

## **CHAPTER 6. CONCLUDING REMARKS AND POLICY**

### **IMPLICATIONS**

#### **6.1 Concluding Remarks**

The primary purpose of this study is to look into whether the degree of fiscal decentralization is able to significantly affect the tax effort of the local government. By using the provincial-level panel data of China's 31 regions for the period from 1996 to 2004 to estimate four specifications of the two-way fixed-effects model, the primary finding of this study is that the degree of fiscal decentralization has a positive and significant impact on the local government's tax effort at a 1% significance level in all model specifications. Although previous studies could not link fiscal decentralization to have a significant influence on the tax effort, this study supports the existence of this influence in the case of China and further supports the assertion of Oates (1972).

With respect to the other independent variables, it is found that industrial structure plays an important role in a region's tax effort. An increase in a region's industrial share could improve its tax effort. This conclusion is consistent with the findings of Piancastell (2001). However, this study cannot find a consistent conclusion regarding the influence of per capita GRP on the tax effort or a significant influence of openness on the tax effort.

Yunan obviously has the highest level of tax effort. Moreover, Shandong, Henan and Hunan have lower region-specificity and a negative effect. In addition, the time-specific effects on tax effort are gradually improving, thus the China authority could use the positive attitude to observe the issue.

Finally, several tests have been conducted to ascertain whether the empirical

results can provide accurate conclusions. Based upon some tests for econometric issues, such as model misspecification and multicollinearity, it is implied that conclusions provided by this study are reliable.

## **6.2 Policy Implications**

While China has achieved remarkable economic growth over the past 25 years, the economic disparity among regions has become a serious problem in China. As indicated by Huang, Kuo, and Kao (2003), the level of inequality in China's regional economies clearly exhibited a slight upward trend after 1991. In order to mitigate the unequal development among China's regional economies, each region must stimulate its economic development. However, the issue of an inadequate fiscal budget seems to be a common obstacle to economic development in all regions of China. Therefore, how to improve a region's tax effort has become a crucial factor affecting each region's economic development.

In this study, it is suggested that fiscal decentralization could improve a region's tax effort. If the central government of China would like to mitigate the economic gap among regions, it could bring about a higher degree of fiscal decentralization to those regions that are less economically developed, and further improve those regions' tax efforts. With larger tax budgets, regions that are less economically developed could have better economic performance. The other factor in terms of determining the degree of tax effort is the level of industrial structure. If a poorly developed region could have a proper industrial policy to adjust its industrial structure, its tax effort could be improved in the following year and would further result in better economic performance.

Hence, this study suggests that with a view of eliminating the unequal economic

development among regions, China's government could use the policy of fiscal decentralization and help regions to design their industrial policies. Once less developed regions have a higher degree of fiscal decentralization and a higher level of industrial structure, the serious problem of economic disparity among regions in China could eventually be mitigated.

Moreover, a higher tax effort will motivate the growth of economic development. The provincial government could raise the tax effort to obtain more tax revenue to construct better infrastructure and other equipment for economic development. The provinces which have a higher tax effort will offer an optimistic economic future for businesses who are interested in investing in these regions. Businesses in general and especially Taiwanese businessmen could adopt the recommendations of this study as references for prudent investments.

