# Features of the Chinese administrative system and the expansion of fiscal expenditures

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The overly rapid expansion of fiscal expenditure is an issue the government should take seriously. There are two major causes for the expansion of fiscal expenditure——stress caused by the demand for public goods and stress caused by the features of the administrative system. The influence of the administrative system on fiscal expenditure is demonstrated through the following aspects——the definition of government functions, the development concept of government as well as hierarchies and department setting of governments. The features of China's administrative system strongly boost the expansion of fiscal expenditure. It is displayed through the concept of rapid development at all government levels, relatively broad definition of government functions, the manifold departments and multi-level settings in the government. The Chinese governments should attach great importance to this issue and take proper measures to relieve the conflict. Some suggested measures include weaving appropriate capital restrictions into government planning, improving the methods of setting targets in planning, building a coordination mechanism for departmental budgets, practicing expenditure budget performance evaluation and releasing the results, as well as adjusting the hierarchical setting of governments.

**Keywords:** fiscal expenditure, government functions, government planning

## 1. Introduction

In the transition period, fiscal expenditures in China have expanded rapidly, with an average annual growth rate higher than the economic growth rate and the rate of price increase. In many years, the growth rate of fiscal expenditures was twice the economic growth rate (1989, 1990, 1998, 1999, 2000, 2001, 2009, and 2011), and over ten times as much as the rate of price increase (1998-2003). The period needed to double fiscal expenditure has been decreasing, from 10 years between 1978 and 1987 to 7 years between 1987 and 1993 and then to 5 or 6 years between 1993 and 2013. The total fiscal expenditure of the U.S increased by 750% in a period of 27 years between 1970 and 1997, while China saw an increase of 2,900% in a same period of 27 years between 1978 and 2005. The comparison shows a supernormal increase in Chinese fiscal

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expenditure. Despite the stress on cutting expenditures, expansionary fiscal policies are always implemented.

The expansion of fiscal expenditure is common to all the countries around the globe, but the rate of expansion in China is too high, with expenditures doubling in a period of 6 years. This causes two alarming issues, first, the rate of increase of fiscal expenditures will inevitably exceed the economic growth rate and the capacity of the general public; second, the expansion will unavoidably be supported by dramatically raising the issuance of debt.

Therefore, it is necessary for us to study from various aspects the causes of the expansion of fiscal expenditures. There are two major causes: the expansion in the demand for public goods and the boosting of the features of the current administrative system. Undeniably, these two interact as both cause and effect, but the essence is the relationship between the demand for public goods and the system of providing them. Nowadays, many studies on the causes of the expansion of fiscal expenditure are conducted from the angle of the demand for public goods; relatively fewer studies are done from the angle of the features of the administrative system. But in China today, the features of the administrative system exert an unusually strong pulling effect on the expansion of fiscal expenditures. In fact, in western countries the pulling effect of the features of the administrative system on the expansion of fiscal expenditure is strong as well, and they have chosen to employ performance budgeting since the 1980s while gradually advancing new public management reforms. The purpose of doing so is to cut wasteful spending caused by the shortcomings of the administrative system, further relieve the pressure on expenditures, and avoid financial crisis. The author of this paper attempts to analyze the pulling effect of the features of the administrative system on the expansion of fiscal expenditures, and to propose some responses.

## 2. The constraints of the system of administrative control on fiscal expenditures

The system of administrative control is a generic term for the administrative system and mode of the administrative activities of governments. Administrative activities are concrete manifestations of governments governing public affairs, and they are expressions of the will of the state. The system of administrative control includes government planning and policy-making, establishment of hierarchy, setting of institutions, managing of employees, etc. Viewed from the results, the system of administrative control is a management system covering the entire process of governments in providing public goods.

The administrative activities of governments are presented through the process of providing public goods, which is displayed by the consumption of manpower and material goods. Some public goods are finally presented in solid forms (such as museums, roads, and traffic lights), others are intellectual products (like educational products), and still others are displayed through the maintenance and adjustment of social interests (such as national defense, diplomacy, and social security). After the emergency of the monetary economy, the various expenditures of governments were manifested in the form of capital flows, and money became the instrument for valuation. In short, the administrative activities of governments are manifested in two chains: the supply of public goods and government cash flow, among which the former plays a leading role and the cash flows along with the scale, structure, quality, and direction of the public goods provided by governments. It is obvious that the system of administrative control determines the basic structure of fiscal expenditure, and any alteration in fiscal expenditure is reflection of the change in the administrative system.

The constraints of the administrative system on fiscal expenditure include the following aspects.

*2.1. The definition of government functions determines the range of expenditures*

The definition of government functions determines which public goods governments provide. The activities of governments involve many dimensions of society. They aim to create basic conditions for the development of various sectors in society and meanwhile to maintain social order by providing public goods. In the economic sphere, governments intervene in both competitive and noncompetitive sectors. However, differing from individuals, governments get involved in such fields to regulate and fulfill social objectives rather than to obtain profit. During certain historical stages, it is necessary for governments to set up a state-owned enterprises system to achieve their goals. “Despite differences in ideology, state-owned enterprises are commonly regarded by people in developing countries as a means of expanding state political rights.”(Cody etc., 1980)

From a theoretical point of view, government functions are abstract and broad, because there are different standards from political, economic, ethical, cultural and ethnic angles as to what governments should do. The general public wishes to maximize public welfare and personalize the supply of public goods, but governments are not omnipotent and can only do limited things with limited resources. Therefore, in real life, government functions exhibit different emphases in the supply of public goods.

Public finance is the finance of governments. It flows to related areas according to the will of the people. Thus, government functions reflect in finance the functional classification of government spending, which shows in which directions resources can be allocated. According to the International Monetary Fund (IMF) definition, government spending can be classified into four aspects according to its functions: economic services, social services, general government services, and other services (such as inter-governmental transfer payments). “Service” shows the essence of government functions, namely, to create conditions for economic and social development. Among the four aspects of spending, general government services and social services are the basic functions of governments. Thus it can be seen that the statistics in the functional classification of government spending are a final presentation of the performance of government functions during a certain period of time, and the total volume and structure is an account of what governments have done and where their focuses are.

It is necessary to point out that due to the broad definition of government functions and the many aspects government spending may cover, it is difficult to define clearly the fiscal expenditure range. Therefore, it is hard to identify the distinctions of expenditure ranges in different countries based merely on the direction of capital flows. The significance of making this point clear is that we cannot generalize and conclude that the Chinese government's functions or scope of expenditure are broad or narrow; meaningful judgments are conclusions drawn from analysis of the structures and features of the administrative system.

### *2.2. The development concept of a government determines its financial management*

Government functions generally consist of the coordination of social development and of economic development. The coordination of social development is the top priority of governments, and coordinating economic development in essence is to coordinate social development. For instance, the purpose of governments regulating the development trend of the macro-economy is to optimize resource allocation and achieve sustainable development and further promote employment and safeguard social stability. The reason we use the word "allocation" is that both social and economic development are autonomous, and it is impossible for governments to control economic or social development. It should be recognized that social development, just like economic development, has inherent laws; therefore, governments can only comply with the laws and coordinate development rather than control development.

The development concept of governments involves the speed and structure of development. The latter refers to the stress governments lay between social and economic development. The development concept of governments has significant constraints on their financial management because government finances must be managed in accordance with the government's mentality for development, and fundraising and utilization cannot be separated from government planning. It is obvious that if governments hold a development concept of high growth for both social and economic development, there will surely be imbalance in financial management. This is because high growth in both social and economic development calls for rapid expansion of fiscal expenditures. However, the increase of government revenue is confined by the limited tax distribution and the decreasing will of the general public to pay taxes. In other words, there is a strong contradiction between the subjectivity of the expansion of fiscal expenditure and the limitedness of the increase in government revenue. As a result, governments have to turn to deficit and issuance of debts to relieve the periodical conflict, which inevitably will lead to a Gordian knot. Consistent high growth for both social and economic development will unavoidably cause a fearful imbalance in financial management.

Viewed from the experiences of other countries, government deficits are more frequently caused by the promotion of social development. When "small government, big society" was advocated in Western countries, there was universal balance in revenue and expenditure. After the Second World War, Western governments raised the standard of social welfare as well as its scope. Meanwhile, the alternation period of expenditure in education, science and technology, energy and resources, and national defense increased. All these gave rise to the imbalance between fiscal revenues and expenditures. The most direct reason for deficits in European countries with high social welfare is that social insurance exceeds those countries' capacity to raise revenue. The deficit in the U.S is the result of its pursuit for a paramount global position, high-level investment in science and technology, and the rising standard of social welfare. Moreover, strategies for social development are a significant aspect when studying the influence of the development concept on financial management.

*2.3. The hierarchies of governments constrain the scale of fiscal expenditure*

The hierarchical setting of governments is the vertical network of the administrative system. It reflects the ideas of administrative control of a country and the relevant regulations and policy implementation models. The reason why there are multi-level governments in a country lies in multifarious public affairs, massive populations, as well as the vast territories. Governments in a country can be categorized in two types-directive-type government and supply-type government. The central and provincial governments belong to the former while grass-roots governments belong to the latter. It is necessary to point out that the two types of governments are not clearly differentiated in reality. As a matter of fact, both types of governments have the directive function and supply function regarding public goods. What is different is that the former type is more directive and the latter is more of a supplier. The number of levels of government changes in the same direction as the scale of fiscal expenditure. The reasons are as follows.

First, There must be a level of financial administration for a level of government. Government by nature is a relatively independent administrative command center and organizer of public goods supply. Therefore, governments at all levels have independent rights in fundraising and spending. Governments would not be able to function and there would not be relative independence for governments if there were no fiscal revenues and expenditures. Thus, with the established functions of governments, the number of governments may determine the amount of fiscal expenditure. The basic corresponding relationship is that there must be an operating cost for a government. Additional levels of government will surely lead to huge government operating costs.

Second, The hierarchical setting determines the number of levels of government. The hierarchical setting determines the number of local governments-the more levels, the more local governments. This is because the many levels of government reflect the high degree of segmentation and the relatively narrow administration of grass-roots governments.

*2.4. The department setting of governments straightly affects the scale of fiscal expenditure*

Concrete government departments carry out government functions and the supply of public goods. In other words, various departments exercise certain administrative power on behalf of governments. Government departments can be classified into three categories—— general government services, social services, and economic services. The number of government departments reflects the degree of segmentation of the execution of government administrative power. All governments around the world attempt to have clear and non-overlapping functional divisions among different departments, but in reality, functional overlap is inevitable. The root lies in the fact that certain administrative power calls for cooperation of several departments or the administrative power itself involves such a wide range that it is difficult to determine which department should be responsible for it.

The functional division of government departments reflected in the financial administration is department expenditure budgeting. Basic expenditure shows the basic cost for the performance of functions, and project expenditure shows the periodical tasks in function performance. Therefore, superabundant departments will lead to the rising operating cost of government. If functional divisions among departments are not clear, then the total project expenditure will rise. The universal phenomenon around the globe is that when making plans, government departments tend to neglect budgetary constraints, which artificially increases the expenditure budget. The more departments there are in a government, the faster fiscal expenditure expands. Meanwhile, government departments tend to make light of efficiency in the aspect of personnel, which artificially raises personnel outlays. The more departments, the more rigid the expansion of personnel outlays.

## 3. The pulling effect of the features of the administrative system on the expansion of fiscal expenditure

China is a highly centralized country with a single political authority. During the transition period, the institutional impulses in economic and social development are always accompanied by rapid expansion of fiscal expenditure. This relatively stable statistical phenomenon indicates that administrative control and fiscal expenditure feed into each other institutionally. Following the above analysis, we can identify that the features of administrative system boost the expansion of fiscal expenditure in the following ways.

### *3.1. Consistent pursuit of Chinese governments at all levels for high growth in both economic and social development*

After reform and opening up, China managed to gradually eliminate the planned economy, but China is still a planning-oriented country. The five-year plans and annual plans of governments at all levels stipulate in detail the goals and tasks of governments, development routes, as well as related performance indicators. Departments make their own plans based on the fundamental principles of the government's general plans. As the compass and timetable for government work, government planning has strong constraints on government actions and is the foundation for the evaluation of the achievements and performance of governments and officials. Therefore, governments at all level attach great importance to the development and implementation of planning. The establishment and alteration of laws and regulations, and policies, setting of institutions, and grouping of functions are all results of planning. Although transformation of government functions and the promotion of social forces to economic and social development have always been stressed, comprehensive and target-for-all government planning implies that governments are being totally responsible for economic and social development.

Thus, the generalized development concept of Chinese government at all levels is that development is the absolute principle and overall high speed development is the major principle. This concept, getting specific to local governments, means carrying out leapfrog development strategies.

Therefore, the plan of government at all levels is to pursue high growth. Several five-year plans of the central government required an economic growth rate of 7%, and local governments set even higher targets. Complying with this target, the growth rates for fixed investments, introduction of foreign capital, export trade, industrial development, and financial revenue are expected to reach double-digit growth. Meanwhile, every five-year plan of the central government stresses the rapid development in various social undertakings, which include development of education, science, culture and health service, synchronous advancement of urban and rural development, raising the rate of urbanization, increasing incomes for farmers, speeding up infrastructure construction of agriculture and forestry, as well as completion and improvement of urban public utilities. To comply with the principles of the central government, local governments also set high targets for social development. Thus, both departments for economic development management and social development management shoulder heavy responsibilities.

Viewed from the subjective angles of demand and emotions, planning for high growth in both economic and social development is in favor with the general public. However, from the objective angle, there seems always to be a sharp contradiction between the demand of human society and reality. Currently, China is faced with the real problem that capital constraints are rarely considered when setting targets in government planning. Ambitious targets are set as if there were no limits to capital supply. When departments establish projects, they adhere to the principle of more projects, higher starting points, and being sustainable, which leads to the need for increasing inputs. When the expenditure increase in the radix method cannot meet the demand, departments start thinking about setting an annual increase at a certain rate or setting a certain ratio for department expenditure in GDP. There is no way the financial departments that are the examination and approval authorities for budget management can contain various departments' increasing demands for expenditure. This is because the each department regards each increased expense as indispensable for overall development. Therefore, after analyzing the increasing structure of the Chinese fiscal expenditure, we can note that there is no focus on the increase. Even the highest rate in education is less than 18%, and the expenses in major categories (education, science and technology, social security, health service, and the Three Rural Issues) nearly increase at similar double-digit growth rates. From the angle of statistical analysis, this structure will ultimately push the total expenditure into rapid growth. The ultimate reason for this pattern is that the institutional impulses for rapid development pull fiscal expenditure onto an imbalanced budgetary path.

*3.2. Relatively broad government functions*

Compared with western countries, the functions of the Chinese governments are so broad that almost every aspect is covered. This is embodied not just in economic development but also in social development. There have been watchful eyes on the former as people have been appealing to the government to cut expenditure, but much less attention is paid to the latter. In fact, overly broad government functions regarding social development have a much stronger pulling effect on the expansion of fiscal expenditures.

Currently, there are seventeen major spending types in the classification of government revenues and expenditures. This classification actually reflects the segmentation of government functions, and a study of this classification indicates that the functions of the Chinese government are very broad.

Viewed from the angle of economic services, the Chinese government is involved in various sectors of the economy, even including competitive sectors. This is totally different from Western countries. The fifteenth type among the current seventeen functional spending types is about affairs in the manufacturing, commerce, and financial industries, which cover ten specific industries. Settings of article and item levels indicate that governments not only have administrative control over these industries, but also intervene in their development through financial investments. For example, settings of spending programs related to the textile industry, chemical industry, and machinery and building materials industry indicate that governments provide financial support for equipment manufacture in these industries. For another instance, the sixth article in the fifteenth type is tourism. The settings of the item state that governments even get involved in tourism publicity (which involves the promotion cost of domestic and overseas tourism). For a third example, items eight and nine indicate that Chinese governments tend to support agricultural development through subsidies which are fractionized to subsidies for grain and oil price differences, subsidies for border-selling tea reserves and for wool reserves.

In social development, Chinese governments are doing almost everything. They even get deeply involved in areas where western governments stop. For instance, there is a category named culture, sports, and media among the functional classifications. In this spending category, governments pay for venues, teams, and athletic events. In the fields where Western governments are also involved, Chinese governments get much deeper. Take education, for example, where China has unique articles such as radio and television education, continuing education for teachers and officials, education for adults etc. Transportation is another example——government functions in this aspect are divided into three articles, which include sixty items. This means that governments are not just responsible for the construction of infrastructure and major traffic routes, but should also provide financial support for transportation facilities.

Such broad government functions signify a broad fiscal expenditure range. It is an incontrovertible fact that there is capital input in every aspect covered by government functions. Every spending program receives financial support, and as long as there is one spending program, related departments strive to maximize its expenditure because they can find thousands of excuses to explain the importance and significance of the spending. It is obvious that a broad expenditure range caused by broad government functions provides a basis for the expansion of expenditures. Rapid expansion of fiscal expenditures is inevitable under the strategy of pursuing high growth in both economic and social development.

### *3.3. A multitude of government departments*

The setting up of government departments depends on the range of government functions and their means of performance. Generally speaking, broad government functions will surely lead to many departments. As has been stated above, China is a country with relatively broad government functions, and this lays a foundation for the setting of a multitude of departments.

There are over eighty government departments at the central government level, over fifty at the provincial government level and more than forty at the municipal government level. The departments of the Chinese government can be categorized into three types. First are constituent departments. The National People's Congress of the equivalent level approves the appointment and removal of such department heads (principals and deputies). Second are functional institutions under the direct control of the government. Third are working bodies. The government determines the appointment and removal of the heads in the second and third types of departments. Some of these institutions and bodies belong to the administrative establishment and others belong to the public institution establishment. Among those belonging to the public institution establishment, some have administrative functions and others, even though without administrative functions, also get involved in providing public goods. In China, the supervision departments of financial markets, such as China Securities Regulatory Commission, China Banking Regulatory Commission, China Insurance Regulatory Commission, and the State Electricity Regulatory Commission, are all public institutions that perform administrative functions. Some departments of social services, like State Seismological Bureau and State Meteorological Administration are also public institutions that perform administrative functions. In China, compulsory education is a typical case of public goods whose decision-making and provision are separated——educational policies and regulations are made by education administrative departments, whereas educational products are provided by education administrative departments and schools, which are public institutions under the direction of some administrative departments. The department of health is a similar case. The working bodies of the Chinese government enjoy both the rights of policy-making and of public goods supply. Some working bodies even have affiliated public institutions, such as the Poverty Relief Office of the State Council. In general, we can come to the conclusion that the decision-making and provision of public goods in China are basically integrative——the administrative departments make the policies and the affiliated public institutions provide public goods.

The number of government departments is determined by many factors. It reflects the basic idea of the system of administrative control and the administration fashion of the heads of governments. There are two major institutional reasons for the multitude of government departments in China.

First, Special departments are set to reinforce leadership. With highly segmented administrative power, people believe every single power is of great importance and should be carefully implemented. Therefore, an administrative department is established for each segmented power. What's more, an institution is set up for a specific affair. For example, science popularization is considered to be important, so a minister-level unit, The Association for Science and Technology Popularization, was established. Covert affairs are important, so a deputy ministerial department, the National Security Agency, was established. Institutions such as Administration of Religious Affairs under the State Council, State Meteorological Administration, National Copyright Administration, National Standards Commission, State Bureau of Cultural Relics and State Forestry Administration were all established for the same reason.

Second, A single administrative power is executed by several departments. The highly segmented authority in China demonstrated in reality is that several departments execute different aspects of power respectively. This pattern is related with the general feature of the administrative system, which is administering a country through planning. The planning of the Chinese government is so fine that even every big project, special regional affair, and special action plan are included. Therefore, when a particular power is stressed, it is segmented again, and additional departments may be established. For example, when agricultural development is stressed, the administrative power of agriculture is performed by the Ministry of Agriculture, the Agricultural Comprehensive Development Office of the State Council, the Poverty Relief Office of the State Council, and the Forestry Bureau. For another instance, when the development of science and technology is emphasized, the administrative power of science and technology is executed by ministry-level departments, including the Ministry of Science and Technology, the Chinese Academy of Science, Chinese Academy of Engineering, National Natural Science Foundation, and Chinese Academy of Social Sciences. A third example is that when maintaining market order is stressed, departments like the Administrative Bureau for Industry and Commerce, Administration of Quality Supervision, Inspection and Quarantine, and State Food and Drug Administration will get involved and implement relative policies.

So many departments have become a powerful driving force for the expansion of fiscal expenditure. The following are the clear cause-and-effect relationships.

There is a budget for each department. Every department has the equal standard for basic expenditure and the same rights to set up projects. The multitude of departments will unavoidably result in increased government operating costs. The basic operating facilities such as office facilities and department buildings give rise to expenditure on infrastructure construction and maintenance. In China, it is a firm belief of administrative officials that financial power and administrative power should be unified. However, what makes things hard is how much financial power should be matched with certain administrative powers. From the departments' point of view, they need limitless money to execute their power because the planning of each department is so ambitious that they set no limits on the needed capital when they make plans. Therefore, all departments seek to maximize expenditure on each project, and budget management institutions have no choice but to see expenditure budgets rise evenly regardless of the size of the departments.

In the current situation where one single administrative power is executed by several departments, governments in China have established the mechanism of coordination and consultation of department budgets. This means that each department makes its own budget, and budget management institutions divide the expenditure budget according to the functions of different departments. Usually the superior budget management institution tends to preserve the budget increase in departments under its jurisdiction. Thus, overlap in setting up projects is inevitable no matter how clear their functions are divided. In fact, functional boundaries cannot be clear among the multitude of departments. This is like a football match. If there are three referees, two of them taking charge of the two sides respectively, and the chief referee the entire field, the function division among them is very clear; but if there are six referees on the sides, three on each, then their functions will be ambiguous, nor will the chief referee be able to tell which linesmen he can trust. Thus, it is evident that several departments executing one single power will surely lead to institutional expansion of expenditure.

*3.4. The setting up of five levels of government is bound to increase fiscal expenditures*

Segmentation in administration is the basic principle of the Chinese administration. It is horizontally embodied as the setting of a multitude of departments, while vertically it is shown via multi-level government. For a long time we have been stressing centralized leadership, level-to-level administration, and arousing the enthusiasm of both central and local governments. In practice, it is manifested through five levels of government, and the principle of financing according to the levels of governments is written in the Constitution. Since tax distribution was put into place, the principle of financing according to the level of government has fully displayed its importance in arousing the enthusiasm of local governments. Meanwhile, centralized leadership is demonstrated in the supervision of superior governments over governments at lower levels. It is stipulated in the Constitution that the State Council has supreme charge over the national administration, provincial governments have supreme charge over the administration of the entire province, and governments at lower levels must follow the direction of superior governments. In this context, over 45,000 local governments have been established, which means there is one government for every 200 square kilometers, and if the Qinghai-Tibet Plateau and deserts are excluded, there is one government for every 150 square kilometers. The area is even smaller in the more populous areas such as Zhejiang and Jiangsu Provinces.

Such hierarchical setting of governments inevitably results in the institutional expansion of fiscal expenditure.

First, there is one level of financial administration for each level of government. One level of financial administration means independent financial revenues and expenditures. Independent expenditures signify independent rights to determine the scope of expenditures. When each level of government attempts to do many things and do well in them, there will be strong rigidity for the expansion of expenditure. When 45,000 local governments follow the same principle, the institutional expansion of fiscal expenditure will be irresistible.

Second, the system of governments at lower levels following the direction of superior governments implies that the former should follow the pattern of the superior governments concerning planning, setting of institutions, expenditure policies and standards. The truth is that when governments at lower levels follow the system arrangements of superior governments, they fail to take into consideration the functional features of governments at different levels. Therefore, it turns out that the setting of institutions, expenditure policies and standards of local governments are totally consistent with those of the superior governments and even with the central government. There is no clearer demonstration of institution-caused excessive spending than this. As we inspect the operation of local governments, it is beyond our comprehension that a county with a population of around 100,000 will set up a sports bureau, a press and publication bureau and an ethnic affairs commission. Are they really necessary? When governments at lower levels implement the policies and system arrangements of superior governments, they do their best to obtain more financial support, and when they fail to get the money they want they have to figure out their own means of financing. Besides, when local governments are given the right to choose independently the public goods they provide, the only feasible means is to incur debts and sell resources, because the budget is all invested in the affairs assigned by the superior governments. It is obvious that consistent system among all levels of governments factitiously raises the operating cost of governments and also directly increases the possibility of the expansion of project expenditure.

## 4. Responses

Based on the above analysis, it can be seen that the features of the Chinese administrative system are the institutional basis of the imbalance in fiscal revenues and expenditures. In other words, to understand the fiscal deficit in China it is necessary to pay attention to the effect of institutional impulses. In China, the demand for public goods expands rapidly due to the objective factors such as a huge population, vast territory, advancement of urbanization, and the gap between public services in urban and rural areas. We must effectively control the institutional impulses that lead to the expansion of fiscal expenditure, otherwise, financial administrations at all levels will unavoidably suffer great imbalance. Thus, we should try to solve the problem from the following angles.

### *4.1. Taking financial restrictions into consideration when making government plans*

From a theoretical point of view, government planning in essence is the planning of the allocation of government funds, because all government actions will be put into place through capital. However, in practical work government planning and budget making are separate in the initial phase. Usually planning is done first and then financial support is sought to put the plan into practice. Such arrangement actually presumes government capital is limitless. But reality is quite the opposite. We should bear in mind that government capital is limited and when government plans are made, it is necessary to pre-estimate the possibility of increasing government revenue and then set specific targets in the planning.

Of course, taking financial restrictions into consideration when making government plans does not mean confining government functions, but that governments should identify key aspects in the periodical development in accordance with revenue, and set feasible standards which won't cause excessive cost expansion. To be specific, taking financial restrictions into consideration is to realize that in a country in the transition period, the percentage of government revenue in GDP should not be too high. It is important to see that government revenue taking up 40% or 50% of GDP is based on a GDP per capita of tens of thousands of dollars. As a matter of fact, the current tax rate in China has brought about enough room for increasing tax revenue. It will be impossible for the general public to accept a higher tax rate. The experiences of western countries have proven that the will of the public must be considered when tax rates are designed, otherwise, there will be turmoil in society. Recent years have seen a relatively large increase in tax revenue, which is the result of the co-effect of higher tax rates and tightened tax levying.

### *4.2. Setting objective targets*

Government planning is the embodiment of government functions. In any country, the public wish is to maximize the general welfare and have problems solved as quickly as possible. From an emotional and ethical point of view, governments should fulfill the wishes of the general public. But the reality is that ideals and objective conditions do not always match and problems can only be solved step by step. The targets in government planning are concrete promises governments make to the public. If the targets were set based on emotions and ethics, there would be sharp contradiction between the unlimited promises and limited real conditions, and the result would be disappointment and incomprehension on the side of the public.

At present, a worrying situation is whether targets can be fulfilled on schedule. The Twelfth Five-year Plan set dozens of targets involving economic growth, population, resources, and the environment, public services and people's livelihood. Although these targets are divided clearly into two types: anticipated and obligatory. They become mandatory at the level of local governments. It would be impossible to fulfill these targets without massive investment from governments who have promised to establish thousands of key projects centering around those targets. Certainly, governments will not fund all of these projects, but some of them do rely totally on governments for financial support (such as key projects regarding education). Others will need at least initial funding from the government. It should be seen that all the projects governments promise to establish are highly consuming. A conservative estimate of the capital needed is hundreds of billions of yuan. If regional key projects promised by local governments are taken into consideration, the cost would be in the trillions. But since governments have promised, they have no choice but to make the investment. In reverse, did they think about the possibility increasing revenue when they set forth those projects? Here is a calculation: if the financial revenue increases 1 trillion every year, all the increased money will be put into the key projects. But the contradiction is where shall we get money to meet the recurrent expenditure increase and the increase in investments in non-key projects?

Therefore, we should keep a calm mind when setting forth targets in planning, keep targets as low as possible, and analyze comprehensively the relevance between the increase of government revenue and the demand for input. Meanwhile, the number of key programs and key projects should be cut. Furthermore, it should be pointed out that some plans for economic and social development should be directive and it is inappropriate to set specific targets, for example, for resident income. In a market economy, resident income is determined by the market, not by government. Every time we make plans, we set annual growth rates for the disposable income of urban residents and for the net income of residents in rural areas. The operability of both targets is very low because the factors affecting the income of urban and rural residents (like employment, wage level, and labor flow, etc.) are uncontrollable. As for the average net income of rural residents, in the context that the cost of agricultural production never comes down and prices for pesticides and fertilizers keep rising, no one can assure net income will rise at a certain rate. We should bear in mind that we have had lessons of failing to meet targets-we promised an economic growth rate of 8% in 1998 and failed, and the target for consumption reduction in 2012 was not met either. All these facts have shown that the market, not the subjective will, determines economic targets.

### *4.3. Building a coordinating mechanism for departmental budgets*

The multitude of departments in the Chinese government is a difficult problem for the reform of the administrative system. It should be admitted that solving this problem is very difficult. In fact, the demand for public goods is huge in China due to the country's great population. Taking compulsory education for example, the number of students enjoying free compulsory education in China is more than the populations of Germany and Japan combined. Under these conditions, the Chinese government is faced with heavy tasks and indeed needs additional departments. Compared with other countries, the percentage of the population supported by government finances in the total population is not very high. Moreover, we cannot simply regard institutional reform as the reduction of the number of institutions and public officials.

However, it should be seen that it is unreasonable not to set up a coordination mechanism for departmental budgets. The function of such a mechanism would be to reduce overlapped projects, especially to reduce overlapping projects in departments sharing the same administrative powers. In order to do this, the first thing is to eliminate the idea that departmental budgets are the business of individual departments only. It should be realized that departments are entrusted by governments as performers of a certain administrative powers, and resources are allocated among departments in comprehensive manner. Therefore, overlap in setting up projects is the worst waste of resources. In practice, holding joint conferences on project budget among departments can be considered, and financial departments can invite an expert group to clarify the projects and then grant approval after the examination of the project budget.

*4.4. Practicing performance evaluations on department expenditure budgets and releasing the results*

Currently performance evaluation on department expenditure budgets has been practiced at the central financial administration level, which is historical progress. The key issue now is how to practice the evaluation at different levels of financial administration. It is generally believed that practicing performance evaluation is difficult and there is no apparent significance. But I believe this is no excuse for giving up or postponing such reform. We should realize that there are difficulties in any reform, or it wouldn't be called reform. There are indeed difficulties in practicing performance evaluations on department budgets, but it is surely better than nothing. The evaluation will serve as an alarm and ultimately reduce some unnecessary spending. It is similar to investment reviews, which were difficult to implement in the beginning but have cut many unnecessary investments. In general, the benefits outweigh the costs. Western countries have been practicing performance evaluations for many years and are persistent even though the system is not mature. The reason lies in the fact that it is an institutional control of expenditures. As for releasing the results of the performance evaluation, there should be no hesitation. Auditing departments have released audit reports for government departments, and now have started performance audits of certain department budgets. Financial departments should keep up with the pace and release results of performance evaluations on department expenditure budgets. Otherwise, the public will see problems only but not the performance of government funds or the transparency of public finances.

In order to practice performance evaluation on department budgets, we should firstly build a government performance evaluation system based on which the performance of fiscal expenditure can be evaluated. While building a government performance evaluation system and fiscal expenditure performance evaluation system, the indices should be simple because the present key issue is to make appropriate evaluations, and refined evaluation still takes time. The fiscal expenditure performance evaluation indices should focus more on effectiveness. The results of the performance evaluation of departmental budgets can be released first within governments.

*4.5. Adjusting the hierarchical establishment of governments*

Five levels of government belong to the standard vertical extension mode. Viewed from the angle of fiscal expenditures, the establishment of five levels of government is the institutional foundation of the expansion of government operating costs. Now we are in the market economy era and the information age, and we have met the requirements for adjusting this system. "The administrative system suitable for under-populated areas connected by stagecoaches and postmen is not suitable for modern, populous areas connected by railroads, telegrams and telephones. What were separated have been unified, thus the administrative system should be more centralized so as to fit the changed environment." (Goodnow, 1900)

The fundamental significance of adjusting the hierarchical establishment of governments is to fit the changing environment and further optimize the mode of administrative control. It seems that we can change township governments into resident agencies. The debts of township governments are spreading and being aggravated. The root cause is that one level of financial administration allows township governments the right to determine independently what public goods to provide, and the rights to expand debts and increase expenditures. If they were changed into resident agencies, the institutional foundation of the expansion of expenditure in township governments would be weakened. Furthermore, it would help to regulate the actions of government officials and put into practice the united will rather than the will of certain village cadres. It may be a concern that no one would take charge of the public affairs if township governments were changed into resident agencies. In my humble opinion, there is no sufficient ground for such concern. We should recognize that many public affairs are managed by resident agencies, such as taxation, quality inspection, customs, and railways. Putting these public affairs under the charge of agencies is not crippling administration. As a matter of fact, many organizations in towns are resident agencies, for example, taxation and public security, as well as industry and commerce. This actually indicates that towns are not qualified to be a level of government. If the issue is viewed from the correspondence between administrative region division and the market features of the distribution of tax sources, the conclusion is more easily drawn that township governments are no longer suitable. There was lack of standardization in the township government fund-raising mechanism before tax reform, and the primary cause lies in the sharp contradiction between the limited tax sources and township-government functions. Changing township-governments into resident agencies can be combined with the advancement of urbanization, and to be more specific, it would mean to group economically developed towns into cities and set up a municipal financial administration for the new city.

## References

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