

The Financial Autonomy of Provincial Governments in Mainland China and Its Effects

Ya-chun Chang

Associate Research Fellow
Institute of International Relations
National Chengchi University

Since the implementation of the financial responsibility system, mainland China's local governments have had increased autonomy in economic affairs and tended to produce items that require less investment but can yield faster returns and more tax income. Utilizing resources this way has brought about rapid economic growth; however, it also has had adverse effects on mainland China's economy. For example, as many places do not want to bring their superior production capabilities into play, production patterns in different areas have remained the same. In addition, there has been imbalanced development between basic industries and processing industries, and a widened gap between rich and poor provinces. Moreover, the economic autonomy of provincial governments has not been guaranteed by law.

Keywords: financial responsibility system, economic autonomy, system of tax distribution, location quotient

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In 1994, mainland China adopted a system of tax distribution to take the place of the financial responsibility system implemented in the 1980s. Under the new system, the central and local governments have their own financial setups; while they collect some taxes separately, they also jointly share others.¹ This change was intended to alter the local governments' tendency to outweigh the central government in financial power. Wang Shaoguang and Hu Angang have pointed out that the ratio of government revenue to gross national

¹“Report on the Implementation of the 1989 State Budget and the Draft of the 1990 State Budget,” *People's Daily* (Domestic edition) (Beijing), April 10, 1990, 3.

product (GNP) declined from 31.2 percent in 1978 to 14.7 percent in 1992 and 13.9 percent in 1993. The ratio is estimated to decline to 11.8 percent in 1995.² In the period 1979-89, the government's financial revenue declined 48.4 percent, with an annual loss of 6.2 percent.³ As for financial expenditures, the ratio of central government to total government expenditures declined from 47.9 percent in 1979 to 33.2 percent in 1989.⁴ In contrast, the financial strength of local governments has expanded. In the period 1986-91, local financial revenue accounted for over 60 percent of total government revenue, and local financial expenditures were 60 percent of the total. All the statistics indicate a continuous decline of the central government's financial powers.⁵

This decline has also placed the central government in a position in which it is unable to exercise effective macro-control of the economy. Evidence of this can be seen in the fast expansion of fixed assets, overheated investments, galloping inflation, the prevalence of regionalism, and worsening of the corruption problem since the mid-1980s. Wang and Hu maintain that these phenomena are a result of the increased financial autonomy of local governments. This article will first examine the economic roles played by local governments since the granting of greater autonomy, followed by the impact of these activities on mainland China's economy and local government autonomy.

Increased Autonomy of Provincial Governments

In order to facilitate reform and opening-up policies, mainland China has adopted a series of measures since the 1980s to grant local governments greater autonomy. Aspects such as finance and taxation, local government income size and expenditures, the division of taxes between central and local governments, and affiliations between enterprising units have all been regulated.⁶ In so doing, past practices

²Wang Shaoguang and Hu Angang, *Zhongguo guojia nengli baogao* (China's state capacity report) (Shenyang: Liaoning chubanshe, 1993), 45; *Ming Bao* (Hong Kong), February 13, 1994, 1.

³Wei Jie, *Shiheng jingjixue* (Unbalanced economics) (Beijing: Zhongguo renmin daxue chubanshe, 1991), 202.

⁴Wang and Hu, *Zhongguo guojia nengli baogao*, 47.

⁵*Ibid.*, 51.

⁶You Lin, Zheng Xinli, and Wang Ruipu, eds., *Zhonghua renmin gongheguo guoshi tongjiari* (Chronology of the history of the People's Republic of China), vol. 4: 1976-

of centrally-dominated finance have been downplayed in favor of provincial independence in financial matters. Under the new system, provinces that create more revenue are allowed to use more while those with only limited revenue will have little to spend. In other words, each province must assume the full responsibility for its own profits and losses. This system was designed to promote the economy by arousing local governments' enthusiasm for production, and has political as well as economic implications. With their increased financial power, local governments—especially at the provincial level—have greater say over their area's affairs.

Local governments have also been allowed greater autonomy in the distribution of resources, especially those in short supply. For example, provincial governments have the power of resource allocation over items both within and without the economic plan. They may use production materials not supplied via the central government for local enterprises. The provincial governments also have the power to make decisions on investment; since 1987, each province has been authorized to examine and approve infrastructure construction and technical innovation items worth up to 30-50 million *yuan*. They also have the power to approve all nonproductive items and have administrative power over enterprise management, commodity prices, tax reduction and exemption, use of foreign exchange, and payment of wages. In addition, they also have a certain input in formulating economic policy and regulations. Some of these policies and regulations are developed under central guidance while others are developed completely by the provincial governments. The latter policies include industrial development, technical renovation, outward development, regional balance and coordination, and revitalization of enterprises.⁷

With increased independence, the provincial governments have more leeway to make decisions on economic matters within their own jurisdiction. While they take orders from the central government in exercising economic control, they are also responsible for organizing interprovincial coordination and regulating local economic affairs in order to cope with special conditions.⁸ They hence must be attentive to the needs of their own areas and maintain a balanced development

1992 (Beijing: Hongqi chubanshe, 1992), 104.

⁷Ibid., 7.

⁸Ibid., 10.

between different provinces.⁹

Prior to the initiation of reform and opening-up policies in 1978, the central government held the bulk of financial power, although local governments and enterprises were delegated some authority. Under the highly centralized planned economy, the central government held power over economic matters and resource distribution, while the provincial governments could only implement the policy decided by the central government. However, as mainland China has shifted to a planned and socialist commodity economy, local governments and even enterprises have been granted more authority. As a result, a decentralized and pluralistic style of resource allocation and economic policymaking has appeared.¹⁰ However, the fact that mainland China lacks a mature market has prevented enterprises from exercising full autonomy. Shortly after the initiation of reform and opening-up policies, the state continued to intervene in enterprise management, and enterprises relied heavily on the state since they were all owned by the state.¹¹ After the central government loosened its control over enterprises, the latter began to rely on local governments. This provided local governments with a chance to gain the autonomy that the central government intended to grant to enterprises;¹² they consequently dominated enterprise production and investment, resulting in the localization of property rights.¹³ In other words, after the central government delegated its power, it was local governments, especially those at the provincial level, that enjoyed economic autonomy.

Joseph Schumpeter points out that for the purpose of obtaining financial gain, a country may change its economic policies and system, or even its political system.¹⁴ It is for exactly this reason that pro-

⁹Ibid., 13.

¹⁰Mei Zhulin, "On Distributing Resources in Accordance with Market Mechanisms," *Dangdai caijing* (Contemporary Finance and Economics) (Nanchang), 1992, no. 12: 15-16.

¹¹You, Zheng, and Wang, *Zhonghua renmin gongheguo guoshi tongjian* 4:95, 774-75; Wang Huning, "The Changing Relationship Between the Central and the Local Governments in China: Political Implications," *Fudan xuebao: Shehui kexue ban* (Journal of Fudan University: Social Science Edition) (Shanghai), 1988, no. 5:4.

¹²Wang, "The Changing Relationship," 4.

¹³Zheng Yongnian and Wu Guoguang, "On the Relationship Between the Central and the Local Governments: A Key Question in the Course of System Transition in China," *Dangdai Zhongguo yanjiu* (Modern China Studies) (Princeton), 1994, no. 6: 39-51.

¹⁴Ibid., 52.

vincial governments have been granted greater autonomy. Finance is an important means of organizing, coordinating, administering, and supervising a society's economic activities.¹⁵ Whether a country applies a planned economy or market economy, its financial policy has the following goals: the most effective disposal of resources, a fair distribution, a stable economy, and rapid economic growth.¹⁶ An effective disposal of resources means that there is a correct arrangement of elements in production input and output. Proper handling of resource allocation will enable a fair distribution of social income and steady and continued economic growth. Therefore, distribution of resources is the major task of financial administration and is also the key to economic development.¹⁷ Under a planned economy, resources are dominated by the state and are used for the benefit of the state and the public; under a market economy, the interest of individuals is emphasized and the government refrains from intervening in resource distribution. Even so, cases in countries applying a market economy tell us that the state cannot stay aloof from the disposal of resources, although its intervention is often regulative and indirect. In countries applying a market economy, finance is an important means of regulating the economy; with its compensation and punitive functions, finance can help maintain relative equality in income levels among different levels of people. It can also compensate for investment and inventory shortages in public service departments, infrastructure input, and industrial production.¹⁸

In the transition from a planned economy to a socialist market economy, resource distribution is under the domain not only of the central government but also local governments and even enterprises. Under such circumstances, public service departments, infrastructure input, and industrial production may sometimes find that their investment and inventory are insufficient. Finance then becomes very

¹⁵Yang Bingkun, "The Economic and Financial Functions of Countries That Have Focused on Output Value," *Zhongguo jingji wenti* (China's Economic Problems) (Beijing), 1994, no. 4:43.

¹⁶Lin Hua-te, *Caizhengxue* (Finance) (Taipei: Sanmin shuju, September 1986), 326.

¹⁷Mei, "On Distributing Resources," 13-16; and Jiang Zuopei, "The Cost and Control of Resources Market Disposition," *Dangdai caijing*, 1993, no. 10:1-2.

¹⁸Jiang, "The Cost and Control," 6; and Li Handong, "Elements of the Financial Policy, the Mechanism of Transmission, and Effect Analysis," *Jingji lilun yu jingji guanli* (Economic Theory and Economic Management) (Beijing), 1994, no. 3:50. The major instruments of finance include taxation, government bonds, public expenditures, and government investment.

important to resource distribution. Granting financial power to provincial-level governments allows them to economically control each province while also enhancing economic results and ensuring balanced economic development in various regions. In other words, local governments are asked to correct inequities in resource distribution and insufficient resource allocation to various departments.

However, although local governments are agencies of the central government under a system of centralized power, they must place top priority on their own area's interests so as to solicit support from their people. In fact, the existence of local governments has been geared to the purpose of seeking the interests of their local areas,¹⁹ even to the extent of sometimes deviating from the central government's demands. Financial power has been used by local governments for their own interests and to strengthen their popularity instead of maintaining balanced regional development or regulating resource disposal. Obviously, local governments have not fulfilled their financial functions as has been expected, but have undertaken many activities which have violated the central government's plans.

Resource Disposal and Investment by Provincial Governments

In order to create more financial income, local governments have tended to increase the sources of their financial income, use available resources mainly for the creation of financial interest, and intervene in investment projects.

Generally speaking, the above three phenomena are mutually related. After the implementation of the new system, the financial burden of local governments has increased to the point that some of them face deficits.²⁰ This has resulted mainly from taking responsi-

¹⁹Shen Liren and Dai Yuanchen, "The Formation, Shortcomings, and Sources of the Fief Economy in Our Country," *Jingji yanjiu* (Economic Research) (Beijing), 1990, no. 3:17.

²⁰*Zhongguo caizheng tongji 1950-1991* (Chinese financial statistics, 1950-91) (Beijing: Kexue chubanshe, 1992), 59, 138. In 1991, provinces with revenues over ten billion *yuan* included Guangdong, Shanghai, Liaoning, Sichuan, Jiangsu, Shandong, and Henan. In areas like Qinghai and Ningxia, the revenue was only several hundred million *yuan*. Provinces that exceeded ten billion *yuan* in financial expenditures are listed in order as follows: Guangdong, Sichuan, Liaoning, Shandong, Jiangsu, Yunnan, Heilongjiang, Henan, and Hunan. Those that had the smallest expenditures were Tibet, Ningxia, Qinghai, and Hainan. Almost all provinces have suffered deficits except the following provinces and areas: Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, and Guangdong.

bility for expenditures previously covered by the central government, including infrastructure construction, technical renovation for enterprises, cultural and educational construction and improvement of public health, and price subsidies.²¹ Under such financial pressure, it was only natural that local governments have made use of their newly-granted financial autonomy to increase their financial income.²² Caring only about their local interests, they have tended to ignore the need for balancing development between various areas through resource distribution. In addition, the lack of a specified policy for balanced regional development has also encouraged the provincial governments to act independently in resource allocation and other economic matters.²³

With increased autonomy over resource allocation, the provincial governments have engaged themselves in investment projects. It had been hoped that the investment of local governments would provide economic control; that is to say, the central government cares about the impact of local governments' investment on society rather than the actual economic results they can obtain.²⁴ For example, provincial governments should take favorable conditions for their own region's economic development into consideration and help main-

²¹Christine P. W. Wong, "Central-Local Relations in an Era of Fiscal Decline: The Paradox of Fiscal Decentralization in Post-Mao China," *The China Quarterly*, no. 128 (December 1991): 702-3.

²²The central government's subsidy to local governments is apparently insufficient. The heaviest burden to provincial governments is their provision of subsidies for grain, oil, and meat. See Wong, "Central-Local Relations," 704. The second heaviest burden on provincial governments is expenditures on administrative and personnel affairs. For this, see Yu Guowei, "The Financial Situation as Viewed from the Financial Report," *Ming Pao*, March 12, 1995. The third largest burden is expenditures on public health, medical care, and education. For this, see Wong, "Central-Local Relations," 705. In 1978, expenditures on public health and education accounted for 10.1 percent of the provincial-level budget. The ratio rose to 18 percent in 1988. In some provinces, these expenditures constitute about one-third of the region's budget. In Jiangxi province, for example, expenditures on public health and education occupied 19 percent of total expenditures in the Fifth Five-Year Plan period, and 32 percent in the Sixth Five-Year Plan period. During these same periods, similar expenditures in Sichuan rose from 25 percent to 34 percent.

²³Zhu Jialiang and Wu Minyi, "Regulation and Control by China's Local Governments: Obstacles and Options," *Jingji yanjiu*, 1992, no. 8:18-19; Jiang Qinghai, "An Analysis and Consideration of the Fief Economy," *Shehui kexue* (Social Sciences) (Beijing), 1992, no. 4:22-23.

²⁴Li, "Elements of the Financial Policy," 50. Government investment refers to the use of financial resources for the building of capital items to create fixed assets. Major items of government investment are basic industries, public facilities, and high-tech industries that have monopolization characteristics, great outward effects, high connections with industries, and inducing effects. See Zhong Chengxun, ed., *Difang zhengfu touzi xingwei yanjiu* (An analysis of local governments' investment behavior) (Beijing: Zhongguo caizheng chubanshe, 1993), 37.

Table 1
The Mean Value of Profits and Taxes in Several Industries, 1985 and 1986

Unit: %			
Light industry	Heavy industry	Excavative industry	Creative industry
29.8	18.9	9.0	17.6

Source: Wu Fangwei, "Regional Economic Development and the Financial System," in *Zhongguo jingji caizheng lilun congshu*, vol. 2 of *Zouxiang xinshiji* (March toward the new era), ed. Xu Yi (Beijing: Jingji kexue chubanshe, 1993), 311.

tain a balanced and rational economic structure. In central-west China, where energy resources and raw materials are abundant, more emphasis should thus be placed on the development of basic industry, while in east China's coastal provinces, where raw materials are in short supply, the processing industry should be developed. However, under a market economy, local governments as well as enterprises tend to invest in items that can produce the highest economic income.²⁵ Likewise, resource allocation has taken precedence over economic considerations. For the relationship between investment and economic results of different industrial production items, see table 1.

To increase the production volume of their investment projects, provincial governments have solicited support from the central government and related departments, and used the power in their hands.²⁶ In order to raise more money for investment, they have either engaged in certain projects to solicit the participation of local enterprises and interest groups, or used administrative orders to organize local units and people to take part in investment projects or raise funds for investment. Banks have been the major avenue through which investment funds for these maneuvers have been provided.²⁷

To promote their own investment projects, provincial governments have also embezzled resources allotted by the central government for other production items and diverted raw materials from enterprises. In the use and distribution of resources, local governments and enterprises focus on price structures because the economic viability of a product depends on the price of goods it can obtain through com-

²⁵Wu Fangwei, "Regional Economic Development and the Financial System," in *Zhongguo jingji caizheng lilun congshu*, vol. 2 of *Zouxiang xinshiji* (March toward the new era), ed. Xu Yi (Beijing: Jingji kexue chubanshe, 1993), 286.

²⁶Zhong, *Difang zhengfu touzi xingwei yanjiu*, 42-49, 53, 87-95.

²⁷Wu, "Regional Economic Development," 286-87.

modity exchange. Investment items that can yield more financial income have been given top priority. The prices of many products and raw materials often do not accurately reflect their value; for example, prices for energy, raw materials, and rudimentary products have been set too low, creating a gap between these types of goods and processed goods. The eastern provinces have made formidable profits through processing, but at the same time have contributed to an imbalance in regional development.²⁸ Such a situation has prompted western provinces to decide on investment and industrial policies purely based on financial considerations, without making good use of their own specialties.

Generally speaking, local governments tend to disregard society's necessities and promote industries that can collect higher circulation tax. For example, although wine and tobacco tax is set at 40 to 60 percent, higher than most other commodity goods, many provinces are still enthusiastic about production because of the income prospects. In 1990, the sales profit rate of tobacco produced by state-owned enterprises was reportedly -0.55 percent and its capital profit rate -1.49 percent, while its sales profit tax rate was 56.2 percent and its capital profit tax rate 153.5 percent.

Local governments also prefer to engage in production that requires less investment, shorter production cycles, and faster results. Generally speaking, if the amount of investment, the percentage of profit retained, and the rate of depreciation are the same, products that have a shorter period of return will be able to deliver more tax to the government. Therefore, local governments have preferred to invest in faster returns, even if some of these products do not have a high tax rate. Hence, top priority has been placed on products that have both a high tax rate and short return period.

In order to maintain a stable financial income, local governments have also protected traditional industries which occupy the bulk of industrial output value in local areas and have good prospects in the international market. In contrast, basic, high-tech, or new industries have not attracted enough attention. East China provinces have not taken the lead in developing high-tech new industries as expected, but engaged themselves in traditional processing industries. In order to receive more income, west China provinces have also dedicated

²⁸Ibid., 317-19.

themselves to developing processing at the expense of basic industry development. All of this has resulted in repeated production of low-level products and excessive market competition in traditional industries.²⁹

Impact of Provincial Governments' Increased Economic Autonomy

Positive Effects

It is undeniable that the increased autonomy of the provincial governments over the disposal of resources has had a positive effect on mainland China's economic development. Since the initiation of the new economic system in 1978, the enthusiasm of provincial governments for investment has made up for insufficient central government investment. As an example, in Anhui province state-budgeted investment occupied 87.82 percent of total capital construction investment from 1949 to 1978. The ratio dropped to 52.2 percent in the ten years from 1979 to 1988, and 38.4 percent in the three years from 1986 to 1988. Meanwhile, extrabudgetary investment increased to 61.6 percent.³⁰ In recent years, the provincial governments have applied a series of measures to protect and support investment by individual people and units, and absorb foreign investment; as a result, foreign investment has increased at a fast pace.³¹ The increase in extrabudgetary investment has enabled the coastal provinces' economy and people's living standards to grow considerably.

Because of the direct investment of the provincial governments and the zeal of enterprises and government institutions in producing quick-return items, projects such as light, textile, and house construction industries, building of public infrastructure facilities, and producing brand-name, specialty, and high-quality products in local areas have been encouraged. The upsurge of township enterprises has not only improved rural areas' economic structures but also narrowed the economic gap between urban and rural areas. In addition, it has improved local industry, foreign trade, the enterprise ownership system, and enterprise production scale. All of these have enhanced

²⁹Zhong, *Difang zhengfu touzi xingwei yanjiu*, 115-17.

³⁰*Ibid.*, 451.

³¹*Ibid.*



economic development and, to a large extent, solved unemployment problems in rural areas.³²

This trend has also resulted in a change in the output proportions of agriculture, light industry, and heavy industry in the national economy's gross production. In 1978, the output of agriculture, light industry, and heavy industry constituted 24.8 percent, 32.4 percent, and 42.8 percent of the gross national income, respectively. In 1990, the ratios had changed to 24.3 percent, 37.4 percent, and 38.3 percent respectively. The output value of light industry as a percentage of total industrial output rose from 43.1 percent in 1978 to 49.4 percent in 1990.³³

Investment by provincial governments and agencies and their enterprise units has also enhanced the housing industry and public facilities. For example, in the period 1985-90, 116.45 billion *yuan* out of 444.93 billion *yuan* in fixed assets investment was used for housing projects; from this portion, 12.23 billion *yuan* was used for the housing industry in urban areas. In the Sixth Five-Year Plan period, 16.6 percent of fixed assets investment was used for the construction of public facilities, an increase of 71 percent over the Fifth Five-Year Plan period. The public facilities ratio rose to 18 percent in the Seventh Five-Year Plan period.³⁴

Adverse Effects

Increased autonomy of the provincial governments over resource allocation has also had adverse effects in mainland China. Expanded investment in various provinces has resulted in an overheated economy and runaway inflation. In addition, local governments and enterprises have invested in profitable items out of their own self-interests, disregarding the principle of production division and cooperation between different areas. This has resulted in a dislocation of supply and demand and an unbalanced production structure, consequently leading

³²In 1988, the number of staffs and workers in township enterprises reached 95,455,000, constituting 16.7 percent of all laborers at that time. During the Seventh Five-Year Plan period, a total of 22,860,000 surplus laborers (or 50 percent of the increased laborers) in rural areas found work opportunities in township enterprises. This enabled rural people to work for industrial and commercial business. See Zhong, *Difang zhengfu touzi xingwei yanjiu*, 120.

³³*Ibid.*

³⁴*Ibid.*, 120-22.

Table 2
The Location Quotient of Basic Industries in Mainland China's 29 Provinces
(Municipalities and Autonomous Regions), 1985-87

Gansu	2.04	Jiangxi	1.21	Guangxi	0.75
Shanxi	1.93	Yunnan	1.19	Tianjin	0.74
Heilongjiang	1.77	Guizhou	1.15	Beijing	0.71
Xinjiang	1.72	Hunan	1.14	Shaanxi	0.70
Tibet	1.64	Anhui	1.12	Guangdong	0.68
Ningxia	1.63	Hubei	1.06	Shanghai	0.68
Inner Mongolia	1.59	Henan	1.05	Fujian	0.59
Liaoning	1.49	Sichuan	1.01	Jiangsu	0.58
Qinghai	1.29	Shandong	1.01	Zhejiang	0.53
Hebei	1.25	Jilin	0.92		

Source: Wu, "Regional Economic Development," 335.

to periodic economic fluctuations.³⁵

Economic structures of different regions have also become more and more similar. Areas rich with natural resources have engaged in processing industries while provinces which formerly concentrated on processing have developed basic industries in order to obtain enough raw materials. Table 2 indicates that if the location quotient of the production value of a certain industry is higher in an area, the area has a greater capacity for production in that industry.³⁶ From table 3, we see that in areas rich with natural resources, the location quotient of the excavative industry and raw materials industry is high but the ability to process industrial products, especially those of light industry, is low. In areas where the processing industry is thriving, there will be a greater need for basic industrial products from elsewhere. Areas between the above two categories do not rely heavily on other areas for raw materials and processing products. However, from 1985 to 1987, the D value of the excavative; raw materials, and light processing industries decreased as areas specializing in processing

³⁵Jiang, "The Cost and Control," 3; and Shen and Dai, "The Formation, Shortcomings, and Sources," 14-15.

³⁶Wu, "Regional Economic Development," 335-36. Location quotient refers to the difference between an industry's position in a certain area and in the whole country.

Table 3
The Location Quotient of the Four Major Industries in Different Areas, 1985-87

	Excavative industry			Raw materials industry			Light processing industry			Heavy processing industry		
	1985	1986	1987	1985	1986	1987	1985	1986	1987	1985	1986	1987
Resources area	2.22	2.21	2.08	1.35	1.35	1.35	0.78	0.78	0.79	0.85	0.85	0.84
Area in-between	1.05	1.09	1.12	1.06	1.06	1.02	1.08	1.07	1.07	0.88	0.88	0.89
Processing area	0.31	0.31	0.34	0.78	0.78	0.82	1.06	1.07	1.07	1.16	1.15	1.16
Location quotient difference	1.91	1.91	1.73	0.57	0.57	0.49	0.30	0.29	0.28	0.31	0.32	0.31

became more self-sufficient in excavation while excavative industry exports from areas rich with natural resources declined. Moreover, in areas rich with natural resources, the location quotient for light and heavy processing industries was higher than that of raw materials output. On the other hand, in areas where the processing industry thrived, the location quotient for the excavative and raw materials industries was higher than that of processing industry input. Such a change indicates that during the Sixth Five-Year Plan period, resources were not allocated in accordance with each local area's specialty; consequently, areas with different economic conditions begin to exhibit similar industrial structures.

These tendencies toward similar investment patterns and industrial structures have resulted not only in a decline in investments' marginal utility but also in ineffective utilization of limited raw materials. The rush for the production of similar products has also resulted in supply exceeding demand. In addition, since investment has been scattered in different provinces, the scale of production in each region is limited and not in line with the principles for an organized economy.³⁷

The convergence of different regions' production structures and the dislocation between supply and demand have manifested themselves in two aspects. One is the neglect of agricultural investment and the other is the structural imbalance between basic industries and processing industries. The latter is further indicated by the following facts:

1. The development of the energy industry has not been well coordinated with other industrial sectors. From 1980 to 1986, the energy output on the mainland increased by an average of only 5.2 percent annually, while at the same time the annual industrial output value increased by an average of 13.3 percent. Since 1985, the average annual growth rate of energy production has been at 5.1 percent, lagging far behind that of the processing industry.

2. The gap between the raw materials industry and the processing industry is increasing. From 1980 to 1988, the average annual growth rate of the raw materials industry was 8.7 percent while that of the processing industry was 10.9 percent, creating a shortage of raw materials. Since 1985, mainland China has had to import steel,

³⁷Ibid., 260-61.

nonferrous metals, alloys, and petrolchemicals from other countries.

3. The mainland's transportation systems are inadequate for supporting industrial growth. Although efforts have been made to promote the industry, railroad transportation could meet only 60-70 percent of required needs in 1988. According to available statistics, from 1985 to 1988 the volume of circular commodities flow in the mainland grew at an average annual rate of 10.4 percent while passenger numbers increased by an average of 13.7 percent.³⁸

Insufficiency in the supply of energy and raw materials resulting from imbalanced development between basic and processing industries has given rise to protectionist policies. To obtain more energy and raw materials, the provincial governments have not only asked for the procurement of these resources from the central government but also prohibited the outflow of resources, personnel, and technology from their own areas and the import of products from other provinces.³⁹ Competition in procuring resources has become more serious since 1985. The coastal provinces have used their economic powers to obtain more resources in the market, while provinces rich with resources have used administrative and economic measures to monopolize their assets and use them as a bargaining chip with the central government and other provinces.⁴⁰ The provincial governments have sought not only resources but also markets. In order to enhance their competitive power, many provinces have used credit, taxation, and supervision measures to offer protection to local products.⁴¹

Profit-oriented investment and resource disposal has also widened the economic gap between different provinces and areas; rich regions have accumulated more wealth while the poor areas have become more impoverished. Within a single province, different areas have varying economic powers because of differences in population size, amount of resources, and natural environment. To narrow the gap by boosting economic development in the comparatively more backward areas, a provincial government should use both adminis-

³⁸Sun Kai, "Local Protectionism and the Intergovernmental Financial Relations," *Zhongguo jingji wenti*, 1994, no. 1:35.

³⁹Wu, "Regional Economic Development," 326.

⁴⁰The price measures include the use of price scissors and adjustment funds, and the practice of not fixing prices for certain products or setting prices by government order. See *ibid.*, 327.

⁴¹*Ibid.*, 324-25.

trative and economic means to ensure a more reasonable distribution of resources. However, most provincial governments are presently investing their money and resources in more developed areas and in more profit-oriented items. As a result, economic development in rural and backward areas has been retarded.

Conclusion

From the above, it is clear that the increased autonomy of the provincial governments over financial matters and resource allocation following the initiation of reform and opening-up policies has contributed greatly to the rapid growth of mainland China's economy. However, since their autonomy is not guaranteed by law, the provincial governments have tended to seek short-term interests at the expense of proportionate economic development in their areas.

Of course, this is not to say that the provincial governments have completely neglected the importance of macro-control and comprehensive balance of the economy. However, the current situation presents many difficulties in exercising effective control. Reform and opening-up policies remain a process of trial and error, and no definitive conclusion has been reached on how to exercise government control of the economy without hindering economic growth. It has also proved more difficult for the provincial governments than the central government to maintain effective control of the economy. At the national level, if a balance between revenue and expenditures can be maintained, a balance between supply and demand can be obtained under normal conditions. However, this is not necessarily the case at the provincial level, as the economic relationships between the provincial and central governments and between the provincial and lower-level governments are rather complicated.⁴²

The provincial governments' engagement in profit-oriented economic activities has weakened the central government's macro-control of the economy, and this in turn has resulted in economic confusion which eventually will reduce the economic benefits obtained by the provincial governments. In the financial aspect, for example, an

⁴²Cao Jinxzhang and Liu Zhijin, "The Functions and Role of Provincial-level Planning Departments under the Condition of Two-level Regulation and Control," in *Shengji jihua guanli wenti tansuo* (A study of the planning and management work at the provincial level) (Beijing: Zhongguo jihua chubanshe, 1988), 12.

overexpansion of investment will result in a loss of economic gains and provincial governments' financial income. In the past, whenever the gross industrial output value increased by one percent, the national financial income would also increase by one percent. But in recent years, each increase of one percent in government financial income has required at least a two percent increase in gross industrial output value.⁴³

To grant greater autonomy to provincial governments is to hand them the responsibility of revitalizing the economy in their own areas. If they fail to play this role, the central government may take back the autonomy given to them at any time, as there are no specified regulations governing the relationship between the central and local governments. For example, to ensure its financial superiority, the central government may change the existing financial system and negotiate with local governments over financial matters whenever there is the need.⁴⁴ In fact, the replacement of the profit delivery system with the tax payment system in 1985 and the enforcement of the tax distribution system in 1994 are cases in point.⁴⁵

Since the enforcement of the latter, the central and local governments have had their own financial income and are responsible for their own budgets. Under such a system, it seems that the autonomy of the provincial governments is guaranteed.⁴⁶ However, since it is difficult to completely separate the functions of the central government from those of the local governments, and since governments at all levels are not only administrators of society but the owners of state property, the autonomy of local governments over financial matters can become uncertain.⁴⁷

⁴³Shen and Dai, "The Formation, Shortcomings, and Sources," 14.

⁴⁴Wong, "Central-Local Relations," 701.

⁴⁵To replace the practice of profit delivery with that of tax payment is to perfect the taxation system so that the profit delivered by enterprises will not be intercepted by local governments, and prevent enterprise tax evasion. See Hu Peng-chun, "A Study of the Replacement of Profit Delivery with Tax Payment in Mainland China" (M. A. thesis, Graduate School of East Asian Studies, National Chengchi University, June 1988).

⁴⁶He Zhenyi, "A Study of the Result and Questions of the Finance and Tax Reform in 1994," *Jingji yanjiu*, 1994, no. 4:36.

⁴⁷*Ibid.*, 34. Some mainland scholars have suggested that in the implementation of a system which replaces profit delivery with tax payment, it is necessary to make a clear examination of the property rights for all levels of government. Xie Guoman, "The New Financial Relationship Between the Central and the Local Governments: A Preliminary Study of the Model and Operation of Finance Systems at Different Levels," *Jinan xuebao: Zhaxue shehui kexue ban* (Journal of Jinan University: Philosophy and Social Science Edition), 1992, no. 1:21.

It is also not easy to clearly distinguish sources of tax income between the central and local governments. In order to maintain effective macro-control of the economy and prevent the prevalence of localism, the central government has to set limits on local governments' sources of tax income. After the implementation of the tax distribution system, the central government's tax revenue has increased enormously while the local governments' revenue has dwindled.⁴⁸ With each descending level of government, the more difficult it becomes to increase financial income.⁴⁹ Therefore, the tax distribution system has met with strong resistance from local governments. Some provincial governments have stated that they prefer the previous financial responsibility system to the new one.⁵⁰ To ensure themselves of enough financial income, the provincial governments have started a practice in which they set more charges on governments underneath them, and the latter hence set more charges on enterprises.⁵¹

⁴⁸Xie, "The New Financial Relationship," 22. Some scholars have maintained that in order to create more income, local governments should collect land tax and house utilization tax. They may also increase the income tax and surtax and strengthen taxation on individual economic households.

⁴⁹Yang Zhengshu and Zhu Huijiang, "The Impact of the Tax Distribution System on Economic Development in Counties and Cities," *Jingji lilun yu jingji guanli*, 1994, no. 2:71.

⁵⁰Zhong Wenyi, "The System of Tax Distribution and the Economy in Guangdong," *Wen Wei Po* (Hong Kong), February 1, 1994, A11.

⁵¹*Ming Pao*, December 23, 1994, B1.