

Research on the Intergovernmental Fiscal Relations of China in the Past 70 Years: Fiscal Decentralization in Evolution

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Since the founding of the People's Republic of China, the Chinese scholars of finance theory have been sparing no effort on the theoretical research of intergovernmental fiscal relations in the past 70 years, with fiscal decentralization at the core. Although fiscal decentralization has a long history, the intergovernmental fiscal relations which use fiscal decentralization as the vehicle did not constitute an independent research topic in the early days of the People's Republic of China. Later, fiscal decentralization was adopted and gradually flourished in China, once systematically explained as the target mode of intergovernmental fiscal relations, and even took the form of tax sharing system. In the new era of socialism with Chinese characteristics, the booming research on intergovernmental fiscal relations, adapted to the theoretical innovation of modern fiscal system, has contributed to coping with the changes of international and domestic economic situation in the new normal and to the sustainable fiscal development of China.

Keywords: 70th anniversary of the founding of the People's Republic of China, intergovernmental fiscal relations, fiscal decentralization

1. Introduction

How to deal with the intergovernmental fiscal relations is an eternal topic. With the development of productivity, the relationship between government and market is constantly adjusted, and the scope of government function and fiscal function is in dynamic adjustment. For this reason, it is necessary to standardize and define each specific fiscal function, each revenue and each expenditure responsibility of the governments at different levels by stages. That is to say, the fiscal relations between governments are not fixed. In the 70 years since the founding of the People's Republic of China (PRC), under the background of market-oriented reform, China's intergovernmental fiscal relations have been adjusted dynamically, and are moving in a circuitous way in the direction of "centralization—decentralization—centralization—decentralization".

Theory originates from practice and guides practice. The dynamic adjustment in practice determines the continuous innovation of theoretical research. In the 70 years of

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reform practice from the beginning of the founding of PRC to the transition from planned economy to market economy, then to the establishment and development of socialist market economy system, till socialism with Chinese characteristics entering the new era, the intergovernmental fiscal relations have risen from an implicit clue to the main line of fiscal and tax reform. Accordingly, the research on intergovernmental fiscal relations in the fiscal academic circle of China has also evolved from scratch and increasingly deepened, making great contributions to the development of research on China's public finance. Therefore, on the 70th anniversary of the founding of PRC, it is of great theoretical and practical value to depict the main line of research on intergovernmental fiscal relations in the past 70 years, collect and analyze the important theoretical achievements in this field, and look to the future of the research in the new era on the basis of summarizing the laws.

Looking back on the 70 years of the study of intergovernmental fiscal relations in China, we can understand it from the following four historical stages (Table 1). It is evident that fiscal decentralization has always been the main line of the development of the theory and practice of intergovernmental fiscal relations in China, with the continuous enrichment of connotation and expansion of extension since its ideological germination.

Table 1. Background and Main Line of the Four Stages of the Study on the Intergovernmental Fiscal Relations in the 70 Years since the Founding of the PRC

Stage	Background	Theoretical main line
Early days of the PRC	Establishment of “unified leadership and decentralized management”, and the publishing of <i>On the Ten Major Relations</i>	Birth of fiscal decentralization
Transition period of economic system	The fiscal control system marked by “dividing revenue and expenditure between the central and local governments” experienced frequent adjustment	Fiscal decentralization was systematically interpreted to lay a solid theoretical foundation for the implementation of tax sharing system reform
The period of the establishment and construction of the socialist market economy system	The establishment of tax sharing system and the mainstream position of public finance	Fiscal decentralization was reflected by tax sharing system. Research on intergovernmental fiscal relations matching tax sharing system was conducted under the framework of public finance theory
Ever since socialism with Chinese characteristics entered the new era	Public finance is granted new position and the fiscal relations between the central and local governments become the top priority of modern fiscal system	Fiscal decentralization thrives. Intergovernmental fiscal relations, as the core of fiscal decentralization, gets unprecedented attention

Source: Relevant data assembled by the authors.

In the early days of the founding of the PRC, with the completion of the socialist transformation and the establishment of socialist planned economy system, most of the fiscal administrative powers and fiscal rights were concentrated in the central government. In the theoretical research, although fiscal decentralization has a long history, in the early days of the founding of the PRC, the focus was to study the

essence of socialist finance with the aim of establishing a fiscal system suitable for the development of the socialist system, while the intergovernmental fiscal relations with fiscal decentralization as the carrier was not yet an independent research topic. With the thought of “unified leadership and decentralized management” taking root in the practice of the First Five-Year Plan, and the publishing of Mao Zedong’s report *On the Ten Major Relations*, the academic circles gradually paid attention to the fiscal relations between the central and local governments under “unified leadership and decentralized management”, and tried to analyze this problem from the perspective of history and comparison.

In the period of transition from planned economy to market economy, the fiscal management system marked by “dividing revenue and expenditure between the central and local governments” experienced frequent adjustment. The theoretical research focused on seeking the causes for the fiscal difficulties of the central government from the perspective of institutional change, and began to systematically explain “fiscal decentralization” as the target mode of fiscal system to straighten out the intergovernmental fiscal relations, which laid a solid theoretical foundation for the implementation of tax sharing system, thus the relevant historical research and international comparative research have also stepped up.

In the period of the establishment and construction of the socialist market economy system, fiscal decentralization was reflected by tax sharing system, the implementation of which highlighted the importance of intergovernmental fiscal relations. The focus of theoretical research was the division of various elements of intergovernmental fiscal relations under the framework of tax sharing system—the division of administrative powers, fiscal rights, fiscal resources, and expenditure responsibilities. At the same time, with the establishment of the mainstream position of public finance, more and more studies were conducted to explain Chinese intergovernmental fiscal relations with the help of western fiscal decentralization theory. In addition, there were breakthroughs in research methods, and relevant empirical studies increased rapidly.

After socialism with Chinese characteristics entered the new era, China established the modernization of state governance as the general goal of deepening reform, and put forward that “finance is the foundation and important pillar of state governance”, fiscal decentralization must be committed to the realization of the new position of public finance and make a new institutional arrangement on the basis of the tax sharing system, and finally, together with the budget system and the tax system, it has been incorporated into the framework of the modern fiscal system, and has become the carrier for the modern fiscal system to give full play to the initiative of the central government and the local governments, thus attracting unprecedented attention and becoming the top priority of the reform. The theoretical research focuses on the intergovernmental fiscal relations that meets the requirements of the modern fiscal system, and studies the deepening reform of the intergovernmental fiscal relations with the reform of the division of fiscal administrative powers and expenditure responsibilities as the main starting point in view of the weak points on expenditure side.

2. Intergovernmental Fiscal Relations Drawing More Attention: The Birth of Fiscal Decentralization

Institutional change has a decisive influence on the development of public finance in the period of national economic recovery and planned economy in China. The introduction of the Soviet fiscal model and the criticism of the capitalist fiscal model served as the basis for re-understanding the essence of finance. As the intergovernmental fiscal relations was not in the scope of this discussion on the nature of finance, this issue was not of interest to the academic community at the beginning, but under the guidance of practice, the scattered views gradually became systematic research.

From the perspective of practice, the reform related to fiscal decentralization has started since the founding of PRC, and has been adjusted with the economic and social development. On March 29, 1951, the central government issued *The Decision on the Division of Fiscal Revenue and Expenditure System in 1951*, which divided the national fiscal revenue and expenditure management system into three levels: the central government, the major administrative regions and the provinces (cities); on November 14, 1957, the Standing Committee of the First National People's Congress approved and adopted *The Provisions on Improving the Fiscal Management System*, which was enforced in 1958 and defined the scope of the central and local fiscal revenue and expenditure. On August 8, 1958, the Ministry of Finance issued *Several Regulations on Further Improving the Fiscal Management System and the Corresponding Improvement of the Bank Credit Management System*, among which the main contents of the reform of the fiscal management system were "revenue and expenditure decentralization, plan contracting, regional adjustment, total amount sharing and change on one-year basis", which was implemented in 1959; since 1971, the state has implemented the method of fiscal revenue and expenditure contracting for provincial governments. The Ministry of Finance issued *The Notice on Implementing the Contracting of Fiscal Revenue and Expenditure*, the specific method being "fixing revenue and expenditure, revenue and expenditure contracting, guarantee the payment to the central government, keeping the balance, and fixing for one year". In 1972, the Ministry of Finance improved the method of fiscal revenue and expenditure contracting, and issued *The Notice on Improving Fiscal Revenue and Expenditure Contracting*.

In such a practical atmosphere, coupled with Mao Zedong's systematic exposition of the "Ten Relations" including the relations between the central and local governments in 1956, the fiscal academic circles paid more and more attention to the relations between the central and the local governments. At this stage, some theoretical research still has a strong guiding significance for the practice and theoretical research of today's intergovernmental fiscal relations reform. For example, in 1964, the Public Finance Teaching and Research Office of Renmin University of China compiled the first draft of Public Finance, which examined how the intergovernmental fiscal relations of China developed under the policy of "unified leadership and decentralized management" in the ten years after the

founding of PRC an carried out a special study on the fiscal relations between the central government and the local governments from the perspective of budget management system, which has a basic guiding significance for the current study in this field.

In addition, at this stage, scholars began to expand the research scope to foreign countries, introducing foreign economists' division principles and standards for intergovernmental fiscal revenue and expenditure, and inspecting the intergovernmental fiscal relations of major countries in the world. Qian (1949) found that the division of fiscal revenue and expenditure between the central and local governments in different countries varied due to different political systems, historical conditions and social environment. Yin (1953) made a comparative study of the intergovernmental fiscal relations in capitalist society and socialist society, and traced back to the primitive society, which provided a historical perspective for understanding this subject. These findings and multi-dimensional systematic discussions have laid a solid foundation for the rapid development of the study of intergovernmental fiscal relations in China.

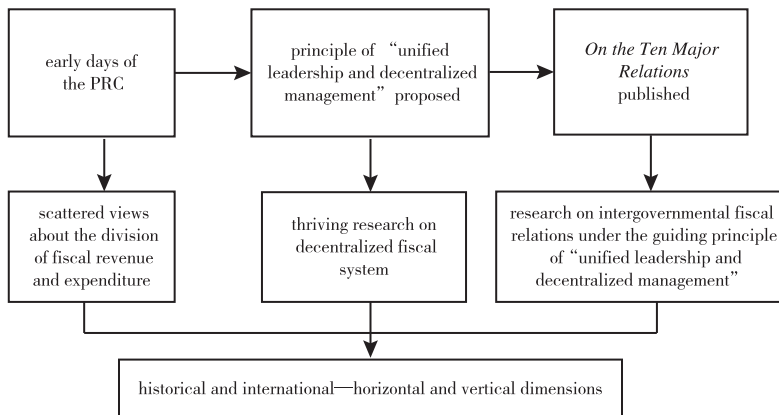


Figure 1. Budding Research on the Intergovernmental Fiscal Relations with Fiscal Decentralization as the Carrier

However, we still need to see that in the historical conditions at that time, it was more important to solve the fundamental theoretical problem of “what is public finance”. The intergovernmental fiscal relations, as an implicit clue for the establishment of socialist finance, focusing on the theoretical interpretation of the practice of fiscal reform, received little attention while the “state distribution theory”, “value distribution theory”, “state capital movement theory”, “surplus product value movement theory” formed at that time were mainstream theories.

3. Research on the Target Mode of Intergovernmental Fiscal Relations: A Systematic Interpretation of Fiscal Decentralization

In the period of economic transition, most of the studies focused on the institutional

causes of central fiscal difficulties, evaluated, analyzed, and proposed suggestions about the frequently adjusted fiscal management system of “dividing revenue and expenditure between the central and local governments”, and began to systematically explain fiscal decentralization as the target mode of fiscal system reform to straighten out the fiscal relations between the central and local governments, studying the intervention of the central government on local finance and the effects of different ways of intervention. The academic research mainly reached the following consensus.

3.1. Fiscal Decentralization Was the Need of Developing Planned Commodity Economy and Solving Fiscal Difficulties

Developing planned commodity economy was the main line of the economic system reform in this period, the reform of intergovernmental fiscal relations being no exception. Under such a realistic background, the relevant theoretical research was also greatly developed. Wang (1998) put forward that “the implementation of fiscal decentralization was the objective need of developing commodity economy and the only way to solve the fiscal difficulties at that time”, thus finding the foundation for the development of the theory of intergovernmental fiscal relations then.

The reason why the development of intergovernmental fiscal relations theory finally fell to the clue of economic system reform is that, in the early stage of reform and opening-up, China's finance took a path of “delegation, tax reduction, interest concession, decentralized management”, and when the fiscal situation was tightening, the public finance of both the central and local governments was tight as the “two proportions”¹ decreased. Subsequent research showed that at that time, the central government frequently drew funds from the local governments, introduced measures which increased local expenditure and reduced local revenue, resulting in instability of the contracting system and seriously dampening local enthusiasm. To cope with the central “borrowing”, local governments converted the budget revenue to extra-budgetary revenue, and left wealth with the enterprises, which eventually led to the loss of central revenue (Yan, 1991).

It is for this reason that the academic community began to deal with the fiscal difficulties of this period, realizing that the reform of the fiscal system focused more on the speed than on the whole, that is to say, the reform was mostly bases on the finance itself, without serious consideration about the fiscal system needed for commodity economic development, which led to the passive reform and the conflict between the dual needs of decentralization of fiscal rights and centralization of fiscal resources. This conflict drove the frequent adjustment of the fiscal system: from “dividing revenue and expenditure, decentralized contracting” to “dividing taxes, approving revenue and expenditure, decentralized contracting”, to various forms of local contracting

¹ “Two proportions” are the proportion of fiscal revenue to national income and the proportion of central fiscal revenue to national fiscal revenue.

system.¹ The above-mentioned fiscal system was not so much fiscal decentralization as fiscal contracting. Therefore, academic discussions about the contracting system yielded approval, neutral attitudes, but more criticism. Proponents believed that the fiscal contracting system improved the transparency of fiscal distribution between the central and local governments, hardened the budget constraints, and expanded the autonomy of local finance. The neutrals analyzed the advantages and disadvantages of the contracting system, and thought that it adjusted interests in terms of distribution, but did not fundamentally straighten out the fiscal relations between the central and local governments. Critics argued that there were institutional defects in the contracting system, including the lack of legal form to protect and fix the distribution relationship between the central and local governments, the lack of objective scientific basis for the quantitative boundary of fiscal division, the prevalence of subjective randomness, and the phenomena of competing for base and proportion and bargaining, which weakened the material basis of macro-control. The sharpened conflict between the central and local finance and the friction of interests aggravated the deterioration of industrial structure and the regional blockade, preventing the formation of a unified national market. In the end, scholars realized that “dividing revenue and expenditure between the central and local governments” was merely a fix on the track of centralized revenue and expenditure, which limited the development of the commodity economy and needed to be reshaped to accommodate the principle of a planned commodity economy (Li, 1992).

So what is the fiscal system appropriate for the development of planned commodity economy? After the layer-by-layer research and analysis, the academic circles began to realize that it was fiscal decentralization, which could straighten out the intergovernmental fiscal relations at that time. Based on the early theoretical exploration, scholars systematically explained fiscal decentralization and gave a clear definition.² Jia (1986) proposed that the fiscal system should “develop towards a deeper economic decentralization and transmit to a thorough central and local tax sharing system and fiscal decentralization”, and he further proposed the need to grasp the principles of transition in “various forms” and two sequences of space and time.

After clarifying what fiscal decentralization was, scholars carried out a comprehensive study on how to straighten out the intergovernmental fiscal relations under its framework. On the whole, to straighten out the fiscal relations between the central and local governments and re-shape the fiscal operation mechanism adapted to the development of commodity economy, is it to implement the fiscal decentralization that is managed independently by all levels of government and is based on the decentralized

¹ The local contracting system includes “revenue incremented contracting”, “total sharing”, “total sharing plus growth sharing”, “payment incremented contracting”, “quota payment”, “quota subsidy” and other forms.

² Wang (1998) pointed out that “fiscal decentralization is the division of fiscal rights on the basis of the division of functions and responsibilities of the central and local governments, so that the local government has the constitutional fiscal legislative power, with independent fiscal resources and independent budget”.

budget, or is it the decentralized management based on the passive implementation and “unitization” of all levels of government? After making a full comparative analysis of the two, the theoretical circles have been in favor of the former and put forward proposals for reform. For example, Guo (1991) defined fiscal decentralization as a “management system of revenue with tax sharing and expenditure responsibility”.

3.2. Implementation of Tax Sharing System Was the Center of Establishing Fiscal Decentralization in China

In accordance with the requirements proposed by the 7th Five-Year Plan that central and local fiscal revenues were divided according to tax categories to clarify the scope of central and local fiscal expenditure, the research on intergovernmental fiscal relations began to put forward the direction and ideas of tax sharing system reform to pave the way theoretically for tax sharing system. At that time, most views held that the establishment of tax sharing system was the central content of the reform of the fiscal system, because the fiscal system was a mixed tax sharing system that combined the tax division with the incomplete categories, which could not meet the development needs of planned commodity economic and needed reform.

The theoretical circle discussed the target mode of tax sharing system, mainly with the following six ideas: (1) Differential tax sharing system. Due to the differences in the economic development in each region, the forms of tax sharing system should be diversified, including both the tax system based and the tax-source based. (2) Tax sharing system with revenue sharing. It was characterized by not only retaining some advantages of the revenue sharing system, but also exerting the advantages of tax sharing system by combing the two. (3) Tax sharing contracting system. On the one hand, the tax sharing system was to be implemented in most parts of the country while in some areas the fiscal contracting system was still implemented, on the other hand, tax sharing system was implemented in provinces and regions where some elements of the fiscal contracting system were retained. (4) Flexible tax sharing system. This mode was characterized by the creation of a flexible pending tax instead of a shared tax. The pending tax was to be determined from a national perspective, but in the case of a certain area, it was either a central tax or a local tax. (5) Tax sharing system with assets distribution. At the same time as the central and local tax sharing system was implemented, the property rights of state-owned assets were divided accordingly. (6) Thorough tax sharing system. The basic framework was composed of the complete separation of taxes, legislation and administration.

After a series of discussions, the theoretical community basically reached a consensus of the thorough tax sharing system as the target mode of tax sharing system, and agreed that there should be a transition period to provide a good link and smooth transition between “dividing revenue and expenditure between the central and local governments” and thorough tax sharing system as the conditions were not ripe for implementation at one.

The reason for making such a judgment is that the realization of a thorough tax sharing system is conditional, first, administrative powers and fiscal rights of all governments at various levels should be clearly defined and reasonably divided, and second, the tax system was more sound and stable, the categories of main tax and auxiliary tax were complete, and the level of tax burden was relatively reasonable; third, the socio-economic development of the various regions of the country was relatively balanced. In fact, these three conditions have not been fully met to this day, so the current tax sharing system is still incomplete and the target mode of tax sharing system has not yet been achieved.

In addition, the theoretical circles also put forward some ideas of great value to the exploration of the reform path. First of all, on how to link the tax sharing system with the fiscal contracting. It was believed that the focus of the convergence between the two was how fiscal revenue should be distributed between the central and local governments. As the tax sharing system was the distribution of tax from the source according to the nature of tax, and the fiscal contracting was the distribution of tax revenue according to the proportion determined by the base, the task of the transition period was to bridge the two distribution methods. Second, on the timing of a thorough tax sharing system. There were two views, one that the sooner the better, thereby increasing the central fiscal rights and fiscal resources, and thus improving the central macro-control capacity. Another view was that it was not appropriate to implement prematurely, because “dividing revenue and expenditure between the central and local governments” could still be improved, and the other was that the conditions for implementing thorough tax sharing system had not been met. Finally, on the choice of transition plans. Some held that transition programmes should take into account the characteristics of interregional imbalances and highlight diversity. Others believed that the transition plans should create conditions for the step-by-step implementation of tax sharing system. Despite the wide differences of view, the core issue to be addressed remained the question of the degree of decentralized management under unified leadership.

During this period, China’s fiscal system reform also received the attention of international institutions and foreign experts. In November 1991, the World Bank’s Asia Region Study Mission, made an assessment of the state of China’s fiscal system reform, and put forward some proposals¹ on the division of China’s fiscal revenues and expenditures under the framework of fiscal decentralization under the title *China: Reforming the Intergovernmental Fiscal relations*. The practice of China’s reform and development has shown that these proposals have a strong forward-looking, In October 1993, the Ministry of Finance, the International Monetary Fund and the World Bank jointly organized an international seminar on China’s intergovernmental fiscal relations

¹ Specific proposals are that, in terms of fiscal revenues, the main taxes should be collected by the central government, so that the central fiscal revenue staked a larger proportion (initially at 60 per cent), and that in terms of fiscal expenditures, considering that the closer the beneficiaries were, the more conducive it was to improving efficiency, a considerable degree of decentralization should be carried out, with local expenditure accounting for a larger proportion, The central government subsidized the local area in some form.

in Shanghai, where experts discussed intergovernmental fiscal relations in China's fiscal reform and believed that China's intergovernmental fiscal relations urgently needed to be straightened out according to scientific procedures, to divide expenditure responsibilities according to scientific standards, to decentralize tax power according to fair efficiency trade-offs, and to correct vertical imbalance with transfer payments.¹ These international evaluations and views have been important references for China to deal with intergovernmental fiscal relations and promote the reform of the fiscal system.

3.3. The Development of the Theory of Intergovernmental Fiscal Relations, with Fiscal Decentralization as the Carrier, should Attach Importance to Thematic Research

First, a special study on the quantitative relations between the quantities of the central and local finance. He (1987) limited the fiscal relations between the central and local governments in the framework of the relationships of responsibility, right and interest, and studied the degree and quantity of fiscal concentration and dispersion respectively based on the hierarchy of common social needs and the fiscal responsibility of the central and local governments, and his views and research paradigms have been used to this day.

Second, a special study on the impact of intergovernmental fiscal relations on economic development. During this period, theorists began to realize that "to improve economic efficiency needs to improve the fiscal relations between the central and local governments", "making the economic pie" and "cutting economic pie" linked.

Third, a special study on intergovernmental fiscal relations based on historical and comparative perspectives. Historical research included the study of intergovernmental fiscal relations in the Ming and Qing Dynasties and the review of the intergovernmental fiscal relations in the First Five-Year Plan period. During this period, Chinese scholars continued systematic research on the intergovernmental fiscal relations of the Soviet Union, while the scope of research was extended to other countries, including the United States, Japan, Britain, France, Canada, India and Australia. At the same time, the academic circle's study of the intergovernmental fiscal relations of capitalist countries shifted from focusing on criticism to relatively pure academic discussion.

4. Research on Intergovernmental Fiscal Relations and Tax Sharing System: The Manifestation of Fiscal Decentralization

During the construction period of socialist market economy, with the full implementation of the tax sharing system, fiscal decentralization was materialized

¹ The views of then-IMF Director of Fiscal Affairs Tantz, experts Amad, Juju Hu, and World Bank experts Ahmed, Agara, Hoffmann, Nurfarmer and Professor of Economics at the University of Turin, Mr. Brosio, were combined.

into a tax sharing system, and the intergovernmental fiscal relations was supported by the system, so the relevant research in this period was mainly carried out within the framework of tax sharing system. In addition, there was a theoretical background, that is, with the establishment of the market economy system, the research topic of China's fiscal circles shifted from the essence to the function of public finance, while the influence of western theory on finance expanded, and the three functions of finance proposed by Musgrave were also widely used in research on China's intergovernmental fiscal relations. Many scholars agreed that the allocation of resources should be mainly carried out by the local governments, and that the functions of income distribution and economic stability and growth should be assumed by the central government.

4.1. Tax Sharing System: Practical Basis for Research on Intergovernmental Fiscal Relations

Theory comes from practice and guides practice. The implementation of tax sharing system was the practical basis of the research on intergovernmental fiscal relations at that time, and the relevant research was carried out from the following four levels.

Firstly, from the level of perfecting tax sharing system. The perspectives included the problem of dealing with intergovernmental fiscal relations and the imbalance of institution supply in implementing tax sharing system. Jia and Bai (2002) put forward the principles of “seven ones” to improve the tax sharing system under the premise of appropriate simplification of the level of governments.¹

Secondly, from the four elements of intergovernmental fiscal relations. The tax sharing system reform in 1994 took “matching fiscal rights with administrative powers” as the basic principle, but in practice, the division of fiscal rights was not as smooth as envisaged, and was subject to resistance from all sides. Therefore, scholars began to look for the system optimization program under this realistic condition, the focus diverted from the division of fiscal rights to the allocation of fiscal resources and administrative responsibilities (expenditure responsibilities). Liu (2008) believed that the principle of “matching fiscal resources with administrative powers” was more adaptable to the changing characteristics of the era of intergovernmental “incremental administrative powers”. Hou (2009) held that the wording of “matching fiscal resources and administrative powers” was not exact, and there may be problems such as breakdown of policy design, misalignment of supervision mechanism, reversal of responsibility mechanism, and he also argued that the “administrative powers” were actually “expenditure responsibilities”. The most comprehensive view was that when straightening out the intergovernmental fiscal relations, we should

¹ The principles of “seven ones” were: one-level regime, one-level administrative powers, one-level fiscal rights, one-level tax base, one-level budget, one-level property rights, and one-level right to borrow.

distinguish between the concepts of “administrative powers” and “administrative responsibilities”, as fiscal rights match administrative powers, and the matching of administrative responsibilities is the fiscal resources (Ma *et al.*, 2013). In this way, the argument and exploration of theory promoted several adjustments and changes of the fiscal relations between the central and local governments which used the four elements of administrative powers, fiscal rights, expenditure responsibilities, and fiscal resources as the carrier.

Thirdly, from the division of administrative powers. Because the division of fiscal rights was not so easy, more research focused on the division of administrative powers. Gao (2010) proposed that the allocation of administrative powers should follow the principle of market priority, benefit scope and efficiency.

Finally, intergovernmental fiscal relations was studied at the sub-provincial levels. The tax sharing system reform in 1994 was mainly concentrated at the central and local levels, while the sub-provincial fiscal management system was not clearly defined, but mainly referred to the higher-level practices, resulting in revenue transferred upwards and expenditure transferred downwards, and finance at the levels of county and town becoming more and more difficult. Then there was the exploration of “placing county finances directly under the management of provincial governments” and “township finances under the management of county governments” with the academic circles actively seeking theoretical basis for it.

4.2. Public Finance: Theoretical Basis for Research on Intergovernmental Fiscal Relations

After Deng Xiaoping delivered the speech in South China in 1992, with the reform goal of socialist market economy established, China started the process of matching “fiscal publicization” with “economic marketization”. Public finance became the mainstream, and the theory of western fiscal decentralization was widely used in the study of China’s intergovernmental fiscal relations.

In terms of the basic logic, public finance is based on the theory of public goods, and analyzing intergovernmental fiscal relations under the framework of public finance should first pay attention to the levels of public goods and the efficiency of public goods supply at different levels, and realize the mechanism of separation of powers and checks and balances or the balance between centralization and decentralization to guarantee the efficiency of public goods. Lv (2005) showed that the difference in efficiency between the central and local public goods determined the concentration and decentralization of the fiscal system.

After the equalization of public services was put forward, the study of intergovernmental fiscal relations was further promoted. Scholars have found that there was a clear logical chain between the equalization of public services and

the intergovernmental fiscal relations: in market economy, in order to achieve the equalization of basic public services, vertical transfer payments were needed to balance the fiscal capabilities at all levels (Research group of *Public Services Equalization of Society of Public Finance of China*, 2007). In order to achieve the generally equal level of public services, we should seek to establish a horizontal transfer payment system. It can be seen that the realization of equalization of basic public services should not only optimize the fiscal relations between governments at all levels, but also optimize the fiscal relations between the governments at the same level.

4.3. Normative Analysis and Empirical Research: Breakthroughs in the Research Methodology of Intergovernmental Fiscal Relations

Methods such as game theory were adopted in this period to study the fiscal relations between the central and local governments under the tax sharing system, to assess the realization of the objectives and internal stability of tax sharing system and the fairness and efficiency of intergovernmental fiscal relations, to identify problems and try to improve. On the whole, the empirical research on the intergovernmental fiscal relations made a breakthrough in the method and expanded in content, especially in the empirical research on the relationship between fiscal decentralization and economic growth, a large number of academic achievements emerged, but their results were quite different. Lin and Liu (2000), Zhang and Gong (2005), Zhou and Zhang (2008) believed that there was a positive correlation between the two, while Zhang and Zou (1998), Hu (2001), Chen *et al.* (2002) believed there was a negative correlation between the two. In addition, a number of results from other perspectives had been found, for example, regional differences in economic growth effects of fiscal decentralization, fiscal imbalance at all levels, the effect of transfer payment and its relationship with fiscal decentralization, and factors affecting the division of intergovernmental functions.

4.4. Thematic Research: Deepening Research on Intergovernmental Fiscal Relations under the Framework of Tax Sharing System

Firstly, thematic studies on intergovernmental fiscal relations based on historical and comparative perspectives. In the field of historical research, the intergovernmental fiscal relations of various dynasties in China were included. In comparative research, the dimensions of the study shifted from specific countries to different levels, including Western countries, developing countries, unitary states, federal states and centralization, decentralization and subsidy models.

Secondly, thematic studies focusing on specific areas of intergovernmental fiscal relations in China. First of all, in the field of rural compulsory education, theorists

agreed that the function of rural compulsory education and the responsibility for expenditure should be borne solely by higher-level governments, with transfer payments and regional differences taken into account. Next, in the field of local government debt, many scholars analyzed the root causes of local government debt from the perspective of intergovernmental relations, and there were also causes including the dual political and economic role of government and the general soft budget constraints of the banking industry. In addition, the academic community were divided into the pre and the con on whether the central government's act of issuing local bonds meant fiscal decentralization. Furthermore, in the field of land finance, many scholars believed that the fiscal system with tax sharing had caused the upward transfer of fiscal rights, the downward transfer of administrative powers, the decrease of local fiscal revenue and the increase of local fiscal expenditure. Jia (2005) criticized this view, arguing that it was because the implementation of the tax sharing system was impeded at sub-provincial levels after 1994, the transition became revenue sharing or contracting system, only to trigger the short-term behavior of land finance, hidden debt, and grass-roots fiscal difficulties. Scholars held that, to change the status quo of land finance, we need to improve the tax sharing system, form a diversified urban public investment mechanism, build a more reasonable local tax system, speed up the construction of local debt system, strengthen budget constraints, and become more open and transparent in the budgets and final accounts. In addition, there was a study of the relations between the central and local finance in the field of rule of law (Figure 2).

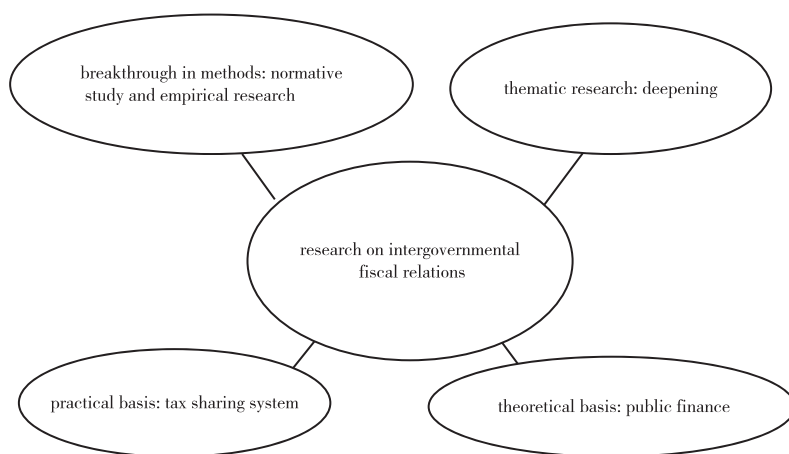


Figure 2. Research on Intergovernmental Fiscal Relations under the Framework of Tax Sharing System
Source: Relevant data assembled by the authors.

5. Research on Intergovernmental Fiscal Relations and Modernization of State Governance: The Prosperity of Fiscal Decentralization

As socialism with Chinese characteristics enters the new era, the Third Plenary Session of the 18th Central Committee of the Communist Party of China (CPC) issued *The Decision of the CPC Central Committee on Major Issues Concerning Comprehensively Deepening Reform*, which states that “finance is the foundation and important pillar of state governance” and “establishing a modern fiscal system to give full play to the central and local initiatives”. Thus, the theoretical innovation of modern fiscal system to meet the needs of the modernization of state governance began to flourish. The report of the 19th National Congress of the Communist Party of China further proposed “accelerating the establishment of a modern fiscal system, the establishment of central and local fiscal relations with clearly defined powers and responsibilities, appropriate fiscal resources allocation and great balance between regions, and put the central and local fiscal relations before the reform requirements of budget system and tax system. In this way, the study of intergovernmental fiscal relations with fiscal decentralization as the carrier has become the focus, and fiscal decentralization has also flourished.

Firstly, the intergovernmental fiscal relations and state governance are connected from multiple dimensions. The focus includes the relationship between the two, deepening the tax reform, deepening the fiscal system reform under the framework of state governance, and the theoretical framework of “fiscal governance in the whole area” based on the “five-sphere integrated plan”. The innovation of intergovernmental fiscal relations theory began to flourish, and it was carried out in the logical chain of “modernization of state governance—modern fiscal system—intergovernmental fiscal relations—central and local initiatives—matching administrative powers and expenditure responsibilities”.

Secondly, the intergovernmental fiscal relations are included in the framework of the modern fiscal system to study. On the one hand, the aim is to clarify the “two types of position”—the position of the modern fiscal system in the state governance and the position of the intergovernmental fiscal relations in the modern fiscal system. On the other hand, it aims to grasp the unique features of the development of fiscal relations between the central and local governments under the framework of modern fiscal system. It is believed that one of the fiscal paths to the modernization of the state governance system and governance capacity is to establish a modern fiscal system which includes the modern tax sharing system, but at present, the intergovernmental fiscal relations, as the “shortest board of the bucket” in the modern fiscal system, has become the key task of establishing the modern fiscal system (Yu, 2015).

Thirdly, the reform of the division of fiscal administrative powers and expenditure responsibilities serves as the focus to study the deepening reform of intergovernmental fiscal relations. Although the logical emphasis of fiscal and tax reform is different,

the current theoretical community agrees that the division of fiscal powers and expenditure responsibilities is the key to straightening out the intergovernmental fiscal relations. Gao (2018) believed that “the establishment of a system with compatible administrative powers and expenditure responsibilities” is proposed to stimulate the two initiatives by matching power and responsibility. As for the logic of the division of administrative powers and expenditure responsibilities, some scholars have proposed the vertical and horizontal dimensions,¹ some scholars emphasized the logical order of legal authorization, and some believed the correct logical starting point should be the division of intergovernmental expenditure responsibilities. In addition, the fiscal academic community has conducted two levels of research: One is to explore the principle of division. Lou (2013) put forward the three principles of division of administrative powers namely, externality, the complexity of information processing, and incentive compatibility, which has been widely recognized. In addition, scholars also discussed the principles of dividing administrative powers and expenditure responsibilities from the perspective of stability and certainty, as well as from formal statutory and substantive statutory perspective of division of administrative powers. The other is to explore the specific areas of fiscal administrative powers and expenditure responsibilities division, involving education, culture, science and technology, environmental protection, transportation, fiscal support for agriculture. In education, the six principles of the division of educational fiscal administrative powers and expenditure responsibilities, and the division mode of “legalized administrative powers, co-ordination by the governments at higher levels, upward transfer of overspending” have been put forward, and the relevant quantitative research is also increasing. In the field of culture, a structured theoretical model of the division of fiscal cultural administrative powers and expenditure responsibilities is formed. In the field of science and technology, the direction of change in the behavior pattern of fulfilling the scientific and technological administrative powers is proposed. In the field of environment, two basic paths to perfect the division of environmental administrative powers and expenditure responsibilities are put forward. In the field of transportation, it is proposed that the particularity of its public service be regarded as the basis of the division of administrative powers and expenditure responsibilities. In the field of fiscal support for agriculture, the key to the division of administrative powers and expenditure responsibilities is that the central government takes the initiative to assume the administrative powers and expenditure responsibilities.

From 2018 to 2019, China has successively introduced a reform plan for the division of central and local fiscal administrative powers and expenditure

¹ Ma (2013) proposed that, vertical division followed the government structure from the central to the local level, while horizontal division was based on the division of labor between the government, the market and the non-profit organizations in the supply of public goods, and the path was also changed from the traditional path of “fiscal resources” to “administrative powers”.

responsibilities in the four fields of health care, science and technology, education and transportation, and the reform of intergovernmental fiscal relations is further developing. It is because the researchers spare no effort to promote the innovation of the theory of intergovernmental fiscal relations, provide theoretical basis for decision-making and guide practice that the fruitful reform achievements emerge.

6. Prospect of Research on Intergovernmental Fiscal Relations: Providing System Guarantees for Sustainable Fiscal Development

Research on intergovernmental fiscal relations of China has thrived from scratch in the past 70 years, but we should be aware that the research is always on the way. At present, under the background of the new economic normal, with the need to continuously cut massive taxes and fees to support steady economic growth, and to deal with the escalating global economic and trade uncertainty, the pressure of finance at all levels is increasing, especially the sustainable development of local finance has been facing a severe test. Adjusting the fiscal relations between the central and local governments from the system perspective is the answer to the problem.

First of all, we should further work on the optimization scheme of the division of fiscal administrative powers and expenditure responsibilities with the goal of establishing the intergovernmental fiscal relations with clearly defined powers and responsibilities. The current division scheme is relatively extensive, and there is still room for further improvement in terms of the precision of the division. Therefore, on the basis of consolidating the reform achievements of the division of fiscal administrative powers and expenditure responsibilities, we can work on the division optimization scheme with fiscal decentralization as the carrier. “Up-to-down integration” should be achieved in the path, that is, after the division scheme is proposed from higher levels to lower levels, feedback is given from the bottom to the top level, and further discussions are needed in case of the lack of clear division, or unreasonable division of the administrative powers and expenditure responsibilities match each other at all levels of government. In addition, the division of fiscal administrative powers and expenditure responsibilities should also take full account of the special characteristics of various public services, and the division of public services of different nature should be different. A feasible and effective measure method should be proposed for the relevant indicators such as public service benefit, externality, cost-benefit and economies of scale, so as to make the division more scientific and accurate.

Secondly, we should study the scheme of adjusting the division of fiscal revenue between the central and local governments with the goal of establishing the intergovernmental fiscal relations of coordinated fiscal resources. It is necessary to follow the principle of “determining revenue based on expenditure”, and to form the idea of dividing revenue and perfecting the transfer payment system on the basis of

optimizing the division of administrative powers and expenditure responsibilities, so as to form a reasonable intergovernmental fiscal structure. The frame of reference can be the path of establishment of the scientific fiscal decentralization: dividing fiscal revenue among governments based on the clarified division of the administrative powers and expenditure responsibilities of government at all levels, filling the fiscal gap at all levels with general transfer payments, compensating for the fiscal resources required for the performance of entrusted administrative powers and expenditure responsibilities with special transfer payments and revenue handed to the higher governments, and exiting in due course after the performance of the duties. Although China's tax sharing system has been continuously improved since 1994, there is still a big gap with the scientific fiscal decentralization. As China is faced with the new economic normal and the changing world economic structure, which is a good opportunity to deepen the tax sharing system reform, the researchers in finance need to strengthen theoretical innovation and explore the reform from current tax sharing system to scientific fiscal decentralization by working on the establishment of intergovernmental fiscal relations of coordinated fiscal resources and ensuring sustainable fiscal development.

Thirdly, we should study the scheme to further improve the sub-provincial tax sharing system with the goal of establishing the intergovernmental fiscal relations of regional balance. Despite the remarkable achievements of the reform of the division of administrative powers and expenditure responsibilities, there are still many local governments (mainly grass-roots governments) in China, which are dealing with huge infrastructure expenditure with a small amount of fiscal revenue, forming a huge debt that cannot be repaid on their own. This phenomenon shows that sub-provincial government are still facing unequal intergovernmental administrative powers and expenditure responsibilities, and the goal of regional balance can only rely on large-scale transfer payments and borrowing. In other words, regionally balanced intergovernmental fiscal relations can hardly be established without fundamentally solving these problems, and the fundamental solution is to deepen the sub-provincial tax sharing system reform.

In addition, a key issue needs to be addressed, namely, how to establish a stable and sustainable local tax system as soon as possible. On the one hand, the establishment of local tax system is one of the basic conditions to consolidate the achievements of tax sharing system reform and promote the further deepening of tax sharing system reform; on the other hand, cultivating a stable tax source for the local governments by granting local tax power is also one of the inherent requirements of fiscal decentralization. The basic idea of establishing the local tax system is to determine the taxes which are weak in liquidity and easy to collect and manage locally, and to redefine the proportion of the shared tax according to the principle of equal powers and responsibilities. In short, to establish the intergovernmental fiscal relations with clearly defined powers and responsibilities, appropriate fiscal resources allocation, and regional balance, it is

impossible to avoid the establishment of a sound local tax system, which is becoming increasingly important and urgent with the deepening of reform.

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