7

Fiscal Reform and Land Public Finance: Zouping County in National Context

SUSAN H. WHITING

Land has become a key source of fiscal revenue for local governments in China. As the value of land has increased with urbanization and economic development, local governments have sought to exploit their control over land in order to generate both on- and off-budget revenue. Scholars and policy makers have come to refer to this phenomenon as "land public finance." This chapter argues that land public finance is in large part an outgrowth of trends in central-local fiscal relations.

During the course of China's transition from a planned to a market economy, central-local fiscal relations have undergone a series of fundamental reforms. Current challenges grow out of a number of features of the Chinese political economy, the most important of which is the mismatch between the allocation of revenues and the assignment of expenditure responsibilities across levels of government. Local governments—county governments in particular—often lack adequate revenues within the formal fiscal system to finance the wide range of public goods and services they are mandated by higher levels to provide. The mismatch between revenues and expenditure responsibilities leads to heavy reliance on intergovernmental fiscal transfers that, nonetheless, have not yet effectively redressed revenue inadequacy or the high levels of inequality that have emerged in the context of economic reform. This fiscal gap drives additional problems, including the growth of hidden government debts and off-budget funds at the local level. In order to shrink the gap between available revenue and expenditure needs, many local governments rely on the taxes and fees they can generate through their control over the conversion of agricultural land to nonagricultural purposes.

This chapter draws links between these broader trends in the fiscal system and the phenomenon of land public finance. The first section provides background on the evolution of the fiscal system since the initiation of economic reform. The second section examines the nature of revenue and expenditure assignments, intergovernmental fiscal transfers, and the implications of these features of the fiscal system for coping with revenue inadequacy at the local level and equalization across locales. The third section introduces some political factors exacerbating problems in central-local fiscal relations. Finally, the fourth section develops a case study of one of China's "top 100" counties in order to examine how it has exploited land to promote revenue generation in the context of the mismatch between fiscal revenue and expenditure.

Background: Evolution of the Fiscal System

Since the initiation of economic reform in the late 1970s, the fiscal system in China has evolved to better suit the needs of a market economy. At the end of the Maoist era, the fiscal system was characterized by unified incomes and expenditures: Subnational governments turned virtually all tax receipts and profits from state-owned enterprises over to the central government and then looked to the center to meet their expenditure needs (Oksenberg and Tong 1991). In the 1980s, a fiscal contracting system emerged in which local governments handed a fixed quota of tax revenues over to higher levels, while retaining a larger share of above-quota revenues. Local governments gained control of much of their own tax revenues, and, at the same time, the central government devolved responsibility for financing many public goods to local governments (Wong 1991). Several features of this system, in place until 1994, are noteworthy: High marginal revenue retention rates encouraged local governments to promote economic activity within their jurisdictions; periodic renegotiations of the tax quota prompted local governments to hide revenues by shifting them off budget; and the central government sacrificed control over a large share of fiscal revenue. These points are evident in the decline in the central share of budgetary revenue to a low of 22 percent in 1993, and in the rapid growth of extrabudgetary funds as a share of total government expenditure. Revenue mobilization also suffered in the shift from a planned to a market economy, with budgetary revenue as a share of GDP falling to a low of about 11 percent by the mid-1990s.[1] See table 7.1.

Tax and fiscal reforms, implemented beginning in 1994, were designed to address these weaknesses of the transitional fiscal system. The reforms entailed revamping of major tax types, establishment of new institutions to collect taxes, and redistribution of control over revenue between central and local governments.

Centralization and Decentralization in a Unitary State

This section describes the institutions of the current fiscal system and highlights the challenges that have emerged in central-local fiscal relations following implementation of the 1994 reforms. It focuses in particular on the combination of relatively more centralized control over fiscal revenue and highly decentralized expenditure responsibility for many public goods and services. This combination of

[1] Corporate income taxes replaced profit remittances by state-owned enterprises as a source of budgetary revenue, but the profits of state-owned enterprises were increasingly competed away by new, nonstate market entrants (Naughton 1995). At the same time, the state's capacity to collect corporate income taxes from new private firms was just beginning to develop (Whiting 2001).

531-44629_ch02_1P.indd 126 30/08/10 11:15 PM

TABLE 7.1
The "Two Ratios," 1984–2005

	Revenue as a Share of GDP	Central Share of Total Revenue
1984	22.8	40.5
1985	22.2	38.4
1986	20.7	36.7
1987	18.2	33.5
1988	15.7	32.9
1989	15.7	30.9
1990	15.7	33.8
1991	15.7	29.8
1992	14.5	28.1
1993	12.3	22.0
1994	10.8	55.7
1995	10.3	52.2
1996	10.4	49.4
1997	11.0	48.9
1998	11.7	49.5
1999	12.8	51.1
2000	13.5	52.2
2001	14.9	52.4
2002	15.7	55.0
2003	16.0	54.6
2004	16.5	54.9
2005	17.3	53.1

SOURCE: Ministry of Finance.

features means that many local governments lack adequate revenue and resort to a range of "creative financing" practices in order to meet their responsibilities.

Decentralization

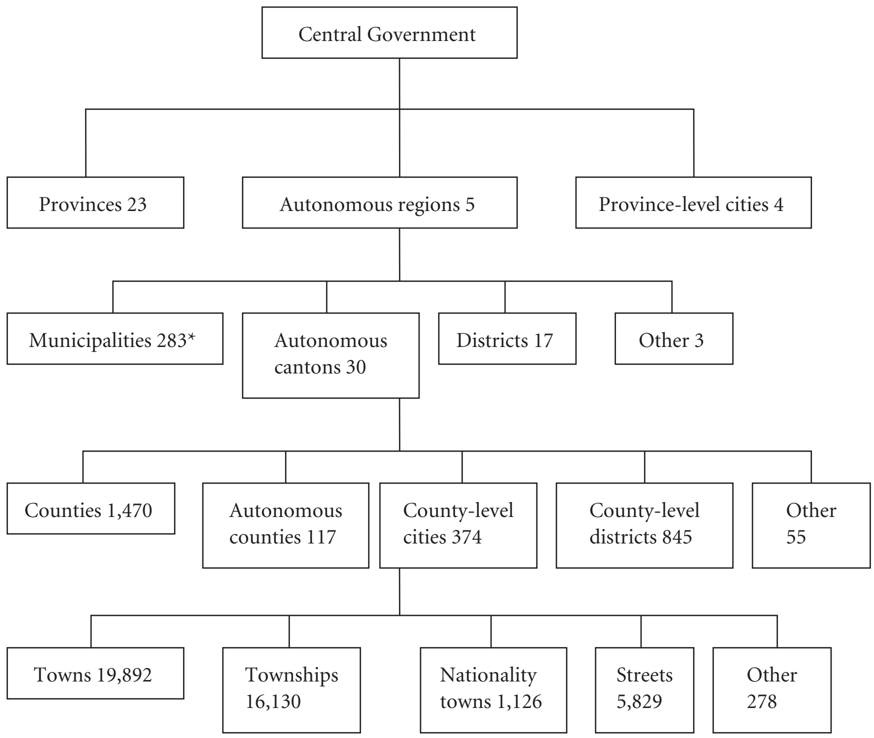
As a continent-sized country with provinces the size of some European states, China is, of necessity, relatively decentralized. There are five tiers of government, reaching from the center through 32 provincial-, 333 municipal-, 2,861 county- and district-, and 43,255 town- and street-level units, the latter two with an average population of roughly 30,000 people as of 2004. See figure 7.1. Moreover, staffing levels suggest that the real work of governance takes place well below the center. Nearly 60 percent of civil service employees work at the county or township level.[2]

Revenue Assignments and Control

China remains a unitary state, however, in which only the center has the right to legislate taxes. There is a hierarchy of authoritative rules and laws issued by the center: Most authoritative, in principle, are the laws—including tax and budget

[2] Xi Liu, *Chinese Civil Service System*, 2002, p. 29, as cited in OECD 2005, p. 60.

FIGURE 7. 1
China's Government Structure



*Includes 15 Prefectures

laws—passed by the National People's Congress (NPC), followed by regulations promulgated by the State Council and rules put out by ministries like the Ministry of Finance (MOF) and then central agencies like the State Administration of Taxation (SAT). Tax bases and rates are set by the central government; local governments have only limited authority to adjust certain tax rates within a certain range in a few instances (OECD 2006). Thus, where formal taxes are insufficient to meet expenditure needs, local governments resort to "creative financing," as illustrated in the later section, "Reliance on Extrabudgetary and Off-Budget Funds."

The center used its authority to implement a new tax-sharing system (TSS) beginning in 1994. This system was designed to recentralize control over revenue following the dissolution of central control during the preceding fiscal contracting regime. As a result, revenue control is now significantly more centralized than expenditure responsibility, since the 1994 reforms left expenditure responsibilities largely unchanged. Under the TSS, taxes are divided into central, local, and shared categories, with major revenue earners controlled primarily by the central government (table 7. 2). For example, in 1994, a revamped and expanded value-added tax (VAT) replaced the turnover taxes of the planned economy as a key revenue source; the center assigned the VAT to the shared category, retaining 75 percent and returning 25 percent to the localities. The reallocation of revenue drove the center's

TABLE 7.2
Revenue Assignments: Central, Local, and Shared as of 2002

Central	Local	Shared
Tariffs	Business tax (except financial institutions and railroads)	VAT (75% central-25% local)
Consumption taxes	Contract tax	Stamp tax (97% central-3% local)
Income taxes of centrally owned SOEs	Urban land use tax	Corporate and individual income taxes (60% central-40% local)
Import-related consumption taxes and value-added taxes	Urban maintenance and development tax (except financial institutions and railroads)	Resource taxes (offshore oil-central; remainder-local)
Taxes on financial institutions and railroads	Fixed asset investment adjustment tax	
Profits from centrally controlled SOEs	Profits from locally controlled SOEs	
	Housing property tax	
	Agriculture-related taxes	
	Tax on use of arable land	
	Tax on land value increase	

SOURCE: Adapted from OECD 2006.

share of budgetary funds from 22 percent in 1993 to more than 50 percent since 1994. See table 7.1.

To improve revenue mobilization and to counter incentives for local governments to hide tax revenues from the center, a National Tax Service (NTS) was established as part of the reforms. The NTS has offices at all levels of government and collects both central and shared taxes. The Local Tax Service (LTS), which has offices at the provincial level and below, collects local taxes. These institutional changes were a contributing factor in the reversal of the trend of falling revenues as a percentage of GDP. Budgetary revenue as a share of GDP increased from 10.8 percent in 1994 to 17.3 percent in 2005 (table 7.1). Even so, the center allocates less than 10 percent of GDP—"a relatively low figure for a large and diversified country that faces many major expenditure needs" (Wong 2005a, 13).

Subsequent changes have further centralized control over revenue and reduced local revenues, which are only partially compensated for by increasing intergovernmental fiscal transfers. In 2002, the central government reassigned corporate and individual income taxes from the local to the shared category, with the center taking 50 percent in the first year and 60 percent thereafter. Hubei Province provides an example, where locally controlled income taxes fell from 5.32 billion yuan in 2001 (23 percent of local revenues) to 3.75 billion yuan (15 percent of local revenues) in 2002 (Li 2006).

In 2006, the center abolished the agriculture tax, culminating a series of changes in taxes and fees on rural residents, including the abolition of collective revenues for villages and townships.[3] In Hubei, 3.3 billion yuan from the four agriculture taxes constituted 11 percent of local revenues in 2004 (Li 2006). The complete abolition of the two primary agriculture taxes—again, only partially compensated for by new intergovernmental fiscal transfers—has put a further revenue squeeze on local administrations at the lowest levels of the government hierarchy.

The trend has been toward concentrating fiscal revenues at the highest levels of the system, while expenditure shares have remained roughly the same. Between 1993 and 2003, central and provincial shares of total revenue increased from 35 percent to 66 percent, while their shares of total expenditure increased from 45 percent to only 49 percent (Wong 2006).

The 1994 budget law and subsequent regulations leave subprovincial revenue sharing arrangements largely to the discretion of governments at the provincial level and below, allowing for significant variation across provinces. World Bank (2002) data from 1999 illustrate this diversity. See table 7.3. In the sample provinces, with the exception of Gansu, revenue control shifted upward—a situation referred to as "having a head but no feet" (Li 2006). To address this problem, some provinces have implemented reforms involving direct provincial oversight of county public finance.

Expenditure Responsibilities

From the perspective of expenditure responsibilities, by contrast, China is among the most decentralized countries in the world; nearly three-quarters of all government expenditure takes place at subnational levels. Elsewhere, the average level of subnational expenditure throughout the 1990s was 14 percent for developing countries, 26 percent for transition countries, and 32 percent for OECD countries. Comparable figures among countries with relatively more decentralized fiscal systems were 61 percent for Japan and 46 percent for India (Wong 2005a). Education and health in particular are shouldered to an unusual degree by local governments in China. Estimates of the average share of these expenditures borne by the lowest-level governments (counties and townships) range from 60 percent to 70 percent for education and from 55 to 60 percent for public health (Wang 2006). Two provinces provide more extreme local examples; the county and township levels accounted for 70.5 percent and 74.2 percent of education expenditures in Gansu and Hunan, respectively, in 1999 (Wong 2005b, 12–13).

In recent years, the State Council has promoted a policy of increasing the importance of the county vis-à-vis the township, although—even at the county level—expenditures remain highly decentralized. With the 2001 State Council "Decision on the Reform and Development of Basic Education," for example, payment of rural teachers' salaries is now handled at the county level. Subsequent reforms in the treasury system have similarly shifted the disbursement of salaries of other public employees to the county level (Wong 2005b, 25). As a result, the township level of public finance is becoming "hollowed out."

[3] Collective revenues include the "three deductions," for public reserve funds, public welfare funds, and management fees, and the "five charges," for rural education, family planning, militia training, rural road construction, and subsidies to entitled groups like disabled veterans. Report on the Work of the Government (2006).

531-44629_ch02_1P.indd 130 30/08/10 11:15 PM

TABLE 7.3
Distribution of Revenues across Sub-national Governments as of 1999 (Percent)

	China	Hebei	Gansu	Hunan	Jiangsu
Province	21.2	20.6	16.5	13.6	16.2
Prefecture	35.4	23.4	24.9	27.8	43.8
County		35.8	39.9	35.2	40.0
(joint)	43.4				
Township		20.2	18.7	23.4	0.0
Total	100.0	100.0	100.0	100.0	100.0

Change in Distribution of Revenues Since 1994–1995

	China	Hebei	Gansu	Hunan	Jiangsu
Province	4.1	0.9	−1.4	−0.4	11.3
Prefecture	−5.6	−1.9	−3.0	3.3	−1.8
County		2.5	0.6	0.8	−9.5
(joint)	1.5				
Township		−1.5	3.8	−3.6	0.0

SOURCE: World Bank (2002).

Ran Tao and Ping Qin (2007, 27–28) write, "Although many townships in rural China have been merged both before and after the rural tax reform, downsizing local bureaucracy has so far been unsuccessful . . . even once townships have merged, most of the cadres from the previous townships have kept their posts." Where alternative sources of employment are scarce, local governments may find political risks in downsizing.

The Fiscal Gap

The disjuncture between revenue assignments and expenditure responsibility has left a substantial fiscal gap facing subnational governments. Local taxes and the local portion of shared taxes cover only about 40–45 percent of local fiscal needs. This fiscal gap has generated a relatively high degree of dependence by lower-level governments on fiscal transfers, which have grown from 239 billion yuan in 1994 to 1,041 billion yuan in 2004 (Sun 2006). Since the consolidation of the TSS, the central government has dedicated roughly 70 percent of its revenues to fiscal transfers, providing between 40 and 50 percent of local governments' budgetary expenditures. With 40–50 percent of fiscal needs covered by intergovernmental fiscal transfers and another 40–45 percent covered by local and shared taxes, 5–10 percent of fiscal needs remain unmet (Wang 2006). As a result of the existing division of expenditure responsibilities, fiscal deficits are effectively pushed onto lower levels. Local governments, in turn, employ a variety of means to cover their expenditure responsibilities.

Reliance on Extrabudgetary and Off-Budget Funds

One of the most prominent ways local governments cope with revenue inadequacy is by generating revenue outside the formal budget system in the form of extrabudgetary and off-budget funds (Liu and Tao 2007, 167). Extrabudgetary funds are surtaxes, levies, and user charges collected and spent by government agencies in performing duties delegated to them by higher levels (OECD 2006, 19); in recent years, the MOF has begun to exert greater oversight over these funds. In principle, all extrabudgetary funds are public fiscal revenues approved at the central or provincial level and deposited in special fiscal accounts (OECD 2006, 143). In addition, pooled pension funds and unemployment insurance funds are registered and managed as extrabudgetary funds in social security accounts.[4] Extrabudgetary, social security, and government bond expenditures add approximately 7 percent of GDP to official expenditure.

Off-budget funds, by contrast, exist outside effective MOF oversight. There exist no comprehensive data for those funds, but they are reported to rival or even exceed the size of the formal budget for many local governments. The sources of off-budget funds reflect both available revenue "handles"—places where revenue opportunities exist to exploit—and gaps in effective MOF oversight. These sources have shifted over time from enterprise fees to highway fees to land transfer fees and sale of government assets.

According to one study of land fees conducted in 2004, Guangdong, Shandong, Hunan, Zhejiang, and Jiangsu provinces generated the most off-budget funds from land transfers (Ping 2007, 9). Nationwide, these funds were estimated to total 615 billion yuan in 2004, equivalent to roughly 3–4 percent of GDP; they have become a primary source of income for many local governments (p. 9). An MOF study of local land revenues (including primarily land transfer fees) shows that they increased at nearly 70 percent per year on average nationwide between 2000 and 2004 (Zhang 2007). By 2004, county-level governments accounted for 28 percent of revenue and 34 percent of expenditures from this source. Zhang Yanlong concludes that "revenue from land transactions has become a critical revenue source for local governments" (p. 20). Moreover, because these funds lack MOF oversight, they easily shade into corruption; real estate developers, for example, may provide kickbacks to local government officials who make land available at low prices, shortchanging the farmers who lose access to the land in the process. These funds also support legitimate government expenditures, however. According to Li (2006, 42), for example, in Hubei Province the funds derived from land transfer fees are "almost without exception" dedicated to basic infrastructure development. Ping Xinqiao (2006) finds that, compared with budgetary funds, off-budget funds tend to have positive effects on spending for infrastructure and administration but negative or neutral effects on spending for education, agriculture, and other public goods. Furthermore,

[4] In 1993, funds belonging to state-owned enterprises, formerly classified as extrabudgetary funds (EBF), were excluded from the definition of EBF. In 1994, 83 types of EBF were redefined as budgetary revenue in a first step toward unifying budgetary and extrabudgetary funds into a single budget. In 1996, 13 major EBF, including vehicle purchase fees, road maintenance fees, road construction funds, were similarly subjected to formal budgetary control (Whiting 1999).

outlays tend to be employed inefficiently—in particular, for increasing the number of administrative staff.

One problem with off-budget funds—including land transfer fees—is that these funds, which constitute an important supplement to budgetary revenues, are most abundant in wealthier areas with the greatest access to budgetary revenues.

Transfer Dependence and Inequality

The fiscal system has failed to address significant and growing regional inequality. The central and western regions enjoyed only 55 and 75 percent, respectively, of the fiscal capacity of the eastern region in 1994, but those figures declined to 43 and 48 percent by the year 2000 (MOF 2007). Such disparities reflect not only the impact of disproportionate growth in the coastal region but also the effect of the TSS. Since the end of the last decade, however, equalization policies have become a higher priority for government policy makers. Resources dedicated to equalization have increased, as the following paragraphs show. Nevertheless, data on per capita budgetary expenditures for the year 2002 reveal a ratio of 8.1:1 for the richest and poorest provincial-level units, with expenditures of 5,307 yuan per capita in Shanghai and 655 in Guizhou (Wong 2005a, 13).[5] Alternative calculations for 2005 indicate per capita budgetary expenditures of 8,008 yuan in Shanghai and 908 in Henan, giving a ratio of 8.8:1 for the richest and poorest provinces (Wang 2006).

Changes in the system of intergovernmental fiscal transfers have slowed the trend toward greater disequalization but have not reversed it. Intergovernmental fiscal transfers are multi-stranded, and only some of the strands are effectively equalizing. The largest element in central government transfers are tax rebates. The main tax rebate, pegged to the growth of VAT and consumption taxes, was negotiated between the center and the provinces in 1993. It was intended to safeguard the immediate interests of powerful localities by preventing any severe decline in revenue after the TSS was implemented. Therefore, it accrues to the benefit of the wealthier provinces (Sun Kai 2006). However, the rebate reflects a shrinking portion of total transfers; it accounted for about three-quarters of central transfers during the mid-1990s, less than half as of 2002, and roughly one-third—or 375.8 billion yuan—in 2005 (Wong 2005a; OECD 2006, 74).

Another large element of intergovernmental fiscal transfers is in the category of earmarked transfers, which totaled 351.7 billion yuan in 2005 (MOF 2007). This category is increasingly broad, reflecting many different government policy initiatives and encompassing funds for such things as major infrastructure development, agricultural development, and development of underdeveloped areas (Song and Shao 2005). With the implementation of the Western Regional Development Initiative beginning in 1999, these funds have been targeted increasingly toward projects in the poorer western and inland regions of the country. A potentially disequalizing element in these transfers is the requirement for local matching funds from local governments in order to access many of these grants.

[5] Note that this calculation excludes Tibet.

A wide array of other special transfer funds are also intended to meet specific purposes. For example, the MOF separately reports an earmarked transfer for minority areas, which has risen from 2.5 billion yuan in 2000 to 15.9 billion yuan in 2005, channeling more funds into potentially equalizing uses. Many special transfer funds reflect central government attempts to compensate local governments for the adverse effects of reforms. Social security subsidies include bailouts for local social security schemes as well as subsidies to support payments to laid-off or unemployed workers, which reached or exceeded 50 billion yuan in 2001 and 2002 (Wong 2005a, 15). A wage adjustment subsidy was introduced in 1998 to offset the cost of centrally mandated wage increases for public employees, which has resulted in the doubling of civil servant salaries. Wage adjustment subsidies reached 99.4 billion yuan in 2004 and remained at that level in 2005, according to MOF figures. Elsewhere, this category is reported to have reached 187.3 billion yuan by 2004 (Wong 2005a, 14). "Both the wage increase subsidies and subsidies to social security and welfare programs are transfers aimed at bailing out local governments: meeting payroll, and keeping social security and unemployment schemes from defaulting" (Wong 2005a, 15). This kind of ad hoc public financing has certain attendant weaknesses. As Wong points out, "Rudimentary budgeting practices that allocate subsidies on a per-staff basis continue to encourage adding staff despite national campaigns calling for downsizing the civil service" (p. 15).

With rural tax and fee reform, another special transfer was established to increase the resources of local governments adversely affected by the reforms, providing funds for the payment of primary and middle school teachers' salaries. This rural-tax-and-fee-reform transfer fund has increased rapidly from 8 billion yuan in 2001 to 66.1 billion yuan in 2005 (MOF; Tao and Qin 2007, 21). In 2005, it was supplemented by a special program to aid counties and townships in difficulty. This program operates on the basis of "awards" or "bonuses," allocating 15 billion yuan in 2005 to counties and townships meeting certain criteria—namely increasing tax revenues, reducing government staff, increasing grain production, and running a clean government. These special transfers went primarily to the central (8.31 billion, yuan or 55 percent) and western (5.2 billion yuan, or 35 percent) regions, with only 1.45 billion, yuan or 10 percent, going to the eastern region (MOF 2007).

In 2005, general purpose transfers, intended to be equalizing, totaled 112 billion yuan, with 48 percent going to the western, 47 percent to the central, and 5 percent to the eastern region (MOF 2007). An important element in the rule-based calculation of this transfer is the number of civil servants on the official government payroll , which introduces a bias away from population-based measures of need for public services and reinforces incentives to add to already high government staffing levels (Li Jieyun 2006, 27; Wong 2005a). The impact of general purpose transfers is limited by their small size compared to rebates and earmarked transfers.

In sum, only certain intergovernmental fiscal transfers are equalizing in their effect. Moreover, even with reliance on multi-stranded, intergovernmental fiscal transfers to supplement their own revenues, local governments face a fiscal gap. Localities where land values are higher—the same areas where overall revenue capacity is greater—have the greatest opportunity to engage in land public finance.

As the following section demonstrates, local officials also face political pressures to generate revenues to meet expenditure responsibilities.

Political Factors in Central-Local Fiscal Relations

Several features of the Leninist political system contribute to the tensions and challenges in central-local fiscal relations discussed above. First, top party and government officials at each level of the state hierarchy (e.g., Chinese Communist Party [CCP] secretaries, mayors, county executives) are accountable not to the citizens they govern but rather to the party-state apparatus at the next higher level, which bears the responsibility for both appointing them and evaluating their job performance (Whiting 2004). The performance of leading cadres is monitored and evaluated on the basis of specific performance targets set for them by their superiors in the administrative hierarchy and strongly linked both to monetary incentives in the form of bonuses and to promotion prospects.

These criteria reflect the priorities and concerns of political elites and not necessarily those of the community members. Performance targets often include GDP growth, employment levels, fiscal revenue, exports, and utilization of foreign direct investment (Wu Hao 2006, 11). In some locales, targets more closely mirror the expenditure responsibilities of local cadres, with targets assessing agricultural procurement levels, realized investments in infrastructure, completion rates for nine-year compulsory education, and population growth rates. Cadres pursue targets with a relatively short time horizon—annual evaluation and a three-year term of office for government executives (five years for party secretaries) (Whiting 2004). These features of the political system lead to counterproductive behaviors such as channeling government investment into wasteful, high-profile projects selected for their short-term impacts (Wang 2006; Wu 2006; Ping 2006). This system also creates pressure to go off-budget or incur debt to meet performance targets when budgetary revenues are inadequate.

There are inadequate mechanisms for citizen oversight of their officials. Although citizens participate in the direct election of local People's Congress deputies at the township and county levels, the nomination process is tightly controlled by the CCP. Once in office, local deputies are only nominally involved in the appraisal of government cadres. The role of the People's Congress remains largely symbolic to date—form without substance in the view of some Chinese scholars (Wu 2006, 14). Local governments are agents of higher levels; even in collecting taxes and allocating scarce public resources, their actions reflect the priorities of their superiors—shaped by the mechanisms of cadre evaluation—rather than those of local residents.

Case Study of a "Top 100 Economic Performer"

As one of the top-performing 100 counties in China, in the top 5 percent of counties nationwide in terms of a range of indicators as of 2004–2005, Zouping County in Shandong Province is a model county (NBS 2006).[6] Yet, as recently as 1998, the

[6] This case study is based on published sources, cited in the text, and interviews conducted by the author in July 2007. All interviewees were guaranteed anonymity and are cited as "author's interviews" in the text.

county was considered "unexceptional in either the pace and nature of change over the past fifteen years or in its historical or geographic endowments" (Walder 1998, 2). This section indicates that what has changed is the county's ability to exploit land as a resource for economic growth and fiscal revenue. Its location along the new major highway linking the provincial capital of Jinan and the port city of Qingdao has been a boon to the county. Other top-performing counties like this one are concentrated in the coastal provinces of Zhejiang, Jiangsu, Guangdong, and Shandong, where urbanization is progressing at a rapid pace (NBS 2006). According to Peking University scholar Ping Xinqiao (2006, 618), also concentrated in these provinces are government land requisitions, which, in turn, are a major source of on-budget and off-budget revenue and a focus of recent central government policy directives.[7] The following paragraphs examine fiscal practices in Zouping County in light of central policy.

The County in Context

As of 2004, in Shandong Province, the county-level economy with the highest GDP per capita achieved 46,669 yuan, while the lowest reached only 3,457 yuan. Disparity is apparent even within wealthy coastal provinces like Shandong. Consistent with the analysis above, two-thirds of counties in Shandong face difficulties meeting wage obligations, and, following the abolition of the agriculture tax, many townships are described as hollow, relying primarily on intergovernmental fiscal transfers (Zhu 2007).[8] Zouping County is advancing rapidly in this context: 2004 GDP per capita was 21,999 yuan, increasing to 38,029 yuan by 2006. Per capita budgetary expenditure reached 2,365 yuan in 2006, up from 722 yuan in 2002 (Zouping County Statistical Bureau).

Zouping County is located in Binzhou Municipality of Shandong Province, where the county level accounts for the bulk of the economic activity, including 78 percent of GDP and 85 percent of local fiscal income (Zouping County Statistical Bureau). County public finance is under the guidance of the municipal and provincial levels. The local share of corporate income taxes (40 percent) is divided, with 8 percent going to the province and 32 percent going to the county. According to a representative of the county public finance bureau, the province takes 15 percent of the local share (40 percent) of individual income taxes, while the county gets 25 percent (author's interview 2007). The distribution of the business tax is 20 percent to the

[7] Similarly, Liu Mingxing and Tao Ran (2007, 169) find that "in richer regions, local governments, especially those at the county and township level , are generally able to provide decent public goods and services to residents and businesses, since they not only enjoy higher tax revenues coming from the development of non-agricultural sectors, but can draw on additional high income from the sale of rights to develop local land . . ."

[8] In Zouping County, the provincial and municipal levels provided subsidies of 30 million yuan and the county itself added 20 million yuan in subsidies linked to the abolition of the agriculture taxes and collective revenues that left some grassroots areas in fiscal difficulty. As of 2001, there were 13,000 active government employees whose salaries were paid through the county budget; by 2006, the number had increased to nearly 15,000. At the township level, the number of active government employees paid with budgetary funds had decreased from 8,582 in 2001 to 7,535 in 2006, of whom 1,091 were paid by budgetary grants and 6,644 were paid with budgetary subsidies, including 4,865 teachers. As noted above, it may be easier for townships in wealthier counties to downsize, as there may be greater opportunities for alternative pursuits. In 2006, Zouping began paying township public employees directly; however, there remain a small number of township public employees and health care providers who are paid by the township directly.

province, 20 percent to the municipality, and 60 percent shared between the county and township levels according to the level at which the tax-paying enterprise is registered (author's interview 2007). Moreover, the county aggressively competes for ear-marked transfers and provides matching funds from the county level.

The ongoing centralization of control over revenue (such as corporate and individual income taxes) and the abolition of agriculture taxes has affected Zouping, but the effects were smaller in Zouping than in many other counties, in part because of Zouping's ability to readily exploit the value of its land. Locally controlled income taxes accounted for 57 percent of local budgetary revenue in 2001, dropping to 27 percent in 2002, following centralization (table 7.4). The reallocation caused a drop in total revenue in 2002, but by 2003 the county had already recovered, exceeding 2001 local budgetary revenue by nearly 100 million yuan (table 7.5). This rapid recovery was due to the dramatic growth in local VAT and business tax revenues, as well as urban maintenance and construction tax revenue (table 7.6). (See the discussion relating land and taxes, in the section entitled Land Public Finance, below.)

TABLE 7.4

Sources of Budgetary Revenue (Percent Share of Total)

Year	Value-added Tax	Business Tax	Direct Land Taxes*	Income Taxes	Agriculture Taxes	Urban Maintenance and Construction Taxes	Fines	Administrative Fees	Other**	Total
2001	18	8	2	57	4	3	1	2	6	100
2002	26	11	3	27	12	4	1	3	13	100
2003	26	13	4	19	9	8	4	3	14	100
2004	26	13	9	13	3	9	7	3	17	100
2005	34	10	13	9	0	8	1	3	22	100
2006	31	9	16	10	0	6	14	3	10	100

TABLE 7.5

Sources of Budgetary Revenue (Level, Million Yuan)

Year	Value-added Tax	Business Tax	Direct Land Taxes*	Income Taxes	Agri-culture Taxes	Urban Maintenance and Construction Taxes	Fines	Administrative Fees	Other**	Total
2001	62.20	26.00	5.42	196.15	12.68	11.24	3.01	8.1 3	21.45	346.28
2002	82.52	35.17	10.43	85.62	39.61	14.41	2.61	10.80	41.63	322.80
2003	116.18	56.75	16.61	81.44	39.17	34.59	19.16	12.49	62.15	438.54
2004	151.30	77.57	54.63	75.25	19.70	54.84	38.66	15.96	103.14	591.05
2005	337.77	100.45	125.56	86.25	0.00	81.07	13.02	35.01	224.34	1003.47
2006	435.63	131.32	221.25	140.66	0.00	80.73	201.71	48.21	142.36	1401.87

TABLE 7.6
Sources of Budgetary Revenue (Percent Increase)

Year	Value-added Tax	Business Tax	Direct Land Taxes*	Income Taxes	Agriculture Taxes	Urban Maintenance and Construction Taxes	Fines	Administrative Fees	Other*	Total
2002	32.7	35.3	92.4	−56.3	212.4	28.2	−13.3	32.8	94.1	−6.8
2003	40.8	61.4	59.3	−4.9	−1.1	140.0	634.1	15.6	49.3	35.9
2004	30.2	36.7	228.9	−7.6	−49.7	58.5	101.8	27.8	66.0	34.8
2005	123.2	29.5	129.8	14.6	0.0	47.8	−66.3	119.4	117.5	69.8
2006	29.0	30.7	76.2	63.1	0.0	−0.4	1449.2	37.7	−36.5	39.7

In Zouping, the county stopped collecting the agricultural special products tax and the slaughter tax after 2002 and the agriculture tax after 2004. In 2004, however, the agriculture tax accounted for only 3.3 percent of county budgetary revenues; thus, the impact was more minimal than in less industrialized localities, where agriculture taxes constituted a larger share of local revenue.

The increase in VAT and other taxes also reflects the growth of the Weiqiao Group, located in Zouping and owner of one of the largest textile plants worldwide. Weiqiao has also diversified into aluminum processing in the county. Overall, it employs approximately 150,000 workers and occupies more than 310 hectares of land in the region in and around Zouping (author's interviews 2007). According to a representative of the National Tax Service, it is the single-largest source of taxes in the county, providing 50–60 percent of tax revenues. In addition, as of 2007, the conglomerate had attracted a large number of related enterprises to the county, including seven additional firms with output valued at over 100 million yuan, 16 with output over 10 million yuan, and 87 with output over 1 million yuan. The growth of the Weiqiao Group is related to the expansion of local development zones (termed "zone fever") occurring in Zouping, as elsewhere (Cartier 2001; see also Liu and Tao 2007, 176).

Land Public Finance

One way local governments—particularly in wealthier, peri-urban areas—cope with revenue inadequacy is by generating revenue through their ability to requisition land "in the public interest" (Land Management Law, Article 2). Local officials cite the creation of job opportunities and new revenue-generating economic activity through conversion of agricultural land to industrial or commercial purposes as a motivation for land transfers. Such land requisitions can generate revenue in at least four ways (Zhang 2007, 24). First, as highlighted during a 2007 Shandong Province state land resources meeting, local governments can use low-priced land to attract investors in industry as a means of increasing GDP growth and taxes. Second, they can promote rapid real estate development, which also generates taxes and other financial opportunities for local governments. Third, county governments can generate land transfer fees. Fourth, they can use land as collateral for loans.

Using Land to Attract Industry

One of multiple land public finance strategies adopted in Zouping is using land to attract core industries. According to several officials interviewed (author's interview 2007), "attracting investment" was a key performance criterion in the county, and "exempting land transfer fees as a preferential policy" was a common measure employed to meet that goal. At the same time, the 2007 Shandong Province State Land Resources Meeting highlighted precisely the problem of local governments reducing or exempting land transfer fees in the name of attracting investment. The meeting called for strict implementation of minimum standards for transfer of land for industrial uses. The same point was made ten years earlier in the 1997 Shandong provincial government's "Notice Regarding Strengthening Collection Management of Transfer Fees for Use Rights over State Land." Article 4 of the notice emphasizes that local governments may not reduce or exempt land transfer fees. However, other local officials in Zouping highlight the "great flexibility" of county policies with respect to land as well, as water and electricity (author's interview 2007). These practices and the trends in tax revenue across types are consistent with a strategy of using land to attract industry. Following marked increases in requisitioned land in the early 2000s (table 7.7), Zouping experienced more than a doubling of VAT revenues in 2005 (table 7.6). VAT revenue climbed from 62 million yuan in 2001 (18 percent of total budgetary revenue) to 338 million yuan in 2005, when it accounted for fully one-third of total budgetary revenue (tables 7.4 and 7.5).

Promoting Land Development to Generate Taxes. Like many other counties, Zouping has developed and expanded an industrial park and a development zone. Originally part of the township-level unit of Gaoxin, the development zone is a county-level entity, and the county controls the tax revenue (author's interview 2007). Development began in 2002, from land transferred originally from local farmers. Data on the area of farm land requisitioned is available only from 2004. These data show that from 2004 to 2006, at least 3–5 percent of the county's arable land was requisitioned each year, and that, in each of those years, 80–95 percent of that land came from Gaoxin (table 7.7). A major expansion of the county development zone began with land from Gaoxin (township level) using land transferred from local farmers (author's interview 2007). At the same time, there were reports of frequent protests by affected farmers in the county (Guy Alitto, University of Chicago, personal communication, 2008).

TABLE 7.7

Year	Zouping land requisitioned (mu)	% of arable land requisitioned	Gaoxin land requisitioned (mu)	Gaoxin % of requisitioned land
2004	28249	3.0	26784	94.8
2005	41654	4.4	33193	79.7
2006	45727	4.8	36973	80.9

SOURCE: Zouping Statistical Yearbook, Zouping County Statistical Bureau, 2001–2006.

Economic activity in the development zone already accounted for half the county's fiscal income as of 2007 (author's interview 2007). With respect to direct land tax revenue in Zouping, the urban land use tax, farmland occupation tax, and deed tax together grew from 1.6 percent of local budgetary revenue in 2001 to more than 15 percent in 2006 (table 7.4). Taken together, these taxes exhibited an average annual growth rate of 110 percent from 2001 to 2006 (table 7.6). In terms of revenue sources indirectly linked to land and land development, the construction and real estate sectors alone accounted for nearly 50 percent of all business taxes in 2005 and 2006, the only years for which data are reported for Zouping. One interviewee highlighted the extent to which taxes from the construction industry followed land management policies, policies to attract investment, and the speed of urban construction (author's interview 2007).

Generating Land Transfer Fees. In principle, county governments must use competitive bidding, auctions, or public listings to ensure that land transfers take place at market levels. These policies were laid out in a stream of central documents, including State Council Document 2001 No. 15, State Land Resources Ministry 2002 No. 11, State Land Resources Ministry and Supervision Ministry 2004 No. 71 (Ministry of Land Resources). In 2004 the deadline was set as 31 August, after which local governments were instructed to end negotiated pricing for land for industrial use and implement competitive bidding.

As noted above, according to one study of land transfer fees, conducted in 2004, Guangdong, Shandong, Hunan, and Jiangsu provinces generated the most off-budget funds from land transfers (Ping 2006). The Zouping County land management bureau officially reported stable land transfer fees of about 100 million yuan annually, equivalent to less than 10 percent of 2006 budgetary revenue. However, a special study commissioned by the State Council in another economic "top 100" county found 1.18 billion yuan from land trades in 2003 alone, equivalent to nearly one-quarter of budgetary revenue (Zhang 2007).

Moreover, land transfer fees are supposed to be subject to official fiscal management. Indeed, in 1997, the Shandong provincial government emphasized that the public finance bureau should collect all fees, including all funds over and above compensation for farmers (Shandong Provincial Government 1997). However, in Zouping, officials report that the public finance bureau has no control over these funds (author's interview 2007). In 2006, the State Council Office (2006) issued document No. 100, "Notice Regarding Standardizing Management of Income and Expenditures from the Transfer of State Land Use Rights," and the Shandong Provincial Government (2007) followed in June 2007 with guidelines for implementation. According to these central and provincial guidelines, income from land transfers may be used for (1) compensation for land takings; (2) land development; (3) supporting agriculture, including social security for farmers; (4) urban infrastructure construction; and (5) other expenditures, including the state land benefit fund (to finance land bank purchases). The guidelines emphasize that the public finance bureau and the land resources bureau are intended to cooperate in submitting land transfer fees for public finance oversight and treasury management.

Since agricultural land must first be converted to state land before being put to nonagricultural uses, and since there is frequently a large gap between the valuation of land for compensation to farmers and the valuation of land for transfer to developers, local cadres can generate and control significant revenues as middlemen in the land transfer process. They subsequently become party to disputes with villagers when villagers raise concerns about the procedures by which land was transferred or about the amount of compensation they receive.

Using Land as Collateral for Debt

The use of banked land as loan collateral for development projects is a fourth important part of land public finance (Zhang 2007, 24). According to Yanlong Zhang (2007, 24), "Land banking centers were built as institutions through which . . . governments could monopolize commercial land trades and maximize financial gains." In 2001 Shandong Province authorized the establishment of land banks at the county level and above, following a State Council (2001) directive to strengthen land management. These centers—like Zouping's Land Bank Exchange Center of the Land Resources Bureau—control not only idled urban land but also requisitioned farm land. Fock and Wong (2008, 26) show that "local governments are increasingly taking out loans using requisitioned land as collateral through the creation of such 'land banks,' and these loans have become an even greater source of funds than the land-use right transfer fees in many areas."

In Zouping, land and new debt are linked at the township level, but not only as straightforward collateral as suggested in many contemporary policy discussions. For example, the county promoted new school construction at the township level but provided "policies not money" to finance construction (author's interview 2007). In 2006, one town invested more than 20 million yuan (total town budgetary expenditures were 19 million in 2006) in a four-building middle school campus. The construction company in essence loaned funds equivalent to the cost of construction to the town, which the town intends gradually to repay. The special policy provided by the county is to allow the town to move all middle school students to the new campus and allow the town to control the land transfer fees from current and future transfers of land from the old school sites. In 2007 the town transferred part of the land to finance some current expenditures, but it is holding the majority of the land in anticipation of appreciating land values as the urban core expands. The town plans to repay the construction loan once it realizes the value of the land from the old school sites.

Summary

The survey of official revenue sources and expenditure responsibilities at the center of this chapter highlights how centralization of control over fiscal revenue has created a wide fiscal gap between revenue and expenditure for many local governments. The gap is only partially addressed by growing intergovernmental fiscal transfers, leaving local governments to engage in a range of "creative financing" approaches, focused increasingly on land. The case study of one county in Shandong

Province shows how a favorably located county has used land to generate revenues to close the fiscal gap. At the same time, the discussion notes that the ability to generate off-budget revenues—from land and other sources—is unevenly distributed, leaving less favorably situated counties struggling to pay salaries and provide public goods and services.

Acknowledgments

The first sections of this chapter are drawn from work done for the International Conference on Intergovernmental Fiscal Relations in China, organized by the National Committee on U.S.-China Relations and Renmin University of China, as reported in Susan H. Whiting, "Central-Local Fiscal Relations in China," *China Policy Series* (No. 22), April 2007, used with permission.

REFERENCES

Brandt, Loren, Scott Rozelle, and Matthew A. Turner. 2004. Local government behavior and property rights formation in rural China. *Journal of Institutional and Theoretical Economics* 160(4):627–662.

Cartier, Carolyn. 2001. 'Zone fever,' the arable land debate, and real estate speculation: China's evolving land use regime and its geographical contradictions. *Journal of Contemporary China* 10(28):445–469.

Fock, Achim, and Christine Wong. 2008. Financing rural development for a harmonious society in China. World Bank Policy Research Working Paper No. 4693 (August). Washington, DC: World Bank.

Land Management Law of the People's Republic of China, adopted 1986, amended 1998, http://www.china.org.cn/english/environment/34345.htm

Li, Bo. 2006. Tax jurisdiction division between central and local government: Hubei Province as an example. Unpublished manuscript, School of Public Finance and Taxation, Zhongnan University of Economics and Law, Wuhan.

Li, Jieyun. 2006. Looking at intergovernmental fiscal relations from the perspective of local public finance. Unpublished manuscript. Guangxi Province Public Finance Bureau.

Liu, Mingxing and Ran Tao. 2007. Local governance, policy mandates and fiscal reform in China. In *Paying for progress in China: Public finance, human welfare, and changing patterns of inequality,* eds. Vivienne Shue and Christine Wong, 166–189. London: Routledge.

Ministry of Finance. 2007. http://www.mof.gov.cn/zhengwuxinxi/caizhengshuju/index_9.htm (2007-10-10) (in Chinese).

Ministry of Land Resources. *Regulations on the invitation of bids, auction, or listing for transfer of use rights over state land.* Beijing: Author.

National Bureau of Statistics (NBS) of China. 2005. *China statistical yearbook.* Beijing: China Statistical Publishing House.

———. 2006. 2005 Top 100 counties nationally basically stable but rankings of top 10 change. http://www.stats.gov.cn/tjfx/fxbg/t20060930_402355417.htm

Naughton, Barry. 1995. *Growing out of the plan: Chinese economic reform, 1978-1993.* New York: Cambridge University Press.

OECD (Organisation for Economic Co-operation and Development). 2006. *Challenges for China's public spending: Toward greater effectiveness and equity.* Paris: OECD Publishing.

OECD (Organisation for Economic Co-operation and Development). 2005. *Governance in China.* Paris: OECD Publishing

Oksenberg, Michel, and James Tong. 1991. The evolution of central-provincial fiscal relations in China, 1971–1984: The formal system. *China Quarterly* 125 (March):1–32.

Ping, Xinqiao. 2006. An estimate of the scale of 'Land Public Finance' in China. *Peking University Chinese Economy Research Center Bulletin* 56.
———. 2007. China's local budget system. *China Development Research Foundation Report*, 30.
"Report on the Work of the Government delivered by Premier Wen Jiabao at the Fourth Session of the Tenth National People's Congress on March 5, 2006.*, http://english.gov.cn/2006-03/14/content_227247.htm.*
Shandong Provincial Government. 1997. *Notice regarding strengthening collection management of transfer fees for use rights over state land.* http://www.southcn.com/law/fzzt/fgsjk/200511140115.htm, accessed 1/24/2008.
———. 2001. *Methods for Banking State Land*. http://shandong.gov.cn/art/2005/11/14/art_9194_84.html, accessed 2/12/2008.
———. 2007. Opinion Regarding Implementation of State Council Office 2006 Notice No. 100, http://www,law110.com/law/32/shandong/law1102006222134.htm, accessed 1/24/2008.
Song Chao and Shao Zhi. 2005. Research on the question of the scale of intergovernmental fiscal transfer in China. *Local Public Finance Research* 1 (in Chinese).
State Council. 2001. Notice on strengthening the management of state-owned land assets. No. 15.
State Council Office. 2006. Notice regarding standardizing management of income and expenditures from state land use rights transfers. No. 100.
Sun, Kai. 2006. Intergovernmental fiscal transfer payment system in China: Issues and reforms. Paper presented at the International Conference on Intergovernmental Fiscal Relations in China, Renmin University, Beijing (July 10–11).
Tao, Ran, and Ping Qin. 2007. How has rural tax reform affected farmers and local governance in China? *China & World Economy* 15(3):19–32.
Walder, Andrew. 1998. *Zouping in transition*. Cambridge, MA: Harvard University Press.
Wang, Yongjun. 2006. Improving the division of revenues among levels of government. Paper presented at the International Conference on Intergovernmental Fiscal Relations in China, Renmin University, Beijing (July 10–11).
Whiting, Susan H. 2001. *Power and wealth in rural China: The political economy of institutional change.* New York: Cambridge University Press.
———. 2004. The cadre evaluation system at the grassroots: The paradox of party rule. In *Holding China together.* eds. Barry Naughton and Dali Yang. New York: Cambridge University Press.
———. 1999. The institutionalization of fiscal reform in China: The problem of extra-budgetary funds. Presented at the Annual Meeting of the Association for Asian Studies. Boston, March 11–14.
Wong, Christine P. W. 1991. Central-local relations in an era of fiscal decline: The paradox of fiscal decentralization in post-Mao China. *China Quarterly* 128 (December): 691–715.
———. 2005a. Can China change development paradigm for the 21st century? German Institute for International and Security Affairs Working Paper FG 7 (April). Berlin: German Institute for International and Security Affairs.
———. 2005b. Decentralization and governance in China: Managing across levels of government. Paper prepared for the OECD, revised (August). Paris: OECD.
———. 2006. Central-local fiscal relations in China. Presented at the International Conference on Intergovernmental Fiscal Relations in China, Renmin University, Beijing (July 10–11).
World Bank. 2002. China: National development and sub-national finance report No. 22951-CHA (April), Washington, DC.
Wu Hao. 2006. Reform of governance and transformation of functions of local governments in China. Unpublished manuscript, Jilin University, Changchun.
Zhang, Yanlong. 2007. Urban entrepreneurialism. Unpublished manuscript, Duke University, Durham, NC.
Zhu, Konglai. 2007. Problems of and approaches to county economic development in Shandong Province. *Macro-Economic Management*, 57–61.
Zouping County Statistical Bureau. 2001–2006. *Zouping Statistical Yearbook*. Zouping: Author.