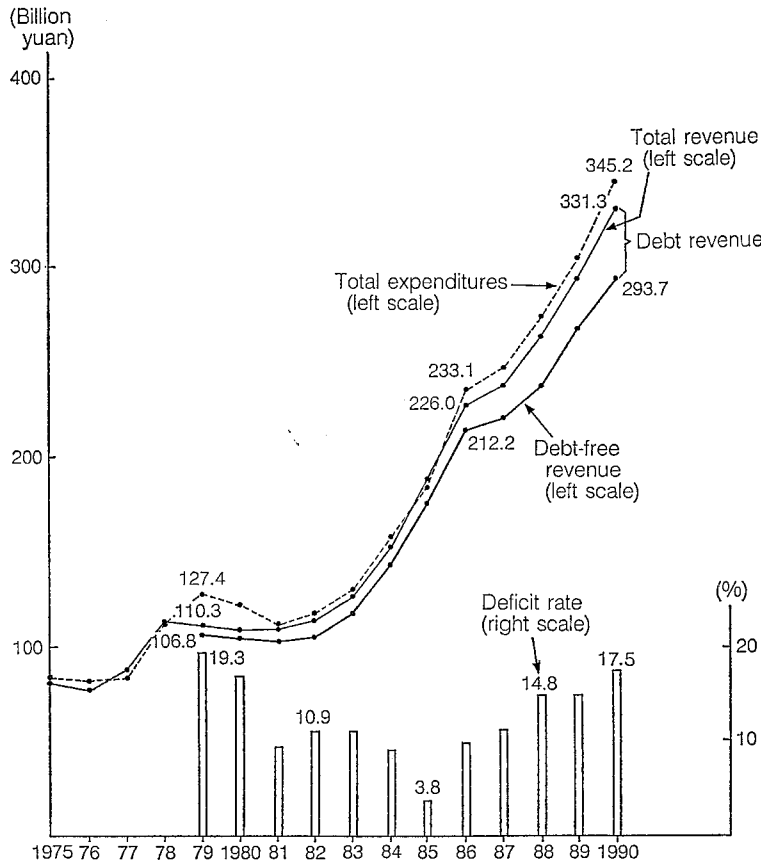
Sources: [4, pp. 209, 222].

Notes: Primary budgets are comprised of debt-free annual government revenue. Secondary budgets are comprised of extra-budgetary revenue.

the same period (Figure 6), we see that China has fallen into a deficit spending scenario since 1979. The temporary increase in the rate of deficit spending in the years 1979 and 1980 was caused by reparations paid to individuals who were labeled as right-wing elements during the Cultural Revolution (1966-76) and as such were persecuted through reductions in their wages and confiscation of their homes without compensation. However, from 1986 on the mounting deficit became the result of more and more fiscal jurisdiction being transferred from the central government to local governments and business enterprises. Within this state of affairs, the central government was forced to adopt a fiscal structure supported by various forms of debt incurred from both home and abroad.

Looking at this transition to deficit spending in historical perspective, in 1950 the Communist Party of China adopted a policy of "debt-free" public finance after criticizing the previous Kuomintang government for causing economy-threatening inflation through the issuance of public debentures to support a budget deficit that continued to expand during the latter half of the 1940s. During the 1980s the

Fig. 6. Deficit Spending, 1975-90



Source: [4, pp. 209, 212].

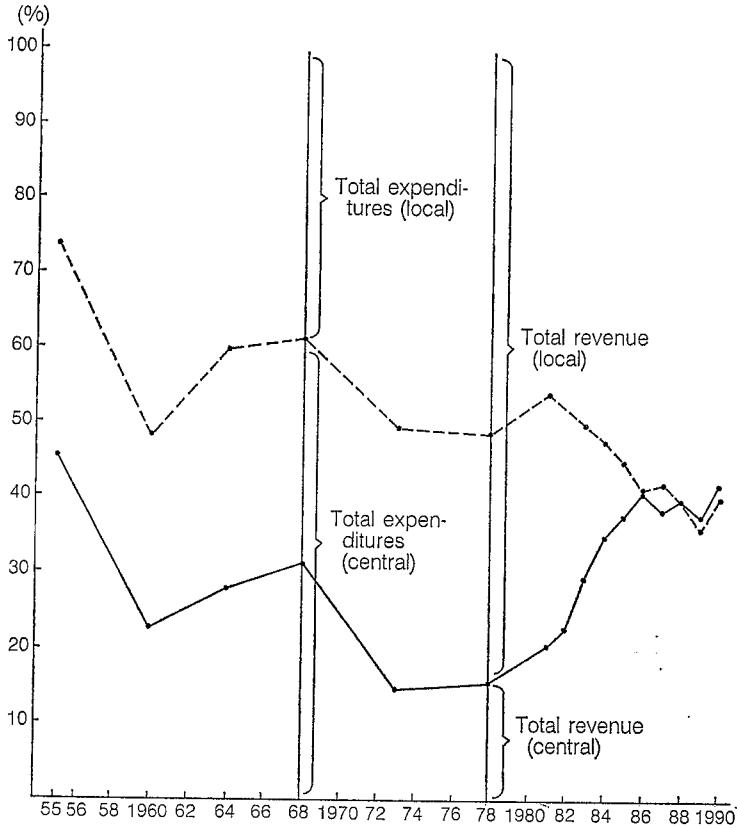
- Notes: 1. Debt-free fiscal revenue = total revenue - debt revenue.  
 Deficit rate = (total expenditures - debt-free revenue) / debt-free revenue.  
 2. At current prices.

central government was destined to abandon any hope of a balanced budget and adopt a similar policy to that of their former rivals.

### III. THE EXPANSION OF PROVINCIAL-LEVEL FISCAL JURISDICTION

Under the economic reform policies initiated during the 1980s, institutional changes were made in China's public finance system, which, as we saw in the previous section, gave rise to deficit spending on the part of the central government. The following is a summary of exactly what institutional reforms were carried out.

Fig. 7. Fiscal Comparison of Central and Local Government, 1955-90



Source: [4, p. 221].

#### A. Trends in Provincial-level Public Finance

Figure 7 shows a comparison between the annual revenue and expenditure compositions of central and local government. The percentages prior to 1980 are averages over periods marking the various five-year plans that were instituted by the central government. (For example, the figure for 1955 is the average for 1953-57). Figures from 1981, the year marking the beginning of in-earnest economic reform, are plotted on a yearly basis.

The curves show the large changes that occurred during 1981 and 1982 in China's public finance system. Prior to 1981, 70 to 80 per cent of total fiscal revenue was collected by local government, while 50 to 60 per cent of spending was carried out by the central government. In other words, local governments

existed as mechanisms in procuring revenue for the central government. This relationship began to change following the initiation of economic reform, leading to a fifty-fifty balance in the ratio of revenue to expenditure for local government beginning in 1986. Then, from 1989 the ratio of expenditure began to surpass revenue, meaning that local government began to show a deficit that had to be paid for by the central government.

The central government's jurisdiction over fiscal spending declined sharply, while at the same time its revenue responsibilities increased, a set of conditions that increased the possibility of having to expand the amount of debt revenue being received from both domestic and foreign sources. (See Table I.)

Figure 8 shows changes that occurred in local government revenue-expenditure balances on the provincial-level from 1978 to 1983 to 1989. The figures for 1978 represent provincial-level fiscal conditions under the Mao Zedong regime. The figures for 1983, just after the central-local fiscal relationship began to change, and 1989, the latest year for which data was available, are three-year averages. Calculations were performed for all provincial-level districts—provinces, municipalities, and autonomous regions—based on the formula: (revenue – expenditure) / expenditure. In other words, the figures show the breadth of budget surpluses (deficit) compared to expenditures. For example, the figure of 6 for Shanghai (9) in 1983 shows that a surplus six times its expenditures was recorded, and that amount was remitted to the central government.

The figure shows the following fiscal trends since 1983.

(a) The surpluses being remitted to the central government by the provincial-level administrative districts of Shanghai (9), Beijing (5), Tianjin (6), Liaoning (3), Jiangsu (8), and Zhejiang (10) have drastically declined, especially in the three municipalities. This is probably the most important factor in the insufficiency of annual revenue on the central government level.

(b) Five provincial-level districts have fallen to a surplus breadth of 0: Hebei (4), Guangdong (12), Hubei (16), Anhui (17), and Shanxi (19). Even Guangdong, which is so well endowed with village and township enterprises, contributes nothing to the central government coffers.

(c) A total of eight provincial-level districts have been transformed from surplus contributing to deficit subsidizing regions: Heilongjiang (1), Jilin (2), Shandong (7), Hunan (15), Henan (18), Shaanxi (21), Gansu (23), and Sichuan (24).

(d) Four provincial-level districts first increased their budget deficits and then experienced a leveling off. They are Guangxi (13), Jiangxi (14), Ningxia (22), and Hainan (29).

(e) Six provincial-level districts—Inner Mongolia (20), Ningxia (22), Guizhou (25), Yunnan (26), Qinghai (27), and Xinjiang (28)—have actually reduced their deficits. As will be discussed in the next section, since the direction being taken in fiscal reform stresses the expansion of provincial-level budgetary jurisdiction, ways are being sought to reduce subsidies from the central government and create autonomous systems of public finance. While on the whole such autonomy seems a long way off, the effects of the reform policy are starting to be felt in the cases of the above six regions.

(f) Overall, the data shows a total of eleven provincial-level administrative districts with budget deficits in 1978—actually twelve if we include Tibet, whose government was almost fully subsidized by China's central government. This means 40 per cent of the thirty provincial-level districts in China were operating in the red. That figure increased to 50 per cent (fifteen districts) by 1983 and presently stands at 83 per cent (twenty-five districts).

Figure 9 focuses on the problem of fiscal autonomy in local government from the time even before 1978. The data was taken from two representative provincial-level districts in each of three groupings: surplus-generating regions, zero-balance regions and deficit-creating regions. The most dramatic change has occurred in Shanghai, whose fiscal surpluses have been supporting the national budget for the past thirty-five years.

What has given rise to such sharp declines in surplus being remitted to the central government is an increase in expenditures on the provincial level rather than any decreases in revenues. Figures 10 and 11 show this trend.

Figure 10 shows the cases of the two provincial-level municipalities, Shanghai and Tianjin, which have contributed large surpluses to the central government over the years. At the present time the revenues of both regions have leveled off. Shanghai has been in this condition for the last ten years, while its expenditures have increased 2.8 times since 1978. Tianjin's spending has increased by about the same amount. Figure 11 shows the cases of Guangdong and Hebei, provinces which have exhibited by and large balanced budgets over the years. Here spending is proceeding at a much higher rate of increase than revenue receipts. Expenditures in all the four regions shown in these two figures have sharply increased since 1985.

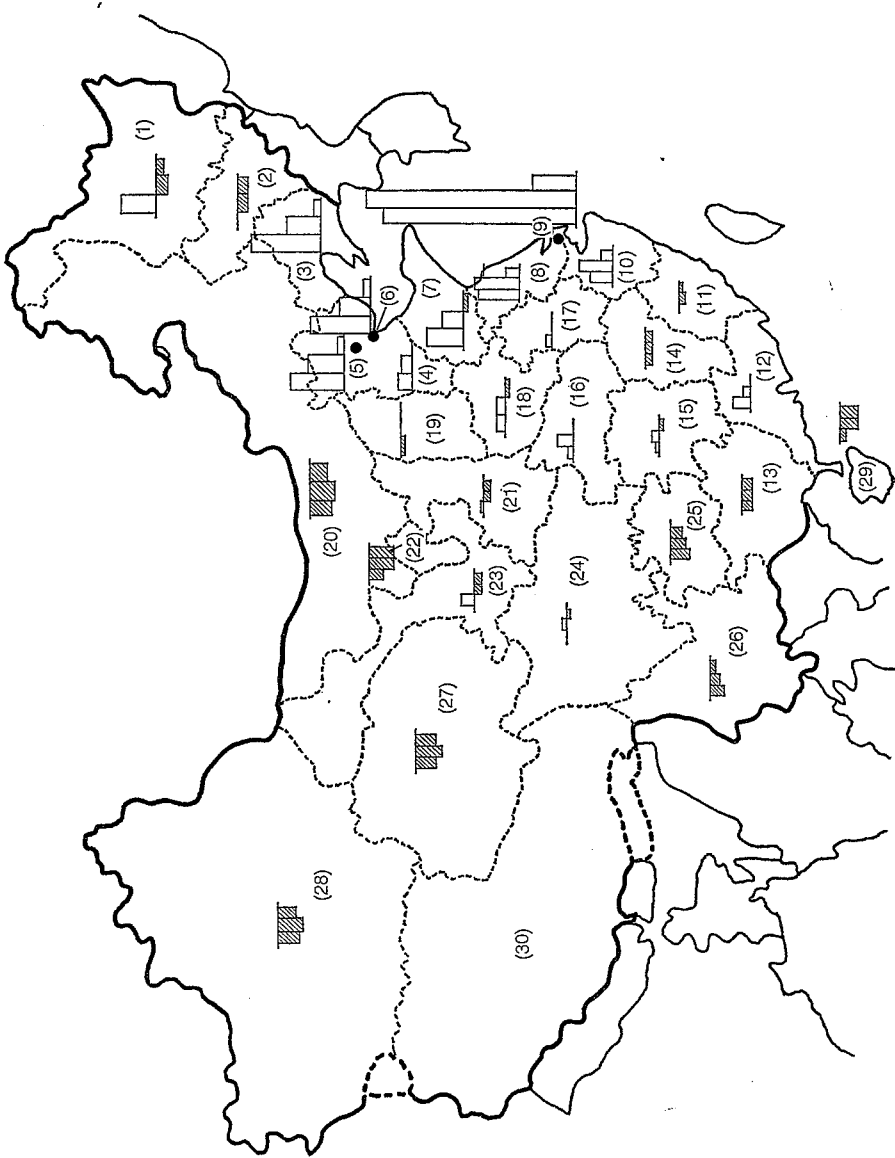
Next, let us look at what specific expenditure items have increased. The four most expensive items are generally capital construction investment, agriculture, administrative costs, and expenditures for health, education, science, and culture. Of these the last two items have risen sharply over the years, as indicated in Figure 12. Agricultural spending follows the overall trend for the period in question. The figure also indicates that as responsibility for various projects was transferred to local governments, administrative costs also ballooned. However, this is not the only reason, for there is also the significant expansion that has taken place in the structure of local government itself, making the task of administration more expensive. This is one of the disadvantages inherent to socialist power structures.

In actual figures, administrative costs amounted to 4.4 per cent of total spending in 1978 and rose sharply to a 9.6 per cent share in 1989. Health, education, science, and culture spending expanded from 10.1 per cent to 18.5 per cent of the total during that period, while spending for agriculture dropped slightly from 6.9 per cent to 6.6 per cent, and capital construction investment were almost halved from 40.7 per cent in 1978 to 20.3 per cent in 1989 [5, p. 30].

#### *B. Institutional Reforms Causing Heavier Provincial-level Fiscal Responsibilities*

There are two important elements to the fiscal reforms that have been carried out in China since 1978. The first is the transfer of more administrative authority from the central government to provincial-level bodies, and the second is the growth

Fig. 8. Provincial-level Government Budget Balances as a Percentage of Fiscal Spending: 1978, 1983, and 1989



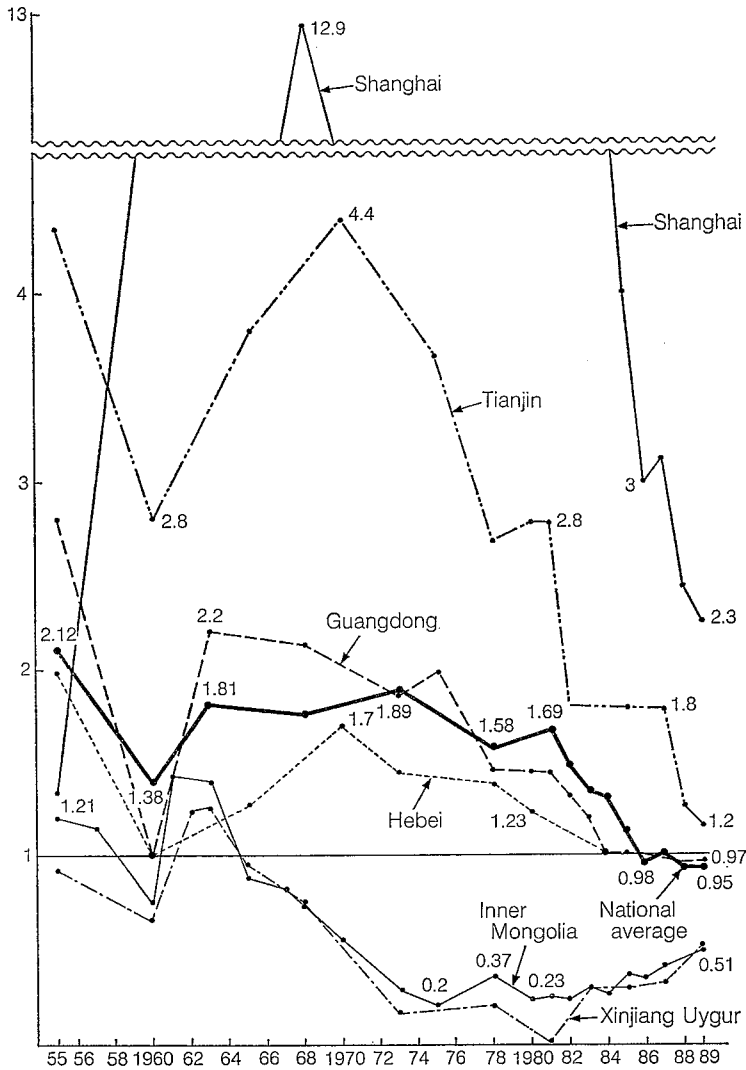


Source: [5].

Notes: Each set of three histograms show the breadth of budget surplus (deficit) vis-à-vis expenditures of provincial-level governments for 1978, 1983, and 1989 respectively. White histograms show surpluses and shaded ones show deficits. The calculation was made according to the formula: (revenue—expenditure) / expenditure. The exact figures are as follows:

	1978			1983			1989				
	1978	1983	1989	1978	1983	1989	1978	1983	1989		
(1) Heilongjiang	1	-0.3	-0.2	(11) Fujian	0	-0.2	-0.1	(21) Shaanxi	0.1	-0.2	-0.2
(2) Jilin	0	-0.3	-0.3	(12) Guangdong	0.5	0.2	0	(22) Ningxia	-0.5	-0.7	-0.7
(3) Liaoning	2	1	0.2	(13) Guangxi	-0.3	-0.3	-0.3	(23) Gansu	0.4	-0.2	-0.2
(4) Hebei	0.4	0.3	0	(14) Jiangxi	-0.2	-0.2	-0.2	(24) Sichuan	0	0.1	-0.1
(5) Beijing	1.5	1	0.2	(15) Hunan	0.1	0.2	-0.1	(25) Guizhou	-0.5	-0.4	-0.3
(6) Tianjin	1.7	0.9	0.2	(16) Hubei	0.1	0.4	0	(26) Yunnan	-0.4	-0.3	-0.2
(7) Shandong	1	0.6	-0.1	(17) Anhui	0.2	0	0	(27) Qinghai	-0.6	-0.8	-0.6
(8) Jiangsu	1.2	1.3	0.4	(18) Henan	0.2	0.2	-0.1	(28) Xinjiang	-0.6	-0.7	-0.5
(9) Shanghai	5.5	6	1.3	(19) Shanxi	-0.1	0	0	(29) Hainan	-0.2	-0.5	-0.5
(10) Zhejiang	0.6	0.9	0.3	(20) Inner Mongolia	-0.6	-0.7	-0.5	(30) Tibet			

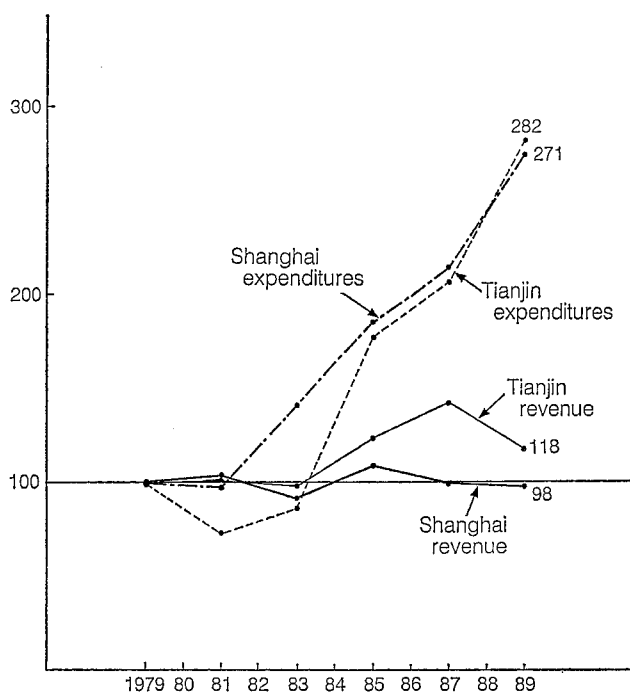
Fig. 9. Provincial-level Government Fiscal Autonomy Rates, 1955-89



Source: [5].

- Notes:
1. Figures based on same formula used in Figure 8.
  2. Figures for years prior to 1979 are averages of fluctuations during five-year plan period. Post-1979 figures are yearly amounts.
  3. For Shanghai, 5.3 (1960), 9.5 (1964), 8.4 (1973), 6.5 (1978), 9.2 (1981), 8.1 (1982), 7 (1983), and 5.4 (1984).

Fig. 10. Fiscal Trends in Shanghai and Tianjin, 1979–89



Source: [5, pp. 117, 336].

Note: At current prices (1979=100).

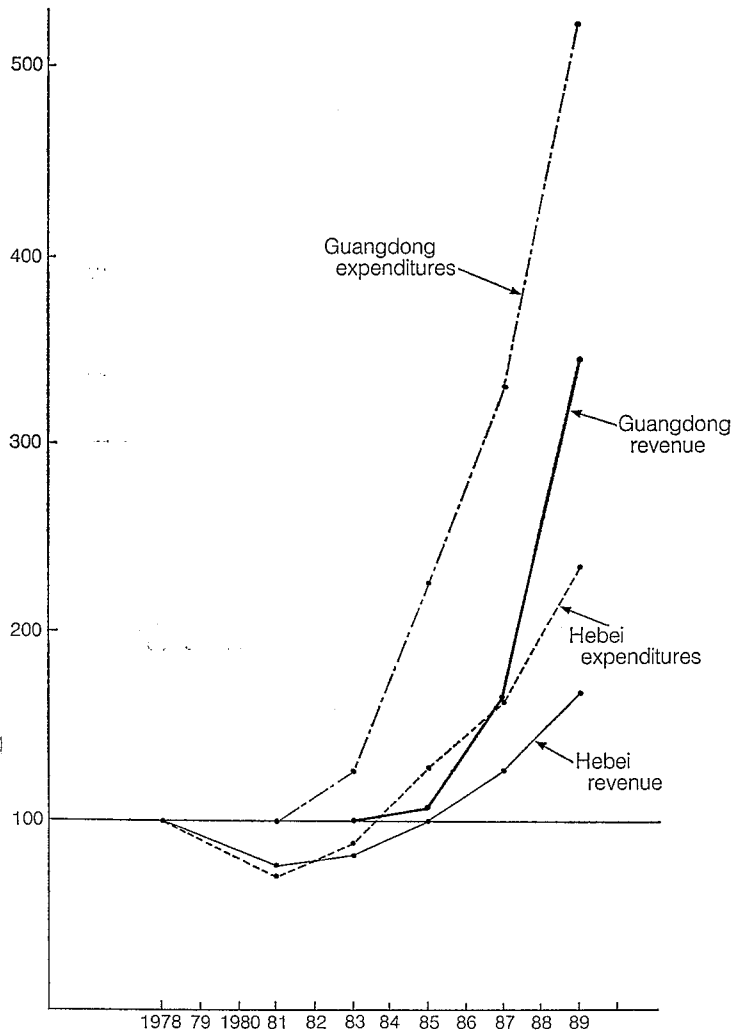
of extra-budgetary funds and the changes that have occurred in which level has the right to manage them.

### 1. *The transfer of more authority to provincial-level governments*

The history of China's present-day fiscal system can be, like its economic organization, divided into two distinct periods: 1950–79 and 1980 to the present.

The legislation that determined fiscal operations during the period 1950–79 was the "Decision on the unification of state financial and economic work" issued by the Government Administration Council in March 1950. At that time the liberation struggle had still not ended, and runaway inflation was threatening a regionally diffused economy. In order to put an end to such a chaotic situation, steps were taken to institute a policy in which fiscal affairs would be conducted on a strong centrally planned basis. The fiscal system created by the "decision" of 1950 was termed *tongshou-tonzhi*, meaning unified control over both revenue and spending. In other words, very detailed managerial authority was instituted over both fiscal revenues and expenditures by the central government. Local governments were directed to remit all of their fiscal income to the central govern-

Fig. 11. Fiscal Trends in Guangdong and Hebei Provinces, 1978-89

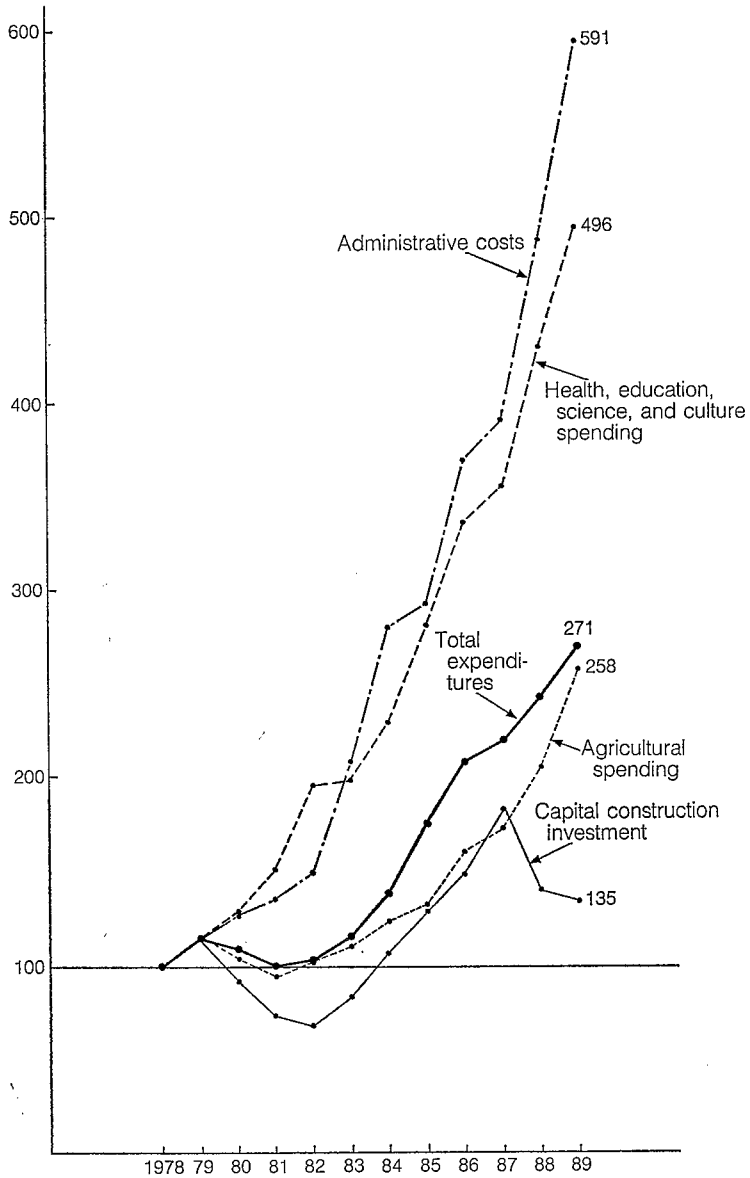


Source: [5, pp. 148, 636].

Note: At current prices (1978=100).

ment, who would then redistribute allotments to cover the expenditures of the former, which were closely monitored and guided by the latter. Even surpluses generated by economizing on expenditure allotments were not allowed to be retained on the local level. However, local governments were allowed to levy surcharges on such federal-level excise as taxes on agriculture, industry, and

Fig. 12. Trends in the Four Largest Spending Items in Local Government Budgets, 1978-89



Source: [5, p. 30].

Note: At current prices (1978=100).

commerce. Authority was granted to use this revenue as "flexible resource funds" on the local level.

Under this principle of strict central control over fiscal affairs, the possibility for active economic participation on the part of local governments was suppressed; but through a number of revisions that followed in 1958, 1959, 1971, and 1973 respectively, governments were gradually given managerial authority over collected tax revenues exceeding centrally determined targets and surpluses generated by economizing on expenditures. And while the absolute amounts retained were not very large, a very important lesson was learned in the fact that as the sphere of fiscal authority held by local governments expanded as a result of these revisions, their economies were stimulated and grew.

The principle of centrally unified revenue and expenditure was changed in December of 1980, when the State Council issued its "Interim provisions concerning the implementation of the financial management system of delineating receipt and expenditure responsibility at each governmental level." Under these provisions revenue and expenditure categories were divided up between the center and local governments, and a system was set up under which each fiscal administrative unit would take responsibility for its budget. Under the former system all revenue was first collected at the center and then redistributed to local bodies to cover their expenditures. In other words, there was one large pocketbook to finance the nation at the central level. The Chinese generally refer to this state of affairs as "eating from the same big pot" (*yizao chifan*). The new system implemented in 1980, on the other hand, set up pocketbooks for a central as well as thirty provincial-level budgets, which the Chinese call "eating out of separate kitchens" (*fenzao chifan*).

Table III shows how in 1985 revenue and expenditure categories were divided up between the center and local governments.

At the present time, roughly three types of fiscal management systems exist in China. The first consists of the new institutions put into effect by the provisions first introduced in December 1980. The second system is in effect in the provinces of Guangdong and Fujian and is based on the principle of "large-scale fiscal responsibility" (*caizheng dabaogan*). Beginning in 1980 both Guangdong and Fujian were granted an extraordinarily broad amount of autonomous authority, characterized by the normal category of "adjustment income" between the center and local governments being transformed into "constant income" in both provinces. The third system is for minority nationality autonomous regions, but is too complicated to describe here given space limitations. The three provincial-level municipalities of Beijing, Tianjin, and Shanghai operate under the first system, but the control exercised over their budgets by the central government is still relatively strong.

The most important facet of the fiscal reforms carried out in 1980 is the provision delegating taxes paid by state-owned enterprises and collective-owned enterprises under local government control to local coffers. This one institutional reform has stimulated very ambitious attempts by many local governments to establish new enterprises. As a result two separate new local venture booms were experienced in 1985 and during 1987-88.

TABLE III  
PROVINCIAL-LEVEL GOVERNMENT BUDGET CATEGORIES, 1985

Revenue Categories	Expenditure Categories
I. Constant income of the central government	I. Expenditures paid by the central government
(1) Income tax and adjustment tax of centrally controlled state enterprises	(1) Investment for central construction projects
(2) Business tax of the Ministry of Railway, main offices of banks and the insurance company	(2) Renovation funds, new product development funds, and normal construction funds for central government-controlled state-owned enterprises
(3) Military-run enterprises	(3) Underground resource exploration funds
(4) Price supports for excess purchases of foodstuffs, raw cotton and petroleum products (negative revenue)	(4) National defense spending
(5) Special oil usage tax	(5) Armed police battalion funds
(6) Tariffs and other taxes on imported goods	(6) Air raid shelter funds
(7) Specially adjusted taxes	(7) Aid to foreign countries
(8) Industrial and commercial united tax, income tax, and mines usage tax of foreign or Chinese-joint enterprises in offshore oil	(8) Central government-held necessities reserve funds
(9) Income from sales of treasury bonds	(9) Central government-sponsored agriculture, forestry, and irrigation project funds
(10) Funds from the special levy for key construction in energy and transportation	(10) Industry, commerce, and transportation ministry-sponsored project funds
(11) Others	(11) Health, education, and culture project funds
	(12) Administrative expenses
	(13) Others
II. Constant income of the local governments <sup>a</sup>	II. Expenditures paid by local governments
(1) Income tax, adjustment tax, and contract fee of locally controlled state enterprises	(1) Local government-sponsored construction project investment
(2) Collective enterprise income tax	(2) Renovation funds, new product development funds and normal construction funds for local government-owned enterprises
(3) Agricultural tax	(3) Agriculture and forestry support funds
(4) Vehicle and vessel licence tax	(4) Urban maintenance construction funds
(5) Municipal tax on land and houses	(5) Basic construction for agriculture, forestry, and construction
(6) Slaughter tax	(6) Industry, commerce and transportation ministry-sponsored project funds
(7) Animal transaction tax	(7) Health, education and culture project funds
(8) Free market transaction tax	(8) Social welfare funds
(9) Revenue stamp tax	(9) Administrative expenses (including
(10) Income from sub-contracts taken on by enterprises under local government control	
(11) Losses incurred by food enterprises managed by local governments (negative revenue)	
(12) Back taxes and fines collected for tax evasion	

TABLE III (Continued)

Revenue Categories	Expenditure Categories
(13) Urban maintenance construction taxes	funds for public safety, the judiciary and district attorney's office)
(14) Others	(10) Funds to support the civilian defense forces
	(11) Others
<hr/>	
III. Central-local shared income	III. Projects under central management
(1) Products tax <sup>b</sup>	(1) Disaster relief
(2) Business tax <sup>b</sup>	(2) Subsidies for drought and flood prevention
(3) Value-added tax <sup>b</sup>	(3) Economic aid to underdeveloped regions
(4) Resource tax	(4) Subsidies for border area construction
(5) Construction tax	
(6) Salt tax	
(7) Personal income tax	
(8) Bonus tax	
(9) Taxes on foreign or Chinese-foreign joint enterprises (except those in offshore oil)	

Source: *Dangdai Zhongguo caizheng* [Present-day China's public finance], Part 1 (Beijing: Zhongguo-tongji-chubanshe, 1988), pp. 374-75.

<sup>a</sup> Thirty per cent of revenue from product taxes, business taxes, and value-added taxes collected from petroleum and electricity ministry-controlled enterprises, the petrochemical corporation and the colored metal corporation goes to local governments, while 70 per cent is remitted to the center as constant income.

<sup>b</sup> Does not include petroleum, electricity, and railroad ministry-controlled enterprises, the petrochemical corporation, colored metal corporation, bank main offices, and the insurance corporation.

## 2. *Extra-budgetary revenue*

We have already in our discussion of Figure 5 seen how extra-budgetary revenue towards the end of the 1980s increased to the extent of matching debt-free revenue as a whole. Since extra-budgetary revenue is essentially not included within public finance affairs per se, it could be thought to fall outside the content of this paper. However, in practice the sphere of this revenue category has changed over the years, at times being partly included in fiscal budgeting considerations, at times not. Because of this state of affairs, extra-budgetary revenue has become very closely related to public finance in China.

At the beginning extra-budgetary finance came from a few surcharges on federal taxes, and then during the 1970s began to gradually expand until during the following decade the category came to include the following three components defined in the government statistics according who controls and manages them [10, p. 1190].

The first is income managed by the fiscal bureaus at each level of local government. Sources include (1) surcharges on various taxes, (2) funds accumulated



from enterprises (for example, the portion of profits from provincial-level government-managed enterprises that has been separated from retained profits and paid to the government), and (3) income from government projects funded by loans of public assets.

The second component is income received in the process of managing non-profit and administrative units. Sources include (1) income from industrial, commercial, and transportation projects (for example, research institutes, hotel services, technical schools, and road maintenance units); (2) income received from agriculture, forestry, and irrigation projects (for example, experimental stations, rural electrification projects, and dams); (3) income received from health, education, and culture projects; (4) income received from various urban services and construction; (5) income from social welfare services; (6) income from administrative organizations; (7) income from industrial and commercial management; and (8) income from housing and real estate.

The third component is income received by state-owned enterprises and the government bureaus that supervise them. Sources include (1) depreciation accumulation and renovation funds officially determined according to production output and other types of legally determined internally retained funds; (2) income received by managing government bureaus (in addition to the above items, funds for production development, employee benefits, bonuses, as well as reserve funds); (3) funds specially earmarked for management by major ministries (for example, travel and freight service funds by the Ministry of Railways, overseas shipping profits by the Ministry of Communications, airport income by the Civil Aviation Administration of China, and excess production funds and titanium production income by the Ministry of Petroleum Industry).

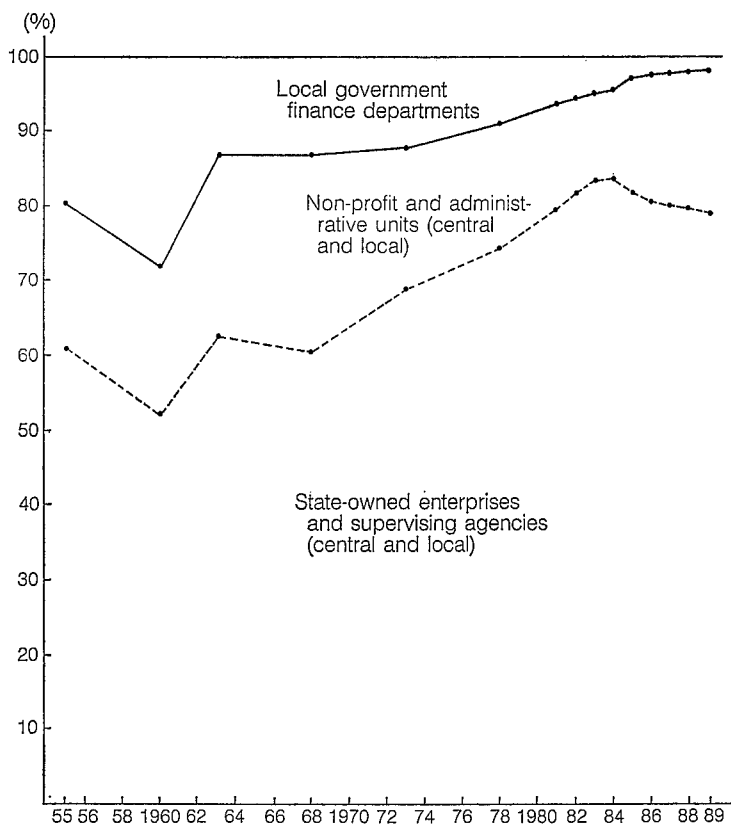
Figure 13 shows the shares of extra-budgetary revenue occupied by its three components both on the national and local levels. The portion going to local-government finance departments decreased sharply at the beginning of the 1980s, as the amount going to state-owned enterprises and their supervisory agencies sharply increased. Today income to the latter occupies 80 per cent of total extra-budgetary revenues. In other words, both on the national and local levels, the amount of extra-budgetary revenue claimed by state-owned enterprises and their supervisory agencies has increased markedly.

Figure 14 shows the relative shares of extra-budgetary revenue and expenditures claimed by the center and local government. Figures are not available prior to 1982. The central government receives and spends about one-third, while local governments receive and spend about two-thirds.

From Figures 2 and 3 we can see that what has caused the enlargement of extra-budgetary revenue is the increasing amount of autonomy given to state-owned enterprises, especially the transfer of authority over them to the local level.

As to the specific forms of autonomy that gave rise to these results, first there was the raising of the percentage of profits after taxes that could be retained by enterprises. The rate was increased to 33.7 per cent in 1987. In 1978 the rate was around 5 per cent [2, p. 55]. This was made possible by the "substituting taxation for profit submission" (*ligaishui*) policy that was partly introduced in

Fig. 13. The Three Major Components of Extra-budgetary Revenue, 1955-89

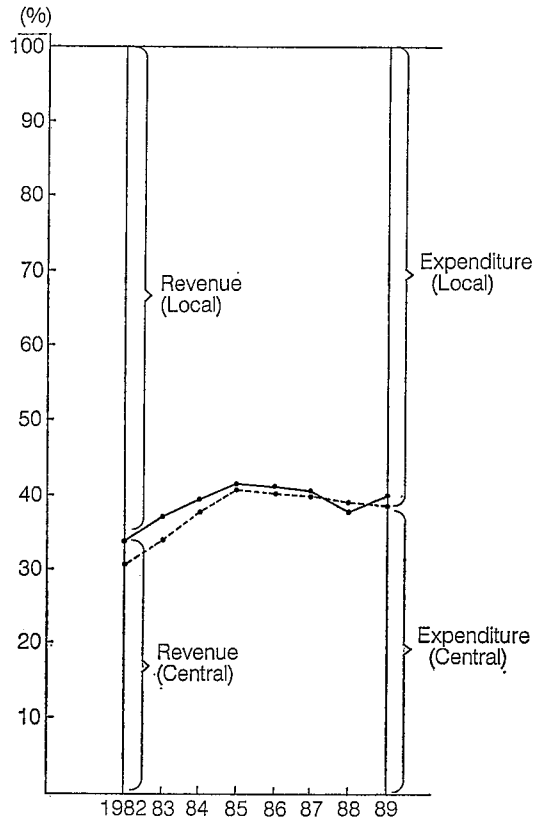


Source: [4, p. 222].

1980 and thoroughly implemented in 1984. Prior to this policy almost all the income generated by state-owned enterprises had been submitted to government bodies in the form of corporate taxes and remittance of net profits. However, upon implementation profit submission requirements were mostly integrated into the corporate tax structure, enabling enterprises to retain larger amounts of net profits.

Secondly, there was the transfer of authority over depreciation accumulation funds to enterprises and their supervisory agencies. In 1978 the average rate of asset depreciation allowed was 3.7 per cent, amounting to 16.6 billion yuan in funds. In 1987 the rate was raised to 4.7 per cent, thus generating 41.8 billion yuan [2, p. 61], which constituted nearly 20 per cent of the 220 billion yuan debt-free budgetary income figure for that year.

Fig. 14. Comparison of Central Government and Local Government Extra-budgetary Revenue and Expenditure, 1982-89



Source: [4, p. 221].

What is more important, however, is the determination of a fixed ratio of large-scale repair funds to depreciation accumulation funds for enterprises and their supervisory agencies [2, p. 62]. While separately established renewal funds have to be shared with government bodies, large-scale repair funds are wholly retained by enterprises.

Extra-budgetary funds ballooned and at the same time narrowly defined fiscal income was being suppressed. The actors in this scenario were none other than state-owned enterprises and their supervisory agencies, especially provincial-level government agencies and locally controlled, state-owned enterprises.

Looking at the two most important elements of fiscal reform—central-local authority transfer and total extra-budgetary revenue—it should be clear that within the process of economic reform the control gained over funds by provincial-level

governments was most prominent in both categories of narrowly defined fiscal budgets and extra-budgetary funds making up secondary budgets. Here we can clearly see the background to the phenomena of waning surpluses and increasing deficits for local governments shown in Figure 8. In other words, it was not a leveling off in income sources that lay at the root of the problem, but rather a significant increase in spending necessitated by increased economic activity on the local level. This state of affairs caused a declining share of revenues being remitted to the central government and worsened the fiscal deficit being incurred at the center.

#### IV. TRENDS IN FISCAL ORGANIZATIONAL UNITS BELOW THE PROVINCIAL LEVEL

##### A. *County-level Fiscal Organizational Units*

The organization units involved in county-level public finance include prefectural-level cities, county-level cities, minority nationality autonomous prefectures, and minority nationality autonomous counties. According to the statistics for 1987, these units serve a total of 444,000 people. As of 1989 there were a total of 2,356 such units, averaging 30 million yuan in budgetary revenue per unit [3, p. 13].<sup>3</sup> Unfortunately, we on the outside know very little about what has been going on within these units, due to the fact that very little related fiscal data is made public.

It has been said, however, that during the eleven-year period between 1979 and 1989 total budgetary income grew at an annual rate of 8.6 per cent per year, while county-level fiscal unit budgetary income rose by 10 per cent per year, a performance outstretching both the central and provincial levels. In 1989 county-level budgetary income reached a figure of 77 billion yuan and accounted for 27.5 per cent of all of China's primary debt-free income and 41.8 per cent of local government income. Spending on the county level came to 84.5 billion yuan, which amounted to 27.8 per cent of total government expenditures and 35.4 per cent of local expenditures.

This data indicates that county-level fiscal units are making a significant contribution to fiscal affairs on the provincial level. There is a large portion of fiscal resources absorbed from the county level by provincial-level governments. Out of the 2,356 fiscal organizational units, there are 1,056 counties remitting surpluses to provinces totaling 20 billion yuan, while there are 1,297 counties with deficits, 16.6 billion yuan of which is covered by provincial-level subsidies.

Although it is difficult to confirm statistically the budgetary conditions of county-level fiscal units since the beginning of economic reform, the impression is that, unlike its provincial counterpart, the county-level as a whole is generating a fiscal surplus. In 1978 county-level fiscal units incurring fiscal deficits numbered 1,430,<sup>4</sup> or roughly 62.2 per cent of an estimated total of 2,300. However, by 1989

<sup>3</sup> The data in the following passages are from the same source [3].

<sup>4</sup> Estimated from [9, p. 7].

the number of fiscal deficits had decreased to 1,297, or 55 per cent of the total. This trend also contrasts sharply with the situation at the provincial level.

As to the possible causes for this state of affairs, while on the spending side outlays have increased in the same proportions as those of provincial governments due to an increased demand for administrative services and a steadily growing Communist party bureaucracy [8, p. 16], it seems that the continuing discovery of new revenue sources has kept the rate of increase on the income side at a higher level. Since the middle of the 1980s a movement has been in progress to nurture county units with fiscal scales exceeding 100 million yuan, in an attempt to improve on the overall average of 30 million yuan per fiscal unit at that time. County units with 100 million yuan budgets totaled forty-two in 1986, rose to fifty-five by 1987 and reached seventy-three by 1989. When the movement began, 100 million yuan units tended to concentrate in such districts as Shanghai, Jiangsu, and Zhejiang; however, by 1989 a total of eighteen provincial-level districts could boast such county success stories. These 100-million-yuan units accounted for 43 per cent of total surpluses paid to their provincial-level governments.

The increase in 100-million-yuan fiscal units may be attributed mainly to the development of village and township enterprises. In other words improvements in the fiscal structures of township-level units have led to increasing revenue sources for county-level budgets.

#### B. *Township-level Fiscal Units*

At the end of 1990 the number of township-level fiscal units in China totaled 55,838. Each unit served about 15,000 people. There is no data available on national averages for budgetary income figures at this level, but there are some statistics for Jilin Province, which almost matches the national average in terms of per capita fiscal income on the provincial level. According to this information, in 1988 budgetary revenues generated by township units averaged 500,000 yuan with a per capita figure of 33 yuan.

Next, let us look at the mechanism by which the development of village and township enterprises contribute to stronger county-level public finance. The year 1983 marked the beginning of fiscal organization at the township level. In April 1985 the Ministry of Finance issued "Procedures for the financial management of townships/towns." From that time until the end of the 1980s fiscal organization at this level remained in the formative stage as evidenced by the following statements.

At the present time [1989] about 90 per cent of the townships/towns throughout the country have their own fiscal administrations and over 180,000 financial experts have been hired for this purpose. . . . However, the majority of townships/towns do not have "cash boxes." Fiscal units without their own "cash boxes" cannot be considered in a healthy financial state. . . .

At the present time [1989] despite the fact that 60,000 townships/towns throughout the country have fiscal mechanisms, large inter-regional differences in economic development still exist. There is no uniform fiscal sphere at this administrative level, and fiscal management standards are inferior. [7, pp. 36, 37]

TABLE IV  
TOWNSHIP-LEVEL GOVERNMENT BUDGET CATEGORIES

Revenue	Expenditures
<b>Budgetary</b>	
(1) Income tax and commercial and industrial tax for village and township enterprises	(1) Administrative management
(2) Slaughter tax	(2) Health, education, and culture projects
(3) Municipal maintenance and construction tax	(3) Agriculture, forestry, and fishery projects
(4) Free market transaction tax	(4) Social welfare projects
(5) Animal transaction tax	
(6) Vehicle and vessel transaction tax	
(7) Landholding tax	
<hr/>	
<b>Extra-budgetary</b>	
(1) Agricultural surtax	(1) Construction projects (budgetary funds also used)
(2) Agrarian village education fund surtax	(2) Township/town administrative projects
(3) Income for administrative projects	(3) Township/town group welfare projects
(4) Added funds for public projects	
<hr/>	
<b>Self-generating funds</b>	
(1) Remittances from village and township enterprise profits	
(2) Depreciation accumulation fund and fixed asset revaluation income	
(3) Township/town government project income	
(4) Income retained from township/town free-market management fees	
<hr/>	
<b>Hidden income<sup>a</sup></b>	
Apportionments ( <i>tanpai</i> )	

Sources: [1, p. 20]; Wang Yongpo, Cheng Tianwang, Gao Qingyi, "Muqian xiang caizheng gongzuozhong cunzai wenti yu duice" [Issues and policy concerning present-day village finance], *Caizheng*, 1989, No. 7, p. 40; and Li Wengping, Ding Xiujun, and Li Hongbo, "Gaohao xiang (zhen) guoku shidian wanshan xian (zhen) caizheng jiangshe" [Organizing model districts for township-level finance to maintain local debt-free budgets], *Caizheng*, 1991, No. 7, p. 37.

<sup>a</sup> An unauthorized assessment. Added by author.

Using the above-mentioned Ministry of Finance April 1985 "procedures for management" and a few other source materials, revenue and expenditure items in the budgets of township/town fiscal units have been arranged in Table IV. There are many items that fall outside of the narrowly defined categories of budgetary income and expenditure, including an unofficial assessment levied whenever deemed necessary by local political leaders. As a matter of fact, this type of assessment exists at the provincial, county, and township levels as well, indicating

that local governments possess wide-ranging powers outside the authority officially granted them.

The budgetary income category indicates work that is done by township-level governments in the name of their county governments. The expression "fiscal units without their own 'cash boxes'" means that each and every revenue and expenditure item is disposed of according to a directive from the county-level. However, in practice this refers only to the narrowly defined budgetary income category. The largest factors influencing county-level governments are village and township enterprise taxation and remittance of enterprise profits. While there is not enough space here to offer any examples, almost all the counties that have transformed themselves from deficit to surplus fiscal units in the process of realizing "100,000 yuan" budgets have done so through creating village and township enterprise ventures. In China a "poor" county is generally considered as one where agriculture dominates and industry is scarce [6, p. 34], which means that agriculture is today gradually losing its comparative advantage in the economy.

We cannot tell what portions of local-enterprise profits are shared between the township- and county-government levels, but they seem to resemble the relationship between the center and provincial governments in the case of provincial-level enterprise profits.

In sum, the more county- and township-level fiscal units aim at deficit-free budgets, the more we will see them promoting industrial ventures at the local level. Already, the many television factories that were built as the result of provinces vying with each other to industrialize have become troubled by an excess production output of between 17 and 18 million sets. Heilongjiang Province consists of sixty-nine prefectural-level districts. It has 89 breweries (1.3 per county/city) and 160 dairies (2.3 per county/city). A scarcity of raw materials has decreased production capacity and profitability [11, p. 46]. This kind of mechanism that has overheated the Chinese economy at the central and provincial levels is now beginning to infiltrate the county and township levels as well.

## CONCLUSIONS

The economic reforms of the 1980s brought about a new set conditions for public finance in China.

First of all, the influence of fiscal affairs on the national economy dropped sharply.

Secondly, at the center fiscal policy was changed from one based on balanced budgets to one depending on deficit spending. Provincial-level governments with deficit budgets increased from 40 per cent to 83 per cent of the total number, while the county-level improved somewhat from 62 per cent to 53 per cent of its fiscal units operating in the red. Despite the fact that fiscal affairs at the lowest township level seem to be generally in a state of confusion, the possibility for fiscal improvement at this and the county level is strong given a growing local industrial sector.

Thirdly, the most important factor in the changes that have occurred in the importance and content of public finance is the expansion of provincial-level

budgetary authority, especially over the expenditure side of the ledger. However, a similarly large-scale transfer of fiscal authority from the provincial to county level is not taking place today, even though it seems an inevitable result as the third stage of economic reform progresses.

Finally, capital accumulation under a number of different names is increasing throughout all levels of government, especially at the provincial and township levels. This phenomenon has the capability of giving rise to investment competition that will overheat the economy. In sum, we can definitely see the rapid expansion of a bureaucratic capitalist sector in the Chinese economy.

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