

Implementation of Profit Remission in Guangzhou, 1983-95: Effects of Policy Regime and Revenue Incentive

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This article seeks to explain the success of China's 1994 tax-assignment reform in bringing about recentralization of fiscal power. Most of the current analyses invoke the static policy rules only; the argument of this research is that much more attention ought to be paid to the dynamic implementation at the local level. To this end, this article explains the implementation of the policy of profit remission from state-owned enterprises (SOEs)—a key issue area of tax policy in China—from 1983 to 1993 and from 1994 to 1995 in the city of Guangzhou in Guangdong Province. This paper shows that Guangzhou's actual implementation turned out to be much less effective at deflecting revenue away from the center from 1994 to 1995 than from 1983 to 1993, a fact which highlights the importance of implementation for understanding the outcome of recentralization after 1994. Empirical analysis also shows that the major factor contributing to the changing implementation pattern was the transformation of policy regime, which overrode the competing factor of revenue incentive.

KEYWORDS: tax-assignment reform; fiscal recentralization; profit remission; policy regime; revenue incentive.

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In the study of contemporary China's central-local fiscal relations, there has been a sweeping consensus that the 1994 fiscal reform of the tax-assignment system (分稅制, *fenshui zhi*; hereafter FSZ) has ushered in a new dynamic in recentralization.¹ The FSZ has redefined the scope of institutionalized fiscal claims by the center and provinces, reversing the thrust of the center's decentralization of fiscal power to the provinces from 1979 through 1993. Recentralization lies in the conspicuous growth of the center's share relative to the provinces' share in total budgetary revenues since the FSZ took effect.

According to these same studies, the predominant—if not the only—explanation for the success of the FSZ in fiscal recentralization lies in the FSZ's institutional design, which generated a particular set of policy rules aimed at recentralization. This article argues, however, that instead of only examining the FSZ's static policy rules, we ought to pay much more attention to the dynamic implementation at the local level. Such a focus will help us better understand why recentralization has indeed taken place as intended by the policy. Accordingly, the puzzle to be explored in this article is this: how and why did local implementation differ in the periods before and after the adoption of the FSZ, such that the local diversion of revenue away from the center has actually waned over time?

¹For academic analyses, see, for instance, Shaoguang Wang, "China's 1994 Fiscal Reform: An Initial Assessment," *Asian Survey* 37, no. 9 (1997): 801-3; Hu Angang, "A Tough Job of Institutional Innovation: Preliminary Evaluation of the Tax Assignment Reform," *Dongya jikan* (East Asia Quarterly) (Taipei) 28, no. 1 (1997): 31-38; Jae Ho Chung, "Beijing Confronting the Provinces: The 1994 Tax-Sharing Reform and Its Implications for Central-Provincial Relations in China," *China Information* 9, no. 2/3 (1994-95): 1-6; Christine P. W. Wong, "Overview of Issues in Local Public Finance in the PRC," in *Financing Local Government in the People's Republic of China*, ed. Christine P. W. Wong (Hong Kong: Oxford University Press, 1997), 35-60; Roy W. Bahl, *Fiscal Policy in China: Taxation and Intergovernmental Fiscal Relations* (Ann Arbor: University of Michigan Press, 1999), 6-9; and Le-Yin Zhang, "Chinese Central-Local Fiscal Relationships, Budgetary Decline, and the Impact of the 1994 Fiscal Reform: An Evaluation," *The China Quarterly*, no. 157 (1999): 122-24. For the perspectives held by policy practitioners, see Xiang Huaicheng, *Zhongguo caizheng guanli* (Fiscal management in China) (Beijing: Zhongguo caizheng jingji chubanshe, 2001), 233-38; and Institute of Fiscal Science, Ministry of Finance, *Caijing gaige yanjiu baogao* (Research report on fiscal and economic reforms) (Beijing: Jingji kexue chubanshe, 1999), 279-82.

This article attempts to answer this question by first describing and then explaining the divergence in policy implementation between the two periods. The policy issue that this research focuses on is profit remission from state-owned enterprises (SOEs)—a key issue area of revenue extraction in China²—from 1983 to 1993 and from 1994 to 1995. The city chosen for investigation is Guangzhou (廣州市), in Guangdong Province (廣東省), a region where policy implementation has typically deviated from policy rules during the reform era.³ The information supporting the empirical analysis in this article is drawn both from documentary sources and intensive interviews. The interviews were conducted in China from May through October 1995, with interviewees including economic officials as well as managers and administrators from SOEs in Beijing (北京) and Guangzhou.

This paper is organized as follows. Section one discusses the nature of the recentralization after the FSZ and why the static policy rules are insufficient to explain its occurrence. Section two defines the concept and identifies the hypothesized effects of policy regime and revenue incentive, both of which affect Guangzhou's implementation in opposite ways. Section three delineates Guangzhou's implementation of tax-for-profit (利改稅, *ligaishui*; hereafter LGS) policy from 1983 to 1985, showing how the locality departed from policy in its zero-sum fiscal interaction with the center. Section four depicts how—under the contract management responsibility system (CMRS, 承包責任制)—Guangzhou continued deviating from policy rules from 1987 to 1993, and ends with a summary of the empirical account in sections three and four by highlighting the substantial impact of policy regime—rather than revenue incentive—on Guangzhou's implementation. Section five scrutinizes Guangzhou's im-

²SOEs' profit remission to the state in China has consistently made the largest contribution to *direct* tax revenue (i.e., excluding the indirect tax revenue such as turnover taxes) in China's reform era, and has been the key determinant of SOEs' net profits.

³Yang Xiaohui, "Shengji zhengfu de zizhu xingwei: Kaifang gaige shiqi de Guangdong zhengfu" (Autonomous behavior of the provincial government: The Guangdong government during the period of reform and opening) (M.A. thesis, Department of Government and Public Administration, Chinese University of Hong Kong, 1990).

plementation under the FSZ, in which the defiance of policy rules became much milder. A final section concludes by suggesting the power of implementation to dictate the outcome of policies of revenue extraction. This conclusion also offers an explanation of Guangzhou's diminished defiance to centrally crafted policies by pointing out the preponderance of policy regime over revenue incentive in their relative influence on local implementation.

Fiscal Recentralization After 1994

As suggested above, fiscal recentralization refers to the growth in the center's share in budgetary revenues relative to that of provinces. As table 1 demonstrates, this relative share before the FSZ stood in sharp contrast to that after it. The center's share chronically declined from 30 to 40 percent during the 1980s to 22 to 30 percent from 1991 to 1993; yet since 1994 the share has remained steady at around 50 percent, the equivalent of the local governments' share. In light of these figures, the FSZ's fiscal recentralization seems indisputable.

By concentrating on the role of the FSZ's policy design to explain the fiscal recentralization, the current literature stresses the core set of the FSZ's institutional rules that differentiate between central, local, and shared revenues. Such institutional differentiation has revoked the system of central-provincial fiscal contracting that was based on periodic negotiation before 1994. In effect, this institutional differentiation is a mechanism for re-designating the various revenue categories above to the respective coffers of the center and provinces. Through such re-designation, the FSZ bestows the central state with a stable, long-term entitlement to the lion's share of the nation's overall fiscal revenues, including especially the value-added tax (VAT). Table 2 reveals the vitality of VAT in China's national revenues. From 1997 to 2000, proceeds from VAT had been the largest source of revenue, accounting for 39.86 percent, 39.17 percent, 36.33 percent, and 36.19 percent of the overall national revenue each year respectively. Under the FSZ, the center and provinces share 75 percent and 25

Table 1

The Relative Shares of China's Central and Local Governments in the Country's Total Budgetary Revenue, 1979-2000 (in 100 million yuan)

Year	Total budgetary revenue	Central government revenue	Local government revenue	Central government share (%)	Local government share (%)
1979	1,146.38	231.34	915.04	20.2	79.8
1980	1,159.93	284.45	875.48	24.5	75.5
1981	1,175.79	311.07	864.72	26.5	73.5
1982	1,212.33	346.84	865.49	28.6	71.4
1983	1,366.95	490.01	876.94	35.8	64.2
1984	1,642.86	665.47	977.39	40.5	59.5
1985	2,004.82	769.63	1,235.19	38.4	61.6
1986	2,122.01	778.42	1,343.59	36.7	63.3
1987	2,199.35	736.29	1,463.06	33.5	66.5
1988	2,357.24	774.76	1,582.48	32.9	67.1
1989	2,664.90	822.52	1,842.38	30.9	69.1
1990	2,937.10	992.42	1,944.68	33.8	66.2
1991	3,149.48	938.25	2,211.23	29.8	70.2
1992	3,483.37	979.51	2,503.86	28.1	71.9
1993	4,348.95	957.51	3,391.44	22.0	78.0
1994	5,218.10	2,906.50	2,311.60	55.7	44.3
1995	6,242.20	3,256.62	2,985.58	52.2	47.8
1996	7,407.99	3,661.07	3,746.92	49.4	50.6
1997	8,651.14	4,226.92	4,424.22	48.9	51.1
1998	9,875.95	4,892.00	4,983.95	49.5	50.5
1999	11,444.08	5,849.21	5,594.87	51.1	48.9
2000	13,395.23	6,989.17	6,406.06	52.2	47.8

Source: *Zhongguo tongji nianjian 2001* (China statistical yearbook 2001) (Beijing: Zhongguo tongji chubanshe, 2001), 257.

percent respectively of the proceeds from VAT. It is thus evident that by employing this mechanism, the policymakers in Beijing had deliberately attempted to achieve fiscal recentralization by re-establishing the institutional rules of revenue allocation in favor of the center.

This explanation of why the FSZ has succeeded may, however, have unduly equated the policy *intention* of the FSZ with its policy *outcome*. In

Table 2
The Composition of China's National Budgetary Revenue, 1997-2000
(in 100 million yuan)

Item	Year			
	2000	1999	1998	1997
Consumption Tax (CT)	858.29	820.66	814.93	678.70
Value-Added Tax (VAT)	4,553.17	3,881.87	3,628.46	3,283.92
Business Tax (BT)	1,868.78	1,668.56	1,575.08	1,324.27
CT & VAT on Imports	1,491.70	1,015.62	555.51	507.50
Urban Maintenance & Construction Tax (UMCT)	352.25	315.20	294.93	271.97
Enterprise Income Tax (EIT)	1,662.02	1,216.13	925.54	890.03
Personal Income Tax (PIT)	659.64	413.66	—	—
Resource Tax (RT)	63.62	62.86	61.93	56.52
Urban Land Use Tax (ULUT)	64.76	59.06	54.09	44.05
Miscellaneous	317.63	457.49	764.35	626.31
Tariffs	750.48	562.23	313.04	319.49
Fixed Assets Investment Adjustment Taxes	46.28	130.11	107.55	78.37
Agriculture Tax	298.91	294.51	365.44	364.99
Arable Land Occupation Tax	35.32	33.03	33.35	32.49
Contract Tax	131.08	95.96	—	—
Securities Transaction and Stamp Tax	477.58	282.32	204.84	237.28
Tax Refunds to Exporters in Foreign Trade	-1,050.00	-626.69	-436.24	-555.00
Total	12,581.51	10,682.58	9,262.80	8,234.04

Source: *Zhongguo caizheng nianjian* (China fiscal yearbook), 1998-2001 editions (Beijing: Zhongguo tongji chubanshe).

general, policy rules installed during policy formulation and legitimatization are rarely able to guarantee by themselves the full attainment of intended policy goals. The static framework of rules aimed at corresponding objectives must go through the dynamic process of implementation before it can be translated into actual effects in the real world.⁴ The role of policy implementation is especially consequential in the area of revenue extrac-

⁴Daniel A. Mazmanian and Paul A. Sabatier, *Implementation and Public Policy* (Lanham, Md.: University Press of America, 1989), 3-5.

tion in China—where local state implementation of centrally framed policy rules heavily influences the degree of actual extraction. This influence occurs primarily because the central and local states are locked in a zero-sum game over revenue extraction in China. Localities typically seek to keep within the local economies some part of the fiscal revenue that should otherwise be levied during policy implementation and eventually remitted to the center. To maintain control over these funds, local states under-collect taxes, divert revenue intended for the center, and tap these funds as extrabudgetary revenue through various means. By doing so, the provinces are able to fill the gap between their budgetary revenue and aggregate local expenditures.⁵ Estimates hold that the center's loss of budgetary revenue from such central-provincial zero-sum interaction ranged from about 17 to 21 percent of the total collected budgetary revenue between 1990 and 1993,⁶ highlighting the substantial impact of local implementation on the outcome of revenue extraction policy.

The tax assignment scheme of the FSZ has not, however, altered the zero-sum nature of this interaction. A major problem is that, despite the unambiguously defined fiscal claims by the center and provinces, the taxpayers—for their respective revenues—still overlap heavily. For instance, locally owned enterprises (whether nominally state-owned, collective, or joint-stock) are subject to the enterprise income tax (EIT) levied by local governments, and at the same time to VAT, of which the center acquires 75 percent. The under-collected portion of VAT from local enterprises can thus either aggrandize the tax base for EIT or accrue to local states' extrabudgetary revenue—both at the expense of the center. The incentive structure for local states, therefore, remains unchanged from the period before 1994. Acting in a rational manner by seeking to maximize their own fiscal revenues, local states have implemented the policy of

⁵Christine P. W. Wong, Christopher Heady, and Wing Thyee Woo, *Fiscal Management and Economic Reform in the People's Republic of China* (Hong Kong: Oxford University Press, 1995), 96; and Ma Jun, *Intergovernmental Relations and Economic Management in China* (New York: St. Martin's Press, 1997), 16.

⁶Jia Shaohua, *Zhongguo shuishou liushi wenti yanjiu* (A study of the problem of tax loss in China) (Beijing: Zhongguo caizheng jingji chubanshe, 2002), 63.

revenue extraction with the same incentive—to divert revenue away from the center—both before and after the adoption of the FSZ. The reasoning above calls our attention to the divergence in policy implementation before and after 1994, beyond the change in policy rules, to better explain the fiscal recentralization.

Effects of Policy Regime and Revenue Incentive on Local Implementation

To account for the divergence in implementation, the analytical focus will be placed on two factors—*policy regime* and *revenue incentive*—that compete and generate diametrically opposite causal effects on local implementation of SOE profit remission.

It is helpful first to define "policy regime." A policy regime refers to the aggregate of all formal and informal regulations and institutions governing the rights and obligations of relevant public and private actors, the authority relations between them, and the operational codes and procedures for putting policy rules into effect. The regulations and institutions—while relevant to the policy issue in question—may or may not aim to address the implementation of the issue itself as their prime focus; they often inform the overall structure of central-local policy interactions as a whole. By delimiting the range of feasible instruments, actions, and tactics, policy regime in essence refers to the "means" for local state implementation; it thus has to be distinguished from centrally imposed policy rules, which are "ends" in themselves. "Revenue incentive," on the other hand, denotes the degree to which a local state is motivated to maximize its available fiscal revenue in policy implementation.

The actual implementation of SOE profit remission by local states is subject to the influence of both policy regime and revenue incentive at the same time. As revealed in the following elaboration, the changes in policy regime after the adoption of the FSZ favor greater local compliance with centrally framed policy rules; conversely, changes in revenue incentive after the creation of the FSZ encourage more local deviation from the rules.

It is the preponderance of policy regime over revenue incentive, as shown in the subsequent empirical account of implementation in Guangzhou, that explains why local implementation since 1994 has become more conforming to the center's policy objective. This growing local conformity helps achieve the center's goal of fiscal recentralization.

Policy Regime

Having conceptualized policy regime above, let us examine the scope and causal logic of this variable in its effects on Guangzhou's implementation. Beginning with "profit remission" in the policy regime, the profit of SOEs is the portion left over from the net sales income after paying turnover taxes (留轉稅, *liuzhuan shui*). Accordingly, profit remission is the Chinese equivalent of corporate income tax in capitalist economies. China's national policy regime for SOE profit remission to the state in the reform era has undergone three distinct stages during the periods under scrutiny here: the LGS scheme from 1983 to 1986, the CMRS from 1987 to 1993, and the FSZ scheme from 1994 until now. Under the LGS scheme, large and medium-sized state industrial enterprises were to pay the SOE income tax (SOEIT) at a uniform rate of 55 percent on realized profits,⁷ and small enterprises were subject to a progressive rate scale.⁸ Furthermore, for a selective pool of roughly ten thousand highly profitable large and medium-sized SOEs (mostly in coastal cities), the SOE income adjustment tax (SOEIAT) was levied on profits after payment of SOEIT.⁹ Under the CMRS, the key parameters of SOE profit remittance—such as the baseline amount of profit (利潤基數, *lirun jishu*), the sharing ratio above the baseline level (which was roughly equivalent to the SOEIT rate under the LGS),

⁷"Provisional Regulations on the Tax-for-Profit Scheme for State-Owned Enterprises" (hereafter LGS Regulations), promulgated by the Ministry of Finance in March 1983.

⁸Contingent on a small SOE's annual income, it was subject to one of eight levels of income tax rate: 7 percent, 10 percent, 20 percent, 30 percent, 35 percent, 40 percent, 50 percent, and 55 percent.

⁹The SOEIAT was institutionalized in the Ministry of Finance's "Report on Implementing the Second Stage of Tax-for-Profit in State-Owned Enterprises," issued on August 10, 1984, and approved by the State Council on September 18, 1984.

the annual progressive rate, the flat level of subsidy, etc.—were all determined primarily through one-on-one bargaining between SOEs and supervisory agencies. Under the FSZ scheme, a uniform rate of 33 percent applies to the profits earned by over 95 percent of all forms of domestic enterprises (such as state-owned, collective, private, stockholding, and the like).¹⁰

Beyond these policy rules directly governing profit remission, however, the elements of policy regime that most shaped Guangzhou's implementation were those regulations and institutions that did not bear specifically on the policy. These elements can be divided into two groups, according to the aspect of implementation with which they are associated.

Group One: The first included those aspects impinging on major policy rules, such as reduction or exemption of SOE remittance, and the full or partial execution, or rejection, of the aforementioned schemes for profit remission. For instance, Central Document No. 27 in 1981 (hereafter CD [81] No. 27) granted Guangdong the exclusive privilege to waive taxes and reduce profit remittances for those enterprises suffering inadequate funds for capital construction.¹¹ More importantly, the province had been repeatedly encouraged by the center via both personal and organizational channels to implement policies in unique and flexible ways that released localities from planned control and facilitated the reform program. The flexible implementation could be as bold as to confront centrally crafted policies "head-on" (頂, *ding*).¹² Such personal and organizational support was codified in Document No. 5 issued by the General Office of the CCP

¹⁰Provisional Regulations on the Enterprise Income Tax of the People's Republic of China" (hereafter Regulations on EIT), promulgated by the State Council on December 13, 1993.

¹¹Liao Bowei et al., *Zhongguo gaige kaifang yu Zhujiang Sanjiaozhou de jingji fazhan* (China's reform and opening and the economic development of the Pearl River Delta) (Hong Kong: Nanyang Commercial Bank, 1992), 19-81, 100-114; and Peter Tsan-yin Cheung, "The Case of Guangdong in Central-Local Relations," in *Changing Central-Local Relations in China*, ed. Jia Hao and Lin Zhimin (Boulder, Colo.: Westview, 1994), 213-29.

¹²Wang Zhuo and Wen Wuhan, *Guangdong gaige kaifang pingshuo* (Evaluation and delineation of Guangdong's reform and opening) (Guangzhou: Guangdong renmin chubanshe, 1992), 397.

Central Committee (中共中央辦公廳, *Zhonggong zhongyang bangongting*) in 1981.

Group Two: The second group included those aspects impinging on minor or ancillary rules, chiefly revolving around the definition or composition of the parameters that determined SOE profits. Regarding the size of the wage bill and bonuses in SOEs—key elements that make up production costs, CD [79] No. 50 and State Council Correspondence (國務院通報, *Guowuyuan tongbao*) No. 25 in 1988 allowed SOEs in Guangdong, for example, to bypass the national restrictions on both the size and annual increase relative to productivity growth.

In addition, in administering SOE remission of profits and taxes, Central Document No. 41 in 1980 authorized Guangdong to keep SOE depreciation funds—another key element of production costs—at the local level, instead of having to remit them upward.¹³ Furthermore, the repayments of principal on bank loans prior to remission of profits or turnover taxes (稅前還貸, *shuiqian huandai*) also affected the size of profits. This pervasive conduct by enterprises everywhere in the PRC was an anomaly of the country's accounting practice, and was not strictly prohibited by the center until the 1994 FSZ reform. In other countries, repayments of interest—but not of principal—are deductible before enterprise income tax, since principal repayments are not a legal business expense. Another problem stemmed from the fact that plenty of bank loans were used to finance infrastructure investment and technological upgrading, as were depreciation allowances which comprised part of production costs. So long as both principal repayments and depreciation allowances were deductible from pre-tax profits, there was a double counting of loan-financed investment costs. Since this double counting eroded the taxable income of SOEs, a big portion of the cost of bank loans was unduly absorbed by the state in the form of less revenue from profit remittance.

As a final category of this second group, the policy regime also included other decrees that nurtured enterprise reform by broadening their

¹³Cheung, "The Case of Guangdong in Central-Local Relations," 213-29.

rights regarding the disposal of their own financial assets. A cornerstone document among these decrees was the "Provisional Regulations on Further Expansion of the Autonomy of State Industrial Enterprises," which was promulgated by the State Council in May 1984. Stipulating ten areas in which SOE autonomy was to be expanded, these regulations were thus usually referred to as the "Ten Articles on Expanded Autonomy" (擴權十條, *Kuoquan shitia*). The document was also the PRC's first administrative regulations issued by the State Council to enumerate a full range of rights accorded to SOEs. The "Ten Articles" used generalized clauses and wording to outline the financial autonomy of SOEs, often without explicating the relationship of these newly articulated rights to national tax policies. Thus, this decree created a gray area where the legal boundaries between the new lenient provisions—provisions regarding firms' profit retention and the firms' obligations from tax levies—were not clearly delimited.

The components in these two groups above were what differentiated the policy regimes on SOE profit remission before and after 1994. During the LGS and CMRS stages before 1994, these components remained active and thereby widened the range of options for Guangzhou to implement the policy in question. Conversely, the 1994 FSZ reform removed these components from the policy regime. First, all locally-authorized tax concessions granted before 1994 were required to be reported to and reconfirmed by the Ministry of Finance, and were allowed to remain in effect until the end of 1995 at the latest, according to Document No. 6 of 1994 issued by the State Council.¹⁴ This measure in effect annulled CD [81] No. 27 altogether, and partially overturned CD [81] No. 5. Second, in the aftermath of the center's 1993 crackdown on financial and taxation malfeasance, both the State Council and the CCP Central Committee in 1994 issued formal decrees to reiterate their resolve to proceed with the crackdown. Given that this gesture immediately preceded the inception of the

¹⁴Zhang Xihong and Chen Zuhuang, "Wosheng shishi xinshuizhi zhong yudao de jige wenti" (Several problems confronting our province in the implementation of the new tax system), *Guangdong caizheng* (Public Finance in Guangdong), no. 111 (1994): 26.

FSZ, local cadres felt that the timing of this crackdown was unequivocally intended to fortify the authoritativeness of the new FSZ tax laws, and it thereby minimized local defiance to the new policy.¹⁵ The center was not so proactive during the adoption of either the LGS or CMRS reforms.

Third, the single EIT rate for the overwhelming majority of SOEs in the nation simply did not leave the local states with much room to maneuver—a situation different from the cases of the LGS and CMRS. Local states' discretion over local SOE remission rate was only one of many integral elements of the LGS (the SOEIT under the LGS) but lay at the core of the CMRS. Given the meticulous provisions on conditions as well as procedures for various tax exemptions and reductions specified by the FSZ and accompanying central decrees, it was now much harder for localities to continue to carry out and justify their measures for direct tax relief. Finally, the ancillary policy rules of the FSZ's EIT scheme—including those on scope of costs, depreciation allowance, and the priority of loan repayment—are now much more rigorously formulated. For instance, the Regulations on EIT codify in specific terms a number of deductible items from taxable enterprise income that were either not mentioned at all or not clearly defined in tax laws under the LGS and CMRS. Chief among such items is the repayment of interest on loans from financial institutions, regardless of whether the loans are to finance fixed asset investment before or after the investment projects are finished. This also applies to the rent paid on any fixed assets leased by SOEs for production purposes. In addition, the deductibles include various elements of the wage bill—such as basic salaries, floating wages, in-kind subsidies, and bonuses. Also deductible is employee income which SOEs draw into pension or unemployment funds to remit to the state. Hence there exists no ambiguity in defining what is and what is not deductible from the tax base of EIT. As a result, all the previously authorized discretion that local states held over the application of related ancillary policy rules—such as the prerogatives of Guangdong mentioned above—has been annulled. This comparison,

¹⁵Interviews #9502-0106, #9502-0111, #9504-0103, #9504-0109.

therefore, leads to the hypothesis that the policy regime since 1994 for SOE profit remission has imposed greater constraints on the ability of local states to defy policy rules during implementation, and has thereby led to greater compliance.

Revenue Incentive

Now we turn to the causal effect of Guangzhou's revenue incentive. Local states seek to maximize their fiscal revenues. The more such revenues local states can claim based on the formal institutional rules of revenue allocation, the less they are motivated to implement the fiscal policy in ways that increase their revenue share at the expense of the center. Table 1 demonstrates that subnational governments have achieved a much smaller share in the country's overall budgetary revenue since FSZ reform began in 1994. A hypothesis can be derived from table 1: the change in revenue incentive since 1994 has encouraged local states to both more aggressively deflect revenue away from the center, and deviate farther from policy rules. Thus, in terms of influencing local implementation, the hypothesized effect of revenue incentive runs counter to the hypothesized effect of policy regime.

Two reasons justify the premise that the revenue incentive effect took place concurrently with the application of the FSZ. First, the shift in the central-local distribution pattern in table 1 should have been predictable even prior to 1994; this is because the designation or sharing ratios of all revenue categories had been a transparent piece of information available to all provinces in their discussions and negotiations with the center over the FSZ. It follows that from the very beginning of 1994, local governments—including that of Guangzhou—were well aware of and thus driven by the implications for revenue distribution of the FSZ in the implementation of SOE profit remission. Second, the local states soon became aware of the expected shift in the distribution pattern, understandably no later than the end of 1994, when they released their first annual local fiscal profile after the adoption of the FSZ. This fact further legitimizes the inference that revenue incentive was a key factor in shaping local implementation in 1994 and 1995.

The Period of LGS Reform (1983-85)

Guangzhou's implementation displayed two salient features during this period. First, Guangzhou was able to avoid implementing the LGS—which favored the center rather than localities in terms of fiscal revenue, compared to the previous profit-retention scheme—selectively for some of its SOEs, without opposition and interference from the center. Second, while applying the LGS to the other SOEs, Guangzhou became increasingly recalcitrant toward the center's policy goal; Guangzhou first challenged ancillary policy rules only, by deflating the tax base for SOEIT and SOEIAT, and afterwards departed from major policy rules by altering the effective tax rate.

Resistance to the LGS in 1983

During the first stage of the LGS, the most distinctive aspect of implementation in Guangzhou was the continued application of profit retention, which was supposed to be phased out as soon as the LGS took effect. Contrary to the will of the center, Guangzhou introduced the standardized SOEIT only to some SOEs.¹⁶ For instance, the largest heavy machinery SOE under the Guangzhou Mechanical and Electrical Industry Bureau reported a net profit increase of 7.19 percent in 1982 and 7.88 percent in 1983, well above the respective averages for all SOEs in the city. Yet the city acquiesced to this firm retaining a *de facto* profit retention mechanism until 1986, instead of requiring it to immediately switch to the LGS mechanism.¹⁷ Given the financial strain on their SOEs, other industrial hubs in the nation had to justify their selective rejection of the LGS, and gain the center's permission for the rejection, in order to avoid the higher profit remission rate. Despite having relatively vibrant SOEs, Guangzhou still rejected the LGS for selected firms, however, without obtaining the re-

¹⁶Guangdong was the only coastal province where some SOEs continued with profit retention and resisted the LGS without the center's approval. See Susan Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993), 284.

¹⁷Interviews #9504-0207, #9504-0208.

quired approval from the center; the center, moreover, raised no objection to Guangzhou's behavior *ex post facto*.

However, even where Guangzhou did employ LGS practices in 1983, the implementation was not without aberration. To broaden the scope of SOE accounting profits as the tax base for profit remittance, in 1983 the Ministry of Finance required all SOEs following the LGS to restrict their workers' welfare fund to below 11 percent of the total wage bill as part of their accounting costs. This ceiling had previously been a more permissive 25 percent. The portion of this fund in excess of this ceiling had to be financed by the post-tax retained profits of SOEs, rather than being counted as part of the cost.¹⁸ Yet at least two major local SOEs were found to have violated this rule; the first one specialized in producing broadcast-related machinery and equipment, and the second in producing ferrous alloys. Both of these two SOEs maintained the former 25 percent ceiling without being ordered to lower the level either by their supervisory industrial bureaus or by the city's fiscal department.¹⁹ Notably, both plants were running with little or zero profit. The first enterprise operated at a loss of 0.42 and 6.34 million *yuan* in 1981 and 1982, respectively, and barely turned a profit—some 2.5 million *yuan*—in 1983. The second enterprise racked up losses totaling 2.93 million *yuan* from 1980 to 1982, and managed to break even after the second quarter of 1983. The fact that such mediocre firms were still able to dispense welfare funds at the relatively generous 25 percent level adds to the credibility of one interviewee's remark that other more dynamic firms under the same industrial bureau as his plant also were sticking to the 25 percent ceiling.²⁰ Likewise, considering the relatively low profitability of the industrial sectors which the above two SOEs belonged to, it could be reasonably inferred that the 25 percent

¹⁸*Guangzhou jingji nianjian 1983* (Guangzhou economic yearbook 1983) (Guangzhou: Guangzhou nianjian chubanshe, 1984), 373.

¹⁹Interviews #9504-0211, #9504-0215. Interestingly, the interviewees did not appear to deem this privilege as a serious transgression of the LGS regulations. This might be partly because it was not a treatment unique to them, and partly because it was rooted in some official, though supposedly expired, regulations.

²⁰Interview #9504-0215.

ceiling likely prevailed during the same period in the SOEs of most industrial sectors throughout the city.²¹

There was indeed an institutional justification for the firm to bypass the requirement regarding the composition of accounting costs, an ancillary policy rule of the LGS. The institutional root was Guangdong's autonomy in deciding on wages and bonuses *per se*, which CD [79] No. 50 had authorized (as elaborated earlier). In defense of this practice, the province's party committee even argued boldly in *Nanfang ribao* (南方日報, Southern Daily)—the newspaper serving as its mouthpiece—that as long as tangible economic benefits accrued to the state, the firms, or the people, local governments ought to be free to be flexible in regard to implementing this ancillary policy rule. The party committee asserted that such freedom should be allowed even if the practice contravened the center's statutes, regulations, or documents.²²

Tinkering with Ancillary Policy Rules in 1984

During the second stage of the LGS in 1984, Guangzhou continued to tinker with the ancillary rules of the LGS related to SOE profit remission. This activity occurred against the backdrop of the aforementioned "Ten Articles on Expanded Autonomy." Invoking the regulation, in June 1984 Guangzhou picked out ninety-one SOEs, all owned by the province or the city, to try out the newly ensured autonomy. In doing so, the city underlined the SOE rights to utilize enterprise funds and wages/bonuses. For instance, on top of their already high retention rate of 1983, a selected pool of SOEs were able to retain additional profits: fifty-one industrial SOEs were allowed to keep an additional 6 to 8 percent, and eight commercial SOEs were granted an extra 4 to 5 percent.²³

²¹In the 1982 figures in Guangzhou, the respective industries of the two SOEs—the machinery and metallurgical industries—generated on average 26.07 *yuan* and 23.03 *yuan* of tax and profit for each 100 *yuan* of fixed assets. Accordingly, they ranked 11th and 12th, respectively, among the fifteen industrial sectors in this regard. Hence, the firms in all the ten leading industrial sectors had at least the stronger financial prowess to afford the more generous 25-percent level concerning welfare fund.

²²Yang, "Shengji zhengfu de zizhu xingwei," 79.

²³*Guangzhou jingji nianjian* 1985, 329.

By the same token, most of the city-owned industrial SOEs were to draw 2 to 3 percent of total sales before profit remission as their technological development fund.²⁴ Moreover, by pleading the need to accelerate technological renovation, Guangzhou raised the standardized depreciation rate for SOE fixed assets by 1 percent only for city-owned SOEs; this practice took place without approval from agencies above Guangdong Province.²⁵ Since the higher rate would by definition enlarge the SOE depreciation allowance in their accounting costs, in effect it shrank their net income as the tax base for both SOEIT and SOEIAT. Given that the above measures all shrunk revenue, they could reasonably be conceived as an exertion of Guangdong's prerogative on tax exemption authorized by CD [81] No. 27.

More Aggressiveness in 1985

Having encountered no interference from the center with the city's deviations in 1983 and 1984, Guangzhou in 1985 defied not only the ancillary but also the major policy rules of the LGS. First, the city enlarged the scope and magnitude of the bonus given to SOE workers for conserving raw materials. Second, all the city-owned industrial SOEs were to draw 1 percent, and commercial SOEs 0.5 percent, of total sales before profit remission as a managers fund, in order to motivate more efficient management.²⁶ Just like the practices used since 1983, both measures in effect undercut the tax base of net profits for both SOEIT and SOEIAT. Third, the Guangzhou Fiscal Bureau decided that three industries with relatively low profits—the packaging, printing, and herbal medicine processing industries—would be totally exempt from SOEIAT until 1987. In addition, the first two industries would pay SOEIT at a reduced rate of 35 percent.²⁷

²⁴Excepting the most lucrative twenty-nine firms manufacturing electronic products. See *Guangzhou jingji nianjian* 1985, 330.

²⁵Interviews #9504-0109, #9504-0110, #9504-0202, #9504-0208, #9504-0211.

²⁶*Guangzhou jingji nianjian* 1986, 328.

²⁷Interviews #9504-0103, #9504-0104, #9504-0109; Wen Jianhui, "Guangzhou shi yijiu-bawu nian yusuan zhixing qingkuang he yijiubaliu nian yusuan caoan de baogao zhaiyao"

Such direct tax relief amounted to an outright alteration of the direct tax rates on SOEs, a core element of LGS policy rules.

The CMRS Period (1987-93)

To continue the revenue diversion found from 1980 to 1984, Guangzhou remained defiant toward policy rules during the CMRS period. The city was the first in the nation to popularize the CMRS while the LGS remained the legal policy framework. Furthermore, although the post-Tiananmen (天安門) economic rectification launched by the center had forced localities to implement policies with greater conformity from 1989 to 1991, Guangzhou resumed its defiance immediately when the rectification gave way to the renewed momentum of reform and local initiatives in 1992.

Guangzhou as Pioneer of the CMRS Ahead of Policy Legitimization

The CMRS was much more conducive to local states' meddling with the retention of earnings by local SOEs. This is because the CMRS was based on the principle of particularistic bargaining, while the LGS had embodied a nationally standardized approach. In 1987, as profit contracting regained political momentum, the LGS scheme was watered down in some provinces, including Guangdong. In these places the LGS served accounting purposes only, and no longer governed the actual determination of remitted profits. Well before the center codified the CMRS and substituted it for the LGS in 1988, Guangzhou quickly took advantage of the policy vacuum to install, in 1987, the CMRS for both local industrial and commercial firms. By the end of 1987, 1,670 city-owned SOEs supplanted the LGS with the CMRS, attaining a remarkably high popularization rate of

(Excerpt of the report on the implementation of Guangzhou's budget in 1985 and on the draft of Guangzhou's budget in 1986), *Guangzhou caizheng kuaiji* (Public Finance and Accounting in Guangzhou), no. 29 (1986): 3.

94.19 percent. Among these SOEs, 194 were large and medium-sized industrial enterprises which accounted for 91.94 percent of the city's SOEs in this group,²⁸ far above the national average of 70 percent.

In addition to the propagation of the CMRS, Guangzhou further lessened the financial obligations of some SOEs by equating part of their loan repayment with profit remittance. For the financially weak SOEs in selected industries—including printing, paper products, machinery for daily use, heavy machinery, and Chinese medicines—a portion of their profit in excess of the 1986 level was designated as the baseline amount for loan repayment. The ratio of this baseline amount to the excess profits was the same as that of their 1986 loan repayment to their 1986 pre-tax profits. The actual obligation for loan repayment was determined by multiplying this baseline amount with the profit remission rate that applied to the excess profit. Moreover, although the banks claimed the resulting amount of loan repayment, this repayment was to be deducted in full from the profits that the SOEs eventually remitted to the city's fiscal and tax bureaus.²⁹

Revived Challenge to Policy Rules After Post-Tiananmen Economic Rectification

The reform program gained new strength in 1992, outgrowing the center's economic rectification and austerity program that followed the 1989 Tiananmen incident. At this time, Guangzhou resumed its defiance of both major and ancillary policy rules of profit remission. Seeking to relieve the burden of profit remission for high-tech industries, Guangzhou scaled down the remittance target for those local SOEs producing inte-

²⁸Guangzhou jingji nianjian 1988, 288.

²⁹Interviews #9504-0108, #9504-0109, #9504-0202, #9504-0203, #9504-0207. From the varying treatment of two major firms producing Chinese medicines, it seems that enterprises' financial conditions and the size of their outstanding loans were not the only criteria for this deduction. One firm had a ratio of profits and taxes to capital 20 percent less and a debt 130 percent more than the other, but the former was not conferred with this deduction while the latter was. On the other hand, the latter possessed fixed assets worth about three times as much as the former's, indicating that the size of the firm might have made a difference.

grated circuits, computers, computer software, and programmable switches for the telecommunications industry. These SOEs were granted a 50 percent overall reduction in their profit remittance, allegedly to beef up their competitive edge in the domestic market.³⁰

In addition, in February 1993 the Guangzhou Fiscal Bureau decreed a 10 percent reduction in the baseline amount of profit remittance under the CMRS for "all the city-owned industrial state enterprises unable to fulfill their contracted level of baseline profit remittance as a result of changes in the nation's industrial policy."³¹ A Guangzhou Fiscal Bureau document explained that such changes referred to the sectoral shift in the nation's investment priorities away from traditional labor-intensive industries and toward more capital-intensive and high-tech industries. Having been categorized as labor-intensive, the bulk of Guangzhou's SOEs would benefit from this reduction—as long as they managed to show they met its precondition. The restrictive nationwide policies in 1993 on investments and credit supply hit the labor-intensive more than the capital-intensive industries.³² In 1993, therefore, more of such SOEs in Guangzhou were able to claim financial hardship. As a result of the concession in baseline remittance, the overall remission rate of Guangzhou's SOEs in 1993 fell to 44 percent, the lowest point since 1987.³³

The above analysis of Guangzhou's implementation during the LGS and CMRS periods demonstrates explicitly that most, if not all, of the local state's actions could be linked directly to the various components of the policy regime expounded earlier. Guangzhou's implementation tactics

³⁰Li Yaotian, "Fazhan woshi xianjin jishu chanye de wenti yu duice" (Problems and solutions in developing our city's industries of advanced technology), *Guangzhou caizheng kuaiji*, no. 66 (1993): 1-5.

³¹"Several Rules Concerning Further Promotion of Transformation of Management Mechanism for the City's State Industrial Enterprises," issued by the Guangzhou Fiscal Bureau as its Circular No. 4 of 1993.

³²Guo Fuchu and Tang Baoquan, "Lun guoyou qiye touzi fanwei" (On the scope of investment by state-owned enterprises), *Touzi yanjiu* (Investment Research), no. 136 (1995): 35-40.

³³Ding Yuewen, "Tan guoyou qiye lirun fenpei zhidu gaige" (On the reform of the distributive mechanism of state-owned enterprises' profits), *Guangdong caizheng*, no. 107 (1994): 19.

challenged the ancillary policy rules governing all the aforementioned elements in SOEs' accounting costs and profits. In addition, the tactics exploited not only the loopholes in the practice of *shuiqian huandai*, but also took advantage of the regulatory ambiguity between tax and enterprise reform statutes. Guangzhou also rejected new tax codes for some SOEs and blatantly interfered with exemptions or reductions of profit remittance, both of which impinged on major policy rules. Most importantly, many of Guangzhou's tactics reflected how prior regulations and institutions—part of the policy regime—had widened the locality's leeway by allowing for implementation that deviated from the standardized policy rules.

The Period of the FSZ (1994-95)

Compared to the LGS and CMRS periods, Guangzhou's defiance of rules of profit remission became much milder and less direct under the FSZ. Considering the opposite effects of policy regime and revenue incentive, this change in Guangzhou's implementation is explained by policy regime, but not by revenue incentive.

Discriminatory Collections of EIT vs. VAT

Despite the circumstances that prohibited defiant implementation of profit remission after the 1994 FSZ reform, Guangzhou was still able to find ways to pursue its own fiscal interest at the expense of the center. Yet the implementation tactics adopted during this period not only were quite different from those in use before 1994, but also applied to a much smaller number of SOEs as well.

One tactic was intended to ensure that Guangzhou's collection of the local share received priority over that of the center's share. The method adopted was that the local offices of both the Guangzhou Bureau of State Taxation and the Guangzhou Bureau of Local Taxation manipulated the order in which they collected enterprise income taxes versus other taxes, depending on the form of SOE property rights. These two bureaus were formed when the original unitary tax bureaucracy was broken up into two

separate sub-systems under the FSZ reorganization. The reorganization was an attempt by the center to solidify its capacity to mobilize revenue, given the low level of local compliance with revenue collection. Since 1980, both the State Council and the Ministry of Finance had viewed this local defiance to be highly correlated to the subservience of local tax officials at all administrative levels to local government pressure.³⁴ This interference was possible chiefly because in the old unitary system of tax administration, these officials were subject to the dual leadership (雙重領導, *shuangchong lingdao*) of both vertical and horizontal formal authorities; the local governments' institutional authority in terms of personnel appointments and job evaluation; and the local government supply of material goods (such as wages, organizational budgets, and housing).

Unquestionably, local governments would not have been able to flout the policy rules without the collaboration of local tax officials. In the old system, when faced with the quandary of competing loyalties for the dual leadership, officials often chose to place local interest above the center's. In order to resolve this problem of competing demands, the newly established State Administration of Taxation (國家稅務總局, *Guojia shuiwu zongju*) and its subnational offices have been charged with collecting all fixed central and shared revenues, while the bureaus of local taxation in all localities are now responsible for collecting all fixed local revenues.

However, the manipulation by the city's Bureau of State Taxation and Bureau of Local Taxation of the order of collection of different taxes mentioned above seemed to be deliberately biased against the center. Two cases involving local SOEs reveal this manipulation. In one case, the firm, located in the Haizhu District (海珠區) of Guangzhou, was supervised by the city's Textile Industry Bureau. Because of chronic scarcity in working capital, this firm had been forced since 1993 to divert part of the funds intended for tax remittance toward the payment of production input purchases. While this firm allegedly complained only to the city's Textile Industry Bureau about the unavailability of working capital, for three months

³⁴Roy Bahl and Christine Wallich, *Intergovernmental Fiscal Relations in China*, World Bank Policy Research Working Paper No. 863 (Washington, D.C.: World Bank, 1992), 8.

in 1994 this firm was able to defer remittance of VAT, which was administered by the Haizhu District Office of the city's Bureau of State Taxation. On the other hand, the firm had to remit EIT on time to the Haizhu District Office.

According to the Provisional Regulations on EIT, the fifteenth day of each month is the due date for enterprises to pay the EIT for the previous month. In contrast, VAT is due on the tenth day after the end of each month, as required by the tax law.³⁵ This firm paid both taxes monthly. During the first nine months the firm remitted both taxes before the deadlines. Yet toward the end of 1994, the firm began to realize it would definitely run into a deficit for the year if it fulfilled all its financial obligations to the state, banks, and other firms. Interestingly, the firm's payment schedule during the last three months revealed its priorities. The firm remitted EIT to the city's Bureau of Local Taxation (the local share) within five days into the new month—a full ten days before the deadline. However, the firm missed by at least ten days the deadline for remitting VAT to the city's Bureau of State Taxation (75 percent of which was the center's share).³⁶

In the second case of manipulation of the order of collection of taxes, the SOE was located in the Baiyun District (白雲區) of Guangzhou and supervised by the city's Bureau of Light Industry. Plagued by the same problem as the first enterprise, this firm received similar relief from the city's Bureau of Local Taxation and Bureau of State Taxation. Having to pay VAT monthly and EIT quarterly, this firm remitted EIT on time for the last two quarters of 1994, yet its VAT payments twice exceeded the deadline by about three weeks during this period. The deferred VAT payments occurred during the same months that the EIT payments were due.³⁷

According to most interviewees, the relief received by these two local SOEs was not typical in Guangzhou. Yet these two cases reveal a pattern

³⁵"Provisional Regulations on the Value-Added Tax of the People's Republic of China," promulgated by the State Council on December 2, 1993; and "Detailed Rules for the Implementation of the Provisional Regulations on the Value-Added Tax of the People's Republic of China," issued by the Ministry of Finance on December 12, 1993.

³⁶Interview #9504-0214.

³⁷Interview #9504-0210.

of prioritizing collections between EIT and VAT, where the collection of EIT—the revenue accruing entirely to the local state—took precedence over the collection of VAT, of which the center claimed the lion's share. This prioritization was undoubtedly based on the understanding of the tax offices that the two financially troubled plants might not be able to remit in full both VAT and EIT at the same time. When determining the priority of collection, the tax officials discriminated against the center and in favor of the locality. Evidently, the local state retained a certain degree of influence over the city's Bureau of State Taxation, which was supposed to be organizationally much more closely affiliated with the center. This anomaly might be due to the fact that at the beginning of the FSZ's reorganization of the tax bureaucracy, the local state was still in command of crucial individual and organizational resources for the local branch of the State Administration of Taxation. More importantly, these two cases in Guangzhou confirmed the observation held by some PRC tax experts that under the new tax system of the FSZ, the center and localities would clash over the revenues from the same enterprise in what was called "scrambling for tax proceeds" (搶稅, *qiang shui*).³⁸

Selective Auctioning of SOEs

The second implementation tactic employed by Guangzhou under the new circumstances created by the FSZ was associated with the restructuring of SOEs' property rights—a main theme of enterprise reform since 1992. The tactic was prioritizing for immediate auctioning those SOEs devolved by the center in the first half of the 1980s. In the wake of the tax reform of 1994, many local governments began to fear that the center might seek to amplify further its share in state revenues via measures beyond revamping the tax system. In their estimate, a likely option for the center was to reclaim property rights, especially the rights to the disposition of incomes and assets of those SOEs devolved to provincial and lower govern-

³⁸Yi Benhang, "Shuiwu jigou fenshe hou qidai jie jue de jige wenti" (Several problems needing prompt solution after the institutional division between tax agencies), *Shuiwu yanjiu* (Taxation Research), no. 116 (1995): 62.

ments in the past.³⁹ After all, this was something the center had done once in the second half of the 1980s. This possibility loomed even larger with the passage of a resolution in the Third Plenary Session of the CCP's 14th Central Committee in 1993. This resolution emphasized that all state assets, including those of SOEs, were ultimately owned by the central state, and that local governments were merely in charge of managing and overseeing (but by no means owning) state assets. Local governments were vehemently against this assertion, arguing that, given the accumulated local investments historically in SOEs' current fixed assets, the local states definitely held a legitimate claim on SOEs' property rights.⁴⁰

Faced with this menace, in the upsurge of restructuring of SOEs' property rights after 1992, local officials were prone to first contemplate auctioning off the SOEs which had been formerly devolved by the center and were now liable to be taken back. Such restructuring took a variety of forms, including merger, acquisition, leasing, bankruptcy, and stockholding. By converting these firms into new corporate entities in these ways, local governments attempted to make it unfeasible for the center to reclaim them; these new forms helped create insurmountable difficulties in delimiting the content and quantity of the original firms' properties. In Guangzhou the SOE auctions were handled by the city's Office of State Assets Management, which was established in 1991. This office operated in coordination with the city's economic commission and relevant city industrial bureaus in order to determine which SOEs were to be auctioned each year.⁴¹

³⁹Ji Xiaonan, "Zhongyang zhengfu yu difang zhengfu jingji guanxi de jiben taishi ji zouxiang" (The basic conditions and trends of the economic relationships between the central and local governments), *Jingji yanjiu cankao* (References for Economic Research), no. 673 (1994): 8-9.

⁴⁰*Ibid.*, 9. Indeed, as David Granick propounds, with the complex array of their administrative as well as financial inputs in SOEs over time, local governments are recognized more aptly as principals, not as mere agents, of these state properties. See David Granick, *Chinese State Enterprises: A Regional Property Rights Analysis* (Chicago: University of Chicago Press, 1990), 3-5.

⁴¹Office of State Assets Management of Guangzhou, "Guangzhoushi qiye jituan guoyou zichan shouquan jingying guanli ruogan wenti yanjiu" (Exploration of several problems

The selection of firms rested on several criteria. The most common was firm profitability. Across the nation, the conversion into stockholding firms tended to begin with those SOEs that have above-average profitability, and the firms to be merged and acquired by others were usually those unable to make ends meet.⁴² Two cases in Guangzhou, however, ran counter to this common model. In 1994, the city's Office of State Assets Management sold four SOEs through merger and issuing stocks. The first case was a city-owned plant that manufactured lathes and bearings. This plant had been decentralized, passed to Guangzhou by the First Ministry of Mechanical Industry in 1980, and had maintained a stable profit margin since 1991, well above the average level of comparable SOEs in the city. Even when bank credit and investment funds were undercut sharply in 1993, for example, the plant was still able to register net earnings of 8.93 million *yuan* with fixed assets worth 70.11 million *yuan*. Meanwhile, the city's enterprises with fixed assets ranging from 50 to 99.99 million *yuan* averaged a net earning of 6.89 million *yuan*.⁴³ This lucrative plant, however, was merged with the city's largest heavy machinery corporate group in 1994, when the plant downsized its original production units by shutting down several production lines in drilling and hobbing machines.⁴⁴ In other words, the financially independent plant was merged by the corporate group which, according to public financial records, was no better-off than the plant.

The second case involved the SOE that was the largest producer of flashlights in Guangzhou. The firm was decentralized by the First Ministry of Light Industry in 1981. Though it had not assumed losses since 1979 thanks to stable domestic demand, the firm's profit margin had never been spectacular. For instance, its annual profit of 1993 was 1.15 million *yuan*, with fixed assets worth 99.17 million *yuan*; equivalently, each *yuan* of

of the authorized management of state assets held by enterprise conglomerates in Guangzhou), *Guangzhou caizheng kuaiji*, no. 77 (1994): 4.

⁴²Ji, "Zhongyang zhengfu yu difang zhengfu," 10.

⁴³The author's calculation, using data from *Guangzhou jingji nianjian* 1994, 98.

⁴⁴Interview #9504-0208.

its fixed assets generated 0.0116 *yuan* of profits, less than 10 percent of the margin of the plant in case one (0.1274 *yuan*). Yet this mediocre firm was allowed by the city's Office of State Assets Management in 1995 to issue stocks that brought in new capital worth 40 percent of its original value of fixed assets, and to become part of the Wanbao Electrical Appliances Group (萬寶電器集團), one of the earliest stockholding corporations in Guangzhou.⁴⁵

What stood out from these two cases was not the contrast between them, but rather how each of them contradicted the general attributes of comparable SOEs similarly undergoing merger or transformation into stockholding. Since both enterprises had at one point been central SOEs devolved to Guangzhou, it follows that the city's Office of State Assets Management and relevant city bureaus might well have deliberately restructured their property rights at the earliest possible opportunity. This reasoning seems quite credible given the fact that before they were auctioned, both firms' economic performance ran counter to the corresponding criteria for auctioning SOEs in general.

Conclusion

This article discusses how Guangzhou implemented, in vastly divergent ways, the policy of SOEs' profit remission before and after 1994. The objective has been to highlight the critical impact of implementation on the policy outcome of fiscal recentralization since the FSZ. As reasoned earlier, the FSZ, by installing a new set of policy rules, has not really altered the zero-sum nature of central-local fiscal interaction. Therefore, although existing literature attributes the FSZ's success in fiscal recentralization to the design of policy rules, this conclusion is evidently misleading. This article shows that the key lies in implementation; in the case of SOE profit remission, implementation matters more than policy rules. If localities'

⁴⁵Interview #9504-0201.

defiance of relevant rules had not waned, the center would not have enjoyed the fiscal gains intended by the policy.

The narrative in this article clearly shows that Guangzhou's implementation of policy after 1994 has been less effective in deflecting revenue away from the center. During the LGS and CMRS periods, Guangzhou was able to defy both major and ancillary policy rules regarding profit remission. Yet the city could not remain as recalcitrant under the FSZ, but instead had to rely on much more moderate, indirect tactics of implementation that either did not deviate so significantly from the policy rules or generated policy consequences springing from some other policy area. One can reasonably infer from such a disparity that if localities like Guangzhou had remained as defiant after 1994 when implementing the income tax policy on SOEs, the recentralization effect of the FSZ would have been significantly less conspicuous, to say the least.

While uncovering the significance of implementation, this article also uses Guangzhou as an example to explain what led to the moderation of local implementation. Whereas the two variables—policy regime and revenue incentive—exerted conflicting effects in this regard, the empirical evidence during all three periods under study in this analysis consistently shows that the former overrode the latter. The former did so by imposing hefty constraints on the locality's choice of viable implementation tactics that outweighed the intensification in the locality's motive to divert revenue delivery after 1994. Guangzhou's diminishing defiance toward the policy rules after 1994 lends credibility to the hypothesized effect of policy regime—a factor pertaining to the "means" of local implementation, instead of the "ends" to be fulfilled; the same reality also falsifies the hypothesized effect of revenue incentive. To further understand the augmentation of the policy regime, a key factor is the center's resolve and capability to formulate, enforce, and monitor the FSZ in order to achieve fiscal recentralization. The implication is that the success of fiscal recentralization has depended heavily on the synergy of power and administrative recentralization, a fact which calls our attention to the under-researched issue of the relations between the two dimensions, both in theory and in practice.