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Yongzheng Liu
Jorge Martinez-Vazquez
Baoyun Qiao

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FROZEN IN TIME: THE MUCH NEEDED REFORM OF EXPENDITURES ASSIGNMENTS IN CHINA¹

Yongzheng Liu
School of Finance
China Financial Policy Research Center
Renmin University of China
E-mail: yongzheng.liu@ruc.edu.cn

Jorge Martinez-Vazquez
International Center for Public Policy
Georgia State University
E-mail: jorgemartinez@gsu.edu

Baoyun Qiao
China Academy of Public Finance and Policy
Central University of Finance and Economics
E-mail: baoyun.qiao@gmail.com

ABSTRACT

China has been carrying out significant fiscal reforms on intergovernmental fiscal relations for over three decades. However, these reforms have largely concentrated on the revenue side of the budget, and generally have not been coordinated with an explicit strategy for the reform of functional expenditure assignments. Currently, there is large consensus that the weaknesses with the current assignment of expenditure responsibilities have become one of the most serious obstructions---if not the most serious---to the further improvement of China fiscal system. In this paper, we provide a comprehensive review of the actual practice with expenditure assignment among different levels of government in China over the past decades. We highlight the most important issues surrounding the current system qualitatively and quantitatively, and provide a road map and practical recommendations for its future reform.

1. INTRODUCTION

China has been carrying out significant reforms on intergovernmental fiscal relations for over three decades. However, these reforms have largely concentrated on the revenue side of the budgets, and generally have not been coordinated

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with an explicit strategy for the reform of expenditure assignments. Although significant strides have been made in the areas of tax assignments and tax administration, other areas and, in particular the assignment of expenditure responsibilities, have seen much less progress. And yet, a stable, efficient and fair decentralized system of public finance in China will require an unambiguous and well defined institutional framework that provides clarity and certainty in the assignment of expenditure responsibilities among the different levels of government. The assignment of responsibilities is by no means the only condition, but it is the most important and it should also be the first to be tackled in a well sequenced decentralization reform effort.²

This paper reviews the most important current issues surrounding the assignment of expenditure responsibilities in China.³ The rest of the paper is organized as follows. In section 2, we discuss in some detail the current practices of expenditure assignments among different levels of government in China. In section 3 we analyze the main issues and problems with current assignments in China. In section 4 we provide a road map and practical recommendations for the reform of expenditure assignments in China. Section 5 concludes.

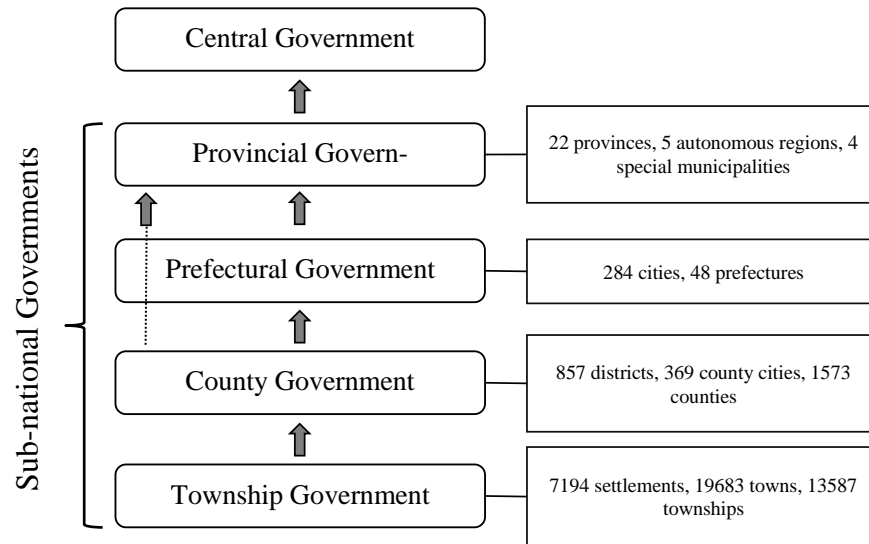
2. AN OVERVIEW OF EXPENDITURE ASSIGNMENT IN CHINA

An important feature of China's vertical structure of government is the strong hierarchical link between the different levels of government. Currently, there are five levels of governments in China. Starting from the top these levels are: the center, provinces, prefectures and prefecture-level cities (hereafter, cities), counties, and townships. Under the current hierarchical system, each subnational level of government is wholly subordinate to the next higher order of government, and so the intergovernmental fiscal relationships are typically defined and implemented between that government and its immediate upper level of government (see Figure 1).⁴

² See Bahl and Martinez-Vazquez (2006a) for a discussion of the sequencing of decentralization reforms.

³ See, for example, Bahl and Martinez-Vazquez (2006b) for a wider perspective of decentralization reform in China.

⁴ Over the last decade, the central government has been encouraging the "province-managing-county" reform under which the provincial government directly (and separately) manages the cities (prefectures) and counties. In this reform there are direct intergovernmental relations between the provincial government and the city (prefecture) government, and separately between the provincial government and the county government in all aspects of intergovernmental relations, including revenue assignments, expenditure assignments, intergovernmental transfers, special subsidies, final account subsidy, borrowing and adjustment of budgetary funds. This reform was formally initiated in some provinces around 2004, and the reform was widely carried out across the

Figure 1. Vertical Structure of Government in China⁵

Source: China Statistical Yearbook 2012

The reforms in the fiscal arrangements over the last three decades mainly involved the fiscal relations between the central government and provincial governments. The latter act as representatives of the entire sub-national government sector in each provincial jurisdiction and engage directly in negotiations and bargaining with the central government. The provinces continue to play a fundamental role in balancing the fiscal relations between the central government and all sub-national governments. In contrast, the fiscal relations between the provincial level and all other sub-national governments have been much less developed, and it is mostly determined at the discretion of the provincial governments.

2.1 Extensive Government Responsibilities: Differentiating between Private and Public Sector Activities

One question prior to the assignment of expenditure responsibilities among different levels of government is the role of government in the market economy. The lack of a clear delineation between the roles of the private and public sectors in China significantly complicates the issue of expenditure responsibilities. While many countries, and especially transitional countries, have undergone in recent decades massive privatization of state and local enterprises involved in what can

nation. By the end of 2009, 22 provinces in China had commenced reform on a pilot basis (Liu et al. 2011).

⁵ The dashed line represents the practice of “province-managing-county” reform that was implemented in some of the provinces in China.

be considered private-sector economic activities, this has not been generally the case in China. Even though there has been some privatization in China, this process has yet to begin in earnest in many areas of the economy.

On the other hand, there have been some visible efforts in government to re-define the role of the public sector more along the conventional lines commonly seen in market economies. For example, in 1998, the State Council initiative to build a Public Finance Framework for government focused on the encouragement of the fundamental function of markets in the allocation of resources in the economy while it provided more space for fiscal policies to meet the demand for public goods and services while gradually decreasing the role of fiscal inputs in the competitive sectors of the economy. Along these same lines, in 2006, the Communist Party proposed the equalization of basic public services across the country as a way to further build the Public Finance Framework. This initiative resulted in the allocation of additional fiscal resources to the social security system, education (particularly through the rural compulsory education program), health care, and rural support. The central government has also begun to use fiscal policies for macroeconomic management. In particular, with the experiences of the 1998 Asian financial crisis and the 2008 global financial crisis, the central government increasingly has paid more attention to macroeconomic management issues.⁶

2.2 Highly Decentralized Responsibilities for Basic Public Services with Wide Concurrent Expenditure Responsibilities

On the more specific subject of expenditure assignments, *the Budget Law* confers quite broad expenditure responsibilities and substantial autonomy to each level of sub-national government. However, expenditure assignments are far from being transparent and clear, mostly because of the lack of formal assignments and the presence of extensive concurrent functions among different levels of government (World Bank, 2002). This pervasive presence of concurrent responsibilities can be traced back to the planned economy era. At that time, it was not considered necessary to separate the responsibilities of different spheres of government as providers of public services (as local governments acted as agents of the central government---only carrying out assigned tasks), nor was it considered necessary

⁶In particular, the central government implemented aggressive fiscal policies in 1998 to stimulate the economy, and changed to more steady fiscal policies in 2004 as the main sector of the economy improved. The central government adopted an aggressive fiscal policy stand again in 2008 to deal with the global financial and economic crisis. In addition, the central government has continued to focus on the implementation of national development strategies, including the promotion of domestic demand, improving equity in income distribution, and changing the growth model for the country.

to separate the expenditure responsibilities of governments from those of state-owned enterprises (SOEs). The latter was due to the cohesive functions of the government in both the public and private sectors; in fact, before the mid-1980s government jointly determined fiscal expenditures and the expenses of the SOEs.

The recent reforms, including the “*Fiscal Responsibility System Reform*” starting at the beginning of the 1980s, the “*Fiscal Contracting System*” starting in 1988, and the “*Tax Sharing System Reform*” (TSS) starting in 1994, offer the striking feature of having put almost exclusive emphasis on improving the revenue assignments and transfer system. But these reforms have practically ignored the question of expenditure assignments.⁷ This means that there has been no apparent change in either the policy framework or the practice of expenditure assignments between the central government and sub-national governments or among sub-provincial government since even before the start of the market-oriented reforms in the late 1970s.

More in particular, the 1994 TSS reform restated the pre-reform expenditure assignment practices and provided only basic guidelines for defining expenditure responsibilities between central and sub-national governments. These guidelines illustrate that both the central government and local governments not only have extensive expenditure responsibilities, but that these responsibilities widely overlap and that additionally are only vaguely defined. For example, *The State Council Regulations on the Implementation of the TSS* defined expenditure responsibilities of central and local governments as follows:

“Central budgets are mainly responsible for national security, international affairs, the running costs of the central government, the needs for adjusting the structure of national economy, coordinating regional development, adjusting and controlling the macro economy, and others. Detail items include: national defense, cost of military police, international affairs and foreign aid, administration costs of the central government, central financed capital investments, the technical renovation of central enterprises and new product development costs, the costs of support to agriculture, debt, and the costs of central culture, education, and health, price subsidies and other expenditures.

Local budgets are mainly responsible for the running costs of local government, and the needs for local social economic development. Detail items include: running costs of local government, the needs of lo-

⁷See Martinez-Vazquez (2006) for a discussion of those reform stages.

cal economic development, a part of the running costs of the military police and militia, locally financed capital investments, the technical renovation of local enterprises and new product development costs, the costs of support to agriculture, urban maintenance and construction, and the costs of local culture, education, and health, price subsidies and other expenditures.”

Fundamentally, responsibilities exclusive to the central government and exclusive to the sub-national governments are few. The central government tends to be *exclusively* responsible for national defense issues and local governments provide basically all local public services, such as urban maintenance. Moreover, as the sub-national governments are treated in some ways as the agents of the central government, this has allowed the decentralization to sub-national governments, particularly at the county-level, of public services such as social security or food safety, that in other countries are typically reserved as central government responsibilities. Meanwhile, the central government, by constitutional design, can be involved in any sub-national function. Thus, as long as a local issue---for example, the rural toilet reconstruction program---is brought up to the central authorities, this responsibility instantly can become a central government’s responsibility.

Although all sub-national governments at different levels have many overlapping expenditure responsibilities, in practice the main responsibilities for some basic public services including basic education and health care are concentrated at the county and township levels of governments, while some other public services such as social security are concentrated at the provincial and prefecture levels of governments; however, even here county level governments in 2009 were responsible for 42% of expenditures on the social safety net and unemployment insurance (Table 1). In the following paragraphs, we discuss in some detail the most important assignments.

Table 1. Share of Each Government Level by Expenditure Type in 2009

	Central	Provincial	Prefecture	County	Township	% Total
Foreign affairs	97.4	1.2	0.7	0.6	0	0.3
National defense	97.3	0.9	1	0.7	0	4.9
Financial affairs	91.5	3.7	3.7	1.1	0	1.6
Payments on government bonds	88.5	3.5	6.2	1.7	0	1.5
Science and technology	51.5	17.7	16	13.7	1	2.8
Reserve for cereals and oils	34.8	28.6	12.5	22.4	1.7	6.6

Transportation	28.9	42.9	15.2	12.7	0.4	2.2
Affordable housing	25.7	24.3	40.5	9.4	0.1	0.1
Mining, quarrying, electricity and IT	22.2	17.5	32.6	23.9	3.9	4.8
Public security	17.4	18.5	28.9	34.1	1	2.2
Culture, sport and media	16.7	27.4	28.4	25.4	2.1	3.6
Other expenditure	19.3	23.1	27	26.5	4.1	3.6
Urban and rural community affairs	1.1	5.6	46.8	42.2	4.3	9.7
Social safety net and employment	5.4	20.5	27.4	42	4.7	12.9
General public services	11.3	18.3	21.4	36.1	12.8	8.5
Environment protection	1.9	21.5	26.6	46.9	3	4.2
Agricultural and water conservancy	6.5	24.3	14.8	45.3	9	2
Education	6.7	18.4	19.3	50.3	5.4	19.4
Post-earthquake recovery	10.4	21.6	10.6	53.1	4.3	7.7
Medical and healthcare	1.5	14.8	25.4	55.9	2.5	1.3
All types of expenditure	18.1	17.3	25	35.1	4.6	100

Source: Local Fiscal Statistical Yearbook 2010.

Education: Fundamentally education is the responsibility of sub-national governments. Education services can be divided into basic education, higher education, and vocational education. Vocational education has been mostly left to private market institutions in China.⁸ For basic education, the role of the central government is that of the policy-maker and overall planner. In addition, the central government has responsibility for setting up special education funds for subsidizing basic education and teachers' (or normal) education in poor, minority areas. The provincial government has the overall responsibility for formulating the development plan for basic education and for providing assistance to counties to help them meet recurrent expenditures in education. The responsibility for actually implementing compulsory education programs, including financing basic education, lies with the cities or districts of large cities in the case of urban areas and with counties in the case of rural areas.

The provision of basic education services in rural areas is one of the major current concerns for the central government because of the generally worse service conditions there, especially in poor rural areas. Some new initiatives, especially the *Decision of Strengthening Rural Education*, issued by the State Council

⁸See the "Implementation Suggestions of the State Council on the Guidelines for the Reform and Development of Education in China" issued in July 1994.

in September 2003 expanded the expenditure responsibilities of the central government on basic education. This basic service was defined as a shared responsibility with the goal of supporting students from poor families by waiving their textbook, tuition, and miscellaneous fees, and by subsidizing housing expenditures for elementary and secondary education students. The central government as well as sub-national governments started setting up special funds for the support of this program in 2003. All students who meet the requirements of the poverty standard were supposed to enjoy the listed benefits by 2006.

The assignment of expenditure responsibilities for higher education differs from that of basic education. In general, private institutions of higher education in China are few and they account for a very small portion of these services; private institutions tend to concentrate on vocational training. Public higher education institutions are divided into two groups: one belongs to the central government, and the other belongs to sub-national governments; thus, expenditure responsibilities for higher education are shared between the central government and the provincial governments. The central government has responsibility for the plan of national development of higher education, and provides direct support to a select group of higher education organizations. The provincial governments have responsibility for the plans of provincial development of higher education and provide support the higher education of provincial institutions.

Health care: The central government has continued to commit to its responsibilities for health care. As a policy objective the central government has determined that total public spending on health care --from both the central and sub-national governments-- needs to increase at a higher growth rate than that of general budgetary expenditures. In practice, the responsibilities for public healthcare are concentrated at the sub-national level, particularly at the county and below levels of government.

The major concern of the central government about health care in China continues to be the spotty service coverage in rural areas. The *Decision to Strengthen Rural Health Care* issued by the central authorities in October 2002 provided detailed responsibilities for the provision of rural health care services among different levels of governments. The central government now has the responsibility for designing the overall plan for rural public health care, the provincial government has responsibility for planning its implementation, and the county (city) governments are assigned the overall responsibility for rural public healthcare delivery. In addition, the central government has the responsibility of subsidizing programs for the prevention and control of infectious disease, endemic diseases, occupational diseases, and so on, in poorer areas; provincial governments have responsi-

bility for subsidizing health programs of county (city) governments and to pay for the costs of planned immunity vaccinations. Finally, county (city) governments have responsibility for the delivery of all rural health care services.⁹

The new initiative of building a new rural collaborative health care system got started in January 2003, and it expanded the responsibilities of both the central government and local governments regarding health care. It established among other measures that from 2003 on the central government should pay US\$ 1.20 a year for each rural resident in the central and western regions who joins the rural collaborative health care system. Meanwhile, sub-national governments need to pay no less than US\$ 1.20 a year in total for each rural resident who joins the rural collaborative health care system, leaving it to the discretion of provincial governments to arrange the sharing into this contribution among the different sub-national levels.

Social security: This expenditure category in China refers to a package of programs which includes pensions, health insurance, unemployment insurance, maternity insurance, occupational injury insurance, and a variety of other health and welfare programs. The social security programs are mainly the responsibility of the city and county governments and are managed through a separate local government fund. Its financing is based on payroll tax contributions and on government subsidies. The system is generally underfunded, and is beset with a legacy of deficits. When responsibilities for social security payments of former SOE workers were passed on to the local governments, shortfalls emerged in government budgets. This left the local governments with unfunded social security liabilities and numerous “empty” accounts. The changing age distribution in China will likely worsen the financial condition of this program (World Bank and Development Research Center, 2014).

The current division of the main expenditure responsibilities among the different levels of government is summarized in Table 2.

Table 2. Expenditure Assignment among Different Levels of Government

	Central	Provincial	Prefecture	County and below
National Defense	√	√		
Foreign Affairs	√	√		
Foreign Aid	√	√		

⁹See “*Decision on Public Health Reform and Development by the Central Government*” issued in January 1997.

Capital Investment	√	√	√	√
Government Administration	√	√	√	√
Education	√	√	√	√
Scientific Research	√	√	√	√
Social Security	√	√	√	√
Health Care	√	√	√	√
Agriculture Expenditure	√	√	√	√
Expenditure for Public Security	√	√	√	√
Agency, Procuratorial Agency and Court of Justice				
Urban Maintenance and Construction		√	√	√

Source: Authors' summary

An important feature of expenditure assignments in practice is that traditionally actual expenditures at the sub-provincial government in China have followed a pattern of first meeting current spending needs. Currently, the predominant expenditure pattern at the county level in poorer areas is still regarded as one of “*feeding finance*”(Chi Fan Cai Zheng) or just meeting government administration costs. The relative shares of components in total expenditure at different levels are shown in Table 1 above for 2009.

All in all, the level of expenditure decentralization in China is among the highest in the world, with about 85% of the total being the responsibility of sub-national governments in 2012. The trend has been increasing one toward expenditure decentralization. For example, in 2001 the sub-national government share in total public expenditures was just a bit over 65%. One reason for this trend is that the most expensive and income elastic expenditures, such as education, health care and social welfare, are still mostly the responsibility of sub-national governments.

2.3 Hierarchical Expenditure Managing Model

Put in perspective, the reforms of intergovernmental fiscal relations over the last two decades have contributed significantly to improving local autonomy in China. In particular, nowadays each sub-national government has its own budget. More specifically, the budget of each government includes its own budget and the consolidated budget, which includes its own budget and all the consolidated budgets of the governments at the next lower level.¹⁰ The government budget at each level is approved by the people's congress at that level; in addition, the people's congress at each government level also checks the consolidated budget. The

¹⁰For the lowest government level, the townships, the own budget is equivalent to the consolidated budget.

approved own budget of a sub-national government is submitted to the upper government, and so on to the MOF for the record and for the compilation of the upper level government's consolidated budget and eventually the national consolidated budget. The national budget is the last to be approved.

However, on the other hand, local residents have little input into shaping the content of local budgets. Instead, local expenditure management has been conducted mostly through the bureaucratic hierarchy, a common practice that still remains. In addition, also reducing actual autonomy, the legal system framing China's fiscal decentralization process still gives provincial authorities complete discretion to overturn and finally determine all budget decisions of sub-provincial governments.

At the same time, the central government has increasingly provided guidelines for local expenditure management although much of it has helped clarify expenditure assignments in practice. A sampling of these regulations includes the following. *The State Council Regulations on the Implementation of the TSS* 1994 reform required provincial governments to define the expenditure responsibilities for sub-provincial governments. *The Suggestions on Improving the Fiscal Management System in Counties and Townships Experimenting with Rural Tax-Fee Reform* by MOF in August 2000 required: (a) a clear definition of expenditure responsibilities between the county and township governments; (b) the improvement of the structure of township government, and strict control of the quota of township employees; and (c) the monitoring of fiscal risks of county and township governments. *The Notice about Eliminating Fiscal Difficulties of County and Township Government* by MOF in 2005 tried to build a monitoring and expenditure performance system.

3. MAIN ISSUES WITH THE CURRENT SYSTEM OF EXPENDITURE ASSIGNMENT

As already mentioned above, expenditure assignments have been largely ignored by the central government in the last three decades of intergovernmental fiscal relations reform in China. The basic assignments of expenditure at the different levels of government are today fundamentally what they were decades ago at the start of the reforms. With the increase in the demand for public services associated with the fast process of industrialization and urbanization and the changes in technologies to deliver those services, the demand for public services has drastically changed and yet little has been done to reform service delivery policies over the past several decades. These issues are especially acute at the sub-provincial level.

This lack of reform on expenditure assignments is striking given that the decentralization in China is fundamentally one-sided-- from the expenditure side of the budget-- and that expenditure decentralization in China is very extensive by any international standards, with about 85% of total public expenditures being the responsibility of sub-national governments in 2013. And the trend has been toward the increase of expenditure decentralization. For example, in 2001 the sub-national government share in total public expenditures was just a bit over 65%. Because of the lack of reform and some fundamental structural weaknesses of the system, the current system of expenditure assignments still faces a series of problems,¹¹ which would be best addressed via a comprehensive reform. In what follows we discuss some of the more important issues in more detail.

3.1 Lack of a Clear Assignment of Expenditure Responsibilities and Its Consequences

The overall efficiency of the system of intergovernmental fiscal relations has been handicapped by the lack of clarity in the current functional assignments in the laws and regulations. As stressed above, recent reforms have made little progress in bringing clarity.

The lack of explicit expenditure assignments has eventually led to lower accountability given the difficulty of identifying the level of government that is actually responsible for the delivery of particular services. Lower accountability means in turn that local governments are likely not prioritizing local budget expenditures according to the needs and preferences of their residents or delivering those services with the lowest possible costs (Oates 1972; 2004). Accountability of government officials to residents has been further reduced because an increasing number of people have migrated internally without the official documents (i.e., Hukou registration) and have been residing in urban areas, especially in the eastern provinces, without a right to access basic services.

The lack of explicit assignments has produced in particular considerable murkiness as to which level is responsible for financing expenditures and how the financing responsibilities are divided. This has facilitated often the “convenient” offloading of responsibilities down the hierarchical structure of government. In education, for example, despite the fact that in many cases there are inadequate resources, counties have been called in recent years to finance basic education

¹¹ Nevertheless, we have to acknowledge that the design of any system of expenditure assignments is a complex matter, and in practice very few countries are able to get it right, especially when the decentralized system of finance is still fairly new in a country, as is the case in China.

reform.

The lack of explicit assignments has also led to significant differences in the assignment of responsibilities among local governments across provinces. Although in theory there is nothing wrong with having a variety of approaches to expenditure assignments, the absence of a holistic approach to expenditure (and revenue) assignments at the sub-provincial level has made it more difficult for matching revenue sources with expenditure functions at each local level. In addition, the vast array of arrangements has made it almost impossible to target pass-through transfers from the central government to lower-level local governments and to set standards for the provision and performance monitoring of public services. This is evidenced by the fact that in the current transfers system, the allocation of funds has to go through the different layers of government from the top to the bottom. All these aspects have contributed to a wide variation in the standards of services across the country.

The lack of a legal framework for expenditure assignments at the sub-provincial level has also allowed for high levels of administrative discretion in ultimately deciding which level of government is responsible for service delivery. In practice, upper-level government decisions regarding expenditure responsibilities have resulted in what can be regarded in many cases unfunded government mandates. Consequently, local residents may have to settle for a subpar level of services. For example, pensions may be underfunded and full payments may not be made to retirees. Or, a provincial government with responsibility for regulating the production of foodstuffs for national consumption may choose not to impose costly food inspection measures, with this decision potentially having adverse effects on the welfare of the whole country.

One last consequence of the lack of explicit expenditure assignment has been the continued blurred distinction between public and private activities, with no clear delineation for what are government functions vis-à-vis those to be carried out by the private sector. During the process of transition from the planned economy to the market economy, government has gradually relied more heavily on market mechanisms and has given up direct intervention in the private sector. However, government's expenditure responsibilities within the private sector are still very wide. Currently, a significant number of enterprises are still owned by (or belong to) governments at different levels, and there is still a variety of channels through which governments can directly or indirectly encroach into private-sector activities through their SOEs (Qiao and Shah 2006). A typical example of this is that local governments may use transfers to support the activities of SOEs, which ultimately affects the market competitive outcomes. Even in the poorer ar-

eas, the limited fiscal resources have not prevented local governments from expanding into areas with heavy overhead expenditures that in many other countries are entirely left to the private sector. This expansion into market economic activities has depleted fiscal resources leaving fewer funds available for the provision of even the most basic public services.

3.2 A Mismatch of Expenditure Responsibilities and Revenue Sources at the Lowest Levels of Administration

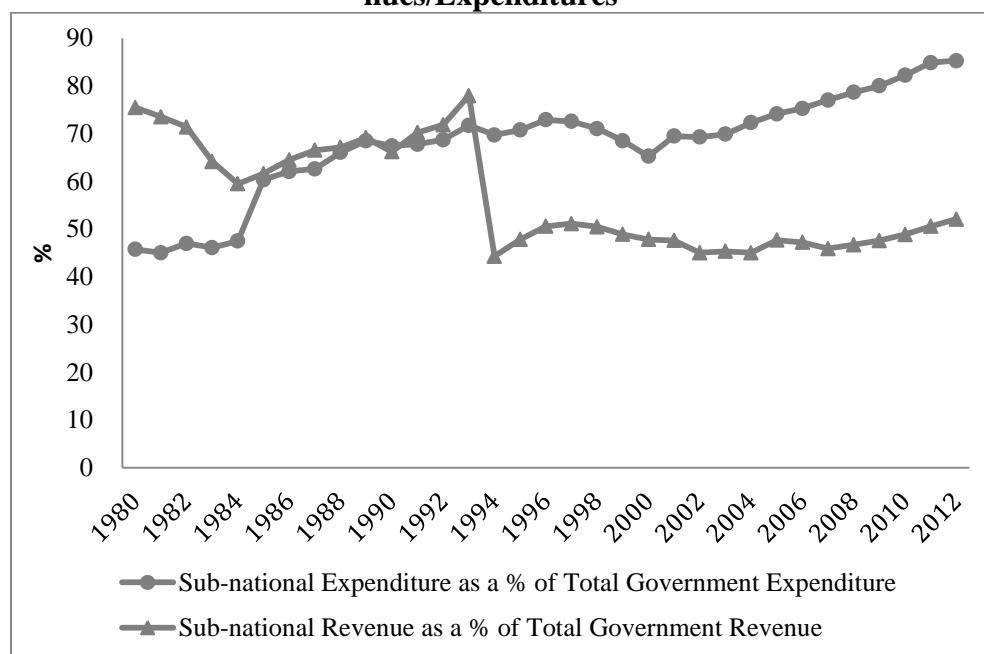
Local governments (especially county and township levels) have very heavy expenditure responsibilities in education, health, and social security that are out of line, especially in the case of social security, with international practice. While the TSS reform re-centralized revenue assignments, there has been considerable devolution of expenditure responsibilities to local governments. The potential disconnect between the revenue and expenditure pillars of fiscal decentralization is illustrated in Figure 2 by the sharp decline in the share of the sub-national government in total government revenues after 1994 and the fact that not much after the share of the sub-national government in total expenditures started to rise. More importantly, the vertical imbalances caused by the opposite trends in revenue centralization and expenditure decentralization have not been adequately offset by intergovernmental transfers (Zhang and Martinez-Vazquez, 2003; Jia, 2004).

This situation has led to a serious under-provision of basic public services in poor jurisdictions. For county governments that have only limited revenues, the ability to spend on local public goods depends heavily upon the availability of intergovernmental transfers (Uchimura and Jütting 2009; Liu et al. 2014). But with the current levels of intergovernmental transfers coupled with the budget priority decisions taken by many local governments (e.g., their forays into private sector activities just discussed above) have led in many cases to the under-provision of basic public services (Martinez-Vazquez et al., 2008).

The bottom line is that China's system of intergovernmental finance is far from achieving the goal of providing all citizens with similar access to basic public services. As shown in Table 3, while the average per capita educational expenditure in year 2000 is 159.49 Yuan, the poorest jurisdiction spends only 77.54 Yuan, less than half of the national average and less than one seventh of that spent by the richest in this same year. The under provision in some areas of health care services and social security are even more significant. The poorest jurisdiction spends 18.10 Yuan per capita on health care in year 2000, which represents 35% of the national average and only 8.6% of what is spent by the richest jurisdiction.

For the case of social security programs, the lowest jurisdiction spends 8.41 Yuan per capita on the subsidies for social security programs in year 2000, which represents 41% of the national average and only 10% of what is spent by the richest jurisdiction. Importantly, however, Table 3 also reveals positive evidence that, over the years there has been convergence; by 2012, the lag of poorer provinces in providing basic public services had been reduced, though quantitatively, the regional gaps are still large.

Figure 2. Trends of Sub-national Government Shares in Total Revenues/Expenditures



Source: China Statistical Yearbooks

Table 3. Sub-national Expenditures on Basic Public Services, Per Capita (2000 and 2012)

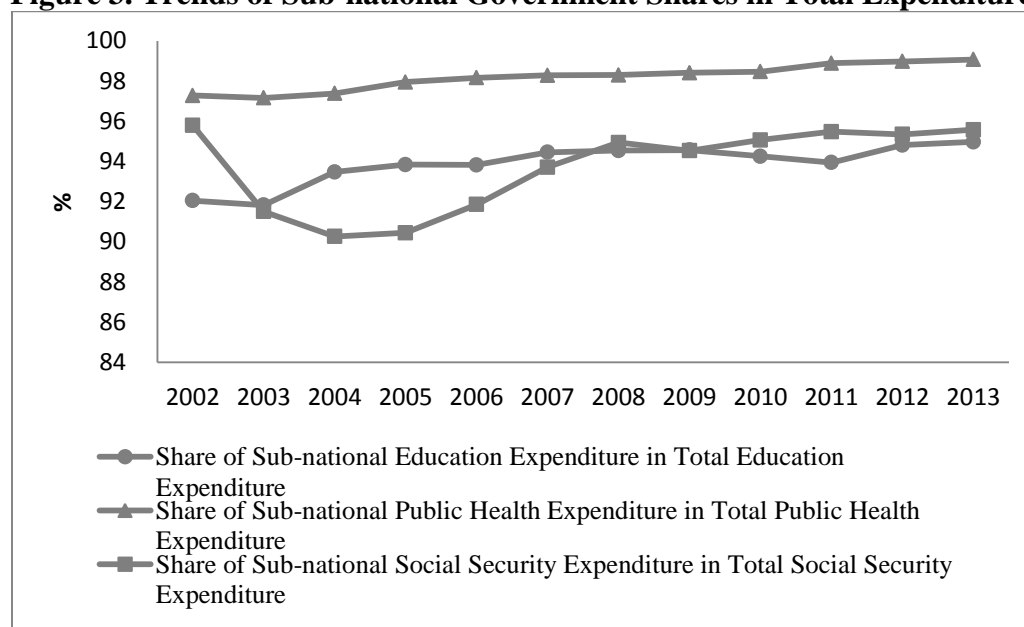
	Year	Min	Max	Mean	C.V.
Total	2000	469.57	3783.41	1080.72	0.72
	2012	5322.56	29394.16	10141.51	0.52
Education	2000	77.54	583.05	159.49	0.68
	2012	1176.39	3067.53	1722.14	0.33
Health Care	2000	18.10	209.17	51.27	0.91
	2012	436.66	1237.60	614.68	0.33
Social Security	2000	8.41	81.70	20.39	0.69
	2012	547.71	3132.81	1132.90	0.51

Source: China Statistical Yearbooks

3.3 Inefficient Assignment of Several Expenditure Responsibilities

Several of the current de facto expenditure assignments are highly problematic. The most conspicuous example is the major responsibility assigned to sub-national governments for social security programs including pensions, unemployment insurance and income support schemes for city- and county-level governments. This illustrated in Figure 3, where, on average, sub-national governments have taken up more than 93% of the total expenditure responsibilities not only for education and health care but also for social security.

Figure 3. Trends of Sub-national Government Shares in Total Expenditures



Source: China Statistical Yearbooks

Such assignments for social security are hardly replicated anywhere else in the world. In general, pension schemes, unemployment insurance, and other social security measures tend to be central government responsibilities, as these types of schemes require a high level of risk pooling and redistribution that cannot be matched at the level of county governments.¹² Therefore, either provincial or national pooling of social risks would seem to be the correct approach to these functional assignments. Beyond the implied inefficiencies, there are also significant distributional consequences. Whereas welfare benefits are almost nonexistent in

¹²See, for example, Ahmad (1995) and the references therein.

some rural areas, in some urban areas there is often a lack of redistribution because poorer communities with the highest needs are the least financially able to fund these expenditures. The inability of many local governments to finance their social safety nets has led in recent years to the widespread presence of pension arrears and defaults, which have forced the central government to intervene with subsidies and bailouts.¹³

3.4 Significant Horizontal Expenditure Disparities Across and Within Provinces

As we highlighted above, the lack of explicit assignments has led to significant differences in the assignment of responsibilities among local governments across provinces. In turn, this has in part contributed to significant horizontal fiscal disparities both across provinces and within provinces. The significant disparities in expenditure per capita and in service delivery are likely to be harmful for cohesion of the country. Here we review the main trends in expenditure disparities across and within provinces and more importantly, we examine how those expenditure disparities have eventually translated into disparities in the levels of service provision. The analysis of this matter is important, as it captures important dimensions of the overall picture of expenditure assignments in China.

Horizontal disparities in total expenditure across provinces: The current system of expenditure assignments generate pronounced expenditure disparities across provinces, especially for the very distinct eastern region—relatively rich, and the central and western regions—relatively poorer. Over time these disparities have not become less pronounced. In fact, before the newly established intergovernmental fiscal transfers system came into effect around 1998, horizontal regional disparities in expenditure across provinces deteriorated (Table 4). A significant contributing factor has been the different revenue capacity in the different regions.

The increasing trend in expenditure disparities, which was temporarily stopped for a few years starting in 1998 as several intergovernmental transfer programs were newly introduced by the central government, has continued its expansion since 2000. Since 2003, reforms in intergovernmental transfers to improve rural basic public services gradually decreased the disparity levels (Table 4.) In 2012, public expenditures per capita in the best off province were 5.5 times larger

¹³There are important issues about the long-term viability of pension funds managed at the local level, liabilities growing much faster than contributions and with the current population dynamic with prospects of things getting worse (Bahl and Martinez-Vazquez, 2006a).

than those for the worst off province and the coefficient of variation across provinces was 0.52. These disparities are still large by international standards.

Table 4. Per Capita Expenditure Disparities across Provinces: 1990-2012

Year	Min	Max	Mean	C.V.
1990	103.51	602.54	254.37	0.56
1991	101.83	663.80	279.95	0.56
1992	111.73	728.60	296.11	0.56
1993	122.11	958.19	372.28	0.57
1994	156.62	1452.21	444.20	0.69
1995	225.97	1837.47	537.59	0.71
1996	278.34	2347.97	632.31	0.72
1997	307.66	2805.86	697.63	0.77
1998	347.42	3210.71	810.59	0.76
1999	409.41	3619.65	942.86	0.76
2000	469.57	3782.24	1069.13	0.72
2001	532.27	4245.43	1377.68	0.72
2002	654.51	5162.67	1611.31	0.74
2003	741.28	6163.30	1784.62	0.76
2004	905.59	7534.20	2070.80	0.73
2005	1165.14	8710.34	2517.68	0.71
2006	1533.31	9142.39	2966.79	0.65
2007	1998.52	10570.15	3706.85	0.63
2008	2419.78	13036.26	4721.22	0.59
2009	3062.89	15829.37	5826.63	0.55
2010	3632.26	18306.98	6957.97	0.51
2011	4525.80	25020.13	8799.88	0.52
2012	5322.56	29394.16	10141.51	0.52

Source: China statistic yearbooks

Total expenditure disparities within the provinces: There are also significant levels of disparity within provinces, although the trends vary over time and can differ significantly across provinces. Table 5 shows the disparities in total expenditure per capita across counties within each province from 1995 to 2011. Overall, while within-provincial disparities in most of the eastern provinces have declined significantly, the trends in other regions have been oscillating or have increased slightly as in the cases of the northwest and southwest regions. On average, the coefficient of variation for per capita total expenditure within provinces suffered a relatively large decline over the observed period; it decreased from 1.0 in 1995 to a value around 0.8 in 2004, and declining after to a value around 0.5 by 2011. A closer look at the declining trends suggests that it is the provinces with

the highest initial levels of disparities in total expenditure that registered the largest drops, while the provinces with low initial levels of disparities generally experienced fewer changes in within-province disparities (Figure 4).

It thus appears that if the central authorities care about reducing horizontal expenditure disparities, then central government policies need to take into account the existing horizontal expenditure disparities within the provinces and need consider the best way to do that given China's strong hierarchical vertical structure of government.

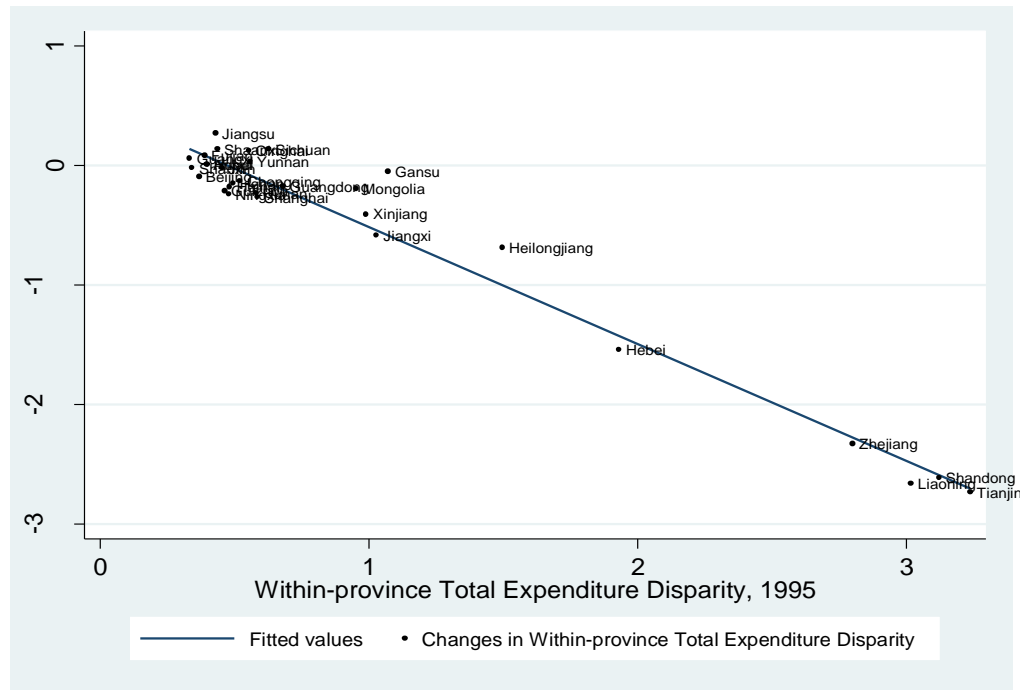
Table 5. Per Capita Total Expenditure Disparities within Provinces, 1995-2011

	Mean			C.V.			Min			Max		
	1995	2004	2011	1995	2004	2011	1995	2004	2011	1995	2004	2011
Beijing	628	4433	15685	0.4	0.3	0.3	81	2834	9918	1197	7006	25404
Tianjin	1442	1544	7109	3.2	0.4	0.5	224	796	3727	20707	3261	14087
Hebei	201	895	3034	1.9	1.9	0.4	66	236	1553	4900	16541	9100
Shanxi	226	908	4530	0.3	0.4	0.3	61	287	2404	479	1806	8493
Mongolia	340	1906	10896	1.0	0.8	0.8	101	699	3772	2661	8514	40856
Liaoning	452	987	4843	3.0	1.3	0.4	109	268	2071	13947	12520	9658
Jilin	261	883	5665	0.5	0.5	0.4	138	333	2278	654	2355	14224
Heilongjiang	298	905	5064	1.5	0.8	0.8	101	343	1202	3875	6293	25123
Shanghai	1100	6389	16686	0.6	0.3	0.3	567	2768	9443	2912	9990	26689
Jiangsu	208	1327	5879	0.4	1.1	0.7	104	283	2993	465	9938	24113
Zhejiang	518	1987	5809	2.8	1.2	0.5	156	666	2668	10580	20263	20713
Anhui	148	521	3515	0.4	0.5	0.4	65	195	1518	411	1253	7917
Fujian	287	1044	3819	0.4	1.5	0.5	126	181	1967	814	11693	10928
Jiangxi	188	679	3713	1.0	0.3	0.4	39	298	-4071	1977	1527	11844
Shandong	303	998	3342	3.1	1.6	0.5	83	249	1556	10172	17500	9901
Henan	136	559	2558	0.5	0.5	0.3	58	252	1554	369	2593	6602
Hubei	172	607	3406	0.4	0.6	0.4	86	221	198	405	2957	7154
Hunan	183	662	2812	0.6	0.8	0.4	81	151	883	771	4552	7475
Guangdong	309	1087	2759	0.7	1.0	0.5	114	178	1159	1050	6553	7738
Guangxi	206	645	3382	0.3	0.8	0.4	84	253	1663	457	5150	9180
Hainan	323	857	5855	0.5	0.3	0.3	136	443	3537	817	1510	9512
Chongqing	167	956	5203	0.5	0.6	0.4	87	458	2761	467	2523	10399
Sichuan	217	1076	5633	0.6	0.9	0.8	9	324	1988	712	5174	23175
Guizhou	140	649	3408	0.5	0.4	0.3	76	347	1120	476	1802	5780
Yunnan	341	945	4803	0.6	0.4	0.6	105	353	2185	1483	2948	25816

Shaanxi	177	674	5054	0.4	0.7	0.6	83	220	2146	491	3321	16764
Gansu	226	1235	6704	1.1	2.4	1.0	87	202	2419	1626	27381	43096
Qinghai	396	1553	14731	0.6	0.5	0.7	121	385	4641	1100	3896	51623
Ningxia	246	1038	7570	0.5	0.4	0.2	141	630	4999	610	2345	10838
Xinjiang	405	1364	8726	1.0	0.8	0.6	70	447	3213	3702	8241	28474
Mean	342	1310	6073	1.0	0.8	0.5	112	510	2582	3009	7047	17423

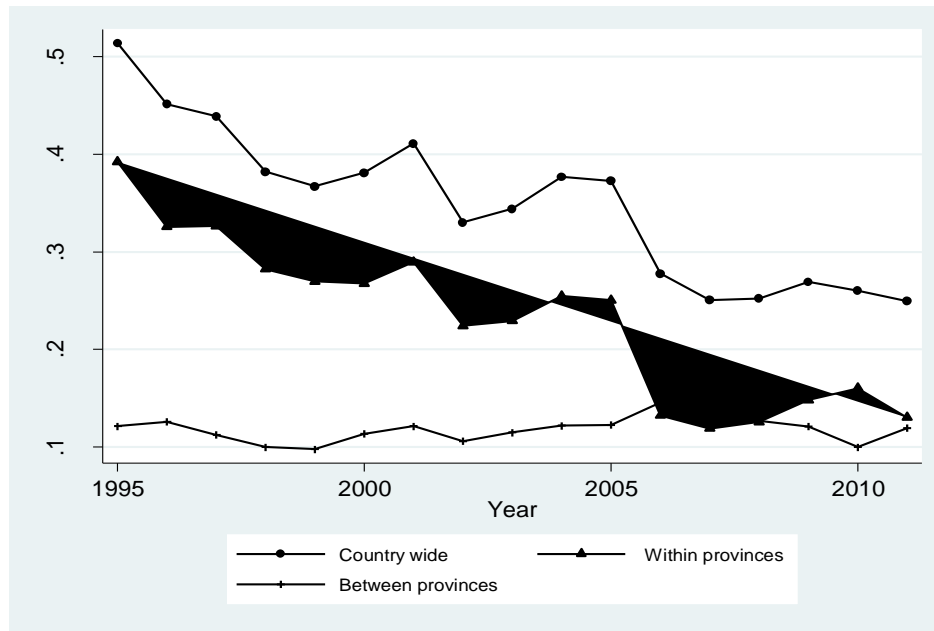
Source: Ministry of Finance, China Statistical Yearbook for Regional Economy, and Authors' Calculation.

Figure 4. The Initial Level and Changes of within Province Total Expenditure Disparity



Note: changes in within-province total expenditure disparity are calculated as the difference of coefficient of variation of per capita county expenditure within province for the years 2011 and 1995.

Source: Ministry of Finance and Authors' Calculation.

Figure 5. The Decomposition of Total Expenditure Disparities, 1995-2011

Source: China Statistical Yearbook for Regional Economy, and Authors' Calculation.

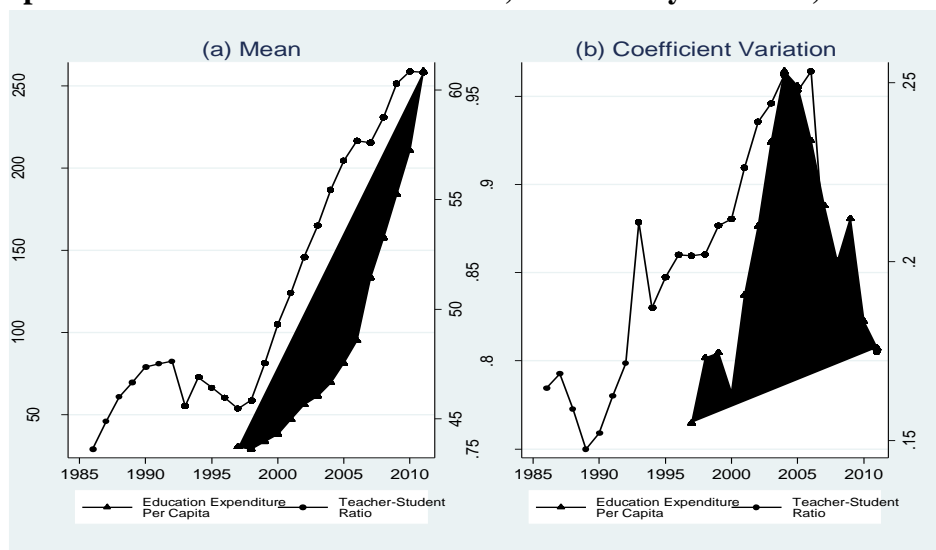
Per capita total expenditure disparities within vs. across provinces: What is the main driving force of disparities? In order to document the relative importance of total expenditure disparities within provinces and across provinces in contributing to the overall expenditure disparities in the nation, we calculate the Theil index based on county data. This index provides a way to decompose the overall disparities into disparities between groups and disparities within groups. As shown in Figure 5, expenditure disparities are generally starker within provinces than across provinces, thus suggesting that expenditure disparities within provinces are the main contributor to the overall expenditure disparities in the nation. This is related to the very different economic experience of counties within a province. Nevertheless, over the years, expenditure disparities within provinces experienced a large decrease from a value around 0.39 in 1995 to a value around 0.11 in 2007, leading to an overall declining trend of expenditure disparities in the country; at the same time, expenditure disparities across provinces experienced a moderate increase in this same period, which is consistent with what we observed in Table 4.

On how expenditure disparities have translated into differences in access to public services: Barring large asymmetric inefficiencies across jurisdictions, undoubtedly there has to be a link between disparities in expenditures per capita and disparities in the level of service provision. Clearly, at the end what really matters

for collective welfare is access to basic services by all citizens. Our analysis below focuses on the two interrelated questions of how well correlated are expenditure per capita and access and service provision, and what have been the trends over time in disparities of service provision.

Quantifying service provision is fraught with difficulties because of the multi-dimensional nature of most services. In the analysis we focus on just several of the most important services (education, health, roads, and social security) and in particular outputs related to those services. Concentrating first just on the case of education, Figure 6(a) shows that there is a high correlation between real per capita provincial expenditure on education and the intermediate output measure of the ratio of teachers per 1,000 students in primary schools, while Figure 6(b) shows the trends in the coefficients of variation for both variables. Disparities, approximated by the coefficient of variation, increased steadily over the period up to 2005 and then started a rapid decline in the subsequent years. It is not clear whether this change in trend is related to any particular policy such as the province-managing-county reform but it is an indication of some convergence across provinces on the budgetary priority given to this basic service. Note, however, that a coefficient of variation of 0.8 in 2011 still denotes a high level of disparity in education outputs.

Figure 6. Mean and Coefficient Variation of Education Expenditure Per Capita and Number of Teachers Per 1,000 Primary Students, 1986-2011.

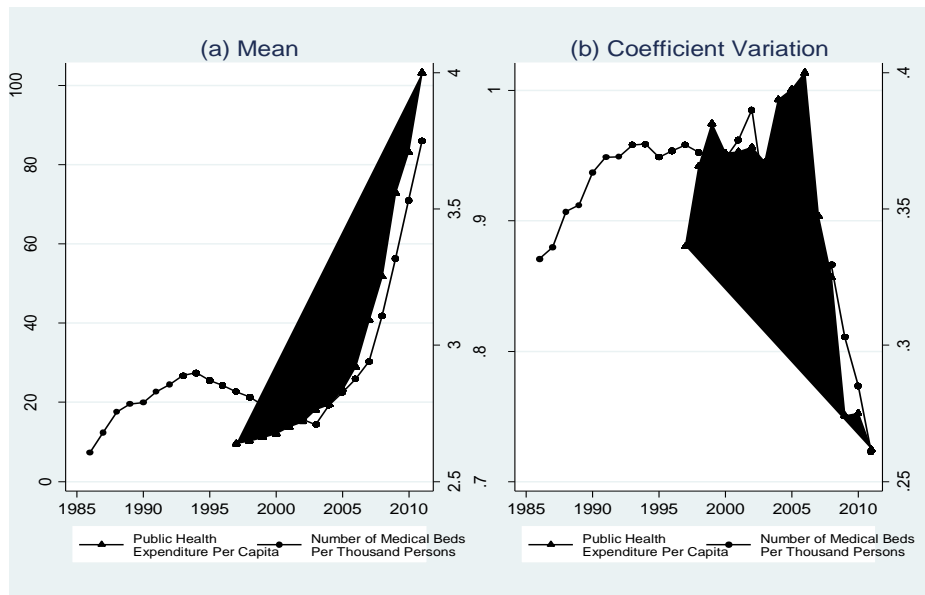


Source: China Statistical Yearbooks and Authors' Calculation.

In the case of health, the story is similar to that in education. Figure 7(a)

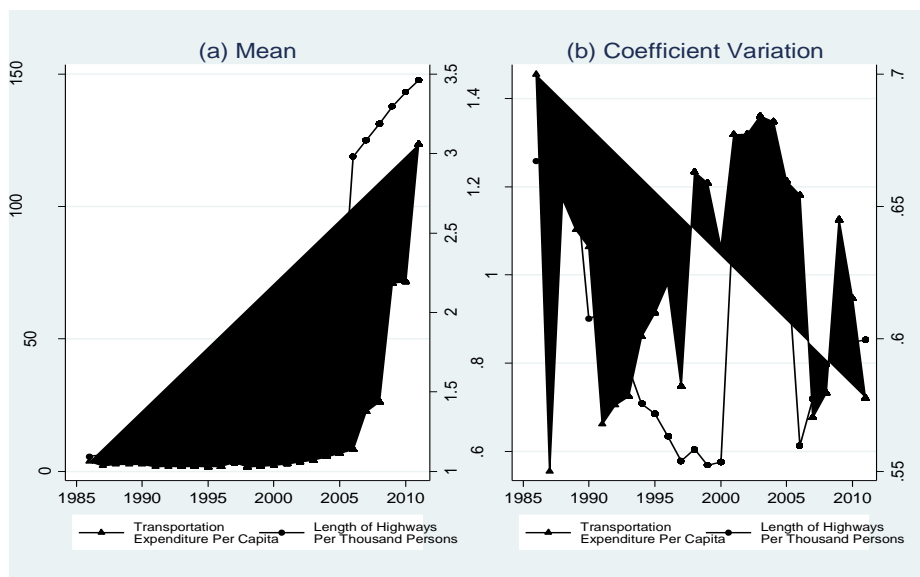
shows a high correlation between expenditure per capita on health care and the outcome of health care provision measured by the number of hospital beds per 1,000 persons. Both expenditures per capita and output rise very fast from the early 2000s. The coefficients of variation for the two variables start high and remain high until 2005, when they experience a rapid drop in levels (Figure 7(b)). Again a very similar story is repeated for transportation expenditures per capita and the output measure of length of highways per 1,000 persons. The expenditure and output measures appear to be highly correlated (Figure 8(a)). In contrast to the cases of education and health, in the case of transportation, the coefficients of variation of expenditures and road mileage exhibit great volatility over the entire period with no particular trend (Figure 8(b)). The higher volatility may be a reflection of the lump-sum nature of road infrastructure spending.

Figure 7. Mean and Coefficient Variation of Public Health Expenditure Per Capita and Number of Hospital Beds Per 1,000 Persons, 1986-2011.



Source: China Statistical Yearbooks and Authors' Calculation.

Figure 8. Mean and Coefficient Variation of Transportation Expenditure Per Capita and Length of Highways Per 1,000 Persons, 1986-2011.

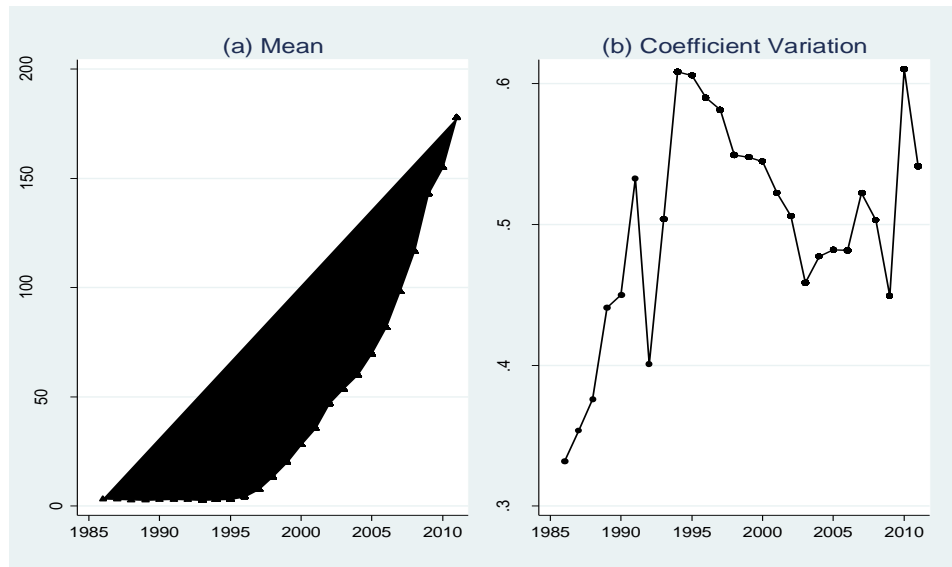


Source: China Statistical Yearbooks and Authors' Calculation.

For other functions for which sub-national governments are also responsible, it is generally harder to identify a quantifiable output. Are expenditures per capita on those functions expected to show similar patterns? It would appear that most if not all functional expenditures per capita have experienced sharp increases in real terms over the last decade but that the disparities across provinces as measured by the coefficient of variation exhibit different patterns and not always showing convergence. For example, Figure 9 shows the mean and coefficient variation of per capita social security expenditures across provinces.¹⁴ Overall mean expenditures on social security have been increasing sharply over the years but regional disparities, although somewhat reduced by the 1994 TSS reform, have become volatile and large in recent years.

Figure 9. Mean and Coefficient Variation of Social Security Expenditure Per Capita, 1986-2011

¹⁴ Data for measuring the outcome of social security services are not available.



Source: China Statistical Yearbooks and Authors' Calculation

4. OPTIONS FOR THE REFORM OF THE CURRENT SYSTEM

Even though in the last two decades China has made progress in some areas such as separating government from SOEs and re-defining the functions and responsibilities of government in the economy, as we have seen above, there are still significant problems from the perspective of expenditure assignments (Martinez-Vazquez, 1998). Setting up formal, stable and sound expenditure assignments to clarify the responsibilities of all government levels must become a priority for reform. A clear and explicit assignment of expenditure responsibilities at all levels could: (1) facilitate a more efficient organization and provision of basic public services; (2) significantly improve the accountability of public officials to residents; (3) help eliminate government encroachment in the private sector; and (4) help to address more effectively the issues of vertical and horizontal fiscal disparities. In this section, we propose several directions for the possible reform of the system and lay out some practical guidelines for proceeding with the reform.

4.1 Directions for the Fundamental Reform of Expenditure Assignments

Achieving a stable and transparent expenditure assignment at all levels of government that emphasizes exclusive over concurrent responsibilities: The reform of expenditure assignments should cover all levels of government and

should emphasize where possible exclusive over concurrent responsibilities.¹⁵ When concurrent responsibilities are desirable, assignments should be clarified by explicitly unbundling the multidimensional array of attributes that go with each function, including (1) actually producing a good or delivering a service; (2) providing or administering the service; (3) financing the service; and (4) setting standards, regulations, and policies for the provision of services. The assignment of expenditure responsibilities should be based on the right balance between devolution of responsibilities according to economies of scale, the internalization of costs, and available administrative capacity. It should allow for asymmetric approaches as a means of allowing sub-national units with greater capacity to assume greater responsibilities. In addition, it will be important to improve coordinating institutions across levels of government to address different interpretations and conflicts arising from concurrent assignments.

Reassign selected expenditure responsibilities: Coming short of comprehensive reform it would still be worthwhile to reform piecemeal the assignment of some basic social services at the sub-provincial level. In particular the financing and provision of social security services (pensions, disability and survivor benefits, and unemployment insurance) should be completely re-centralized, at the provincial and/or central government levels. Variations in benefits and payroll contribution rates among provinces and local government, as they exist under the present system, are at odds with a goal of uniform standards for all Chinese citizens. The present arrangements of city and county government responsibility for pensions has forced pooling to the prefecture and provincial level in many provinces, and in general, payroll contributions are exceeding benefits in most systems. Meanwhile, the reassignments of the provision of social security to the upper levels of government should be accompanied with an increase in the available pool of funds from the central government---for example in some form of equalization grant---to bring the less well-off provinces to the country average.¹⁶

Improving the accountability of subnational governments and the quality of local expenditure management: Weak accountability of sub-national government officials to local residents remains a significant feature of China's decentralization system. This leads to a less efficient public sector. The direct appointment of offi-

¹⁵ For example, in many decentralized large countries, including Australia, Brazil, Canada, the Russian Federation, and the U.S., there are a number of responsibilities that are exclusively assigned to local governments

¹⁶As we have just seen, even though national average expenditures per capita on most if not all government functions have experienced great increases over the past decades, overall disparities across provinces in expenditures per capita remain very high by international --and also China's own historical-- standards.

cials tends to make them mostly accountable to the upper level and central government authorities. The system needs to introduce adequate accountability mechanisms to provide incentives to sub-national governments to properly weigh spending on economic development versus other public services, especially those in the social sectors. Meanwhile, in those areas where public services generate larger externalities, the upper level government should focus more on direct provision of these services, as the presence of externalities would result in the suboptimal provision of those services if they were to be supplied by the local governments.

How to do it? Besides the introduction of local elections, different approaches are used internationally to better empower communities for increasing accountability. For example, local governance in some countries is reinforced by institutions that facilitate the involvement of civil society in the delivery of public services and for more directly participating in budget decisions. For example, in the education sector, there is now evidence that community-managed schools can lower teacher absenteeism and improve schooling outcomes.

4.2 Some Practical Guidelines for the Comprehensive Reform of Expenditure Assignments in China

Bringing clarity on several important preliminary questions:

(1) What should be the scope of the reform in expenditure assignments and privatization? A benefit of extending the scope of the reform to all activities within the fiscal system is that we can identify activities at the central and sub-national levels that do not serve a public function and that by their nature can be better provided in the private sector. More specifically, the reform of expenditure assignments provides an excellent opportunity for the privatization of activities that do not belong in the public sector.

(2) Decide between general assignments versus differentiating between “delegated” and “own” responsibilities. In determining expenditure assignments we may want to make a distinction between voluntarily (or “own” responsibilities) versus mandatory (or “delegated”) functions of sub-national governments. That is, a decision needs to be made as to whether it is desirable to differentiate between what sub-national governments can do and what they must do. However, doing this is not a requirement for a clear assignment of expenditure responsibilities. The arrangement for paying for delegated responsibilities is typically via conditional or tied grants.

(3) How far to carry “exclusive” (as opposed to “concurrent”) assignments? Exclusive responsibility is more conducive to accountability and generally more efficient provision of services; however, in practice, exclusive responsibilities are not always possible and it may not be desirable in some cases.

(4) Decide on what general approach to use, “general competence” versus “closed list” for expenditure responsibilities? Here the choice is between a “general competence” approach followed by some exclusions or exceptions versus a “closed list” of competences. A closed list approach is more cumbersome but it can offer more protection to sub-national governments against encroachment by central or upper-level governments. Typically the question boils down to what level of government may have “residual powers” in case a particular (new) function does not appear in the law in the closed lists.

(5) Make a choice on the legal instrument to be employed to specify expenditure assignments. Because the assignment should be stable over time, especially given the time needed for strategic planning and capacity building, it should be in the law, for example the Decentralization Law or the Budget Code. It is less preferable to introduce expenditure assignments in the Constitution given the difficulty of making changes in this case; however, the enunciation of the general principles of expenditure assignments in the Constitution is desirable as it offers more certainty and protection to subnational governments.

(6) Deciding on how much needs to be specified in the law and how much can be left to coordination through intergovernmental committees or even to interpretation by the courts? No expenditure assignment can ever be detailed enough to preempt the need for dialog and coordination among different levels of government, but there is the matter of the level of specificity in the law. That is, how much should we rely on the legal text and implementation rules vis-à-vis a more general text that will be subject to interpretation as we go, by practice and coordinating institutions, and ultimately be left for interpretation and rulings by the courts of law?

(7) Determining expenditure assignments at all levels or just between the central and the “aggregated” sub-national level? When there is a single tier of government below the central government, the assignment of functions must cover all government levels. However, when there are two or more tiers of government at the sub-national level there are several choices of approach. An explicit assignment at all levels is more transparent and efficient and therefore much preferred even though it would be less flexible in adapting to specific characteristics of sub-national units.

(8) Deciding between uniform versus asymmetric responsibilities? Some local jurisdictions may be too small¹⁷ to realize economies of scale in the delivery of public services. Although there are some ways to get around the small scale, such as privatization of services, the creation of special districts, or associations of local governments, the most preferable solution to the problem is the amalgamation of smaller local governments into larger units with adequate size and capacity. But this solution (amalgamation) may not be politically feasible or even desirable in terms of accountability in the case of very dispersed populations. The solution could be an asymmetric assignment of expenditure responsibilities, where more responsibilities are assigned according to the capacity of local governments.

Identifying who should be involved: It may be assumed that in the case of China, the determination of expenditure assignments is the prerogative of the national or central authorities. As mentioned earlier, leadership of the reform should be assigned to an intergovernmental reform commission with wide representation of the most important stakeholders at the central and subnational levels. The commission, with support of a technical secretariat or working group, would need to establish the general strategy and scope of the reform, as well as an implementation plan with an explicit time schedule. If there is no commission, perhaps the Ministry of Finance could take the lead in the reform effort. However, that is likely to be less than ideal.

Determining what different types information will be needed: Setting up to conduct comprehensive reform of expenditure assignments will require significant amounts of data on actual and potential expenditures and expenditure needs associated with the reassignment. Getting all of this information on a timely basis may be one of the most significant hurdles to expenditure assignment reform. But it will be important that adequate resources are dedicated to this task.

Enforcement: One of the big difficulties with expenditure assignments, is the potential disconnect between the assignments specified in the law and regulations and what is actually done in practice. These problems will be reduced if the process of reform is highly participatory, involving all stakeholders, and the reforms are well publicized. The added clarity to the assignment of expenditure responsibilities by the reform should also contribute to reducing differences between practice and law. Intergovernmental institutions for cooperation and dialogue among the different levels of government can also work well in this context.

¹⁷ They might be small in the sense that they may lack adequate fiscal capacity and tax base and also lack administrative and managerial capacity.

5. CONCLUDING REMARKS

China's system of intergovernmental fiscal relations has experienced considerable progress over the past three decades but, as is documented in this paper, significant challenges remain, especially on the side of expenditure assignments. In fact, the two major reforms that have been undertaken by China's central government in the area of intergovernmental relations---in 1979 and 1994---were mainly focused on the revenue side of budget---revenue assignments and tax policy and tax administration reform. Although building a system with a sound assignment of expenditure responsibilities may require more time, especially in order to build the necessary consensus, there is clearly a need to act.

Most recently there are signals that the central authority is considering some potential policy changes relating to expenditure assignments. On November 12, 2013, the Third Plenary Session of the 18th Central Committee of the Communist Party of China (CCCPC) adopted the "Decision of the CCCPC on Some Major Issues Concerning Comprehensively Deepening the Reform". The Decision of the CCCPC puts forth a clear requirement to establish a system of correspondence between administrative authority and expenditure responsibility. It requires that the administrative authority and expenditure responsibility of the central government, including those concerning national defense, foreign affairs, national security, and unified national market rules and management will be increased. The administrative authority over some social security programs, and the construction and maintenance of major trans-regional projects will be shared between the central and the local governments. Regional public services will remain the responsibilities of local governments. The central government will delegate some expenditure responsibilities to local governments and finance these with transfer payments. Nevertheless, so far there has been no significant improvement in the system.

With the increase in the demand for public services associated with the fast process of industrialization and urbanization of the country, the lack of reform on expenditure assignment has resulted in a series of problems related to the efficiency and equity of the system---as discussed in this paper. Obsolete and inefficient expenditure assignments are now becoming a major obstacle for the modernization of the country's fiscal system. Therefore, the setting up of a formal, stable and sound expenditure assignment system must become a priority for China's fiscal reform at the current stage.

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