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### Title: How to Divide the Intergovernmental Administrative and Financial Powers?

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#### Abstract:

The worldwide trend of decentralisation involves both administrative and financial powers of government, namely expenditure responsibilities (administrative power) = own income + transfer income (financial power). The administrative and financial powers of each levels of government should be matched with each other. However, in reality, there is still a dispute on the two issues of “how to match the administrative and financial powers of the government” and “how to carry out the division of powers”. Obviously, if expenditure responsibilities of the central government are greater than the sum of governments’ own income and transfer income, it will result in insufficient government services; otherwise there will be the problem of a waste of resources and so forth. Most of the decentralisation worldwide is carried out in the form of decentralisation of expenditure responsibilities, whilst the local governments’ right to tax (or own share of income) did not increase, and the intergovernmental pattern of vertical fiscal imbalance has not shown signs of diminishing.

Based on the federal paradox of Weingast, the author reconciles the ideas of constitutional economics with a new analytical framework (Figure 2). He further splits the government control described by Weingast into two dimensions, namely personnel control and financial control, and these two variables form the four combinations in the higher and lower levels of government, which can cover all types of intergovernmental relations in the world.

Figure 2: Four structures of intergovernmental relations

		Higher	Structure 1 (Western developed countries)
Lower level	Finance	Lower	Structure 2 (Federation, American Federation in the early years)
Personnel		Higher	Structure 3 (Russian style: Planned economy system)
Higher level	Finance	Lower	Structure 4 (China before tax distribution system)

Structure one shows that local officials are elected through the “bottom up” process and the higher levels of government control the major fiscal revenue. An effective verification relationship is formed between the higher and lower levels of government through personnel and financial powers. This type of structure is called by Weingast as “a kind of self-executive function” structure. Structure 2 is a weak central structure, the central government has no control over both the appointment and dismissal of personnel in local governments, it also cannot control the finance of the local governments, and therefore it is an unstable structure. Structure 3 is a strong central structure, in which because the central government is too powerful, it is easy to infringe the interests of local governments, and thus it is also an unstable structure. Structure 4 is a relatively balanced

structure, but as the central government has control over the appointment and dismissal of personnel in local governments, this results in the latter not really having the same power to bargain with the central government.

Looking at the evolution of administrative and financial powers among the Chinese governments, it can be seen that the intergovernmental relations before reform and opening up, is similar to structure 3, after reform and opening up, it is similar to structure 4. After the implementation of tax distribution system in 1994, the fiscal revenue of central government increased rapidly, the relations between the central government and provincial government changed from structure 4 to structure 3. It shows that higher levels of government control the major fiscal revenue of lower levels of government, whereas lower levels of government to a large extent are dependent on transfer payments from higher levels of government. In structure 3, due to the higher levels of government having control over both the appointment and dismissal of personnel in lower levels of government, they also control the revenue of local governments. The circumstances, as stated by Weingast, that will appear are the central government will violate the interests of local governments, try to push expenditure responsibilities onto lower levels of government, but preserve financial power, leading to emergence of grass-roots government powers being too large, but financial power being inadequate. As a result, China is suffering from a lack of fundamental public services, with local governments seeking rent from the market, disguising their borrowings and many other issues. The author believes that the direction of reform to solve the imbalance between administrative power and financial power in the local governments are mainly not to significantly increase the taxation power of the local governments, but to establish an effective verification relationship between the higher and lower levels of government through the personnel system of the reformed local governments. Also, on this basis, improve the fiscal transfer payment system. China has to change the way local officials are recruited, to form an effective verification relationship between the higher and lower levels of government, to improve the negotiating capacity between the lower levels and the higher levels of government. Only in this way can the standardised fiscal transfer payment operated steadily.