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Chinese Public Finance Framework: A Critical Analysis

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Abstract

This paper explores the complexities of government financial management in China and examines the nature of the recent Public Finance Framework reform in that country. We argue that this Public Finance Framework reform is not just the latest idea in a centrally dominated reform agenda (and a logical and strategic development in the process of social, political and economic transformation) but that it reflects the Central Government’s struggle to fine-tune central-local financial relationships and to grapple with the consequences of previously misplaced delegation of government budgets. In doing so, the paper challenges the prescriptive research which often pervades policy studies in China. Instead, it offers a critical reflection on the historical and contemporary contingencies shaping Chinese state administration and sheds new light on the background, the implementation and the future prospects of public sector financial reform in China. Overall, our contextual analysis provides a starting point for more critical research of changes in the Chinese state administration at both policy and organisational levels.
CHINESE PUBLIC FINANCE FRAMEWORK: A CRITICAL ANALYSIS

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CHINESE PUBLIC FINANCE FRAMEWORK: A CRITICAL ANALYSIS

ABSTRACT

This paper explores the complexities of government financial management in China and examines the nature of the recent Public Finance Framework reform in that country. We argue that this Public Finance Framework reform is not just the latest idea in a centrally dominated reform agenda (and a logical and strategic development in the process of social, political and economic transformation) but that it reflects the Central Government’s struggle to fine-tune central-local financial relationships and to grapple with the consequences of previously misplaced delegation of government budgets. In doing so, the paper challenges the prescriptive research which often pervades policy studies in China. Instead, it offers a critical reflection on the historical and contemporary contingencies shaping Chinese state administration and sheds new light on the background, the implementation and the future prospects of public sector financial reform in China. Overall, our contextual analysis provides a starting point for more critical research of changes in the Chinese state administration at both policy and organisational levels.

Key Words: China Public Finance Reform
INTRODUCTION: PUBLIC FINANCE FRAMEWORK REFORM

The last seven years have witnessed the Chinese Central Government making remarkable efforts to transform the structure and management style of government sector organisations in China. The term “Public Finance Framework” (PFF) was coined in 2000 to indicate the radical nature of the changes. It was claimed that a new public administrative order of transparency and accountability was the central theme of the “Public Finance Framework”

PFF consists of a carefully designed package of reforms aimed at establishing a public financial management style, suitable for China’s socialist market economy. According to the official “2004 Government Sector Budget Manual” there are four elements to PFF reform: (1) changes to the government budgeting process, called the “Department Budget reform”; (2) the centralisation of the treasury function at all levels of government; and changes to the (3) internal and (4) external mechanisms for monitoring public spending.

The Chinese public sector, quite often still called the “state/government sector”, is no stranger to change. As we will explain later (in the first part of this paper), PFF is the latest development in the countless post-1949 campaigns to improve the structure and performance of the state bureaucracy. So what is new in this latest reform? The design and rhetoric of PFF suggests a strong desire to improve financial accountability and to enhance control at all levels of government. However, these ideas are not particularly novel, and in the second part of the paper we will explain why. In our view, it is the explicit notion of “Public Finance” that confers this reform with far-reaching political significance. The term “Public” not only denotes the changing nature of the Chinese state/government sector, but also implies a more clear-cut boundary between the public and private domains in Chinese society.

2 Source: Interview with officials from Chinese Ministry of Finance.
For these reasons, PFF has attracted broad attention since it first came out. However, although seven years have gone by, research into PFF continues to be conducted primarily from the perspective of the Central Government policy makers—the tone of the research remains optimistic and the findings prescriptive. There is a lack of analytical studies of the background to the reform, and an absence of any critique of the process of change in Chinese state administration. Neither the West, nor the general public in China, have much in-depth knowledge of the ongoing changes in the Chinese government sector. There is a tendency to decontextualise reform initiatives and to accept official documents at face value.

This paper seeks to advance our understanding of PFF by critically analysing its broader context. Two distinct dimensions of contextual information are presented, analysed and weaved together to form an overview of the context of PFF reform. First, in the following section, we adopt a historical perspective to examine the nature of PFF in relation to the dynamics of Chinese state administration and establish the connection between the past and the present. Then, in the subsequent section, we turn to the second dimension and explore PFF in the context of Chinese inter-governmental financial relations. Finally, we conclude on the nature of PFF reform in the light of our contextual analysis and suggest directions for future research.

We have built this paper on published material and research articles written in Chinese, but supplemented by interviews with government officials at the central and local government levels in China. Our interviewees include three senior officials from the Chinese Ministry of Finance, two division chiefs of a municipal Finance Bureau, the Executive Finance Officer of a municipal police force, and two department chiefs of local government agencies in a large Northern Chinese city. Our research has also benefited from interviews and discussions with the project leaders of PFF in two local research institutions in China. But at the request of our interviewees, their names will not be used in this paper.

3 For some of the policy-oriented research undertaken from a Chinese perspective, see Fu, 2002; Wang, 2004; Wang, 2002; Wan, 2002; Li, 2002; Song, 2002; Wang, 2002; Wang, 2004; Li, 2004; Xu, 2003; Li & Liu 1997; Li, 1999; Zhao, 1996.
1. IN SEARCH OF MODERNISATION: PFF AS A STRATEGIC CHOICE

China is a country with a very long history and its people, as well as its model of state administration, are profoundly shaped by its long established traditions. In this section we will argue that in order to understand the nature of modern-day administrative reforms in China we cannot ignore the shadow of history. We will first describe the moral institution which is the legacy of the history of Chinese state administration and then examine its impact on the current attempts to modernise Chinese state administration in general, and on PFF reform in particular.

1.1 Moral institution: the legacy of history

The history of China as a state dates to around 1122BC when a primitive government was formed based on a loosely organised feudal system, which had little integration and military conflicts between feudal states were frequent. In 221BC the First Emperor, YingZheng of Qin, united China into an integrated political entity and established a totalitarian regime of administration. Rather than leaving local issues to the feudal lords, the First Emperor divided local governments into the prefecture (Jun) and the county (Xian), and he exercised direct and absolute control over the governors of the prefecture. This administrative model became extremely influential and it set the foundation for a political idea shared by virtually all subsequent dynasties; i.e., that China should always remain a united single political entity (Li, 1975). It also laid the groundwork for a remarkably monolithic way of ruling the country; with all political action taken within a bureaucracy headed by the emperor who has absolute legislative, executive and judicial power. Underpinning these ideas was the philosophy of Legalism, which maintained that an ideal society is an orderly one governed by the law; and the law must be enforced at all costs. The only exception was the emperor who, as someone empowered by heaven, was above all constitutional and social constraints. The state bureaucracy was merely his executive instrument and the bureaucrats his servants who must unconditionally submit to his monarchical power.
The Qin dynasty was quite short-lived (221BC-206BC). Its ruthless rule triggered a nation-wide peasant rebellion which eventually overthrew the monarch and transformed the norm of ruling in subsequent dynasties (Bielenstein, 1980). Circa 140BC the Confucian ideal of “governing by virtue and integrity” superseded the Legalist idea of “governing by law”, and became the official ideology of the state administration. Confucianism accepted the emperors’ divine right to rule, but argued that it is legitimate only insofar as the emperor has “virtue and integrity”. Therefore, instead of offering unconditional obedience, the duty of government officials is to provide the moral and intellectual support needed by the emperor to achieve enlightened rule (Huang, 1997). Confucianism was broadly accepted and gradually became the central feature of the Chinese system of ethics. Around 1000AD an extreme version of Confucianism, called “Neo-Confucianism”, emerged. It advocated an absolute social order sustained by rigid moral standards that encourage submissiveness, obedience and conservatism. The rise of Neo-Confucianism marked an important turning point in the history of China, and since then Chinese society has become increasingly conservative, insular and culturally introverted.

Neo-Confucianism had a direct impact on the state administration as it played a crucial role in developing the procedures for recruiting government officials (Miyazaki, 1981). In the entrance examinations candidates were required to address Neo-Confucianism principles in a rigid literal style called “Baguwen”. Only those who satisfied the examiners could pass onto the next level of examinations, which followed a similar format, but organised by the next higher level of administrative authority. An official’s post in the bureaucracy was largely determined by his ability to climb this examination ladder. This system enabled the “literal scholars” (Wen Guan) of Neo-Confucianism to become powerful governmental officials during the Song (960-1279), Ming (1368-1644), and Qing (1616-1911) dynasties. The appointment of these literal scholars as officials at all levels of governments reinforced Neo-Confucianism even further, and turned the state administrative apparatus into “cogs in a machine”.

This brief historical review serves an important purpose, as the legacy of Confucianism and Neo-Confucianism underpins the “moral institution” which has
profoundly shaped the Chinese state administration, and continues to do so even today. This moral institution has two distinct characteristics. First, it assumes that good government depends on the moral authority of the ruler and his officials—so long as the ruler is moral and sensible about human relations, his government will be good, regardless of the effectiveness of law enforcement mechanisms. This explains why China has been rather slow in developing sophisticated technical means of control. Second, the moral institution associates authority with moral persuasion rather than technical ability (Huang, 1975), and regards a “virtuous” man as superior to a technical expert. Consequently the performance of government officials is assessed by ethical principles like sincerity, loyalty, prudence and devotion—administrative efficiency and effectiveness are also seen as important but must be justified within the framework of Confucian morality.

In practice, this moral institution has become rather problematic—ambiguities in the notion of “morality” have led to an oppressive and hypocritical administrative culture in which moral principles have been used more as the instruments for political persecution than means to improve government performance. Nevertheless, since at least the fifteenth century, the fundamental rationality of the Chinese bureaucracy has been morality or, in other words, morality has been used to justify the actions of the bureaucracy (Lee, 1985). However, by the late seventeenth century there was a proliferation of intelligence organisations spying on government officials, as well as brutal persecutions within the government bureaucracy, and government officials at all levels playing the “game of politics”. It is rather ironic that a system over-dependant upon the virtue of the administrators eventually led to its general moral deterioration.

1.2 In search of modernisation: the Communist era

The more recent history of China has been plagued with political, military and economic disasters. Prolonged foreign invasions and social backwardness have left deep wounds in the nation’s pride and its people’s identity as “The Chinese”. For many, the period from 1840 to 1949 was a constant struggle to demolish the Manchu imperial
regime, to catch up with the West, and to restore the ancient glory of China. This struggle has had a distinct impact on the path of reform in modern China since 1949.

The most striking feature of reforms since 1949 has been the radical but uneven pace of change engineered by Chinese Communist Party (CCP) leaders (see Saich, 2001). The eventful period from 1949 to 1978 was marked by audacious experiments to promote national economic and political development. For example, the “Great Leap Forward” towards the end of the 1950s was followed by the upheavals of the “Cultural Revolution” in 1966 and the subsequent myriad of radical political and economic experiments. Though mixed in intentions, the consequences of these movements were often catastrophic (Lawrance, 2004).

Mao also introduced drastic measures to modernise the state sector. However, even though it was set up in an era of proclaimed modernisation, the post-1949 state administration was shaped more by the notions of “unification” and “moral institution” than Western ideas of public administration. After the founding of the PRC in 1949, it was firmly held by Mao (an admirer of the First Emperor and the philosophy of Legalism), and most Chinese people, that unification was the only way to rejuvenate the nation (Huang, 2004). This notion of “unification”, with its extremist tone, not only defined the mode of state administration, but also dictated how Chinese society was organised and a communist “new man” ought to think and behave. A totalitarian model of state administration was established and reinforced by the CCP party cell and a system called the “work unit” (Danwei) was introduced (Yang and Zhou 1999; Lu, 1989, 1993) to impose this idea of unification at a micro-level, with each “communist person” allocated a work unit where he/she obtained a social identity and gave a lifetime commitment to it. In many ways, how Chinese society was organised from 1949 to 1978 corresponded to the pattern of most other communist nations. However, it is important to recognise that this totalitarian regime was successful and efficient in China (more so than in other communist countries) primarily because it was consistent with China’s own administrative history; i.e. local government agencies should function as extension of the Centre and every individual’s contribution is an important building block in a larger project.
The ideas of Confucianism and Neo-Confucianism also made their way into Communist China. Throughout the Maoist era, Party members with communist “morality” were delegated substantial responsibility in the state administrative process because they were deemed superior to the technical specialists. At the height of the Cultural Revolution, technical experts and intellectuals were sent to rural farms to develop a communist morality, and Party cells took over the government bureaucracy in order to become the moral “engine” of the state administrative machinery. The procedures used to evaluate the performance of government officials also followed a very traditional path. A decree issued on November 4, 1949 instructed governments at all levels to evaluate their officials annually using a scorecard to assess each candidate’s political integrity, commitment to Communist doctrines, professional ability and task accomplishments (Chow, 1993a, 1993b). Although the structure of these performance indicators has been subject to the changing political atmosphere, “morality” has always remained the key measure.\(^4\)

1.3 State administration 1978-2000: uneasy adjustment

The Death of Mao Zedong in 1976 brought an end to the red Communist era. After Deng Xiaoping and his associates came to power at the Third Plenum of the 11th CCP in 1978, the personality cult of Mao was dismantled and the CCP tried to restore its legitimacy by promising a bright economic future for the country. The notion of “modernisation” continues to guide the work of the Party, but unlike in the Communist era, the theme of the post-1978 reforms in China has been to replace the central planning system with a market mechanism (Qian, 2000), but incrementally (Lawrance, 2004; Howell, 1993; Saich, 2001). Looking back, it is possible to identify three phases in this reform, each under the direct leadership of the CCP. The initial phase (1978-1982) saw de-collectivisation of the countryside and emergence of private markets for agricultural products. This was followed by relatively moderate change in urban China—this second

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\(^4\) The definition of morality in the Maoist era drew upon the vocabulary of Communism. After Mao launched the Cultural Revolution, political learning (meaning the candidate’s devotion to the study of political documents and active participation in political events) superseded task accomplishment as the key performance indicator. Towards the end of the Cultural Revolution, the state bureaucracy was paralysed and the whole nation fell once again into chaos. However, since the 1978 economic reforms, professionalism has begun to assume a somewhat greater significance in the performance measurement system.
phase (1982-1998) sought to integrate China into the rest of the world and to modernise its urban industries. The theme of the third phase (2000-present) is to reform the government sector; PFF is a key element of this phase.

It has been broadly acknowledged that reforms in the first and second phases (in the agricultural and industrial sectors) have been largely successful—the new policies were accepted with enthusiasm and China achieved remarkable economic growth and rising standards of living. China has also become a more open society and an active player in the global economy. On the other hand these successes also exposed problems including unemployment, corruption, regional disparities, and expanding inequalities between the rich and the poor (Qian and Litwack, 1998; Leung, 1995; Saich, 2001), which highlighted the belated political reform. The absence of radical change in the political system probably created the stability which contributed to economic growth during the early reform phases (Saich, 2001), but as most “easy” reform measures appear to have been taken, the government sector problems have become a major hindrance to future economic growth and social stability (Howell, 1995; Garnaut, 2001; Saich, 2001).

The third phase of reform thus emerged in response to calls for changes in the political system, and especially in the state administration. But because the “state” is entangled in virtually all aspects of social and economic affairs, the process of change has been rather strenuous. Throughout the economic reform era, a clear definition of the “state sector” has been tactically avoided, the nature of the fiscal fund and issues of “public accountability” rarely debated. The term of “State/Government Finance” was not questioned or even discussed until 2000, when the PFF reform was implemented. But this is not to suggest that the Chinese government sector has been immune to change. To respond to criticisms concerning the excessive concentration of power, the abuse of privilege, and the “appalling” behaviour of some of the governmental officials, at the start of the economic reforms (in 1978) Deng raised the idea of an “administrative revolution”. In the early 1980s, formal measures were introduced to reduce the size of the bureaucracy, eliminate functional overlap, recruit younger and more technically oriented administrators (Fang, 1993) and promote citizen participation (Zhang, 1993).
Meanwhile, a respect for technical experts began to be established. Unlike Mao, who distrusted intellectuals and technical experts because of their lack of “communist faith”, Deng argued that technology is the foundation of national power and effective administration depends on the technical quality of government officials. He stressed that officials should be appointed for their professional ability, as well as their political commitment and moral integrity. In 1979, the system of periodic personal appraisal was revised and although political integrity remained a key performance indicator, the structure of the performance appraisal system started to give more weight to task accomplishment and job related achievements. By 1984, all government departments and party offices conducted periodic appraisals and they were required to make personnel decisions based on the performance of the candidates. Against this background, from mid-1980s, China saw the rise of new technical and economic elites which began to form the new middle-class and the ruling base of the CCP in the reform era.

In 1986, more radical ideas about political reform, including notions of “democracy” and “administration by law”, started to appear in the media and for a short while they were welcomed by the Central Government. The most noticeable change was a separation of the work of the Party from that of the government (Saich, 2001). It was agreed that Party cells should not interfere in operational responsibilities, and, consequently the late 1980s saw Party cells removed from the operational affairs of government departments. However, the appeal for “reform within the CCP” met strong opposition from many senior Party leaders who maintained that the CCP should remain firmly in control of social life. The conflicts and tensions, which had accumulated during the early years of reform, eventually triggered the so-called Tiananmen event in 1989, which not only highlighted tensions in the political and administrative system but profoundly shaped agendas for state administrative reform in the subsequent decade.

According to Lawrance (2004) and Saich (2001), the political reforms since 1989 have been much more cautious, with fewer promises and less concrete proposals than in the early 1980s. Consequently, the political reform agenda has been limited to administrative system changes, comprising mainly of downsizing and removing overlapping functional departments. In the 1990s, the Central Government introduced the
“Chinese civil service system”, which turned four million government officials into national civil servants. Meanwhile, two massive campaigns (1993-1996 and 1998-2001) were launched to streamline the over-staffed bureaucracy at all levels, clarify lines of responsibility for all government departments and abolish government ministries no longer functional in a market economy. In addition, the 1990s saw vigorous campaigns to enhance the integrity of public servants. Several senior officials were sentenced for fraud and corruption, with some given the death penalty.

Alongside these changes, Party control was strengthened once again at all levels in state administration and society more generally. After 1989, the process of withdrawing Party cells was abandoned, and within the CCP system, the traditions of political learning, mass scrutiny and self-criticism were re-emphasised through the 1996 “Three Emphases” political campaign, the 1999 “Three Represents” learning program and the recent “Three Emphases Revisited” movement. All of these campaigns aimed to associate the CCP with the prosperity of the Chinese people and the nation.

Overall, in contrast to earlier reforms in agriculture and industry, changes in the government sector from 1978 to 2000 have been rather uneasy and have showed signs of struggle and a lack of strategic coherence. Because the reform packages launched by Deng Xiaoping and his successors were tactically ambiguous about the political nature of state administration, changes in the state bureaucracy took place in a rather slow and “quiet” way, and were limited to the coastal and southern areas. However, even these limited changes have been difficult to implement. Our interviews with the Central Government officials revealed that short-term cuts in the number of public servants were often followed by renewed expansion; that responsibilities for expenditure at different levels of government remain unclear; and financial scandals continue despite severe punishments for corrupt officials.

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5 The “Three Emphases” movement requires all Party members to emphasise political learning, political awareness and political integrity.
6 The formal statement of the “Three Represents” programme is: “Reviewing the course of struggle and the experience over the past 80 years ... our Party should continue to stand in the forefront at the time and lead the people in marching toward victory ... the Party must always represent advanced means of economic production, the progression of China's cultural development and the fundamental interests of the majority of the Chinese people. (translated from Jiang Zemin's speech at the 16th CPC Congress, November 2002)
Moreover, with these “old” problems remaining largely unresolved, new administrative issues have kept emerging. Problems, such as waste, incompetence, low efficiency, soft budget constraints and financial fraud, are causing growing concerns. Among these issues, government financial administration has often been highlighted as particularly problematic. In 1998 the Chinese Ministry of Finance came under unprecedented pressure to reform the fiscal regime and to address serious criticisms from the National Audit Committee (NAC) and the National People’s Congress. In its 1998 annual report, the NAC made a stinging criticism of government financial administration, describing it as “slack” at the Centre and “appalling” in the localities. In the same year, members of the National People’s Congress pointed out that government budgets were “incomprehensible”, and sometimes totally “unreadable”. It was recommended that immediate actions be taken to tighten up financial discipline at all levels of government administration, and to improve transparency and comprehensiveness of government budgets.

1.4 Towards a Public Finance Framework

At the 1998 National People’s Congress, the newly appointed Premier Zhu announced that his next-step reform was to rationalise the state bureaucracy and to tackle managerial issues in government departments. Following the Premier’s speech, the Regulation Department of the Ministry of Finance was given the task of policy making, and by 2000 it had proposed five programs under the title of the “Public Finance Framework” (PFF), the central policy being Department Budget reform. The general aim of PFF reform was to establish a framework of Western concepts of administrative rationality to establish a Western-style civil service in China. The Ministry of Finance called it “an important part of the process of building a framework of public finance and a major measure in building clean government”. PFF emphasises notions such as

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7 In this sense, budgets are not treated as hard targets which should constrain expenditures; instead they are seen only as very ‘soft’ guidelines.
8 “The Centre” in this context refers to the Ministry of Finance. Because NAC’s annual budget comes directly from the State Council, rather than the Ministry of Finance, the NAC is able to comment on the work of MOF more openly than the audit committees at the local levels where they are resourced by local treasuries.
9 Source: Interviews with officials from the Ministry of Finance and a local Finance Bureau.
10 Source: Interviews with officials from the Ministry of Finance and a local Finance Bureau.
11 Source: interview with a senior official from the Minister of Finance.
managerial efficiency, financial accountability and operational transparency. It sets out to deal with administrative issues like waste, soft budget constraints, inefficiency and the lack of transparency in government organisations. The design was heavily influenced by recommendations from several international organisations, including the World Bank and the Asian Development Bank, who suggested that Chinese government agencies could learn from Western experience and modernize public administration by employing advanced management techniques for collecting, analysing and reporting managerial information (World Bank, 1995, 2000, 2002; OECD-China dialogue in budgeting).

Overall, the ideas behind the “Public Finance Framework” are regarded as the solution to challenges faced by the CCP in the third phase of social transformation in China. The use of the term “Public Finance” was particularly significant in that it highlighted the public nature of the fiscal fund and signalled a departure from the old “State Finance” regime towards a form of public accountability. As such PFF has been acclaimed as a “groundbreaking event” in transforming the Chinese state bureaucracy and has stimulated considerable interest among China’s intellectuals (see Wang, 2002; Li, 2002; Song, 2002; Cui, et al, 2003; Liu and Deng, 2003).

However, these goals are not easy to achieve. To begin with, the notion of “Public” necessitates a more fundamental change in the existing political structure, which is beyond the scope of PFF agenda alone. Second, and more importantly, PFF requires a shift in the administrative rationality from the moral institution to the values of public responsibility, efficiency and effectiveness. The crucial question is how to reconcile Western notions of public administration with a two-thousand-year old moral institution which values unification and personal virtue. Our historical review suggests that such reconciliation is still in its infancy, as the Chinese state administration since 1949 has demonstrated more of the characteristics of its imperial tradition than of the notions of public administration found in its industrialised Western counterparts.

A similar conclusion was reached at by Saich (2001), who observed that post-1949 governance in China has been even more monolithic than its imperial ancestors, with the state and society combining into a bounded and inseparable moral unity. We argue that
such a moral unity has two distinct impacts on state administration. First, in such a unity, the state assumes the role of a great “educator”, and officials at all levels are supposed to set good examples for the masses (White, 1991). This state education comes in various forms. Sometimes the state establishes “role models” for the purpose of teaching; other times it uses mass mobilisation and political campaigns. The result is a scholar-official liaison, which mirrors the “literal scholar” system in the Song dynasty and closely links intellectual activities with the desire for political control. Second, the moral unity defines the relationship between subordinates and superiors as a bond of mutual service, whereby superiors think on behalf of the subordinates and make rational decisions for them in return for obedience and submission. Government officials often describe their administrative duty as “parenting” and describe themselves as “parents”.

Overall, such a moral unity blurs responsibilities for administration and frustrates the introduction of formal accountability systems within government departments, because the individual responsibility of officials can be easily deflected by claims that they are acting on behalf of their subordinates who are presumably incapable of making the right decisions and acting on their own behalf, and will thereby benefit only under the “right” leadership. This type of argument, which is probably quite alien to Western norms of professionalism, is likely to damage the proper functioning of technical systems even further.

The moral institution also underlies the logic of administrative change in China—literally all reforms were manoeuvred through a process of the personnel control, in sharp contrast to Western administrative rationality which is rather impersonal and rule-based. To-date, state administration in China is sustained by stringent personnel control (rather than managerial systems and techniques), is supported by an administrative culture which values moral and political integrity (more than technical capability), and equates good government with virtuous administrators. Over-reliance on personnel control has led to a vicious cycle whereby government officials cultivate political relationships for career

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12 Source: interviews with local government officials.
advancement rather than making efforts to improve performance, and this creates its own source of waste and inefficiency.

Hence in several respects today’s state bureaucracy in China is a modern wrap over an ancient moral institution. As a result, although PFF has been implemented under the banner of “modernisation”, state administration in China will continue to be imprinted with the characteristics of a moral institution and this casts serious doubt on the prospects for successfully implementing PFF. However, there is a more recent and probably more serious obstacle created by the misalignment of central-local financial relationships, which is discussed below.

2. PFF AND FINANCIAL DECENTRALISATION

We have identified the general pattern of reforms in China and attempted to set PFF in the broader historical context of Chinese government administration. In this second part we examine PFF within the context of the complex financial relations between Central Government and sub-provincial authorities. We argue that PFF is not simply a strategic reform package, introduced at the “right” time in a linear process of reform. Rather, it is an expedient measure of a central government which is grappling with the consequences of policies of financial decentralisation that have gone out of control during their implementation. To follow our discussion, it is necessary for readers to be acquainted with the structure of the Chinese bureaucracy and, in particular, the relationship between the central and the provincial governments. These are described in Appendices 1 and 2.

2.1 EBF and OBF: the unintended outcome of post-1978 fiscal decentralisation

regulatory framework has experienced four such cyclical movements, summarised in Table 1. Underlying the dynamic of central-local financial relationships is the need to balance CCP control with flexible policy-making and a more incentive-based economy. The dilemma of control vs. devolution is clearly reflected in oscillations of fiscal policy between centralisation and decentralisation from 1949 to date.

**Insert Table 1 about here**

China’s transition towards a market economy since 1978 has been accompanied by vast fiscal decentralisation (Bahl and Wallich, 1992; World Bank, 1993, 1995; Xiang and Jiang, 1992), which has given considerable autonomy to local government agencies in both economic decision making and budget management. An initial scheme for sharing revenues between the Centre and the provinces, which was introduced in the early 1980s, provided local authorities with a powerful incentive to pursue economic expansion (Yang, 1994) and contributed to economic growth in many regions. Before its major overhaul in 1994, this scheme had transformed a province-collecting, centre-spending fiscal regime into a self-financing regime (see table 2) for both the Centre and the provinces (Zhang, 1999).

**Insert Table 2 about here**

The revenue sharing system used from 1983 to 1994 was only intended as a temporary measure, but it had two weaknesses: there was too much backdoor negotiation and *ad hoc* bargaining between the Centre and the provinces; and it led to a massive loss of central revenue. Consequently, the Central Government struggled to raise necessary funds despite the economic prosperity of this period (Lall and Hofman, 1995). To overcome these weaknesses, the Central Government launched a “Tax-Sharing” policy in 1994 (Herschler, 1995; Zhang, 1995), which had two aims: to increase central revenue, and to introduce more transparency and to avoid the unpleasant threats and counter-threats which often featured in relations between the Centre and localities prior to the annual NPC\(^{13}\) budget session. To reinforce this policy, the Centre made considerable

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\(^{13}\) National People’s Congress.
compromises with provincial governments and the policy was proclaimed a success. In terms of total revenue, “centrally collected” revenues increased from 22% in 1993 to 56.5% in 1997 (Zhang, 1999; Chung, 2000).

The post-1978 fiscal decentralisation played an important role in invigorating the local economy but it also had another, less attractive, side effect. Due to a lack of financial accountability, fiscal decentralisation led to serious problems, including an “explosion” of expenditure outside formal government budgeting systems and increasing regional disparities in public service provision (Lin and Liu, 2000, World Bank, 1997; West, 1999; Qian, 1994; Zhang, 1994). Tackling these problems has proved much more difficult than rearranging the allocation of resources between the Centre and provinces.

Table 3 shows fluctuations in Extra-Budget Finance (EBF)\textsuperscript{14}, as a percentage of the formal government budgets, over the last fifty years\textsuperscript{15}. A prominent feature of the post-reform fiscal landscape has been the expansion of the EBF—in 1992 it amounted to nearly 100% of the (formal) budget revenue. Even after 1993, when retained earnings and depreciation of the State Owned Enterprises were excluded from the calculations, it still comprised 30% of the formal budget.

\textit{Insert Table 3 about here}

The problem of the EBF is not just its sheer size (although given its size, Wang (2000) called the EBF China’s “second budget”), but the lack of any financial accountability for it. It is an open secret that government departments keep separate books to account for EBF transactions and to hide the information from external scrutiny. It has always been difficult to estimate the real scale of the EBF—it is been suggested that the 1995 figure was twice that in official statistics (Zhang, 1999). Furthermore, alongside the EBF, there was rapid expansion in “Off-Budget Finance” (OBF), or “secret

\begin{table}[h]
\centering
\caption{Extra-Budget Finance (EBF) as a percentage of the formal government budget}
\begin{tabular}{|c|c|c|c|c|}
\hline
\textbf{Year} & \textbf{EBF as a percentage of formal budget} \\
\hline
1992 & 99.5\% \\
1993 & 30\% \\
1994 & 20\% \\
1995 & 15\% \\
1996 & 10\% \\
1997 & 5\% \\
\hline
\end{tabular}
\end{table}

\textsuperscript{14} The government revenue reported in Chinese statistics consists of the formal budget and the extra-budget fund (EBF). The formal budget includes taxes, fees and revenues collected by finance bureaus and subject to formal budgeting by the government. The EBF covers officially sanctioned charges for public utilities, road maintenance fees and income from enterprises run by various government departments and agencies.

\textsuperscript{15} The reduction in 1993 was achieved by a re-definition of EBF; whereby the EBF of State Owned Enterprises was no longer included.
the treasury”, whereby income accruing directly to income generating units is often spent immediately. The OBF is even more problematic than the EBF, as it is closely allied to financial fraud and corruption.

In order to fully understand the nature of the EBF and OBF, it is necessary to trace their origins back to 1983, when the “Extra-budget Finance Act” formed part of a reform package which increased fiscal decentralisation. Because officially approved sources of EBF are closely linked to the local economy, central policy makers expected that the EBF would provide a powerful incentive for local officials to engage in economic development. The 1983 Act gave legitimacy to the EBF, and the commercial activities associated with it, but it did not specify the reporting mechanisms needed to account for these government funds. Under the Act, EBF budgets did not have to be discussed by local People’s Congresses and local administrative units only had to report the total revenue figure to their local Finance Bureau at the end of each year. The 1983 Act also connected EBF spending with EBF revenue generation, which meant that the more local units could collect, the more they could spend.

The messages implied in the 1983 Act were consistent with the general theme of fiscal decentralisation of the time; i.e., on one hand it would motivate local agencies to pursue economic development (Qian, 1994a); and on the other hand it would make local authorities self-sufficient and minimise the funds they needed from Central Government. But when the 1983 Act first appeared most local government authorities had multiple bank accounts under various names, which made EBF revenue easy to hide. It is, therefore, not surprising that this crudely designed “incentive scheme” soon collapsed and EBF and OBF grew out of control. Throughout the later 1980s and early 1990s Central Government made several cautious attempts to reverse the 1983 Act and curtail the expansion of the EBF (Ding, 1997). Nationwide EBF administration reforms began in 1996 and were intensified in 1998 and 1999. Stringent regulations were issued to restrain EBF and OBF activities (See Figure 4). However, these regulations achieved little and financial scandals involving local government officials kept occurring. Many of the

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16 Even today, the formal budget and the extra-budget are still subject to separate lines of reporting.
problems were voiced in the National Auditor-General’s criticisms at the 1999 NPC Standing Committee. In the same year, NPC urged the Ministry of Finance to introduce immediate changes to improve the administration of fiscal funds and called for a comprehensive government budget for each ministry and their subordinate government agencies.

2.2 The muddled process of reform in EBF administration

Many suggested that it was a serious mistake on the part of the Central Government to retain EBF at the local level (see Oi, 1992). It has been argued that, given personal interests were at stake, local government officials would inevitably resist attempts to re-centralise, as it would reduce the amount of EBF available to the local economy (Chung, 2000; Ma, 1995). An explanation in terms of local opportunism is probably valid but incomplete, as it ignores how unfavourable the changes in the formal budgetary sphere, introduced post-1978, have been to local governments. Only a quarter of all state expenditure is incurred at the Central Government level, and the major responsibility for financing infrastructure and providing social services is at the local level. Yet, the trend has been to shift ever more budgetary expenditure from the Centre to lower levels of government.

Wong (2000) observed that local authorities are increasingly being loaded with responsibilities for expenditures often beyond their financing capacities. Under the self-financing fiscal regime, resources to finance local expenditure include local revenues and net transfers from other administrative levels. To date, fiscal reforms have focused exclusively on the central-provincial revenue division, leaving finance at lower administrative levels to the discretion of each province. But within each province, higher-level government departments struggling to balance their budgets have tended to devolve expenditures whilst reducing the downward transfer of funds, which has led to mounting fiscal pressures on the lowest levels of administration. Wedeman (2000) observed that in many rural regions the province and county depend upon transfers from cities and
townships to make ends meet; while cities and townships then impose further financial burdens downwards upon villages. The extra fees and levies worsen the already hard lives of the villagers and are a cause social unrest in many parts of the countryside.

Such downward shifting of financial responsibilities forces governments at lower levels, which cannot delegate responsibilities further, to meet local expenditures from locally generated revenues and/or to seek supplementary funding off-budget; i.e., through EBF and OBF. But this not only gives rise to the criticisms mentioned earlier, but also amplifies existing inequalities between rich and poor regions. In poor areas, where the size of the market economy is relatively limited, and local governments have little access to EBF, it is not uncommon for local governments to struggle to pay the wage bill (see Huang, 2001; Park et al., 1996). Consequently, they have little recourse other than to reduce services and to cut back the number of staff.

However, reducing the number of staff in local government to save money is not really an option for most local authorities. Central Government “streamlining” was carried out in 1998 and there were provincial-level cut backs in 1999; but due to fears of social instability, cuts at county and township levels did not start until 2000. But by then, the policy had changed to a “step-by-step” approach and the scale of downsizing was redefined to what could “realistically” be achieved (South China Morning Post, 6 March 1999). Even then, only ten provinces had submitted proposals for local cut backs by 2000, and after that, the streamlining campaign went awkwardly quiet.

In addition, local governments are also under pressure to maintain economic growth above a certain rate, but usually without extra funds for economic development. Because economic growth is the guiding theme of current reforms in China, producing a steady rate of local economic growth becomes a key measure of local governments’ performance. This has led many local government to compete with each other by setting up, and sometimes duplicating, grand projects to promote local economic growth. This is particularly problematic in rural China, where local leaders tend to imitate coastal cities by building similar industries and businesses. However, due to poor infrastructure, shortages of skilled labour and limited markets, many such investments have failed. Even
worse, some local authorities have fabricated central-local joint projects, e.g. by producing artificial infrastructure proposals, to secure central funding or gain access to special capital budgets.

Given that government agencies at the lower levels have suffered the most in attempts to reform the state bureaucracy, it is not surprising that local agencies tend to hide their EBF and OBE from higher authorities. The numerous political campaigns and movements aimed at “tightening up financial discipline” and regulating charges and levies at the local level have almost always led to reduced local revenue, cuts in public funding, and delays in salary payments, eventually triggering a further cycle of “alternative revenue” seeking. For these local authorities, fiscal decentralisation has become the delegation of financial pressures and responsibilities, with the lowest levels in the chain of devolution feeling the greatest burden of operational pressures, financial constraints and criticisms from both the higher authorities and the general public.

Therefore we argue that the policies of revenue-sharing, fiscal decentralisation and especially EBF suggest that Chinese bureaucratic authority is founded on a “political contracting” principle, whereby local officials must trade their compliance for economic benefits and career advancement. Implicit in fiscal decentralisation throughout the 1980s and 1990s was the idea that economic gain is the major driver which encourages people to work harder and perform better. In order to make local authorities economically responsible, various profit retention schemes were invented and applied in practice. These schemes have underpinned the dynamics of central-local relations in the reform era and are at the heart of many successful and unsuccessful stories associated with fiscal decentralisation.

However, this economic-based incentive system builds upon the existing bureaucratic personnel system, with senior local officials being appointed rather than elected. Consequently, they are accountable only to their superiors at one level higher in the government hierarchy and to the Party cell at their own level; not to the general public. In such a one-level downward personnel management system, compliance to authority is priority for all local officials. It helps sustain the unitary political system, as it makes it
difficult for provincial leaders to openly challenge the Centre. Among the post-1978 reforms, personnel management has been one of the areas least affected (Lin and Liu, 2000). Huang (1996) noted that the continuing role of the CCP in appointing, managing and promoting local officials has enhanced, rather than weakened, central control during fiscal decentralisation. Due to this political contracting principle and stringent personnel controls, the contemporary Chinese government sector has become a paradoxical entity – high in both coercion and local variety.

Understanding this background and muddled nature of the reform process sheds new light on PFF reform. By examining it in the context of financial devolution, we argue that PFF is a new round of fiscal reform aiming at improving inter-governmental financial accountability by tackling two persistent problems in central-local financial relations: regulating local income that falls outside the formal budget, and making budgets into meaningful targets. As both are linked to EBF, PFF reform has introduced two changes in EBF administration: (1) the decoupling of EBF revenue from EBF expenditure—government departments are no longer allowed to spend locally any income generated at their own discretion; and (2) bringing EBF back into the formal budget, thereby making the government budget more “comprehensive” (Fu, 2002; Liu and Deng, 2003). In this respect, PFF reform can be interpreted as the latest “aspiration” in a long list of the Central Government’s attempts to strengthen its control over locally generated income.

Due to China’s five-tiered hierarchical system of fiscal management, implementing the Department Budget Reform requires a high degree of coordination of, and cooperation from, government agencies at all levels. However, because of the sensitivity of extra-budget revenue, and conflicts over resource allocations, the necessary coordination is unlikely to be achieved without substantial compromises (e.g., to implement the 1994 Tax-Sharing Scheme, the central government had to give up substantial economic resources in return for local coordination). Moreover, whereas the PFF reform package is focused primarily on internal transparency, it leaves the notion of public accountability unaddressed and continues to exclude the general public from public sector budgeting and spending, and this weaken the effects of the reform policy even further.
Having examined PFF in the context of financial devolution, we argue that it takes more than a Department Budget Reform, or PFF, to formalise the government’s budget and to control locally generated income. In the absence of an effective financial accountability mechanism, it is more likely that the Department Budget Reform will lead to changes in the form, rather than substance, of local public financial administration in China.

3. Concluding remarks and directions for future research

This paper has examined the Chinese PFF reform from two directions. The first sees PFF as a strategic measure adopted by CCP leaders during the third phase of social transition. This emphasised the unitary view and focussed on the relationship between the Party, the state and society, and China’s tradition and modernity. It maintains that the success of economic reforms has pushed state administration to the fore in the third phase of social transition, making debates about the boundaries, function and administrative style of the “state sector” under the socialist market economy unavoidable. PFF emerged as an attempt to comprehensively answer these pressing issues, but the central dilemma for policy makers is reforming public administration without undermining the power and legitimacy of the CCP; and the crucial question is how to reconcile Western notions of public administration with a two-thousand-year old moral institution which values unification and personal virtue.

The second direction examines the financial devolution which is driving much of the economic reform in China. It explored financial and political interactions between the various layers of government agencies in order to understand the intriguing relationships between Central and local governments. We argued that ensuing tensions stem from the Central Government’s desire to stimulate growth in the local economy, whilst simultaneously pushing financial burdens down the hierarchy, and local governments’ growing demands for greater discretion over locally generated income. Here, the key issue for policy makers is how to reconcile the consequences of their programmes of fiscal decentralisation in the early 1980s without undermining local governments’ enthusiasm for pursuing economic growth. We suggested that the process of
reconciliation will be rather difficult, due to the lack of an effective system of financial accountability in the Chinese bureaucracy.

To summarise, PFF is not only the latest idea in a long list of centrally dominated reform agendas and a logical development in the blueprint for “agriculture-industry-government” reform, but it also reflects the Central Government’s struggle, through trial and error experiments, to fine-tune central-local relations. As such, it is an expedient measure designed largely to overcome problems created by previously misplaced delegation of the governments’ budgets. Our discussion reveals that PFF is a rather muddled reform with conflicting intentions and contradictory requirements. In comparison to the prevailing prescriptive research of PFF, this argument contributes to a fuller understanding of the nature of that reform.

It also points to several directions for future research on PFF in China. As it is now seven years since the term “Public Finance Framework” first appeared, so researchers could usefully address whether the rhetoric of PFF has delivered a genuine departure from the old state finance regime. So far, the effects of the policy at various organisation levels are rather unclear. On the surface, PFF policies seem to have been successfully implemented—according to various official reports\(^\text{17}\) most Central Government agencies have changed their internal financial reporting systems. Following the example set by Central Government, PFF reform at the sub-provincial level started in 2002. However, the general situation is difficult to summarise, due to vast differences in the process of the reform among the provinces. Nonetheless, available local reports\(^\text{18}\) indicate that the idea of establishing a “Public Finance Framework” has been supported by local authorities at all levels and the implementation of reform has progressed well.

But these reports should not be taken at their face value—due to the sensitive nature of central-local relations, it would be unsurprising if in practice PFF transpires to be different from what is portrayed in official documents. We argue that official claims are no substitute for field-based case study research. A legitimate question is whether the

\(^{17}\) For example, the “Implementation Review of Department Budget Reform in Central Government Departments”, 2004, issued by the Chinese Ministry of Finance.

\(^{18}\) Source: Local Finance Bureau official documents collected during our fieldwork.
rhetoric of PFF has produced more than an increased amount of paperwork in government departments. Future research should pay attention to the every-day process of local financial administration, and the extent to which it is affected by PFF reform. So far, research on this subject is very limited, due primarily to “the great difficulty in getting access to government departments”\footnote{Source: interview with the project leader on Department Budget Reform of the Party Committee Research Institute of the city where our fieldwork was conducted.}. As a result most research by Chinese academics simply promotes the need for PFF reform agenda, rather than collecting and analysing the evidence of local financial administration practices. This is unfortunate as the aim of PFF is to reform government administration at the organisational level. The lack of available evidence considerably undermines the contribution of existing research in China. This may be due to the restricted scope of “public” accountability, and the secretive culture that still prevails in many Chinese public sector organisations. Although this paper is not about the implementation of PFF in concrete organisational settings, it raises important questions and offers a critical reflection on contexts that have shaped PFF, and forms a necessary starting point for future studies of public sector organisations in China, and suggests promising areas for future research.

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The Chinese Parliament is called the National People’s Congress (NPC). It is elected for a term of five years and holds one session in each year. The 1982 Constitution bestowed on the NPC a wide range of powers, including law making, supervising legal enforcement, appointing senior government officials and reviewing the national economic plan and state budget. However, in practice, it is the CCP that makes most of the crucial organisational and personnel decisions. For this reason, the NPC is often called the CCP’s “rubber stamp”. Recent economic reforms have strengthened the position of the NPC. Although far from functioning as a Western legislature (O’Brien, 1990), the NPC has attempted to play a more active role in government decision making—at NPC annual sessions negative votes on personnel appointments are increasing (Tanner, 1999), so are criticisms of financial scandals and corruption.

The State Council is the executive function of the NPC. It is led by an executive board comprising the premier, vice-premier, state councillors and the secretary general. Under the State Council are the ministries, commissions, committees, bureaus, and ad hoc organisations. The functional fields of the state bureaucracy are categorised into a number of “XiTong”. A XiTong includes all the government organisations under the supervision of a particular ministry; it links to the CCP leadership group at the centre and is responsible for implementing policy initiatives, developing and promulgating new policy ideas.

Coordination within XiTong is achieved through a system called “Tiao-Kuai” (Tiao: vertical lines of command; Kuai: horizontal lines of command). Tiao is defined as the control of a ministry over all the subordinate organisations under its administrative supervision. In comparison, Kuai means Party committees at each hierarchical level oversee the performance of government organisations within its geographical jurisdiction. Hence, the Chinese government departments are under dual-supervision—they are subject to control by both Tiao—the corresponding departments in the ministry, and Kuai—the Party committee at the same administrative level.

Such an administrative system tends to create tensions between vertical (administrative) authority and horizontal (Party) authority. The initial domination of the “vertical” over the “horizontal” was reversed in 1957. Since then the horizontal CCP control has been to the fore. During the Cultural Revolution, Party cells took entire control over the state administration and the functional departments of line ministries were all disabled. The 1978 reform sought to empower administrative authorities over the Party cells. However, CCP interventions remain strong. After 1989, Party scrutiny was re-strengthened. At present all government departments must report to the external Party committee at the same administrative level; meanwhile they are also subject to the scrutiny of an internal Party committee within the work unit.

Beyond the Centre, the state is administered through 22 provinces, five autonomous regions, four provincial municipalities, and two special administrative regions (Hong Kong and Macao). Under the provinces and equivalents, there is a three-level administrative hierarchy, consisting of (i) prefectures, (ii) counties and cities, and (iii)
townships (however, prefectures do not constitute a level of political power). The leading members at each of these levels are appointed rather than elected. Each level of the local government is organised in basically the same way as the Centre, with government and party cells paralleling one another. The People’s Congress represents state power at the local level and is entitled to organise local government. The people’s government is the administrative organ of the local People’s Congress and is, in theory, accountable to both the People’s Congress and its standing committee at the same level, as well as to the state administration at the next higher level, hence it is ultimately subordinate to the State Council.

The nature of the province in the Chinese state bureaucracy has puzzled many outside readers. In articles written from a central policy maker’s point of view, the term “locality” is often used to refer to administration at the provincial level. But the government authorities at the grass roots level tend to see provincial authorities, not as part of the local government, but as an extension of Central Government apparatus. As for many provincial leaders, they see themselves both as local leaders and as potential candidates for senior Central Government office. Such ambiguity is caused by the dual roles of the provincial leaders in bridging central and local governments (Bo, 1996)—on one hand provincial government oversees local administration within each province; on the other, provincial governors must collaborate with the Centre as that is where their career prospects lie. Consequently, governors of provinces are sometimes called “political brokers” (Breslin, 1995), who carry a rank equivalent to a minister in Beijing and they mediate the wishes of the Centre with the needs of the localities.

Under the totalitarian regime prior to 1978, the governor of a province was more like an agent of central control than a local leader (Goodman 1980; Lieberthal and Oksenberg, 1988). In the past three decades, however, the power of the provinces has increased dramatically as a result of the economic reforms (Saich, 2001), and the Centre has become increasingly reliant upon the provinces for policy implementation and experimentation. During this period, the provinces have not only provided the Central Government with “incubators” for its reform initiatives, but also fine-tuned central policy and allowed more flexibility during its implementation (Cheung, 1998).

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20 Source: interview with members of the Party Committee in the city where we did our fieldwork.
APPENDIX 2: THE CHINESE FISCAL SYSTEM

Central Government

Provincial Governments

Municipal Governments

Governments at the lower levels

Ministry of Finance

- Social welfare
- Education, Science, culture & healthcare
- Public security & Law enhancement
- Transportation
- National defence
- Agriculture
- Communication
- ......

Provincial Finance Bureau

- Social welfare
- Education, Science, culture & healthcare
- Public security & Law enhancement
- Transportation
- Agriculture
- Communication
- ......
### TABLE 1: THE CHANGING CENTRAL-LOCAL FINANCIAL RELATIONSHIPS

<table>
<thead>
<tr>
<th>Centralisation</th>
<th>Decentralisation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>March 1950</strong></td>
<td><strong>1958-1960</strong></td>
</tr>
<tr>
<td>“Unified revenue and unified expenditure system”</td>
<td>“Great Leap Forward” and 1960 economic crisis</td>
</tr>
<tr>
<td><strong>1961-1965</strong></td>
<td><strong>1966-1968</strong></td>
</tr>
<tr>
<td>1961 Budget control tightened; 1965 Economic turned for better</td>
<td>“Cultural Revolution” began: government paralysed &amp; fiscal administration decentralized.</td>
</tr>
<tr>
<td><strong>1970</strong></td>
<td><strong>1971</strong></td>
</tr>
<tr>
<td>Government departments restored; fiscal administration recentralised</td>
<td>Fiscal decentralization</td>
</tr>
<tr>
<td><strong>1978 Market reform</strong></td>
<td></td>
</tr>
<tr>
<td>Massive decentralisation of economic decision making and budget administration Material incentives introduced into local income generation units;</td>
<td></td>
</tr>
<tr>
<td><strong>1980-1993: “Fiscal contracting period”; massive loss of central revenue; explosion of EBF and OBF.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>1994</strong></td>
<td></td>
</tr>
<tr>
<td>Tax sharing policy; taking measures to improve the financial accountability of EBF and OBF</td>
<td></td>
</tr>
<tr>
<td><strong>2000-present</strong></td>
<td></td>
</tr>
<tr>
<td>Public Finance Framework—further enhances control over locally generated income.</td>
<td></td>
</tr>
</tbody>
</table>
TABLE 2: THE “SELF-FINANCING” PRINCIPLE

State budget

- Central budgets
  - Central departments’ budgets
  - Provincial departments’ budgets
- Local budgets
  - Municipal budgets
  - County budgets
  - Township budgets

Source: Finance Yearbook of China (2000)

TABLE 3: EXTRA-BUDGET FINANCE AS A PERCENTAGE OF THE STATE BUDGET

- % of state budget
- Year

Source: Finance Yearbook of China (2000)
**TABLE 4: ADMINISTRATION OF THE EXTRA-BUDGET FINANCE**

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>“Honeymoon” period: EBFs were allowed to be kept by the income generation units and separately accounted for.</td>
</tr>
<tr>
<td>1983</td>
<td>Special Fiscal Account policy: EBFs were required to be deposited in a Special Fiscal Account held by the local treasury. Most income generating units ignored the policy.</td>
</tr>
<tr>
<td>1986</td>
<td>Reinforcing the Special Fiscal Account policy</td>
</tr>
<tr>
<td>1996</td>
<td>PFF reform: Introducing the Department Budget Reform—EBFs are accounted as part of the formal government budgets</td>
</tr>
<tr>
<td>2000</td>
<td></td>
</tr>
</tbody>
</table>