Perspective on Local Governance Reform in China

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Abstract
This paper is an attempt to present an analysis of China’s decentralization and local governance practices, the dilemmas rooted in the current institution. We argue that the misbehavior of local government officials is endogenous to China’s central–local structure and that competition among localities has become distorted and constrained by various policy burdens and development mandates imposed from above. The information asymmetry for the enforcement cost of mandates that exists between central and local governments not only leads to difficulties and distortions in local performance evaluations, but also creates opportunities for local bureaucracy expansion and rent-seeking. Enhancing fiscal transfers, or strengthening political restraint, although necessary, would be far from enough to solve the local governance problems. The ultimate solution entails an in-depth deregulation reform on factor mobility and a furthest eradication of policy mandates for the local government.

Keywords: political competition, decentralization, local governance, policy mandate

JEL codes: H57, H71, P32, P35

I. Introduction
The difficulty of improving local governance in contemporary China has recently aroused a great deal of attention from both academics and policy-makers. Among the many issues needing to be addressed, inefficiency in the work of local administrative agencies and
shortcomings in the delivery of public services rank as the most significant. Many Chinese farmers, especially those in less developed regions, have been plagued by excessive tax burdens, insecure land property rights and intrusive local governments. From the center’s perspective, local government officials, in pursuit of their own interests, tend to ignore the demands of local people. However, local officials complain that higher levels of government, (especially the center) unduly monopolize fiscal resources. They argue that in many less developed regions the center has failed to provide fiscal transfers commensurate with ever-increasing local expenditure needs, therefore creating local fiscal insolvency leading to chronic under-provision of public services.

Such differing governmental perspectives have generated differing analyses of and proposed solutions to China’s current problems in delivering a good standard of local governance to the people. On the one hand, the center understands that local government officials, who are appointed from above and lack accountability to local people, have a tendency to stray from good governance practices; on the other hand, fearing that uncontrolled elections could gravely weaken the center’s ability to enforce its policies and even destroy the Party’s power base, the center has no strong desire to promote popular elections at local levels. Instead, it has tried to restrain local officials by issuing numerous policy documents designed to limit various forms of local government misbehavior, such as levying excessive fees on farmers and arbitrarily expropriating farmers’ lands, and requiring them to be more accountable to the center.

Can the center, by issuing more such policy documents and regulations, effectively improve local governance? Many experts believe that such measures will not work well because local officials and bureaucrats can always manage to find ways to evade central regulations when they conflict with local vested interests (O’Brien and Li, 1999). It is argued by many that the games routinely played between the center and the localities almost always result in the erosion of the center’s actual ability to supervise and in chronically poor local implementation of central policy. Although not pretending to be completely innocent of all bad governance practices, local government officials still believe they have many reasons to complain. Facing heavy expenditure responsibilities and a host of unfunded development mandates, local governments have no way to make ends meet except by drawing on illegitimate revenue sources. Therefore, local officials, especially those in less developed regions, are constantly seeking changes in intergovernmental fiscal arrangements aimed at securing either larger fiscal transfers or higher shares of tax revenue.

Can higher intergovernmental transfers ensure better local governance and better quality public services, or would that only lead to further local government rent-seeking and bureaucratic expansion? What causes the ineffectiveness for the center to improve
local governance by strengthening supervision and regulation? If holding free elections at local levels is not a possible solution in the short run, what can be done to improve local government accountability? This paper is an attempt to answer these questions based on ideas drawn from the published theoretical literature on decentralization and on an empirical analysis of China’s local governance experiences. All the evidence in the present paper is based on the field works by the authors during the period of September 2003 to August 2005.1

II. Literature Review

1. Centralization–decentralization Tradeoffs

In the standard scholarly literature on federalism, the boundary between what is properly administered centrally and what should be managed locally is determined largely by the characteristics of the public goods/services that are to be delivered. If the benefits are local and there are no interregional spillovers, then public service provision can be devolved to local governments to maximize efficiency. If the adaptability of public services to local conditions is important, then decentralization can improve the allocation efficiency by moving decision-making closer to the beneficiaries.

Under the Pigouvian (Pigou, 1938) local government assumption (social welfare maximizing), inter-jurisdictional externalities might arise as local tax policy creates spillover costs for other jurisdictions. For example, competition for capital might be too intense, leading to a “race-to-the bottom” in local tax rates, welfare provision, or in the supply of consumer-oriented local public goods like parks or libraries (Keen and Marchand, 1997). Alternatively, competition might prompt local governments to exploit spillovers, exporting taxes or pollution to their neighbors (Gordon, 1983; Oates and Schwab, 1988). With the under-use of certain taxes under decentralized government competition, under-provision of public goods can emerge. Furthermore, if local public goods have positive spillovers (such as provision of local road infrastructure or certain forms of environmental protection) inefficiently low spending within decentralized jurisdictions will occur.

When inter-jurisdictional externalities exist in taxation and expenditure, a degree of centralization, or supra-local coordination is necessary (Wildasin, 1989). If interregional competition leads to excessive pollution or to under-provision of public goods with

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1 We interviewed officials at county, township, and village levels regarding governance of the township and the village. Thus far we have finished interviews in Shaanxi, Anhui, Sichuan, Zhejiang, Hunan, Gansu, and Jiangsu.
externalities, the central government can regulate or provide the public goods itself. If tax competition depletes local revenues, the central government can collect and share taxes on mobile bases, or allocate corrective grants to the “losers” from such capital mobility. In addition, if localities have different fiscal capacities and different preferences, central redistribution can also be justified.

However, a centralized system will incur several types of costs. First, any centralization through redistributive fiscal policy will lead to negative local incentives. For transfer “net contributing regions”, tax sharing will harm their incentives to promote economic development and the development of the local tax base. Whereas, for transfer “net receiving regions”, it creates a common pool problem and will induce local governments to compete for transfers instead of providing growth-enhancing public goods (Weingast, 2000). Second, even in many developed countries, the actual fiscal arrangements between the center and the localities are usually based on political negotiations rather than on rule-based formula, which renders the center’s decision on transfer discretionary (Besley and Coate, 2001). In this way, centralization gives rise to greater opportunities for local agents to engage in lobbying, and unless economic spillovers are sufficiently high, vested interests influence costs and reduce the general welfare under centralization. In reality, the final resource allocation is to a large extent determined by the political game at play among different local representatives: if the game is cooperative, it leads to over-spending, whereas a non-cooperative game leads to inequity in central resource distribution (Ebel and Yilmaz, 2002). Finally, although the central government might in principle help to alleviate the spillover in taxing and spending, the center might have serious problems in collecting local information and catering to local needs. At least in democracies, local governments not only have better means (in the form of information) to be responsive; they also have better (electoral) incentives to be responsive.

Because of the heavy costs associated with centralization, decentralization as an alternative has become more and more popular around the world in the past several decades. More importantly, the arguments for centralization have frequently been based on the Pigouvian

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2 In the developed world, decentralization is an effective tool for reorganization of the government in order to provide public services cost-effectively in the “post-welfare state” era (Bennett, 1990; Wildasin, 1997). Developing countries are turning to decentralization to escape from the traps of ineffective and inefficient governance, macroeconomic instability and inadequate economic growth (Bird and Vaillancourt, 1999). Throughout post-communist Central and Eastern Europe, decentralization is the direct result of the transition from a socialist state-planned system to a market economy and democracy (Bird et al., 1995). In Latin America, the origin of decentralization has been traced to political pressure from the people for democratization (Rojas, 1999). In Africa, decentralization has served as a path to national unity (World Bank, 2000).
assumption that a government’s objective is to maximize social welfare. But if we assume, as most of the published literature on decentralization does, that a government tends, rather, to be revenue-maximizing or even rent-seeking in nature, then decentralized governance systems are likely to be further favored. Under such an assumption, local taxes can be predicted to be too high under the “revenue-maximizing Leviathan government”. As a result, the more important effect of decentralized government competition is the disciplining force on local politicians that such competition introduces when tax bases are mobile, not the fiscal externalities that arise under a Pigouvian model.

2. Political Competition and Accountability

In the published literature on decentralization, promoting interregional and local political competition is regarded as essential to enhancing local accountability. Traditional analyses of the appropriate degree of decentralization (Tiebout, 1956; Oates, 1972) have emphasized the role of local governments in providing differentiated public goods in response to heterogeneous preferences. If we assume that local government is rent-seeking by nature, then competitive pressures can act as a disciplining force in the horizontal contests among local governments. Competition for mobile residents should match bundles of public goods to residents’ demands more accurately (Oates, 1972); competition for mobile capital should improve governance by increasing the cost to officials who provide public services inefficiently or steal budget funds (Brennan and Buchanan, 1980); competition might also reduce governments’ incentives to distort resource allocation, for instance by bailing out failing enterprises (Qian and Roland, 1998).

A second and potentially equally important disciplining force arises from the political competition that also shapes local governments and their behavior. Recently, more explicit political economy analyses of incentives in the public sector (Besley and Coate, 1999; Persson and Tabellini, 1999; Seabright 1996) have placed political accountability at the crux of the debate on decentralization. An appealing argument in this vein is that citizens exert greater effort in monitoring government agencies when they are more local and, hence, decentralization increases accountability by bringing government closer to the people.

One mechanism by which a populace monitors government is through elections. However, even in a democratic system, the information asymmetry that exists between the constituency and the elected makes it difficult for people to evaluate government performance. As Rodden and Rose-Ackerman (1997) have pointed out, even in a democracy, electoral competition does not necessarily punish local leaders who fail to respond to exit threats of mobile asset owners and are instead more responsive to coalition building and the voice of well-organized lobbies. Political accountability in poor countries is particularly affected by the likelihood of corruption or capture by interest groups. Although local
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governments might possess better local information and feel more directly the pressures for popular accountability, they might also be more vulnerable to capture by local elites, who will then receive a disproportionate share of spending on public goods.3

Local accountability might also be strengthened by what is known as “yardstick competition”, wherein jurisdictions are compared and evaluated by higher-level government in accordance with a set of standardized performance criteria, which might or might not include some measurement of local citizen satisfaction. The effort expended or the competence of public officials is not directly observable by citizens, and if poor results occur, public officials can always plead that they have done the best that was possible under the circumstances. However, if better and worse results are correlated across jurisdictions, yardstick competition can act as an indicator of relative effort on the part of local state agents. Therefore, if local taxes rise disproportionately (relative to neighboring districts), it can be interpreted as a signal that local politicians are either ineffective or are engaged in excessive rent seeking.

Compared to yardstick competition, the Tiebout model gives priority to the mechanism of “voting with feet”. Be it capital or labor, any mobile factors can move out of a region if the owner is not happy with local public services. Therefore, conditions of high factor mobility can potentially put pressure on local governments to improve service provision.4

In the case of China, voting with hands cannot play a role because free elections do not take place at township level or above. We are left, then, with the options of upper-level government supervision, yardstick competition, and Tiebout-type competition under factor mobility. The next section will examine how these three mechanisms might be interacting with each other and how they are producing differing outcomes across regions.

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3 According to Bardhan (2002), this is so because there are certain fixed costs of organizing resistance groups or lobbies, such as the oligarchic owners of immobile factors of production like land in rural India. As a result, the poor might sometimes be more unorganized at the local level than at the national level where they can pool their organizing capacities. But, in Chinese case, the lack of such strong rural lobbies and issues of local capture (owing largely to the egalitarian land distribution) might have made a incentive for local governments’ vigorous pursuit of rural industrialization.

4 Another implication of the Tiebout model is that if in a jurisdiction there are heterogeneous preferences, voting by hands will not easily satisfy the demands for public goods, but factor mobility can reduce the heterogeneity in preferences, therefore improving efficiency of public goods provision. Although the Tiebout model could be right in improving efficiency, it does not necessarily follow that equity or even adequacy in public goods provision would be the result in such a scenario.
III. China’s Decentralization and Local Governance

1. Imbalanced Decentralization and Disordered Governance

China’s present-day central–local framework is beyond the standard arrangement of federalism in the literature, which has been criticized for there is a serious lack of a clear assignment of responsibilities among different levels of governments (World Bank, 2002). Such ambiguity implies a high degree of concurrent and overlapping expenditures among the sub-national levels and might easily lead to revenue concentration and delegation of expenditure responsibilities to lower-level governments because of the weak bargaining position of lower-level governments. This has been very obvious since the 1994 fiscal reform. Actually, responsibility for government expenditures has been decentralized to local governments since the 1980s. But important new fiscal and tax reforms undertaken in 1994 and afterwards significantly re-centralized control over revenues, and this created larger vertical imbalances that have not been offset by a sufficient quantity of equalizing transfers. Although total transfers were increased after 1998, much of that increase came from hundreds of types of earmarked grants allocated in an ad hoc, nontransparent fashion rather than general-purpose equalizing transfers, which signals the center’s obvious intention to retain control. At the same time, the responses of upper-level governments were to squeeze even larger shares of revenues from lower-level governments, but assign more responsibility for expenditure to them.

However, during this period, county and township governments played the unpopular role for the citizens and peasants of delivering local services and improving operation efficiency. For example, the problem of the expansion of local bureaucracy has become one of the most serious headaches for the Central Government in recent years (Chen, 2003). Notwithstanding the Central Government’s downsizing efforts, the number of people working in township bureaucracies has continued to expand throughout the 1980s and even after the mid-1990s. Because their own administrative staffs are ever growing, many county and township level governments actually lay out the bulk of their expenditures on wages for government employees (including employees in local schools and public health institutions). After paying government staff, little is left to be spent on local public goods and services. Numerous less-developed counties and townships in China are facing nothing short of a fiscal crisis for fulfilling public tasks.

To enhance fiscal capacity, local governments have used various illegitimate ways to raise funds. For example, unauthorized fee collection by local authorities in the poor regions became an even more serious problem in rural areas. Although the Central Government circulated many documents regarding the reduction of farmers’ burden, local cadres became
not less but even more likely to engage in levy.collecting and rent-seeking. Local
governments also continued to engage in extensive borrowing in the latter 1990s, seeking
loans from banks, private businesses and even local residents. The working assumption
behind local government borrowing might be that upper levels of government will, if
necessary, ultimately bail them out.

The problem is further complicated and aggravated by the fact that all levels of
government in China are growth-driven in nature. Since the reforms of the mid-1990s, local
governments across China have initiated new waves of urban expansion, establishing new
development zones, building ambitious industrial parks and urban residential projects, and
expropriating farmers’ land at below-market prices to do so. Still, during this process of
accelerated urbanization, millions of farmers have been losing their land without being
adequately compensated, resulting in widespread complaints and social unrest.

2. Policy Mandates and Soft Budget Constraints
What then is the broader logic behind the issues of local governance we have just
discussed? A political centralization in which all local leadership is appointed and monitored
from above has to be kept because it is necessary for the Party to stay in power. Under
conditions of continued political centralization, the policy targets of local governments
are set from above, even though they must be implemented locally. Policy targets are set
from above in part because there is no election mechanism to reveal voters’ preferences
and to monitor local governments from below. Therefore, the center has to do the
monitoring of local leaders by stipulating policy targets and evaluating cadre performance
on the basis of how well or poorly those policy targets are achieved. Top-down policy
targets are also favored because the Chinese government, both before and after the
economic reforms in late 1970s, has behaved essentially like a developmental state that is
strongly motivated to realize economic progress to ensure its political legitimacy.

Therefore, different layers of governments all have incentives to push their subordinate
levels toward certain markers of economic and social development as manifest through
“objective” measurement.

The performance of individual government officials at every level are evaluated by a
series of indicators imposed from above. These indicators usually include several economic
targets, such as the annual growth rate achieved in local GDP, the amount of revenue
collected and revenue contributions made to higher levels of the state, and the quantities
of foreign investment attracted, as well as various social targets, such as those for birth
control, maintaining public security and raising school enrolments. Successfully reaching
or exceeding the targets set up by higher-level governments is decisive for local officials
seeking political promotion. In a process of political competition for promotion across all
regions, local government officials understandably compete against each other to reach such policy targets. However, because these policy targets are set from above, it is highly likely that they are not consistent with local needs because of the high transition costs of catering to local preferences by the center, such as the costs in gathering local information.

To ensure that policy targets are met by local governments, the center either has to provide them with some financial support (in the form of transfers), or it has to give them certain autonomy in administrative methods and in taxation (by e.g. winking at illicit fee collections and land requisitions) or both. Under such circumstances as these, the center not only controls political appointments, but also has a strong incentive to control formal fiscal revenues, whereas at the same time grant certain local informal fiscal autonomy. Therefore, controls on local cadres’ careers, fiscal transfers and certain local informal tax autonomy can be used as carrots and sticks to induce better local coordination.

However, because the responsibilities of local governments are dictated from above, and the enforcement cost of policy implementation is unobservable for the upper-level governments, soft-budget constraints on local governments necessarily ensue. That is, the mandates from above might create excuses for local officials to seek the self interest, which could not be controlled by the upper authority. Local officials have continued to find ways to overspend their budgets by persisting in illicit taxation, by borrowing, and by requisitioning farmland (at low prices) and then reselling it or letting it out for more lucrative development.

For one illustrative example of the dilemmas the system gives rise to, we consider the problem of the expansion of local bureaucracy. Although it is true that local cadres often create government jobs for their relatives and friends and that this is one important source of uncontrolled government overstaffing, higher-level authorities are not completely innocent. In many cases, local-level bureaucratic expansion is simply a response to the new tasks and assignments that have come down from above. In the 1990s, local governments were frequently instructed to take up newly designated “core tasks” in addition to the routine administrative tasks they are already performing. These new tasks could be flagged as policy priorities, identified for immediate action or extra attention. Ad hoc offices were then set up at local levels, but many soon became permanent and required extra permanent staff. Once new local offices and posts are created, it becomes very difficult to eliminate them, especially in less developed regions where government employment ranks among the best of local job opportunities. As the number of township agencies and personnel increase, so do local administrative expenditures and wage bills for government staff. All this increases the burden on townships, which is inevitably passed on to farmers.
IV. Local Governance Heterogeneity and Reform Strategy

1. Heterogeneity in Local Governance Practice

Under this imbalanced central–local structure, we also observe significant regional variations in local governance practices. In the more developed coastal regions, local governments have, to a large extent, limited their predatory and regulatory roles and have been much quicker in readjusting and fine-tuning their local policies. In wealthy provinces where the authors recently visited, township governments have significantly changed their roles, lately emphasizing their provision of public services rather than their enforcement of administrative regulations. By setting up a so-called “Enterprise Service Center” and an “Agriculture Service Center”, township governments have strengthened their roles in providing various public services to compete for industrial investment and promote agricultural development. Meanwhile, in many less developed inland regions, local governments tend to remain firmly engaged in implementing higher-level government policies, such as birth control, administrative agricultural restructuring and tax revenue collecting, so as to reach the performance targets imposed from above. At higher levels, such as county and city, we also find significant differences across regions. In the coastal areas, local governments compete very hard for investment, and especially for foreign investment, by providing better infrastructure and services to enterprises, whereas in inland areas, local governments show more interest in competing for transfers from the central or provincial government, by proposing different development projects that they hope will cater to the tastes of upper-level authorities.

Accompanying the policy priority changes, the structure of governmental control, such as the instruments of policy implementation and the scheme of powering sharing, does show the cross-regional difference. Significant differences exist in different regions in the cadre evaluation system. In more developed regions, the cadre evaluation system tends to be more a comprehensive one that covers different aspects of economic and social development and the evaluation covers the whole level of government and the major leadership, whereas in less developed regions, specific evaluation on individual tasks by upper-level line of agencies is much more common. In richer provinces, such as Zhejiang, evaluation by traditional targets such as birth control and public security tends to be less important, whereas the targets more closely related to investment climate and public service provision become increasingly important. The less developed regions, such as Gansu, attach much more weight on state policies, such as birth control and compulsory agricultural restructuring. In middle-income areas that lack central transfers, the dominant role of local
governments is to collect taxes and to implement the state policies of birth control.

Compared to more developed regions, less developed regions not only experience greater difficulty in meeting the targets set, but they are also much slower in adjusting local policies when they turn out to be harmful. In the more prosperous townships in Zhejiang and Jiangsu, local governments usually do not even need to impose mandates from above, aside from implementing central policy on birth control. Local governments, even when they have the motivation to implement certain policies, such as agricultural restructuring, only send out guidelines to townships and villages but are in no position to force local implementation. This is not only because farmers in these regions usually have better access to market information than local government officials and their counterparts in less developed regions, but also because local governments tend to focus more on industrial development. However, in inland provinces such as Hunan and Sha’anxi, the higher dependence of the local budget on transfers, the dominance of agriculture in local economy and, therefore, the heavier career pressures on officials to demonstrate performance from agricultural development usually result in compelling farmers to conform to unpopular policies and to stronger government interventions into economic and social activities.

Administrative and fiscal arrangements also differ. Although in more developed regions, horizontal administration (or *kuaikuai* (more decentralized administration)) dominates, administration through line bureaus (or *tiaotiao* (vertical, more centralized administration)) is more common in less developed regions. Take Zhejiang, Hubei Province and Gansu as examples. Before the rural tax reform in 2003, in the most developed province of Zhejiang, both the finance department and the land department were directly controlled by the township governments, whereas in the middle-income province of Hubei, township finance department were under the control of township governments but land departments were controlled by county land bureaus. The situation has recently been changed with a tightening central policy on land management and the rural tax reform; Zhejiang’s land departments at township level are now vertically administrated with personnel and salaries directly controlled by county level land bureau. In Hubei, even finance departments are now vertically controlled by county finance bureaus because of the serious fiscal shortfalls at county level. In the least developed province of Gansu, both land and finance departments at township level were and still are vertically controlled directly by county land and finance bureaus.

In fiscal terms, township governments in relatively developed regions enjoy more fiscal autonomy and higher marginal share in revenue. Township governments in Gansu province have no independent budgets. In the middle-income provinces, such as Hunan and Anhui, the most popular fiscal arrangements is the so-called “Tax Sharing System”, in which the township level government usually delivers a certain benchmark amount to the
perspective on local governance reform in China county government, and then the additional revenue is shared by township and county for any individual tax. In more developed regions, such as Zhejiang, a different type of revenue sharing, according to actually realized revenue, is more common. Under this system, county-township governments do not share revenues according to different tax category, but share according to the total tax revenue actually collected. Even under such a system, benchmark revenue (or revenue quota) for some major taxes are still imposed to ensure local delivery for central taxes. Because the tax revenue to be submitted to county level in such a system is usually relatively low and such revenue is to be submitted to provincial and national levels, this means that township governments have quite significant fiscal autonomy.

2. Heterogeneous Factor Mobility and Local Governance
One important reason for interregional heterogeneity in local governance is factor mobility. In an industrializing country like China, interregional disparity in level of development contributes significantly to differences in local governance. In coastal regions where market-oriented industrialization started earlier, factor mobility is much higher and competition for investment and labor has begun to push local governments to deregulate and rescind various local policies that are perceived as restricting factor mobility or local competitiveness. To attract investment and to increase the value of land (which is immobile but can be an important source of local extra-budgetary revenue), local governments in rapidly industrializing regions are keen to invest heavily in infrastructure development from local budgets and to establish industrial and commercial development parks offering preferential policies and tax treatment to investors. Under this circumstance, the county and township governments could gain more autonomy for administration and finance, because the lower-level governments would have stronger bargaining power. In less developed regions with lower factor mobility (or where production factors, under market forces, are mostly moving out to other regions), competition for investment is less intense and local governments without external competitive pressure have a tendency instead to be more regulatory, or more predatory.

In the general published literature on economic growth, it is widely accepted that regional disparity tends to enlarge at the initial stages of development, to be followed by regional convergence (the so-called Kuznets inverted U curve) over time. It might be expected then that heterogeneity in local governance will tend to widen as a result of the disparity of factor mobility in the early stages of development, before it re-converges as more regions are drawn into the industrialization process and trans-regional competition. The governance structure is also endogenous to the dynamic change of horizontal competition pressure, which means that the central government can devolve more authority to the local
governments in developed regions. And, the governance structure in different regions might be adjusted by following these divergence and convergence trends.

3. Heterogeneous Policy Burdens and Distorted Regional Competition

The above theory of development stage cannot fully account for all the interregional heterogeneity we now observe in local governance in China. The particular growth-driven development strategy that has been pursued coupled with the various policy burdens that have been imposed from above have tended to produce even larger adverse impacts on less developed regions and poor people. There are three main causes for this. First, central policy demands themselves vary across different regions and across the different social groups. Before the grain market liberalization in the 1990s, state grain procurement quotas, for example, differed markedly from region to region thanks to natural environmental, historical or economic factors. According to our research, in the late 1990s grain sales quotas as a share of total grain output could be as high as 30–40 percent in the central province of Hunan, whereas they amounted to virtually zero in many coastal regions, such as Zhejiang and Guangdong (Tao et al., 2004). Another example is the quota policy and monopoly power of land development for the local government. This regulatory policy distorts the land transaction and makes the land price ambiguous, which provides an excuse for local officials to depress the cost of land development and to deprive farmers.

Second, the implementation costs of a policy vary across regions. Enforcement of the state’s birth control policies can serve as one good example. In less developed areas where income is lower, non-agricultural employment more limited and women and girls are less well-educated, farmers usually prefer to have more children than do farmers living in richer regions. Therefore, poorer regions face greater difficulties in fulfilling the birth control quota set by the center, entailing higher administrative costs and more financial and personnel resources. For example, in Hunan province almost 30–40 percent of all the township cadres’ time has to be devoted to enforcing birth control policy, at a cost of RMB10 per capita (approximately RMB200,000 per township, 20 percent of the township revenue), whereas in Zhejiang, enforcing the birth control policy has been much easier and has required far fewer resources.

A third factor leading to interregional variation in policy burdens is to be found in the systems used for allocating central–local fiscal transfers. Because many of the transfers are earmarked to be used for certain purposes that embody central policy intentions, local governments must implement the policies in question to ensure that they actually receive the transfer, and in many cases, local governments might be required to provide matching funds when they do receive a transfer. As a result, central policy intentions tend to be
followed more closely by the more transfer-dependent local governments; that is, by
governments in less developed regions, whereas in more developed and less transfer-
dependent regions, local governments have room in which to exercise their own discretion
about how hard to push a central policy when they consider that it does not suit local
conditions.

Under heterogeneous policy burdens, yardstick competition comparing and evaluating
local governance across regions becomes further distorted. The competitions lose their
effect in evaluating, controlling, and motivating cadres, therefore, because everyone
understands that the burdens of policy are different in different localities and the
accomplishments in different places simply cannot be measured according to a single
yardstick.

All in all, in more developed regions, the increasingly intensive interregional competition
that has resulted from much higher mobility of labor and capital, together with what are in
effect proportionately lower policy burdens from above, have worked well to curb predatory
and excessively regulatory government behavior and to make local government officials
relatively adept at altering or adjusting irrational policies to better meet local realities and
relatively quick to compete in providing better services. However, in less developed regions,
lower factor mobility, together with higher dependence on upper-level transfers and the
tougher central development mandates work systematically to distort local government
behavior and draw local governments in these regions into soft-budget constraint, unhealthy
competition for upper-level transfers and a style of political behavior that caters to higher
levels of government instead of local people.

V. Conclusions

Under a still-centralized political system with extensive expenditure decentralization but
with little revenue decentralization, local government officials have tended to be more
responsive to the Party and to higher-level government policies than they are to local
needs. These officials are, after all, controlled from above both by tight hierarchical personnel
arrangements and by fiscal transfer arrangements. Local governments in many regions are
usually more interested in various show case projects that cater to upper-level governments
rather than local tastes. Central–local information asymmetry also contributes to the
perpetuation, even after the reforms of the mid-1990s, of what are effectively soft budget
constraints on local governments. This not only diverts resources from the most needed
public goods provision, but also limits the effects of healthy regional competition and
delays the anticipated convergence of local governance and economic growth in the long
run.

It is important to note that some radical strategies to centralize administrative and fiscal power, as political expediency in the short run, might not enhance the effectiveness of governance, but possibly demoralize local cadres, and further destroy regional competition in the long run. However, matching actual local fiscal needs with more equalizing transfers is necessary to ensure equity in public service access across regions. However, because of the lack of government accountability to the local population, increasing transfers alone cannot guarantee better local government efficiency and public service provision.

If free elections are not achievable in the short run, improving local governance in China requires a fundamental change of the current “growth-centered” development strategy that imposes policy burdens and various development mandates from the center. It also requires thorough reform of the current cadre evaluation system, which is characterized by performance contracts that directly target local economic growth and fiscal revenue. What the local government should be doing, after all, is finding ways of providing public goods and services that will, in the long run, serve to promote economic growth: instead of trying to create that growth itself.

Only when the unreasonable policy burdens are downgraded and cadre evaluation criteria are reoriented to public goods more closely related to local needs, can the conditions for actually downsizing excessive local bureaucracies created and the role of healthy regional competition be strengthened to contain local misbehavior. Otherwise, the alternative can only be further administrative and fiscal centralization, which in turn might bring yet more distortions in local government behavior. In the long run, good governance will be the outcome of a more decentralized administrative and fiscal system that includes a sound intergovernmental fiscal arrangement, of wider local political participation and competition under free elections (supported by information revealed through yardstick comparison) and, ultimately, of stronger factor mobility across regions.

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