

Local Public Finance in China: Intergovernmental transfers

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Overview

China's transfer system is still evolving. The 1994 TSS reform tried to build a framework of intergovernmental transfer system in China and was only partially successful at that. A positive aspect of the reform was to try to provide, for the first time in China, a rules-based mechanism for transfers moving away from the ad hoc, negotiated transfers of the past. Another objective of the reform was to increase the central government's share in total revenues in order to improve its capacity to redistribute fiscal resources across jurisdictions. On the negative side, the 1994 TSS reform added the "tax rebates" to the transfer system, which have been highly un-equalizing and a major part of the intergovernmental transfer system; in practice, the tax rebates were introduced to smooth out resistance to the TSS reform from richer sub-national governments and were justified as the means to improve local governments' incentive to develop the local economy and collect revenues.¹

The general purpose equalization transfer (known as the "transitional equalization transfer") introduced in 1995 represents only a small portion of all intergovernmental transfers, and therefore is ineffective in addressing horizontal fiscal disparities. Although intergovernmental transfers finance a significant part of local expenditure (see table 4.1), the framework for intergovernmental transfers between the central and provincial governments still is not well developed. In addition, not much has been done in developing a transfer framework at the sub-provincial level.

Table 4.1 Intergovernmental transfer as % of sub-national government expenditures

	Sub-national expenditures (billion Yuan)	Intergovernmental transfer Amount(billion Yuan)	%
1994	404	239	59
1995	483	253	52
1996	579	267	46
1997	670	280	42
1998	767	329	43
1999	904	399	44
2000	1037	475	46
2001	1313	612	47
2002	1528	735	48
2003	1723	806	47
2004	2059	1018	49

Source: MOF

A complex intergovernmental transfer system

¹ In reality, the incentive effects of the tax rebate are pretty negligible since the transfers are actually linked to the collections in a base year more than a decade ago.

Although currently there are hundreds of transfer programs in China, they can be grouped into four main types.² Table 4.2 shows the general structure of intergovernmental transfers.

Table 4.2 General Structure of Intergovernmental Transfer: 2004

	Amount (billion Yuan)	As % of Total
General purpose grants	75	7
Tax rebate	405	40
<u>Gap-filling transfers</u>	216	21
Special Purpose Grants	322	32
Total	1018	100

Source: MOF

1. Equalization transfers (general purpose grants): This transfer is designed to help equalize fiscal disparities across provinces. The distribution is based on a formula that incorporates objective measurements of fiscal capacity and expenditure needs for the provinces; the actual amount distributed is calculated on the basis of the gap between standard current expenditures and standard current needs, adjusted for coefficients that take into account the size of the gap. Fiscal capacity is measured using estimates of the tax bases and standard tax rates. Expenditure needs are calculated using standard expenditure needs in a myriad of categories including spending on administration services, public safety, education, urban maintenance, social assistance, and heating.

This transfer has its origins in the "transitional pilot intergovernmental transfer scheme" introduced in 1995, as a first exploratory step toward a formula-driven equalization system. The initial formula had two parts: an objective component, measuring fiscal disparities as just explained in the previous paragraph, and a policy component that directed subsidies to regions with large ethnic minority populations. Even though its origins can be traced back to 1995, equalization transfers were first explicitly budgeted in 2001. The Minister of Finance Xiang Huaicheng announced that the 2001 draft budget provided about 2 billion for the scheme; this was the equivalent of around 0.8 percent of all transfers in the budget proposal to the National People's Congress that year.

Table 4.3 Size of general purpose grants

Year	Total (in billion)	As % of Total Transfers
1994		0
1995	2.1	0.8
1996	3.5	1.3
1997	5.0	1.8
1998	6.1	1.9

² See Zhang and Martinez-Vazquez (2002) for an extensive discussion of China's transfer system.

1999	7.5	1.9
2000	8.5	1.8
2001	13.8	2.3
2002	27.9	3.8
2003	38.0	4.7
2004	74.5	7.3

Source: MOF

2. **The tax rebate:** Tax rebate was introduced as a “hold harmless” provision in reference to the fiscal system prevalent just before the TSS reform. The amount of the tax rebate for the VAT and consumption tax is computed according to a formula.³ The corporate income tax, individual income tax⁴, and export tax rebates are based on the base amount. An interesting aspect of the tax rebate transfer is that it was determined on the basis of the nominal collections in a base year, and so although very significant in absolute and relative size in the initial years, its relative importance has been rapidly decreasing over time. As shown in Table 4.2, as percent of total transfers, the tax rebate now represents almost one-third of what it represented back in 1994-95. Nevertheless, the tax rebates remain highly unequalizing because they go largely to the richer provinces and lower level sub-national jurisdictions.

Table 4.4 The tax rebate transfers

Year	Total	VAT and Consumption	Income Taxes Base	Export Taxes Base	As % of Total Transfers
1994	179.9	179.9			75
1995	186.7	186.7			74
1996	194.9	194.9			73
1997	201.2	201.2			72
1998	208.3	208.3			63
1999	212.1	212.1			53
2000	220.7	220.7			46
2001	230.9	230.9			38
2002	300.6	240.8	59.7		33
2003	342.5	252.7	89.8		31
2004	405.0	271.1	89.8	44.0	27

Source: MOF

³ The formula is

$$R_t = (S_t + 75\% V_t - S_{t-1} + 75\% V_{t-1}) * 0.3$$

Where R_t was the central compensation in year t ; S was revenue from consumption tax; V was revenue from VAT.

⁴ In 2001, income taxes became shared taxes as opposed to 100 percent assigned to local governments; the sharing ratio for the central government was 50 percent, and became 60 percent beginning in 2003. The formula is

$$R_t = \text{Max}\{ I_t * 0.4, I_{2001} \}$$

Where R_t was the central compensation in year t and I_t was revenue from income taxes.

3. Gap-filling transfers.⁵ The main purpose of these transfers is to address different manifestations of vertical imbalance at the sub-national level by filling the fiscal gap for local governments. There are a few categories for this transfer, and the major types include:

(a). Revenue returned: ⁶ This type of transfer was designed to fill the fiscal gaps caused by the 1994 reform and ensure that every province would have total nominal revenues no lower than those in 1993.

(b). Transfer for minority regions. Established in 2000 with \$12 million to support the development of minority regions, this transfer comes from two sources: one is directly from the central budget with a yearly growth rate, which is equal to that of central VAT revenue; the other is 80% of the central government VAT revenue increases collected in minority regions.

(c). Transfers for increasing wage expenditure of public employees. These transfers were designed to support central and western provinces to meet the requirements of the central government to increase the wage standard of public employees.

(d). Transfer for rural fee-to-tax reform and transfer for abandoning the agriculture tax. The purpose of this transfer, as we have seen above, is to compensate partially at the provincial level for the fiscal gap caused by the rural fee-to-tax reform and the reform of abandoning the agriculture tax.

The structure of gap-filling transfers is shown in Table 4.3

Table 4.5 Gap-filling transfers 1994-2004 (in billion Yuan)

Year	Total	Revenue returned	Transfer for minority Regions	Transfers for increasing wage expenditure of public employees	Transfer for rural fee-to-tax reform	Transfer for abandon agriculture tax	Other transfers	As % of Total Transfer
1994	22.9	11.7					11.2	9.6
1995	27	11.8					15.2	10.7
1996	20	11.4					8.7	7.5
1997	22.4	11.8					10.6	8.0
1998	26.4	14.1					12.3	8.0
1999	43.7	16.7		10.8			16.1	10.9
2000	80.8	16.6	2.5	21.7	1.1		38.9	17.0
2001	143.3	29.8	3.5	63.1	8		38.9	23.4

⁵ Although the intent of these transfers is indeed to fill the budget gap, which arises from different sources, in general, these transfers do not carry many of the perverse negative effects (for revenue mobilization and expenditure management) associated with the annual gap-filling transfers of, for example, the former Soviet Union. The gap-filling transfers in China are associated with adjustments for one-time events or targeted to particular regions and in most cases the current behavior of the recipients does not affect the amount of the transfer.

⁶ Except Shandong province which received subsidies and also remits to the central government, sixteen provincial governments were on the recipient side which included all eight of the provinces where minority nationalities were concentrated (Tibet, Xinjiang, Inner Mongolia, Ningxia, Guangxi, Qinghai, Yunnan, and Guizhou) and other poor provinces such as Sichuan and Jiangxi. The other fourteen are on the remitting side.

2002	163.4	27.3	3.9	81.7	24.5		25.9	22.2
2003	182.8	28.6	5.5	90.1	30.5		28	22.7
2004	215.9	28.6	7.7	98.3	30.7	21.7	29.1	21.2

Source: MOF

4. Specific purpose grants or earmarked transfers: There are literally hundreds of specific purpose grants associated with a variety of programs at the central level, many of which got started in a “putting the fire out” fashion: as new problems and challenges arose the tendency has been to create a new earmarked transfer to deal with the problem. Special purpose grants also include the subsidy for increased issuing of state bonds.

Table 4.6 Special Purpose Grants (in billion Yuan)

Year	Total	Special grants	Subsidy for increased issuing of state bonds	As % of Total Transfer
1994	36.2	36.2		15.2
1995	37.5	37.5		14.8
1996	48.9	48.9		18.3
1997	51.6	51.6		18.4
1998	87.8	59.1	28.7	26.7
1999	136.0	113.9	22.1	34.1
2000	164.8	119.9	44.9	34.7
2001	223.7	135.9	87.7	36.6
2002	243.5	158.8	84.7	33.1
2003	242.5	181.8	60.6	30.1
2004	322.3	252.4	69.9	31.7

Source: MOF

Sub-provincial intergovernmental transfer is at the discretion of the provincial government. Currently, the basic framework of sub-provincial transfer is similar to that of the central government even though there is significant diversity in structure across provinces because of differences in the availability of fiscal resources and because the provincial governments use their discretion to pass on smaller or larger shares of the funds received from the central government. Table 4.7 shows the aggregate sharing among different levels of governments for the main types of transfers for 2003.

Table 4.7 Sharing of transfer funds among different levels of government: 2003 (in billion Yuan)

Types of Transfers	Provincial	Prefecture	County
Tax rebates: VAT and Consumption tax	164.6	10.4	77.7
Tax rebates: Income tax	11.5	29.9	48.3
Revenue returned	-5.8	2.2	16.1
Specific purpose grants	32.6	51.3	97.9
Subsidy for increasing issuing of bond	34.7	11.9	14.0

General purpose grants	-1.2	8.3	30.9
Transfer for minority Regions	3.6	0.7	1.3
Transfer for rural fee-to-tax reform and transfer for abandoning the agriculture tax	-2.4	-0.6	33.5
Transfers for increasing wage expenditure of public employees	4.2	11.3	68.1
Final account transfers	-22.7	20.1	21.2
Total	251.2	145.5	409.0

Source: MOF

Table 4.7 shows that the lower level governments are the main beneficiaries of several types of transfers, including the tax rebates for the income tax, specific purpose grants, equalization of general purpose grants, transfer for increasing wage expenditure for public employees, and transfers for rural fee-to-tax reform and for abolishing the agriculture tax.

Thus, in the case of transfers for rural fee-to-tax reform and for abandoning the agriculture tax it is the counties who are supposed to get these transfers and indeed they appear to do so, with the negative values at the provincial and prefecture levels indicating that in some cases these upper-level governments are providing compensation to the county governments on their own (without central government funds). However, the level of aggregation in Table 4.7 does not allow us to reach any conclusion on the sufficiency of these transfers to compensate county governments for their losses in own revenues. Other profiles, such as for transfers for increasing wage expenditure of public employees, simply reflect the fact that it is at the county level where the highest level of government activity takes place.

Gap-filling oriented system and small role for equalization.

Although the intergovernmental transfer programs have a multiplicity of objectives, a dominant purpose of many of the intergovernmental transfers is budget gap-filling. Typical examples include the transfers for increasing wage expenditure of public employees, transfers for rural fee-to-tax reform, transfers for abandoning the agriculture tax, final account transfers, and so on. Some of these gap-filling transfers may have some equalizing effects, but the general impact of the transfers system is unequalizing. Table 4.8 shows the correlation among transfers and GDP in per capita terms across provinces in 2003.

Table 4.8 Correlation among transfers and GDP in per capita term across provinces: 2003

	Total Transfer	General transfer	Tax rebates	gap-filling	Special Purpose
General transfer	0.84				

Tax rebates	0.20	-0.30			
gap-filling	0.91	0.96	-0.20		
Special Purpose	0.91	0.94	-0.20	0.97	
GDP	0.14	-0.35	0.94	-0.24	-0.23

One main reason for this result is that the “general transfer” is the only one with an explicit equalization purpose, and that the pool of funds distributed through it is still relatively small as shown in Table 4.1.

The overall un-equalizing effect of total transfers in China is a well-researched and established issue. There is some more recent evidence that total transfers have become less “regressive” over time, especially in recent years.⁷ However, practically all the previous analysis has been at the central-provincial level and much less is known about the allocation patterns for transfers at below the provincial level. Up to now, we do not know of any analysis on the properties of transfers to sub-provincial units. Several important questions remain in this area. Are transfers to lower-level governments more equalizing (or less un-equalizing) than at the central-provincial level? To what extent do increased transfers from the center to the provinces (either with earmarked purposes or unconditional) filter down to lower-level governments?

In what follows, we take a short detour to look at the question of the equalizing or un-equalizing effect of transfers from upper-level governments (the provinces and the prefectures—cities) to county governments.

Because of the information contained in the county data set from the MOF discussed above, we are only able to decompose per capita total transfers (“pttransfer”) into two categories, the per capita tax rebates (“prebate”) and all other per capita transfers, which includes the equalization transfers per se (“ptransfer”). In order to analyze the equalizing effect of the three categories of transfers we run a set of panel regressions with per capita transfers as the dependent variable and per capita GDP (“pgdp”) as the main explanatory variable. In addition, we introduce several other control variables including population (“epop”), the share of population residing in rural areas (“srpop”), the share of public employees in the total population (“spubem”). Per capita own revenues at the county level (“pownrev”), and lagged per capita expenditures (“lagexp”). We also include as control variables the “tax-for-fee” reform dummy and the interaction term between the “tax-for-fee” reform dummy and the share of rural population (“rimact”) we introduced in the previous section. The summary statistics of the variables used in the regression are presented in Table 4.9.

Table 4.9 Summary of Statistics for the Transfer Regressions

⁷ See for example Persson and Erikson (2005), Wang (2005) and Wong (2005).

Variable	Obs	Mean	Std.Dev.	Min	Max
ptransfer	17320	316.9874	403.7067	6.844828	12588.5
prebate	17320	84.83605	192.8237	0.266667	9424
ptransfer	17320	232.1513	323.6702	0.157407	6628.75
pgdp	17320	6468.948	10562.54	157.8947	438000
epop	17320	44.44662	34.14197	1	875
lagexp	14435	505.9781	712.1937	22.50144	25646
sropop	17320	74.49545	23.61557	0	100
spubem	17318	3.173472	1.927135	0.016923	50.69
pownrev	17320	284.3333	625.8963	0	30922.5
reformdummy	17320	0.25843	0.437784	0	1
rimpact	17320	0.198522	0.350482	0	1

The regression results are presented in Table 4.10. The most important finding is that the coefficient for per capita GDP is positive and statistical significant in the regressions for total transfers. Thus, it does appear that the un-equalizing nature of transfers at the central-provincial level is maintained at the lower levels of government. Better-off counties receive more per capita total transfers. However, the coefficient for per capita GDP in is negative and significant in the all other transfers (including equalization) regressions. This means that if one excludes the tax rebate, transfers at the county level are somewhat equalizing. Nevertheless, the un-qualizing effect of the tax rebate is much larger and it overwhelms any equalizing effect of other transfers.

The estimated coefficients for the other control variables also suggest some interesting processes at work. For the first three regressions, when the “impact of the reform” variable is not included, we can see from the coefficients for the tax-for-fee reform dummy that the impact of reform on equalization and other transfers is positive and significant, while negative and significant for tax rebate transfers. These counteracting components make the impact of the tax-for-fee reform on the total transfer not significantly different from zero. But, in the three regressions (4) through (6), when the impact of reform on rural population is included, the reform dummy in general becomes negative and significant both for tax rebate and total transfer, while the impact on rural population is significantly positive for all other transfers (including equalization transfers) as well as for total transfer. This would seem to indicate that while the tax rebate transfers in dominantly rural areas are (expectedly) quite insignificant, equalization and other transfers are much more important in these areas and that overall have an equalizing effect. The estimated coefficient for the “share of rural population” tells the same story. Since the central and provincial governments have been allocating increased transfers to compensate for for the losses in agriculture taxes, counties with higher rural population shares tend to receive higher per capita total transfers.

The estimated coefficients for the the other two control variables in Table 4.10, the share of public employees in the total population and per capita own revenues, show that there may be some perverse incentive issues in the implementation of transfers at the county level. The transfers per capita of all kinds increase with the share of public employees at the county level. This may mean that county governments are encouraged through

different transfer channels to increase their number of employees. In addition, all other things the same, the per capita discretionary transfers decrease with per capita own revenues; this may mean that discretionary transfers work to discourage tax effort by county governments.

Table 4.10 the Impact of Tax-for-Fee Reform and Different Components of Transfers (1997-2003)

	(1)	(2)	(3)	(4)	(5)	(6)
Dependent variable (in Yuan per capita)	Total	Equalization and others	Rebate	Total	Equalization and others	Rebate
Per Capita GDP	0.006 (17.88)***	-0.001 (2.70)***	0.006 (44.66)***	0.006 (17.99)***	-0.001 (2.54)**	0.006 (44.58)***
Population	-0.108 (0.71)	-0.214 (1.52)	0.106 (1.52)	-0.111 (0.73)	-0.217 (1.54)	0.106 (1.52)
Lag of Per capita Exp	0.232 (35.14)***	0.246 (40.40)***	-0.014 (4.67)***	0.232 (35.16)***	0.246 (40.42)***	-0.014 (4.67)***
Share of Rural Population	1.087 (3.54)***	1.211 (4.28)***	-0.125 (0.89)	0.993 (3.22)***	1.112 (3.90)***	-0.119 (0.85)
Share of Public Employee/Pop	20.285 (12.31)***	5.718 (3.76)***	14.567 (19.37)***	20.339 (12.34)***	5.775 (3.80)***	14.564 (19.37)***
Per Capita Own Revenue	0.124 (17.02)***	-0.036 (5.32)***	0.160 (48.07)***	0.125 (17.07)***	-0.036 (5.27)***	0.160 (48.06)***
Reform Dummy	-11.873 (1.49)	31.642 (4.30)***	-43.516 (11.95)***	-35.962 (2.93)***	6.208 (0.55)	-42.170 (7.53)***
Impact of Reform				31.350 (2.58)***	33.101 (2.96)***	-1.751 (0.32)
y98	-264.556 (27.41)***	-201.035 (22.58)***	-63.521 (14.43)***	-264.558 (27.42)***	-201.037 (22.59)***	-63.521 (14.43)***
y99	-236.997 (24.99)***	-174.287 (19.92)***	-62.710 (14.49)***	-237.040 (25.00)***	-174.332 (19.93)***	-62.708 (14.49)***
y00	-195.436 (20.95)***	-128.502 (14.93)***	-66.934 (15.73)***	-196.512 (21.05)***	-129.638 (15.05)***	-66.873 (15.70)***
y01	-122.713 (13.39)***	-46.330 (5.48)***	-76.383 (18.27)***	-123.994 (13.51)***	-47.682 (5.63)***	-76.312 (18.23)***
y02	-25.871 (5.33)***	-23.811 (5.32)***	-2.061 (0.93)	-26.293 (5.42)***	-24.255 (5.42)***	-2.037 (0.92)
Constant	148.905 (5.54)***	127.547 (5.15)***	21.358 (1.74)*	155.954 (5.78)***	134.990 (5.42)***	20.964 (1.70)*
Observations	14433	14433	14433	14433	14433	14433
Number of ID	2703	2703	2703	2703	2703	2703
R-squared	0.53	0.45	0.49	0.53	0.45	0.49

Absolute value of t-statistics in parentheses

* Significant at 10%; ** significant at 5%; *** significant at 1% levels.

Source: County level dataset from MOF.

Vertical Imbalances

Returning to our discussion on the nature of central-provincial transfers, the main reason for the gap-filling orientation of the transfer system is that the majority of sub-national governments face significant vertical imbalances; as discussed above, a main feature of the current fiscal decentralization system in China is that while expenditures are highly decentralized, tax revenues remain highly centralized. The size of the vertical imbalances is shown in Table 4.11 by the share of sub-national government expenditure financed out of own revenues for the period 1994 to 2003. Although this share has fluctuated over time, it is significant that in 1994 and 2003 the share of sub-national expenditures financed by own revenues were grossly the same, 57 percent.

Table 4.11 Share of sub-national expenditures financed with own revenues: 1994-2003. (in billion Yuan)

Year	Sub-national Own Revenues	Sub-national Expenditures	Own Revenues as % of Expenditures
1994	231.2	403.8	57.24
1995	298.6	482.8	61.83
1996	374.7	578.6	64.76
1997	442.4	670.1	66.02
1998	498.4	767.3	64.96
1999	559.5	903.5	61.92
2000	640.6	1036.7	61.79
2001	780.3	1313.5	59.41
2002	851.5	1528.1	55.72
2003	985.0	1723.0	57.17

Source: China Statistical yearbook 2004

Dependence on intergovernmental transfers differs across the different levels of sub-national governments. This dependence also has fluctuated quite significantly since 1994, as shown in Table 4.12 as China is still in the process of building stable and formula-driven national and sub-national intergovernmental transfer systems. In some recent years, the fast growth of the central government fiscal resources provided the possibility of introducing several intergovernmental transfer programs. However, the intergovernmental transfer system is still characterized by a lack of stability and predictability. By design, it is not only the central government, but also the provincial, and even the prefecture governments that need to implement intergovernmental transfer programs to fill the budget gap of lower-level governments. It is interesting to note that the level of transfer dependency has increased for county governments in recent years, a natural consequence of the policy initiatives on rural fee-to-tax reform and the elimination of the agriculture tax.

Table 4.12 Share of expenditures financed by own revenues at different levels of sub-national governments: 1994-2003

Year	Provincial	Prefecture	County
1994	37.1	76.4	55.7
1995	47.1	77.3	57.8
1996	53.6	80.6	58.4
1997	62.5	68.5	66.8
1998	56.2	64.4	73.5
1999	46.0	89.3	53.1
2000	48.3	82.5	55.6
2001	46.7	78.1	54.8
2002	51.1	69.5	48.7
2003	54.5	71.4	48.5

Source: MOF

Besides the variation in the level of transfer dependency across different levels of government, there are also significant variations across jurisdictions. Table 4.13 shows transfer as percentage of total local expenditures across provinces in China for 2003.

Table 4.13 transfer as percentage of total local expenditures across provinces: 2003

Provinces	Total Expenditure (in billion Yuan)	Transfer (in billion Yuan)	Transfer as % of Total Expenditure
Beijing	73	18	25
Tianjin	31	13	42
Hebei	65	34	53
Shanxi	42	22	54
Inner Mongol	45	27	61
Liaoning	78	41	53
Jilin	41	29	72
Heilongjiang	56	32	57
Shanghai	109	33	30
Jiangsu	105	33	32
Zhejiang	90	28	31
Anhui	51	29	58
Fujian	45	15	33
Jiangxi	38	22	59
Shandong	101	33	33
Henan	72	39	55
Hubei	54	31	58
Hunan	57	33	57
Guangdong	170	44	26
Guangxi	44	24	54
Hainan	11	6	59
Chongqing	34	20	57
Sichuan	73	41	56
Guizhou	33	22	65
Yunnan	59	35	59

Tibet	15	13	92
Shaanxi	42	25	60
Gansu	30	21	71
Qinghai	12	10	78
Ningxia	11	7	70
Xinjiang	37	24	65
Max			92
Min			25
Average			54

Source: MOF

The overall operation of the transfer system leaves China's intergovernmental system with significant fiscal disparities. Table 4.14 shows disparities in expenditures per capita for provinces from 1990 to 2003. The increasing trend in expenditure disparities, which was temporarily stopped for several years starting in 1998 as several intergovernmental transfer programs were newly introduced by the central government, has continued its expansion since 2000. In 2003, public expenditures per capita in the best off province were 8.5 times larger than those for the worst off province and the coefficient of variation across provinces was 0.77.

Table 4.14 Expenditure disparities for provinces in per capita terms: 1990-2003 (in Yuan)

	<i>Max</i>	<i>Min</i>	<i>Average</i>	<i>C.V.</i>
1990	613	99	251	0.57
1991	664	102	280	0.56
1992	729	112	296	0.56
1993	958	122	372	0.57
1994	1452	157	444	0.69
1995	1837	226	538	0.71
1996	2348	278	632	0.72
1997	2806	308	698	0.77
1998	3211	347	811	0.76
1999	3620	409	943	0.76
2000	3635	225	1075	0.70
2001	4387	532	1383	0.73
2002	5307	655	1620	0.75
2003	6361	741	1792	0.77

Source: China statistic yearbook various years

In fact, these regional disparities in expenditures per capita are present for almost all major expenditure items in sub-national budgets (Table 4.15.) For some items, the disparities are more pronounced; for example for public health expenditures the differences between the highest and lowest provincial expenditures in 2003 were over 13 fold and the coefficient of variation 0.8. In contrast, the disparities between maximum and minimum values for "public administration" per capita expenditures were only three fold and the coefficient of variation 0.4.

Table 4.15 Public expenditures per capita for selected budget items across provinces: 2003 (in Yuan)

Region*	Capital Investment	Education	Health	Public Administration	Agriculture
Beijing	494.3	678.5	340.8	268.4	179.8
Tianjin	518.4	470.5	151.4	173.5	79.5
Hebei	61.4	175.9	51.5	99.0	45.2
Shanxi	111.2	203.4	61.3	137.1	79.0
Inner Mongol	328.3	228.4	71.8	191.9	149.4
Liaoning	161.6	233.6	59.8	147.9	104.0
Jilin	117.8	198.6	59.7	115.5	80.5
Heilongjiang	101.6	212.6	60.5	128.3	116.6
Shanghai	1430.4	767.8	213.0	261.8	138.8
Jiangsu	102.6	241.8	75.0	144.7	89.0
Zhejiang	135.3	350.9	97.0	203.5	127.9
Anhui	74.0	131.9	26.7	80.0	50.9
Fujian	107.4	266.5	59.4	105.1	77.8
Jiangxi	79.7	151.5	35.4	84.5	55.2
Shandong	69.8	196.3	43.4	123.1	67.7
Henan	52.0	135.7	31.2	86.0	37.3
Hubei	51.2	148.4	40.4	95.1	47.3
Hunan	77.1	135.2	25.3	88.8	54.3
Guangdong	302.8	333.5	92.5	220.6	120.7
Guangxi	82.4	162.9	43.3	95.4	61.6
Hainan	165.9	182.6	57.3	129.6	86.5
Chongqing	204.7	137.2	34.6	117.7	54.3
Sichuan	86.2	125.2	36.1	108.7	55.8
Guizhou	81.8	155.4	44.7	112.0	63.7
Yunnan	161.1	212.9	74.8	126.7	112.0
Shaanxi	125.4	179.8	45.3	127.2	78.8
Gansu	126.7	182.7	45.3	120.3	79.3
Qinghai	553.2	236.6	99.2	208.3	140.2
Ningxia	350.8	237.5	77.2	133.3	149.0
Xinjiang	330.9	274.2	94.2	197.1	120.0
Max	1430.4	767.8	340.8	268.4	179.8
Min	51.2	125.2	25.3	80.0	37.3
Average	221.5	244.9	74.9	141.0	90.1
C.V.	1.2	0.6	0.8	0.4	0.4

Source: China statistic yearbook 2004. (*Tibet is excluded)

Of course, the relative low importance of equalization transfers and the fact that per capita overall transfers are positively related to per capita GDP are only two of the reasons, and not the most important ones for the existence of these disparities. Regional disparities in economic wealth and consequently in tax bases and revenues are the main causes of these disparities. This can be seen in Table 4.16 which shows the disparities in own revenues per capita at the provincial level for 1990 to 2003. There we can see that

the coefficient of variation for per capita own revenues has increased over time and stood at 1.17 in 2003, which is 50 percent higher than the coefficient of variation for per capita expenditures for 2003 in Table 4.14. Note also that the maximum value of own revenues per capita in 2003 was over 17 times higher than the minimum provincial value. This means that in the absence of the transfer system, no matter how deficient it may be, fiscal disparities across provinces would have been much larger.

Table 4.16 Per Capita Disparities in Overall Own Revenues: 1990-2003

Year	Max	Min	Average	C.V.
1990	1179.66	8.11	217.54	1.03
1991	1431.94	28.32	266.30	1.01
1992	1308.63	47.81	259.47	0.96
1993	1725.50	67.24	349.56	0.90
1994	1250.89	90.34	242.02	0.92
1995	1551.66	89.58	305.34	0.97
1996	1976.53	100.00	378.90	1.00
1997	2281.88	118.95	421.14	1.04
1998	2600.41	142.86	489.52	1.05
1999	2849.06	178.64	545.70	1.07
2000	2899.51	104.75	602.65	1.02
2001	3776.16	232.35	734.02	1.12
2002	4362.78	273.72	805.05	1.17
2003	5179.59	301.85	921.59	1.17

Source: China Statistical yearbook 2004

In fact, regional disparities in tax bases and revenues are present for all major taxes, as shown in table 4.17 across provinces in 2003. Observe that the largest differences are for personal and corporate income taxes putting the coefficient of variation at 1.77 and 1.67, respectively; and Shanghai collects 42 times more personal income taxes per capita than Hunan.

Table 4.17 Provincial disparities across major taxes: 2003 (in Yuan)

<i>Region</i>	VAT	Business Tax	Agriculture Tax	Corporate income tax	Individual Income Tax
Beijing	517	1811	4	644	393
Tianjin	447	636	4	235	124
Hebei	102	97	37	42	27
Shanxi	155	111	12	43	26
Inner Mongolia	95	153	29	30	23
Liaoning	203	283	17	85	56
Jilin	113	130	38	44	29
Heilongjiang	154	121	43	28	29
Shanghai	995	1942	1	854	420
Jiangsu	245	280	36	125	54
Zhejiang	331	470	12	228	98

Anhui	58	72	42	30	13
Fujian	156	243	3	106	61
Jiangxi	54	101	37	23	17
Shandong	138	159	46	73	29
Henan	60	78	39	30	16
Hubei	76	96	39	36	19
Hunan	54	90	27	20	18
Guangdong	294	523	10	214	119
Guangxi	59	99	14	27	21
Hainan	78	198	6	32	34
Chongqing	79	149	20	28	25
Sichuan	55	103	24	28	17
Guizhou	50	81	13	22	14
Yunnan	89	103	11	49	19
Tibet	35	149	0	27	11
Shaanxi	86	138	18	35	19
Gansu	70	92	20	20	14
Qinghai	98	137	9	23	15
Ningxia	87	188	13	29	22
Xinjiang	130	206	16	27	33
Max	995	1942	46	854	420
Min	35	72	0	20	11
Average	167	292	21	104	59
C. of V.	1.16	1.52	0.69	1.77	1.67

Source: China statistical yearbook 2004.

Overall, the existing levels of fiscal disparities are still very high by international standards or any other standard. This calls for the need for comprehensive reform of the current transfer system emphasizing the equalization objective and simplifying and de-emphasizing other transfers that go against the equalization objective, especially the tax rebates, still the main component of the intergovernmental transfer system.

Limited normative framework for intergovernmental transfer reform

The system of intergovernmental transfers is one of the least regulated fields in China's fiscal system. Fundamentally, currently there is no formal procedure to introduce or reform intergovernmental transfers. The current intergovernmental transfer programs were introduced through various approaches, often *ad hoc* and subject to negotiation between different levels of government. Leaving the process to these influences risks the distortion of desirable properties of the intergovernmental transfers and the rest of the decentralization system, including their equity and efficiency objectives. The lack of properly regulated procedures also exposes the system to arbitrariness and even corruption. These issues acquire greater relevance at the sub-provincial level, because of the discretion the current systems grants to upper-level government to design their own transfer system. Currently, provincial governments could easily use their hierarchical position to detain or deviate central government transfers that have equalization or other

objectives at lower levels of government. Little is known about these issues, but for example, it is conventionally accepted that the lower the government level, the worse the effectiveness of equalization transfers, especially in poorer provinces which have poorer prefecture and county and township governments. These are issues that deserve close attention by the central authorities.

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