

Mainland China's Tax Revenue and Extrabudgetary Funds

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Since the initiation of reform and opening-up policies, mainland China's enterprises have been asked to pay taxes instead of continuing to deliver a portion of their profits to the state. At the same time, local governments have also increased their extrabudgetary funds through taxation.

In the process of instituting the taxation system, the central government has kept most of the financial power in its own hands, completely deviating from the new economic policy of allowing local governments to enjoy greater autonomy. On the other hand, local governments have taken advantage of the new taxation system's loopholes to transfer part of their tax revenue into extrabudgetary funds and using these funds to support state-owned enterprises in their own areas. If this phenomenon develops unchecked, the central government will have difficulties in exercising effective financial control, although its tax distribution system, which was implemented at the beginning of the 1990s, aims to consolidate its financial power.

Keywords: extrabudgetary funds; individual industrial and commercial households; collective enterprises; value-added tax; state-run enterprises

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In a financial effort to realize economic modernization, mainland China has discontinued its past practice of having enterprises deliver a portion of their profits to the state and adopted the taxation system. This new system has not only resulted in changes of the state's financial control patterns, but has also enabled the state to relieve its heavy financial burden of giving subsidies to unprofitable enterprises.

Due to the lack of clear boundaries between the central and local governments' property rights over enterprises, some local governments, who have enjoyed increased economic autonomy since the

initiation of reform, have begun to challenge the central government's financial power. Such a phenomenon is expected to dissipate in the future when mainland China practices a market economy, as implementation of a shareholding system will clearly define the central and local governments' property rights and governments at all levels will no longer have to subsidize unprofitable enterprises.

The enforcement of the taxation system has also influenced how local governments raise their extrabudgetary funds. Before economic reform, extrabudgetary funds came mainly from the profits of state-owned enterprises, but they now come from tax revenue. However, as the taxation system is imperfect, some localities have inevitably taken advantage of loopholes to procure extrabudgetary revenue for their own uses. Therefore, examining the taxation system and how the central and local governments raise their extrabudgetary funds will give us a better understanding of their financial capabilities.

Taxation Reform in Mainland China

All-out taxation reform in mainland China began in 1973, under the guiding principles of "combining similar tax categories, simplifying tax collection measures, and reforming unreasonable taxation systems."¹ Based on these principles, unified industrial and commercial taxes and their surtaxes, real estate taxes, vehicle license taxes, animal slaughtering taxes, and salt taxes were incorporated into the industrial and commercial tax. Taxable items were reduced from the original 108 to 44, and the number of tax rates from 141 to 16.² Most enterprises were allowed to use only one tax rate. To simplify the process of tax collection, intermediate and processing products were not levied taxes, and local governments were granted some autonomy over tax administration.

In the 1973 taxation reform, both state-run and collective enterprises were levied an industrial and commercial tax, and the latter were also levied an additional industrial and commercial income tax. The industrial and commercial tax comprised the majority of taxes levied on enterprises, accounting for 90 percent of their tax payment.

¹Yang Weihua and Zhou Kai, *Zhongguo shuishou zhidu* (China's taxation system) (Guangzhou: Zhongshan daxue chubanshe, 1994), 36-37.

²Many tax rates disappeared with the elimination of tax items.

Obviously, this reform intended to simplify the taxation process. However, it seriously restricted taxation's role and obliterated the boundaries between the central and local governments in terms of tax categories.³

To cope with economic development needs following the initiation of reform and opening-up policies in 1978, old tax categories were revived and new ones also created. In the meantime, in order to enhance local governments' incentive for tax collection and clearly define central and local government autonomy over taxation, the industrial and commercial tax was divided into three parts: one exclusively delivered to the state, the second to local governments, and the third jointly shared by both levels of government.

In addition to taxes relating with foreign countries, tariffs, and agricultural affairs, various tax categories also underwent reform.⁴ For example, state-run enterprises were levied income tax to take the place of the previous practice of delivering profits to the state. This was the first step toward the building of a taxation system. In general, large and medium-sized enterprises were imposed a tax rate of 55 percent, and after paying the tax, enterprises had to deliver more of its income to the central government if their retained profits exceeded the amount allowed.

In the reform of tax categories, local governments began to collect four kinds of taxes, i.e., real estate tax, land utilization tax, vehicle utilization tax, and city maintenance tax. In 1985, mainland China published two documents governing income tax for collective enterprises and individual industrial and commercial households, respectively. Efforts were also made to revive old taxes or establish new ones, including the petroleum special tax and the fund for the capital construction on energy and transportation in 1982; the construction tax in 1983; and the state-run enterprise bonus tax, the state-run enterprise wage adjustment tax, and the institution bonus tax in 1985.

By the end of 1993, mainland China had thirty-eight items for taxation in three categories: industrial and commercial tax, agricultural

³Zhong Ren, *Zuixin shuiwu gongzuo shiyong quanshu* (The latest practical manual of taxation work) (Beijing: Zhongguo minzhu fazhi chubanshe, 1994), 543.

⁴Hao Zhaocheng, *Caishui tizhi tupo yu liyi congzu* (A breakthrough in the financial and taxation system and a realignment of interests) (Beijing: Zhongguo caizheng jingji chubanshe, 1993), 4-27.

tax, and customs duty. A multi-level, multi-category, and multi-link compound taxation system was then formed, under which the circulation tax is dominant while income tax is supplementary.⁵ It can thus be said that taxation is currently playing a more important role in state finance, leaving little room for Marxist anti-taxation theories to exist.⁶

The tax revenue of the central and local governments has undergone changes in recent years, as can be observed from the following facts.⁷ The first concerns local taxes. In 1987, there were nine kinds of local taxes, but the number increased to thirteen the following year with the addition of the individual income adjustment tax, the bonus tax, the wage adjustment tax, and the construction tax. However, local taxes constituted only 5 percent of the state's total industrial and commercial tax and state-run enterprises' income tax in 1987, and the proportion increased only to 12 percent the following year. Such a low revenue simply could not meet local expenditure needs. In addition, local governments' authority over tax administration had been curbed. For example, taxation regulations promulgated in 1977 stipulated that the provincial government had the right to decide on the collection, reduction, and exemption of some local taxes as well as their tax rates, but the right was reappropriated by the central government in 1988.⁸

The second issue concerns tax reductions, exemptions, and other preferential treatment for enterprises. Local governments have been given the right to grant such preferential treatment in order to give enterprises incentive for production. However, some local governments have tended to reduce or exempt taxes that should be delivered

⁵Yang and Zhou, *Zhongguo shuishou zhidu*, 41.

⁶According to Marxist theory, the final goal of communism is to eliminate the state and have the proletariat exercise the dictatorship. During the transition period toward communism, the state is only allowed to collect the profits of state-owned enterprises (the surplus value of products). In Marxists' eyes, the taxation system is an instrument for capitalist countries to exploit the middle and lower classes. They therefore propose the elimination of the states, or the so-called "nontaxation system" theory. Although the Chinese Communists have made some revisions to Marxism and regard tax revenue as a major source of the state's financial revenue, the taxation system has not been smoothly enforced as a result of Marxism's influence. See Kuo Chien-chung, *Zhongguo dalu shuishou zhidu, 1950-1994* (Mainland China's taxation system, 1950-94) (Taipei: Wunan tushu chubun youxian gongsi, 1996), 100-102.

⁷Hao, *Caishui tizhi tupo yu liyi congzu*, 98-111.

⁸Wang Shaofei, *Zhongguo shuizhi gaige shexiang* (Some proposals on the reform of China's taxation system) (Beijing: Zhongguo caizheng jingji chubanshe, 1990), 92-95.

to the central government. For example, there are few legal restrictions on deducting profits before making a statement on dutiable income, and many local governments have used income tax deduction to keep a portion of their earnings for their own uses. To procure the highest possible profit for their own areas, local governments have even competed with one another in withholding dutiable income. Some have even offered tax reductions or exemptions to industries not encouraged by the central government. As a result, the central government has lost control over taxation, in terms of both tax revenue and taxation effects on the direction of economic development.

The third issue concerns industrial structure and the financial conditions of state-owned enterprises. In order to control investment flow and scale, an investment direction readjustment tax has been introduced in which revenue is delivered to the central government.⁹ However, most local governments have declined to collect such a tax, resulting in a repetition in investment. In addition, since the income tax rate for state-owned enterprises is higher than that for collective and individual enterprises, the basic and raw material industries urgently needed by the country have generally been developed by large-scale state-owned enterprises, while collective and individual enterprises have mainly engaged in processing industries. This has resulted in production convergence in local areas. In some places, tax exemptions or reductions have been used to provide relief to state-owned enterprises that have suffered from losses or are in debt for tax payments, as well as enterprises which have no prospects and need to be closed down, stop production, or be merged with other enterprises. In other areas, tax exemptions or reductions have been listed as nonproductive expenditures, and some enterprises have indiscriminately given bonuses or subsidies to their staffs.¹⁰

The fourth issue concerns the affiliations of tax organizations. Tax collection work has been delegated to local tax organizations, although local governments have only limited tax revenue. To ensure

⁹After the implementation of the system of having enterprises pay taxes instead of delivering profits, the state-owned enterprises not only began to pay income tax but also investment direction readjustment tax, as the state must guide state-owned enterprises in their investment.

¹⁰In some coastal provinces and cities which have been opened to the outside world, some foreign businessmen have been granted tax exemptions and deductions. The central government thus has to subsidize those local governments to make up for the resultant financial losses.

that the taxes in their areas are effectively collected, some local governments have asked their tax personnel to place top priority on collecting local taxes. Some local governments have used all possible means to increase their own revenue, even at the expense of the central government's financial revenue.

At the end of 1993, a new taxation system featuring the value-added tax was implemented, and a tax distribution system between the central and local governments was legalized. Under such a system, the central government takes the bulk of tax revenue; a jointly-shared tax provides the financial resources needed by the central and local governments;¹¹ state-owned enterprises must deliver tax to the central and local governments; and tax organizations exist at both the central and local levels.¹² However, the new taxation system can only be implemented when legalization is faithfully observed; otherwise, local governments will continue to intercept profits intended for the central government through tax exemptions and reductions.

Local governments obviously have not favored this system. For example, a group of financial officials headed by Vice Premier Zhu Rongji had to travel to Guangdong on the eve of 1994 to persuade the provincial government there to accept the system. As this system has only been implemented between the central and provincial governments, the latter also now face financial pressure from both the central government and governments below them.

Tax Collection and Tax Categories

In building the taxation system, mainland China has emulated advanced Western countries in deciding on tax categories, taxation scope and targets, the organizations handling tax collection, and tax rates.¹³ All these factors are decided by the central government before they are put through legislative procedures. Although local areas have been given greater economic autonomy, the central government holds

¹¹Ye Zhenpeng, "The Financial Administrative Power of the Central and Local Governments under the Tax Distribution System," in *Shichang jingji zhong de zhongyang yu difang jingji guanxi* (The economic relationship between the central and local governments in a market economy) (Beijing: Zhongguo jingji chubanshe, 1994), 58.

¹²Fang Fugen and Teng Biyan, *Zuixin shuishou zhidu shiyong shouce* (The latest practical manual of the taxation system) (Beijing: Jingji ribao chubanshe, 1994), 432.

¹³Here, "Western countries" refer to those applying a centralized but not federal system. In federal states, governments at all levels have the right to collect taxes.

taxation authority. To create more financial revenue, some local governments have not levied taxes in accordance with state regulations, and consequently have challenged this authority. Therefore, in order to perfect the taxation system, the relationship between the central and local governments has to be regulated. For example, local government procurement and use of tax revenue and financial transfers and payment between different government levels should be regulated by law.¹⁴

Localities have tended to use tax exemptions and other favorable economic measures to create more revenue for their own areas.¹⁵ Although tax exemption can be used as a means to boost the economy, it should be made within limits, so as not to hamper the central government's authority over taxation. On the other hand, centralization of financial power will leave local governments little room to exercise autonomy and discourage their enthusiasm for tax collection.

In recent years, mainland China's theoretical circles as well as the World Bank and other international organizations have made a series of studies on plausible financial structures.¹⁶ One model that has frequently been discussed is power separation; that is, central and local government taxes are separated. For this model, efforts should be made to decide the tax categories for various government levels and tax administration methods. One version of this model has the central government holding dominant power and possessing the revenue of major taxes, such as income tax, commodity tax, business tax, and value-added tax, while local governments keep the revenue of minor ones. Under such a situation, local governments may not have enough incentive to collect taxes for the central government. To facilitate this system, the functions of concerned organizations at both the central and local levels would have to be clearly defined

¹⁴In his article entitled "Some Questions on Financial Transfers and Payment in Our Country," Li Dachang holds the view that the central government can appropriate a portion of tax revenue to local governments in accordance with their population, area, agricultural production value, and the amount of poverty-stricken population, or it may just set a unified tax-sharing ratio with local areas. See *Caizheng* (Finance) (Beijing), 1994, no. 9:39.

¹⁵Xie Xuezhong, "On the Corrosion of the Tax Base," *Shehuizhuyi shichang jingji yu shuizhi gaige* (The socialist market economy and the reform of the taxation system) (Shenyang: Dongbei caijing daxue chubanshe, 1992), 173.

¹⁶Zhou Xiaochuan and Yang Zhigang, *Zhongguo caishui tizhi zhi wenti yu chulu* (Questions and outlet of China's financial and taxation system) (Tianjin: Tianjin renmin chubanshe, 1992), 188-92.

and regulated. The system's greatest merit is that the central government will be able to control the investment scale and maintain maximum equality in financial distribution. The other power separation model allows localities to have autonomy over certain productive taxes.¹⁷ In some areas, such revenue would be large enough to cover all their expenses, freeing the central government from having to make allocations.¹⁸ This would also enable local governments to have greater power over financial affairs and taxation, and is suitable for mainland China since its local governments must cover a wide range of expenses, and have enough personnel and experience to collect consumption and income taxes, which have a wide tax base. However, allowing local areas to have productive tax revenue will inevitably result in income inequalities in different regions, forcing the central government to grant compensation subsidies to some areas.

In the second financial structure model, the central and local governments jointly share income tax, commodity tax, and value-added tax revenue, but local governments are allowed to levy surtaxes on certain items. For example, if the income tax rate of an enterprise is 20 percent, a local government can require from the enterprise a surtax at a rate of 10 to 20 percent of the income tax. As for indirect taxes, take the commodity tax as an example: local governments are allowed to decide on and levy a certain amount of surtax (such as tax on the maintenance of city construction).¹⁹ In such a system, local governments are allowed to administer their own revenue but are prohibited from adopting any duty-free policies that would adversely affect the central government's tax base and tax rates. In other words, local governments are allowed to reduce their own tax base and offer favorable terms to enterprises, but cannot offer exemptions on taxes that should be delivered to the central government.

¹⁷The production taxes are mainly those collected from enterprises, such as income tax, production tax, value-added tax, and business tax of state-owned, collective, and private enterprises.

¹⁸In countries which have a vast territory, tax categories will be different in different areas. The central government would give subsidies to those places where tax revenue cannot support local construction, in the name of supplementary appropriation.

¹⁹Suppose the tax rate of a certain product is set by the central government at 20 percent. If the local government levies a surtax valued at 20 percent of the tax collected by the central government, the product has been taxed a total amount of 24 percent. While 20 percent is delivered to the central government, the remaining 4 percent is held by local governments. See Ding Wen, *Shuishou yu caiwu shouce* (Handbook of tax revenue and finance) (Beijing: Jingji guanli chubanshe, 1988), 12.

With this method, the merits of power decentralization are apparent and local governments can be held responsible for tax collection. However, in order to maintain a certain degree of equality, the central government has to allocate money to economically backward areas. Moreover, the administration and information system would have to be remarkably improved in order to guarantee effective tax collection. If the localities are granted some autonomy in tax collection, the central government's authority over the economy through taxation will also be reduced.

Mainland China will have to undertake some reforms before it can emulate either of the above two models, both of which have been applied in Western countries. The financial relationship between the central and provincial governments would have to be readjusted. For example, the ratio of taxes owned by the central and provincial governments would have to be made according to practical needs, so that areas with limited financial revenue or high expenditures can be provided with enough financial resources, while provinces that have distinguished themselves in tax collection can be encouraged. Also, the proportion of taxes distributed to the central and local governments would have to be set on a longstanding basis to ensure a consistent policy. For instance, provincial governments would have to be informed of their financial revenue so that they can work out their own financial plans effectively. Allocations to provincial governments would also have to be set in a systematic way so that the proportion of taxes they own can be properly decided.²⁰

Provincial governments' financial leadership over lower-level governments should also be designed to ensure all-out development in various areas and fulfill the state's financial target. Different areas within the same province should try to adopt an identical financial contract system so that their financial revenues can be calculated more easily.²¹

²⁰Wang Xingyi, "On the System of Financial Transfers and Payment," *Caimao jingji* (Finance and Trade Economics), 1994, no. 8:36-38.

²¹Before the enforcement of the tax distribution system in 1994, the major financial system between the central and local governments was the contract system. Under that system, the central government was required to give a certain amount or ratio of subsidies while local governments were asked to deliver a fixed amount of their profits. After the implementation of the tax distribution system, the contract system remains the major system for governments below the provincial level to handle their financial relations. See Zhu Limin, *Difang jigou gaige sikao* (Some thoughts on the reform of local organizations) (Beijing: Gaige chubanshe, 1992), 171-73.

In addition to the above reforms, the central government should establish a set of statistics to facilitate its supervision over local government tax collection and extension of tax exemptions to enterprises. This will help to ensure policy stability and equal distribution.²² The central government should also guard against the phenomenon in which some local governments intercept tax revenue intended for the central government and reinvest it in state-owned enterprises in their own areas. Otherwise, the scale and the direction of enterprise investment will be out of control.

What is most important is that governments at all levels should modernize their administration of taxation and finance. For example, they should work out their budgetary report at regular intervals and include the following items: expenditures for the building and maintenance of capital constructions; loans; and accounts transfers.²³

Extrabudgetary Funds

Before its implementation of the double budget system in 1992,²⁴ mainland China lacked a scientific budget system, and local governments often used extrabudgetary funds to relieve their financial problems. Strictly speaking, extrabudgetary funds are financial resources independent of the state finance system and not controlled by the state or local governments. However, according to mainland China's budget system, extrabudgetary funds are resources which can be used by local governments, administrative units of enterprises, and state-owned enterprises. Although they are not included in the state budget, there are regulations governing their collection, the volume of their revenue and expenditures, and how they can be used.²⁵

Mainland China's overall budget is usually set in two ways.²⁶ The first method is to make readjustments to the previous year's budget by considering possible political and economic factors, such

²²Hu Zhongliu and Dong Qingzheng, *Guojia shuishou* (The state's tax revenue) (Beijing: Zhongyang guangbo dianshi daxue chubanshe, 1993), 478-81.

²³Zhu, *Difang jigou gaige sikao*, 190.

²⁴Under the double budget system, budget items are counted as credit or loans, and a balance between the two items is required.

²⁵Xu Yi, *Caizheng shuishou caiwu kuaiji shiyong congshu* (A practical manual of financial revenue and financial accounting) (Beijing: Jingji kexue chubanshe, 1994), 190.

²⁶Liu Xingya, *Guojia yusuan yu shuishou* (State budget and tax revenue) (Beijing: Zhongguo jinrong chubanshe, 1991), 442-44.

as the major political tasks to be accomplished, the scale of economic construction, and the speed of national economic development. In this way, the calculation of the budget can be expressed with the following formula:

$$RE = BN \pm IF$$

in which RE stands for the planned budget, BN is the base, and IF the factors that may result in a budget increase or decrease.

In the other method of determining the budget, the coefficient (ratio) of the revenue and expenditures of each budget item to the scale of related economic activities is also taken into consideration. The budget is estimated with the following formula:

$$RE = EP \times CN \pm IF$$

in which EP stands for the planned economic target and CN for the coefficient.

The above two calculation methods have reformed the coefficient, quota, and ratio systems used before the initiation of reform. This is not to say that mainland China's previous methods of calculating the base of budget revenue and expenditures were inaccurate, but rather that the factors that might lead to an increase or decrease were not up to the requirements of modern statistics. Moreover, local governments and enterprises have taken advantage of loopholes to convert some budgetary funds into extrabudgetary funds for profit.²⁷

Extrabudgetary funds have aimed to enhance local areas' incentive for economic activities. To a certain extent, local governments and state-owned enterprises have relied on these funds to develop investment plans, as the revenue of extrabudgetary funds is owned by local financial departments, enterprise administrative units, and state-owned enterprises and their responsible institutions. Their total amount has increased rapidly: it exceeded 1 billion *yuan* in 1970, rose to 45.28 billion *yuan* in 1979, 55.74 billion *yuan* in 1980, 118.85 billion *yuan* in 1984, and 202.88 billion *yuan* in 1987. Growth further accelerated

²⁷In addition to inexperience in drawing up the budget, other reasons for converting budgetary funds into extrabudgetary funds include: extrabudgetary funds cannot be diverted for use by other units and they are not limited by administrative decrees.

Table 1
Extrabudgetary Revenue of Different Units

Year	Local financial departments	Administrative units	Unit: Billion <i>yuan</i>	
			State-owned enterprises and their authorities	Total
1978	3.11	6.34	25.26	34.71
1979	3.99	6.87	34.43	45.28
1980	4.08	7.44	44.21	55.74
1981	4.13	8.49	47.49	60.11
1982	4.53	10.12	65.63	80.27
1983	4.98	11.39	80.40	96.77
1984	5.52	14.25	99.07	118.85
1985	4.41	23.32	125.27	153.00
1986	4.32	29.42	139.99	173.73
1987	4.46	35.84	162.58	202.88
1988	4.89	43.89	187.29	236.08
1989	5.44	50.07	210.38	265.88
1990	6.06	57.70	207.11	270.86
1991	6.88	69.70	247.75	324.33
1992	9.09	88.55	287.86	385.49
1993	11.47	131.78	—	143.25

Source: *Zhongguo caizheng nianjian 1994* (China's finance yearbook 1994), 427.

Remark: Since 1993, state-owned enterprises no longer have the right to retain extrabudgetary funds.

to 270.86 billion *yuan* in 1990 and 385.49 billion *yuan* in 1992. In short, extrabudgetary revenue has increased over six times in twelve years (see table 1).

In 1978, the ratios of budgetary revenue and extrabudgetary revenue to national revenue were 37.2 percent and 11.5 percent, respectively. Since then, the ratio of budgetary revenue has declined while that of extrabudgetary revenue has increased. In 1986, the ratio of extrabudgetary revenue reached 22.1 percent, while budgetary revenue was 27.8 percent. After 1986, the ratio of both budgetary revenue and extrabudgetary revenue declined, and by 1992, the ratios of budgetary and extrabudgetary revenue were 19.5 percent and 19.1 percent respectively (see table 2).

In the period 1978-92, extrabudgetary revenue increased ten times, from 34.71 billion *yuan* to 385.49 billion *yuan*. During the same period, the revenue of local financial departments increased from 3.11 billion *yuan* to 9.09 billion *yuan*, that of enterprise administrative units increased from 6.34 billion *yuan* to 88.55 billion *yuan*, and

Table 2

The Ratio of Budgetary and Extrabudgetary Revenue to National Revenue (%)

Year	Budgetary revenue to national revenue	Extrabudgetary revenue to national revenue
1978	37.2	11.5
1979	31.9	13.5
1980	28.3	15.1
1981	25.8	15.3
1982	25.5	18.9
1983	25.6	20.4
1984	26.0	21.0
1985	26.2	21.8
1986	27.8	22.1
1987	24.3	21.8
1988	21.2	20.1
1989	21.3	20.2
1990	21.8	18.8
1991	20.7	19.6
1992	19.5	19.1
1993	19.0	5.8

Source: *Zhongguo caizheng nianjian 1994*, 432.

Remark: The budgetary revenue does not include foreign loans.

that of state-owned enterprises and their responsible institutions from 25.26 billion *yuan* to 287.86 billion *yuan*. The above statistics indicate that extrabudgetary revenue of local financial departments has been less than that of the other two kinds of units, and its ratio to the total extrabudgetary revenue has never exceeded 9 percent. In contrast, the ratio of enterprise administrative units' revenue to total extrabudgetary revenue has averaged about 20 percent, while that of state-owned enterprises and their responsible institutions has not been less than 70 percent. It should also be noted that the ratio of local financial departments' extrabudgetary revenue to total extrabudgetary revenue decreased from 8.9 percent in 1978 to 2.3 percent in 1992. Such a decline can be attributed to the discontinuation of the industrial and commercial surtax after 1985, the policy of including county-run enterprises' retained profits as part of budgetary funds, and the practice of having central-level financial departments take over local ones in distributing 30 percent of the enterprise depreciation funds (see table 3).

The increase in the ratio of extrabudgetary revenue to national revenue and the decrease in that of budgetary revenue is not only

Table 3
The Proportion of Extrabudgetary Funds of Different Units (%)

Year	Local financial units	Administrative units	State-owned enterprises and their authorities	Ratio of extra- budgetary revenue to total budgetary revenue
1978	8.9	18.3	72.8	31.0
1979	8.8	15.2	76.0	42.4
1980	7.3	13.3	79.3	53.3
1981	6.9	14.1	79.0	59.1
1982	5.6	12.6	81.8	74.1
1983	5.1	11.8	83.1	79.9
1984	4.6	12.0	83.4	81.0
1985	2.9	15.2	81.9	83.3
1986	2.5	16.9	80.6	79.5
1987	2.2	17.7	80.1	89.7
1988	2.1	18.6	79.3	94.8
1989	2.1	18.8	79.1	94.8
1990	2.2	21.3	76.5	86.4
1991	2.1	21.5	76.4	94.5
1992	2.3	23.0	74.7	97.7
1993	8.0	92.0	—	30.3

Source: *Zhongguo caizheng nianjian 1994*, 427.

an indication of declining state financial capacity, but also a sign of extrabudgetary fund encroachment on budgetary funds. Since extrabudgetary funds are not listed in the state budget, either at the central or local levels, neither central nor local financial departments have the right to dispose of them.²⁸

Although the central financial department has no disposal rights over extrabudgetary funds, enterprise units and state-owned enterprises with institutions affiliated to the central government have been able to make use of them.²⁹ In 1982, the central government controlled only 33.7 percent of all extrabudgetary funds, as many

²⁸ At the central level, the financial department refers to the Ministry of Finance, and at the provincial level, it refers to the finance department.

²⁹ Extrabudgetary funds are governed not only by financial departments, but also by the responsible institutions of state-owned enterprises. For example, the State Council's ministry in charge of steel and iron industry is responsible for the Anshan Iron and Steel Company, while the State Council's Ministry of Coal Industry is responsible for the Datong Coal Mine Company.

Table 4**The Proportion of the Central and Local Governments in Extrabudgetary Revenue (%)**

Year	Central government	Local governments
1982	33.7	66.3
1983	37.2	62.8
1984	39.6	60.4
1985	41.6	58.4
1986	41.2	58.8
1987	40.8	59.2
1988	38.4	61.6
1989	40.3	59.7
1990	39.6	60.4
1991	42.6	57.4
1992	44.3	55.7
1993	17.2	82.8

Sources: *Zhongguo caizheng nianjian* 1994, 429.

budgetary funds were converted into extrabudgetary ones under localities and “unpaid service” was listed as “paid service” according to the policy of delegating greater economic power and profits to local governments. To procure more financial resources for building basic industries and infrastructure facilities and developing agriculture, the state began to impose energy and transportation key construction funds in 1983. This resulted in an increase in the central government’s share of extrabudgetary revenue, from 37.2 percent in 1983 to 41.6 percent in 1985. However, by 1988 the share had declined again to 38.4 percent. As a result, the state imposed the state budget readjustment fund,³⁰ which improved the ratio to 40.3 percent in 1989 and 44.3 percent in 1992 (see table 4).

In addition to the collection of these two funds, in February 1983 the Ministry of Finance promulgated the “Proposed Measures for the Administration of Extrabudgetary Funds,” governing the nature, scope, items, utility, collection standards, proportion of reten-

³⁰State-owned enterprises, government organizations, troops, and local governments give 10 percent of their extrabudgetary funds to the budget readjustment fund, while collective and private enterprises and individual industrial and commercial households pay 10 percent of after-tax profits to the fund.

tion, and expenditures for extrabudgetary funds.³¹ In April 1986, the State Council promulgated the "Notice on Strengthening the Administration of Extrabudgetary Funds," which not only ratified the "Proposed Measures for the Administration of Extrabudgetary Funds" but also ruled that extrabudgetary funds of enterprise administrative units should be administered by financial departments and deposited in special accounts, while those of state-owned enterprises and their responsible institutions were to be guided by state policy.³²

Although the imposition of funds and the promulgation of administrative regulations have enabled the state to control more extrabudgetary funds, it has been difficult for it to maintain effective authority over them. For example, even though central financial departments control enterprise administrative units' special extrabudgetary fund accounts, these accounts only total 20 percent of all extrabudgetary funds. In addition, little can be done about extrabudgetary funds held by state-owned enterprises and their responsible institutions (which account for over 70 percent of the total), as these funds are only under the guidance of state policy. That is, after they have been deposited in the construction bank for over half an year, state-owned enterprises and their responsible institutions are allowed to withdraw these funds for use, without any protests from local financial departments.³³ Consequently, local financial units have helped enterprise units in using these extrabudgetary funds. Take Xuzhou city, for example; although it has experience in utilizing extrabudgetary funds, only 12 percent of these funds used in the city in 1988 were actually sent to the Ministry of Finance for approval.³⁴

Furthermore, the ratio of extrabudgetary revenue to budgetary revenue has become much too high, rising from 31 percent in 1978 to 97.7 percent in 1992 (see table 3). The rapid expansion of extra-

³¹Ho Guoqiang, *Dangdai Zhongguo difang zhengfu* (The contemporary local governments in China) (Guangzhou: Guangdong gaodeng jiaoyu chubanshe, 1994), 213.

³²Xu, *Caizheng shuishou caiwu kuaiji shiyong congshu*, 195-96.

³³In mainland China's planned economy, the planning commission has established programs for economic development in governments at all levels. Take the State Council, for example: the State Planning Commission is in a position to construct development programs for all ministries, commissions, and state-owned enterprises. The relationship between local planning commissions and local departments is similar to that on the central level.

³⁴Wu Junpei, "On Taxation Readjustment," in *Zouxiang xin shiji* (Walk toward a new era), vol. 2 (Beijing: Jingji kexue chubanshe, 1993), 405.

budgetary revenue has manifested itself in the following phenomena: some local governments have intercepted financial resources meant to be delivered to higher-level governments, wantonly converted budgetary items into extrabudgetary ones, collected extrabudgetary funds, and included the management of large-scale and profitable enterprises in the extrabudgetary sphere.³⁵ In some places, local governments and enterprises have collaborated with each other to deceive the central government in procuring extrabudgetary revenue.

In 1993, state-owned enterprises were no longer allowed to keep extrabudgetary revenue. As a result, the total amount of extrabudgetary revenue dropped by 62.8 percent (or 242.2 billion *yuan*) to only 143.3 billion *yuan*. Nevertheless, local financial and enterprise units' extrabudgetary revenue increased slightly in 1993 as they appropriated some of the funds which originally belonged to state-owned enterprises and their responsible institutions. The extrabudgetary revenue of local financial units in 1993 was 11.47 billion *yuan*, occupying 8 percent of total extrabudgetary funds, while that of enterprise units accounted for 131.78 billion *yuan*, or 92 percent of the total (see table 1). Also noteworthy is that the ratio of central government extrabudgetary revenue to national extrabudgetary revenue dropped from 44.3 percent in 1992 to 17.2 percent in 1993, while the ratio of local government extrabudgetary revenue rose from 55.7 percent to 82.8 percent in the same period (see table 4).

If state-owned enterprises had returned their extrabudgetary funds to the institutions they belonged to as was requested in 1993, the state's total amount of extrabudgetary funds would not have been dropped so remarkably. State-owned enterprises have probably retained a formidable amount of extrabudgetary funds, but since they would suffer serious losses if they did not turn over their extrabudgetary funds to central-level financial departments, they have probably transferred their funds to local enterprise administrative units.

In fact, it is impossible to ascertain the financial capabilities of the central and local governments merely from their circulation and deployment of extrabudgetary funds, as the latter have not been under strict control, and some local governments have not faithfully reported the sums of their funds. In most cases, local governments have controlled extrabudgetary funds at the expense of the central

³⁵Ibid., 413-16.

government. For example, because of local government support for processing industries since the 1980s, about 80 percent of the extra-budgetary funds have been used for promoting those industries, with only 20 percent left for developing basic industries and infrastructure construction. In addition, local governments have pressed authorized banks to release money to enterprises so they can cover nonproductive expenses, such as bonus and welfare funds.³⁶

Conclusion

To meet the need of economic development following the initiation of reform and opening-up policies, mainland China has begun to focus on legalization and adopting a taxation system. In the process of building this system, the central government has played a dominant role. Since the enforcement of the tax distribution system in 1994, the central government's financial power has been greatly enhanced while economic localism has been curbed somewhat.

Taking advantage of areas where the legal system is not well-established, local governments have grabbed financial resources by diverting budgetary funds into extrabudgetary ones and aided enterprises by offering them tax exemptions. Efforts have now been taken to strengthen regulation on extrabudgetary funds, and state-owned enterprises have been deprived of their right to possess such funds. Faced with this concentration of financial power, collaborations between local governments and enterprises for their own economic profits have been inevitable.

³⁶In 1985-87, state-owned enterprises used 75 percent of their extrabudgetary funds to pay awards to their staffs; this portion of expenditures rose at an annual rate of 34.3 percent. See Gao Xiang, *Zhongguo zijin guanli tizhi de gaige* (Reform of China's capital administration system) (Beijing: Zhongguo jinrong chubanshe, 1991).